UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended January 31, 2002

OR

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

For the transition period from..................to.........................

Commission file number: 0-21969

CIENA CORPORATION
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**23-2725311** (I.R.S. Employer Identification No.)
1201 Winterson Road, Linthicum, MD (Address of Principal Executive Offices)	**21090** (Zip Code)

(410) 865-8500
(Registrant's telephone number, including area code)

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding at February 21, 2002
Common stock. $.01 par value	328,730,443

CIENA CORPORATION

INDEX

FORM 10-Q

		PAGE NUMBER
PART I - FINANCIAL INFORMATION		
Item 1.	Unaudited Financial Statements	
	Consolidated Statements of Operations Quarters ended January 31, 2001 and January 31, 2002	3
	Consolidated Balance Sheets October 31, 2001 and January 31, 2002	4
	Consolidated Statements of Cash Flows Quarters ended January 31, 2001 and January 31, 2002	5
	Notes to Consolidated Financial Statements	6
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations	10
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	23
PART II - OTHER INFORMATION		
Item 1.	Legal Proceedings	24
Item 6.	Exhibits and Reports on Form 8-K	24
Signatures		25

Item 1. Financial Statements

CIENA CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Quarter ended January 31,	
	2001	2002
Revenue	$351,989	$ 162,156
Cost of goods sold	191,837	139,687
Gross profit	160,152	22,469
Operating expenses:		
Research and development (exclusive of $0 and $3,951 deferred stock compensation)	42,504	64,756
Selling and marketing (exclusive of $0 and $956 deferred stock compensation)	29,636	37,600
General and administrative (exclusive of $0 and $227 deferred stock compensation)	11,145	13,655
Deferred stock compensation costs	—	5,134
Amortization of goodwill	898	—
Amortization of intangible assets	109	1,813
Restructuring costs	—	6,828
Total operating expenses	84,292	129,786
Income (loss) from operations	75,860	(107,317)
Interest and other income (expense), net	4,296	16,172
Interest expense	(87)	(10,505)
Loss on equity investments, net	—	(5,306)
Income (loss) before income taxes	80,069	(106,956)
Provision (benefit) for income taxes	26,823	(36,365)
Net income (loss)	$ 53,246	$ (70,591)
Basic net income (loss) per common share	$ 0.19	$ (0.22)
Diluted net income (loss) per common share and dilutive potential common share	$ 0.18	$ (0.22)
Weighted average basic common shares outstanding	287,001	327,620
Weighted average basic common and dilutive potential common shares outstanding	300,956	327,620

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

CIENA CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(unaudited)

	October 31, 2001	January 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 397,890	$ 472,533
Short-term investments	902,594	1,051,117
Accounts receivable, net of allowance of ($1,491 and $1,100)	395,063	150,221
Inventories, net	254,968	250,191
Deferred income taxes	186,861	60,234
Prepaid expenses and other	53,713	47,110
Total current assets	2,191,089	2,031,406
Long-term investments	494,657	416,330
Equipment, furniture and fixtures, net	331,490	316,039
Goodwill	178,891	178,891
Other intangible assets, net	47,874	46,061
Deferred income taxes	—	160,496
Other assets	73,300	69,555
Total assets	$ 3,317,301	$ 3,218,778
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 68,735	$ 46,962
Accrued liabilities	148,523	125,883
Income taxes payable	6,649	6,399
Deferred revenue	29,480	21,435
Other current obligations	995	1,159
Convertible notes payable	—	176,533
Total current liabilities	254,382	378,371
Deferred income taxes	64,072	58,318
Long-term deferred revenue	—	17,984
Other long-term obligations	5,982	5,740
Convertible notes payable	863,883	690,000
Total liabilities	1,188,319	1,150,413
Commitments and contingencies		
Stockholders' equity:		
Preferred stock – par value $.01; 20,000,000 shares authorized; zero shares issued and outstanding	—	—
Common stock – par value $.01; 980,000,000 shares authorized; 328,022,264 and 328,577,712 shares issued and outstanding	3,280	3,286
Additional paid-in capital	3,667,512	3,676,192
Notes receivable from stockholders	(3,236)	(2,453)
Accumulated other comprehensive income	4,842	5,347
Accumulated deficit	(1,543,416)	(1,614,007)
Total stockholders' equity	2,128,982	2,068,365
Total liabilities and stockholders' equity	$ 3,317,301	$ 3,218,778

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

CIENA CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended January 31,	
	2001	2002
Cash flows from operating activities:		
Net income (loss)	$ 53,246	$ (70,591)
Adjustments to reconcile net income to net cash provided by operating activities:		
Tax benefit related to the exercise of stock options	50,067	—
Non-cash loss on equity investments, net	—	3,321
Accretion of redemption premium	—	2,650
Effect of accumulated other comprehensive income (loss)	(659)	930
Depreciation and amortization	19,773	32,363
Amortization of goodwill, other intangibles, deferred stock compensation and debt issuance costs	1,007	7,703
Provision for inventory excess and obsolescence	5,701	20,414
Provision for warranty and other contractual obligations	7,811	5,526
Changes in assets and liabilities:		
Accounts receivable	(2,046)	243,315
Prepaid expenses and other	(5,216)	9,541
Inventories	(71,643)	(15,637)
Deferred income tax asset	(23,244)	(33,869)
Accounts payable and accrued liabilities	10,665	(32,531)
Income taxes payable	(217)	(250)
Deferred income tax liability	—	(5,754)
Deferred revenue and other obligations	9,192	9,939
Net cash provided by operating activities	54,437	177,070
Cash flows from investing activities:		
Additions to equipment, furniture and fixtures	(42,166)	(29,531)
Maturities of available for sale securities	44,653	223,894
Purchases of available for sale securities	(32,480)	(300,255)
Net cash used in investing activities	(29,993)	(105,892)
Cash flows from financing activities:		
Net proceeds from (repayment of) other obligations	474	(313)
Proceeds from issuance of common stock	8,590	2,995
Repayment of notes receivable from stockholders	30	783
Net cash provided by financing activities	9,094	3,465
Net increase in cash and cash equivalents	33,538	74,643
Cash and cash equivalents at beginning of period	143,187	397,890
Cash and cash equivalents at end of period	$176,725	$ 472,533

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

CIENA CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

(1) SIGNIFICANT ACCOUNTING POLICIES

Interim Financial Statements

The interim financial statements included herein for CIENA Corporation (the “Company” or “CIENA”) have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, financial statements included in this report reflect all normal recurring adjustments which the Company considers necessary for the fair presentation of the results of operations for the interim periods covered and of the financial position of the Company at the date of the interim balance sheet. Certain information and footnote disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to understand the information presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with the Company’s October 31, 2001 audited consolidated financial statements and notes thereto included in the Company’s Form 10-K annual report for the fiscal year ended October 31, 2001.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements requires CIENA to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, CIENA evaluates its estimates, including those related to bad debts, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring, and contingencies and litigation. CIENA bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. CIENA believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

CIENA recognizes product revenue in accordance with the shipping terms specified and where collection is reasonably assured. For transactions where CIENA has yet to obtain customer acceptance, revenue is deferred until the terms of acceptance are satisfied. Revenue for installation services is recognized as the services are performed unless the terms of the supply contract combine product acceptance with installation, in which case, revenues for installation services are recognized when the terms of acceptance are satisfied and installation is completed. Revenues from installation service fixed price contracts are recognized on the percentage-of-completion method, measured by the percentage of costs incurred to date compared to estimated total costs for each contract. Amounts received in excess of revenue recognized are included as deferred revenue in the accompanying balance sheets. For transactions involving the sale of software, revenue is recognized in accordance with Statement of Position No. 97-2 (SOP 97-2), “Software Revenue Recognition”, including deferral of revenue recognition in instances where vendor specific objective evidence for undelivered elements is not determinable. For distributor sales where risks of ownership have not transferred, CIENA recognizes revenue when the product is shipped through to the end user.

CIENA maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of CIENA’s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

CIENA provides for the estimated cost of product warranties at the time revenue is recognized. While CIENA engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, CIENA’s warranty obligation is affected by product failure rates and material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from CIENA’s estimates, revisions to the estimated warranty liability would be required.

CIENA writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

CIENA holds minority interests in companies having operations or technology in areas within its strategic focus, some of which are publicly traded and have highly volatile share prices. CIENA records an investment impairment charge when it believes an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future.

Although realization is not assured, CIENA has concluded that it is more likely than not that the deferred tax assets as of January 31, 2002 will be realized based on the scheduling of deferred tax liabilities and projected taxable income. The amount of the deferred tax assets actually realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the actual amounts of future taxable income. Should CIENA determine that it would not be able to realize all or part of its deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Newly Issued Accounting Standards

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 143, "Accounting for Asset Retirement Obligation" (SFAS No. 143). SFAS No. 143 is effective for fiscal years beginning after June 15, 2002, and will require companies to record a liability for asset retirement obligations in the period in which they are incurred, which typically could be upon completion or shortly thereafter. The FASB decided to limit the scope to legal obligation and the liability will be recorded at fair value. The effect of adoption of this standard on the Company's results of operations and financial positions is being evaluated.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standard No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. It provides a single accounting model for long-lived assets to be disposed of and replaces SFAS No. 121 "Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of". The effect of adoption of this standard on the Company's results of operations and financial positions is being evaluated

Reclassification

Certain prior year amounts have been reclassified to conform to current year consolidated financial statement presentation.

(2) Goodwill and Other Intangible Asset – Adoption of Statement 142

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 "Business Combinations" (SFAS No. 141) and Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 141 addresses financial accounting and reporting for business combinations. This statement requires the purchase method of accounting to be used for all business combinations, and prohibits the pooling-of-interests method of accounting. This statement is effective for all business combinations initiated after June 30, 2001 and supercedes APB Opinion No. 16, "Business Combinations" as well as Financial Accounting Standards Board Statement of Financial Accounting Standards No. 38, "Accounting for Preacquisition Contingencies of Purchased Enterprises".

SFAS No. 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition. This statement requires goodwill amortization to cease and for goodwill to be periodically reviewed for impairment, for fiscal years beginning after October 31, 2001. SFAS No. 142 supercedes APB Opinion No. 17, "Intangible Assets". The Company adopted the provisions of this standard for its first quarter of fiscal 2002.

The following table presents the impact of SFAS 142 on net income (loss) and net income (loss) per share had SFAS 142 been in effect for the first quarter of fiscal 2001 (in thousands, except per share amounts):

	Three Months Ended January 31,	
	2001	2002
Net income (loss)	$ 53,246	$ (70,591)
Adjustments:		
Amortization of goodwill	898	—
Adjusted net income (loss)	$ 54,144	$ (70,591)
Weighted average shares-basic	287,001	327,620
Weighted average shares-diluted	300,956	327,620
Adjusted basic EPS	$ 0.19	$ (0.22)
Adjusted diluted EPS	$ 0.18	$ (0.22)
Reported basic EPS	$ 0.19	$ (0.22)
Reported diluted EPS	$ 0.18	$ (0.22)

There was no impairment of goodwill recorded for the first quarter ended January 31, 2002.

(3) INVENTORIES

Inventories are comprised of the following (in thousands):

	October 31, 2001	January 31, 2002
Raw materials	$161,837	$167,936
Work-in-process	75,669	49,473
Finished goods	71,266	92,737
	308,772	310,146
Less reserve for excess and obsolescence	(53,804)	(59,955)
	$254,968	$250,191

(4) EARNINGS PER SHARE CALCULATION

The following is a reconciliation of the numerators and denominators of the basic net income (loss) per common share ("basic EPS") and diluted net income (loss) per common and dilutive potential common share ("diluted EPS"). Basic EPS is computed using the weighted average number of common shares outstanding. Diluted EPS is computed using the weighted average number of common shares outstanding, and stock options using the treasury stock method (in thousands except per share amounts).

	Quarter ended January 31,	
	2001	2002
Net income (loss)	$ 53,246	$ (70,591)
Weighted average shares-basic	287,001	327,620
Effect of dilutive securities:		
Employee stock options and warrants	13,955	—
Weighted average shares-diluted	300,956	327,620
Basic EPS	$ 0.19	$ (0.22)
Diluted EPS	$ 0.18	$ (0.22)

During the quarter ended January 31, 2001 and January 31, 2002, approximately 8,044,000 and 37,717,000, respectively, weighted shares from employee stock options and restricted stock were not included in the computation of diluted EPS because the effect would be anti-dilutive.

(5) COMPREHENSIVE INCOME

The components of comprehensive income are as follows (in thousands):

	Quarter ended January 31,	
	2001	**2002**
Net income (loss)	$53,246	$(70,591)
Changes in net unrealized gains on investments	—	450
Change in accumulated translation adjustments	93	55
Total comprehensive income (loss)	$53,339	$(70,086)

(6) RESTRUCTURING CHARGE AND RELATED ACCRUAL

During the fiscal year ended October 31, 2001 the Company recorded a restructuring charge of $15.4 million relating to consolidation of excess facilities. The consolidation of excess facilities included the closure of certain manufacturing warehouse facilities and the consolidation of certain operational centers related to business activities that have been restructured. The charge included $7.0 million primarily related to lease terminations and non-cancelable lease costs and also included an $8.4 million write-down related to property and equipment consisting primarily of leasehold improvements and production equipment.

On November 12, 2001, the Company announced a workforce reduction of approximately 380 employees concentrated in manufacturing operations staff. CIENA recorded a restructuring charge of $6.8 million associated with this action, in the first quarter of fiscal 2002. On February 5, 2002, CIENA announced a workforce reduction of approximately 400 employees largely concentrated in manufacturing operations and research and development activities associated with the closure of our Marlborough, Massachusetts, research and development facility. CIENA expects to record a restructuring charge of between $9.0 million and $11.0 million in the second quarter of fiscal 2002 associated with the February 5, 2002 workforce reduction, lease terminations, non-cancelable lease costs and the write-down of certain property, equipment and leasehold improvements.

The following table displays the activity and balances of the restructuring reserve account for the period ended January 31, 2002 (in thousands):

	Restructure charges				
	Balance at Oct 31, 2001	**Reserves recorded during the Quarter ended Jan 31, 2002**	**Non-cash reduction**	**Cash reduction**	**Balance Jan 31, 2002**
Workforce reduction	$ —	$5,685	$ 557	$4,059	$1,069
Consolidation of excess facilities and other charges	15,439	1,143	10,752	1,065	4,765
Total	$15,439	$6,828	$11,309	$5,124	$5,834

(7) SUBSEQUENT EVENTS

On February 18, 2002, CIENA announced that it had entered into an agreement to acquire by merger ONI Systems Corp. (“ONI”), a NASDAQ-listed corporation headquartered in San Jose, California. ONI is a provider of optical networking equipment specifically designed to address bandwidth and service limitations of regional and metropolitan networks. Under the terms of the agreement, each outstanding share of capital stock of ONI will be exchanged for 0.7104 shares of CIENA common stock, and CIENA will assume all of ONI’s outstanding options and warrants as well as its outstanding convertible debt. Based on the closing price of CIENA common stock on Friday, February 15, 2002, the transaction is valued at approximately $900.0 million. CIENA expects to complete the acquisition during the second or third calendar quarter of 2002. The ONI acquisition is subject to various conditions and approval by appropriate government agencies and the stockholders of CIENA and ONI.

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

This *Management's Discussion and Analysis of Financial Condition and Results of Operations* contains certain forward-looking statements that involve risks and uncertainties. CIENA has set forth in its Form 10-K Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations-Risk Factors," as filed with the Securities and Exchange Commission on December 13, 2001, a detailed statement of risks and uncertainties relating to the Company's business. In addition, set forth below under the heading "Risk Factors" is a further discussion of certain of those risks as they relate to the period covered by this report, the Company's near-term outlook with respect thereto, and the forward-looking statements set forth herein. Investors should review this quarterly report in combination with the Form 10-K in order to have a more complete understanding of the principal risks associated with an investment in the Company's Common Stock.

Overview

CIENA is a leader in the intelligent optical networking equipment market. We offer a portfolio of products for communications service providers worldwide. Our customers include long-distance carriers, competitive and incumbent local exchange carriers, Internet service providers, wireless and wholesale carriers. CIENA offers optical transport and intelligent optical switching systems that enable service providers to provision, manage and deliver high-bandwidth services to their customers. We have pursued a strategy to develop and leverage the power of disruptive technologies to change the fundamental economics of building carrier-class tele- and data-communications networks, thereby providing our customers with a competitive advantage. CIENA's intelligent optical networking products are designed to enable carriers to deliver any time, any size, any priority bandwidth to their customers.

For much of the last five years the market for our equipment has been influenced by the entry into the communications services business of a substantial number of new companies. In the United States, this was due largely to changes in the regulatory environment, in particular those brought about by the Telecommunications Act of 1996. These new companies raised billions of dollars in capital, much of which they invested in new plant, causing an acceleration in the growth of the market for telecommunications equipment.

The last year or so has seen a reversal of this trend, including the failure of a large number of the new entrants and a sharp contraction of the availability of capital to the industry. This, in turn, has caused a substantial reduction in demand for telecommunications equipment, including our products.

This industry trend has been compounded by the slowing not only of the United States economy, but the economies in virtually all of the countries in which we are marketing our products. Moreover, the economic uncertainty has been accentuated by the events of September 11, 2001. The combination of these factors has caused most of our customers to become more conservative in their capital investment plans and more uncertain about their future purchases. As a consequence, we are facing a market that is both reduced in absolute size and more difficult to predict and plan for. We recently received information that leads us to believe that two of our historically most important customers may purchase significantly less from us than they had previously indicated. As a result, we now anticipate that our fiscal second quarter revenue is likely to be in the neighborhood of $100 million. See "Risk Factors."

As of January 31, 2002, CIENA and its subsidiaries employed approximately 3,294 persons, which was a reduction of 484 persons from the approximate 3,778 employed on October 31, 2001. On November 12, 2001, we announced a workforce reduction of approximately 380 employees concentrated in manufacturing operations staff. We recorded a restructuring charge of $6.8 million associated with this action, in the first quarter of fiscal 2002. On November 16, 2001, CIENA sold 80.1% of its ownership in ATI International Investments, Inc., the parent company of ATI Telecom International Ltd. ("Alta"), which resulted in a reduction of approximately 84 employees concentrated in engineering, furnishing and installation operations staff. On February 5, 2002, we announced a workforce reduction of approximately 400 employees largely concentrated in manufacturing operations and research and development activities associated with the closure of our Marlborough, Massachusetts, research and development facility. We expect to record a restructuring charge of between $9.0 million and $11.0 million in our second quarter of fiscal 2002 associated with the February 5, 2002 workforce reduction, lease terminations, non-cancelable lease costs and the write-down of certain property, equipment and leasehold improvements.

On February 18, 2002, CIENA announced that it had entered into an agreement to acquire by merger ONI Systems Corp. ("ONI"), a NASDAQ-listed corporation headquartered in San Jose, California. ONI is a provider of optical networking equipment specifically designed to address bandwidth and service limitations of regional and metropolitan networks. Under the terms of the agreement, each outstanding share of capital stock of ONI will be exchanged for 0.7104 shares of CIENA common stock, and CIENA will assume all of ONI's outstanding options and warrants as well as its outstanding convertible debt. Based on the closing price of CIENA common stock

on Friday, February 15, 2002, the transaction is valued at approximately $900.0 million. CIENA expects to complete the acquisition during the second or third calendar quarter of 2002. The ONI acquisition is subject to various conditions and approval by appropriate government agencies and the stockholders of CIENA and ONI. CIENA expects to issue approximately 100,500,000 shares of its common stock in the acquisition and will become obligated for ONI's $300 million issue of convertible subordinated debt. See "Risk Factors" below.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements requires CIENA to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, CIENA evaluates its estimates, including those related to bad debts, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring, and contingencies and litigation. CIENA bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. CIENA believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements.

CIENA recognizes product revenue in accordance with the shipping terms specified and where collection is reasonably assured. For transactions where CIENA has yet to obtain customer acceptance, revenue is deferred until the terms of acceptance are satisfied. Revenue for installation services is recognized as the services are performed unless the terms of the supply contract combine product acceptance with installation, in which case revenues for installation services are recognized when the terms of acceptance are satisfied and installation is completed. Revenues from installation service fixed price contracts are recognized on the percentage-of-completion method, measured by the percentage of costs incurred to date compared to estimated total costs for each contract. Amounts received in excess of revenue recognized are included as deferred revenue in the accompanying balance sheets. For transactions involving the sale of software, revenue is recognized in accordance with Statement of Position No. 97-2 (SOP 97-2), "Software Revenue Recognition", including deferral of revenue recognition in instances where vendor specific objective evidence for undelivered elements is not determinable. For distributor sales where risks of ownership have not transferred, CIENA recognizes revenue when the product is shipped through to the end user.

CIENA maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of CIENA's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

CIENA provides for the estimated cost of product warranties at the time revenue is recognized. While CIENA engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of its component suppliers, CIENA's warranty obligation is affected by product failure rates and material usage and service delivery costs incurred in correcting a product failure. Should actual product failure rates, material usage or service delivery costs differ from CIENA's estimates, revisions to the estimated warranty liability would be required.

CIENA writes down its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

CIENA holds minority interests in companies having operations or technology in areas within its strategic focus, some of which are publicly traded and have highly volatile share prices. CIENA records an investment impairment charge when it believes an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or an inability to recover the carrying value of the investments that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future.

Although realization is not assured, CIENA has concluded that it is more likely than not that the deferred tax assets as of January 31, 2002 will be realized based on the scheduling of deferred tax liabilities and projected taxable income. The amount of the deferred tax assets actually realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the actual amounts of future taxable income. Should CIENA determine that it would not be able to realize all or part of its

deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Results of Operations

Three Months Ended January 31, 2001 Compared to Three Months Ended January 31, 2002

Revenue. CIENA recognized revenues of $352.0 million and $162.2 million for the quarters ended January 31, 2001 and 2002, respectively. The approximate $189.8 million or 53.9% decrease in revenues in the first quarter 2002 compared to the first quarter 2001 was the result of a decrease in revenues recognized from 41 different optical networking equipment customers in the quarter ended January 31, 2002, as compared to 30 such customers in the same quarter of the prior year. Additionally, during the quarter ended January 31, 2002, each of two optical networking equipment customers accounted for 10% or more of CIENA's quarterly revenue and, combined, accounted for 52.2% of CIENA's quarterly revenue. This compares to the quarter ended January 31, 2001 where each of three optical transport equipment customers accounted for 10% or more of the Company's quarterly revenue and, combined, accounted for approximately 62.3%. Revenues derived from foreign sales accounted for approximately 42.0% and 22.4% of the Company's revenues during the quarters ended January 31, 2001 and January 31, 2002, respectively.

Revenues during CIENA's first quarter 2002 were largely derived from sales of our long distance optical transport products and intelligent core switching products. CIENA's first quarter 2001 revenues, were largely derived from sales of our long distance optical transport products. Revenue derived from services accounted for approximately 5.3% and 13.7% of revenue during the first quarters of 2001 and 2002, respectively.

Gross Profit. Cost of goods sold consists of component costs, direct compensation costs, warranty and other contractual obligations, royalties, license fees, inventory obsolescence costs and overhead related to the Company's manufacturing and engineering, furnishing and installation ("EF&I") operations. Gross profits were $160.2 million and $22.5 million for the quarters ended January 31, 2001 and 2002, respectively. The approximate $137.7 million or 86.0% decrease in gross profit from the first quarter 2002 to the first quarter 2001 was the result of decreased revenues and gross profit margin. Gross margin was 45.5% and 13.9% of revenues for the first fiscal quarters of 2001 and 2002, respectively. The decrease was largely attributable to increases in inventory obsolescence costs, lower manufacturing volumes resulting in reduced manufacturing efficiencies, and changes in product mix resulting in sales of a higher proportion of revenue from lower margin installation and tech support services.

As discussed above, our current ability to make reliable forecasts for fiscal 2002 is limited. It is possible, however, that we could continue to experience reductions of gross margins compared to fiscal 2001 as a result of one or more of several factors, including changes in product mix, downward pressure on pricing due to more aggressive competition, decreased manufacturing efficiencies, increases in inventory obsolescence, and increased costs of components.

Research and Development Expenses. Research and development expenses (exclusive of stock compensation costs of $0 and $4.0 million) were $42.5 million and $64.8 million for the quarters ended January 31, 2001 and 2002, respectively. During the first quarters of 2001 and 2002, research and development expenses were 12.1% and 39.9% of revenue, respectively. The approximate $22.3 million or 52.4% increase in research and development expenses in the first quarter 2002 compared to the first quarter 2001 was the result of increases in staffing levels, depreciation expense, and facilities-related costs. CIENA expenses research and development costs as incurred.

Selling and Marketing Expenses. Selling and marketing expenses (exclusive of stock compensation costs of $0 and $1.0 million) were $29.6 million and $37.6 million for the quarters ended January 31, 2001 and 2002, respectively. During the first quarters of 2001 and 2002, selling and marketing expenses were 8.4% and 23.2% of revenues, respectively. The approximate $8.0 million or 26.9% increase in selling and marketing expenses in the first quarter 2002 compared to the first quarter 2001 was primarily the result of increased staffing levels in the areas of sales, marketing, technical assistance and field support, depreciation expense and facilities-related costs.

General and Administrative Expenses. General and administrative expenses (exclusive of stock compensation costs of $0 and $0.2 million) were $11.1 million and $13.7 million for the quarters ended January 31, 2001 and 2002, respectively. General and administrative expenses were 3.2% and 8.4% of revenues, respectively. The approximate $2.5 million or 22.5% increase in general and administrative expenses was primarily the result of increases in outside consulting services and facilities-related costs.

Deferred Stock Compensation Costs. Deferred stock compensation costs were $5.1 million for the three months ended January 31, 2002. As part of our acquisition of Cyras, we recorded $98.5 million of deferred stock compensation related to the unvested stock options and restricted stock assumed in the acquisition. Deferred stock compensation is presented as a reduction of stockholders' equity and is amortized over the remaining vesting period of the applicable options. As of January 31, 2002 the balance of unearned deferred stock compensation was $44.2 million.

Amortization of Goodwill. Amortization of goodwill was $0.9 million for the three months ended January 2001. In July 2001 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 142 addresses how intangible assets that are acquired individually or with a group of other assets should be accounted for in financial statements upon their acquisition. This statement requires goodwill amortization to cease and for goodwill to be periodically reviewed for impairment, for fiscal years beginning after October 31, 2001. SFAS No. 142 supercedes APB Opinion No. 17, "Intangible Assets". The Company adopted the provisions of this standard for its first quarter of fiscal 2002. There was no impairment of goodwill recorded for the quarter ended January 31, 2002.

Amortization of Intangible Assets. Amortization of intangible assets was $0.1 million and $1.8 million for the three months ended January 2001 and 2002, respectively. As part of our acquisition of Cyras we recorded $47.7 million worth of other intangible assets. The intangible assets from the Cyras purchase are being amortized over a seven-year period.

Restructuring Costs. On November 12, 2001, we announced a workforce reduction of approximately 380 employees concentrated in manufacturing operations staff. We recorded a restructuring charge of $6.8 million associated with this action in the first quarter of fiscal 2002. On February 5, 2002, we announced a workforce reduction of approximately 400 employees largely concentrated in manufacturing operations and research and development activities associated with the closure of our Marlborough, Massachusetts, research and development facility. We expect to record a restructuring charge of between $9.0 million and $11.0 million in our second quarter of fiscal 2002 associated with the February 5, 2002 workforce reduction, lease terminations, non-cancelable lease costs and the write-down of certain property, equipment and leasehold improvements.

Interest and Other Income (Expense), Net. Interest income and other income (expense), net were $4.3 million and $16.2 million for the first quarters ended January 31, 2001 and 2002, respectively. The approximate $11.9 million or 276.4% increase in interest income and other income (expense), net was largely attributable to higher invested cash balances.

Interest Expense. Interest expense was $0.1 million and $10.5 million for the quarters ended January 31, 2001 and 2002, respectively. The $10.4 million or 119.7% increase in interest expense was attributable to the increase in our debt obligations between the two periods.

Loss on Equity Investments, Net. Loss on equity investments, net was $5.3 million for the first quarter of fiscal 2002. We realized a loss of approximately $1.9 million from the sale of a public equity investment and a loss of approximately $6.2 million from a decline in the fair value of a public equity investment that was determined to be other than temporary. On November 16, 2001 CIENA sold 80.1% of its ownership in ATI International Investments, Inc., the parent company of ATI Telecom International Ltd. ("Alta"), which resulted in a gain of approximately $2.8 million. CIENA retains a 19.9% ownership in ATI International Investments, Inc.

Provision (Benefit) for Income Taxes. CIENA's provision for income taxes was $26.8 million for the quarter ended January 31, 2001. We recorded a tax benefit of $36.4 million for the quarter ended January 31, 2002. During the first quarters of 2001 and 2002, the tax rate used for income taxes were 33.5% and 34.0% of income (loss) before income taxes, respectively. The increase in the income tax rate in first quarter 2002 compared to first quarter 2001 was due to a reduction in the marginal benefits derived from research and development credits. As of January 31, 2002 CIENA's deferred tax asset was $220.7 million. The realization of this asset could be adversely affected if future earnings are lower than anticipated.

Liquidity and Capital Resources

At January 31, 2002, CIENA's principal source of liquidity was its cash and cash equivalents, short-term and long-term investments. The Company had $472.5 million in cash and cash equivalents, and $1,467.4 million in short-term and long-term investments.

The Company's operating activities provided cash of $177.1 million and $54.4 million for the three months ended January 31, 2002 and 2001, respectively. Cash provided by operations for the three months ended January 31, 2002 was primarily attributable to net loss adjusted for the non-cash charges of depreciation and amortization, decreases in accounts receivable, and the increase in provisions for inventory obsolescence, and warranty, offset by increases in inventory, accounts payable and deferred income tax assets.

Cash used in investing activities for three months ended January 31, 2002 and 2001, was $105.9 million and $30.0 million, respectively. Included in investment activities were additions to capital equipment and leasehold improvements for the three months ended January 31, 2002 and 2001, of $29.5 million and $42.2 million, respectively. The capital equipment expenditures were primarily for test, manufacturing and computer equipment. The Company expects additional combined capital equipment and leasehold improvement expenditures of approximately $60.5 million to be made during the remaining nine months of fiscal 2002 to support selling and marketing, manufacturing and product development activities and the construction of leasehold improvements for its facilities.

We generated $3.5 million and $9.1 million in cash from financing activities in the three months ended January 31, 2002 and 2001, respectively. During the three months ended January 31, 2002 and 2001, cash from financing activities included receipts of $3.0 million and $8.6 million from the exercise of stock options, respectively.

Cyras Systems LLC, our wholly owned subsidiary, has $150 million of 4.5% convertible subordinated notes outstanding. In the event that the holders of the Cyras notes convert their notes into our common stock, we would have to issue a significant number of shares of additional common stock. Based on the exchange ratio for the Cyras acquisition of approximately 0.13, we will have to issue approximately 1,037,055 shares of our common stock if holders of the entire $150 million of convertible notes decided to convert their notes. At our current stock price it appears more likely that the holders of the Cyras notes will not elect to convert them into our common stock before March 31, 2002. As a result, it is probable that we will have to make an offer to repurchase the notes at 118.942% of their principal balance on April 30, 2002. If all of the note holders accept that offer, we will have to expend approximately $178 million of our cash and cash equivalents for the repurchase.

When the merger with ONI Systems, Inc. is consummated (assuming that the necessary shareholder and regulatory approvals are obtained), we will acquire to the cash, cash equivalents, short-term and long-term investments held by ONI and assume ONI's debt obligations. As of December 31, 2001, ONI had approximately $678.8 million in cash, cash equivalents and short-term and long-term investments and had outstanding $300 million of 5% convertible subordinated debentures, due October 15, 2002.

CIENA does not engage in any off-balance sheet financing arrangements. In particular, we do not have any interest in so-called limited purpose entities, which include special purpose entities (SPEs) and structured finance entities.

We believe that our existing cash balances and investments will be sufficient to meet our liquidity and capital spending requirements for the next 18 to 24 months. However, possible investments in or acquisitions of complementary businesses, products or technologies may require additional financing prior to such time. There can be no assurance that additional debt or equity financing will be available when required or, if available, can be secured on terms satisfactory to us.

Quarterly Adjusted Results of Operations

The table below (in thousands, except per share data) sets forth as adjusted net income and as adjusted net income per share data to assist readers in understanding our operating results. These adjustments are not in accordance with, or an alternative for, generally accepted accounting principles and may be different from the presentation of financial information provided by other companies:

	Jan. 31, 2001	Jan. 31, 2002
Net income (loss)	$ 53,246	$ (70,591)
Payroll tax on stock options	1,280	29
Deferred stock compensation costs	—	5,134
Amortization of goodwill	898	—
Amortization of intangible assets	109	1,813
Restructuring costs	—	6,828
Loss on equity investments, net	—	5,306
Income tax effect	(767)	(5,180)
Adjusted net income (loss)	$ 54,766	$ (56,661)
As adjusted diluted net income (loss) per common share and dilutive potential common share	$ 0.18	$ (0.17)
Weighted average basic common and dilutive potential common share	300,956	327,620

Risk Factors

Investing in our securities involves a high degree of risk. In addition to the other information contained in this quarterly report, including the reports we incorporate by reference, you should consider the following factors before investing in our securities.

Our Business Has Been Adversely Affected by Recent Developments in the Communications Industry and the Economy in General

For much of the last five years, the market for our equipment has been influenced by the entry into the communications services business of a substantial number of new companies. In the United States this was due largely to changes in the regulatory environment, in particular those brought about by the Telecommunications Act of 1996. These new companies raised billions of dollars in capital, much of which they invested in new plants, causing an acceleration in the growth of the market for telecommunications equipment.

The last year or so has seen a reversal of this trend, including the failure of a large number of the new entrants and a sharp contraction of the availability of capital to the industry. This, in turn, has caused a substantial reduction in demand for telecommunications equipment, including our products.

This industry trend has been compounded by the slowing not only of the United States economy, but the economies in virtually all of the countries in which we are marketing our products. Moreover, the economic uncertainty has been accentuated by the events of September 11, 2001. The combination of these factors has caused most of our customers to become more conservative in their capital investment plans and more uncertain about their future purchases. As a consequence, we are facing a market that is both reduced in absolute size and more difficult to predict and plan for.

We expect the factors described above to affect our business, for at least several quarters if not longer, in several significant ways compared to the recent past:

- it is likely that our markets will be characterized by reduced capital expenditures by our customers; our ability to forecast the volume and product mix of our sales will be substantially reduced;

- managing our expenditures will be significantly more difficult in light of the uncertainties surrounding our business;

- increased competition resulting from reduced demand will put substantial downward pressures on the pricing of our products, tending to reduce our profit margins;

- increased competition has also enabled customers to insist on more favorable terms and conditions for sales, including extended payment terms or other financing assistance, as a condition of procuring their business; and

- the result in any or combination of these factors could be reduced revenues and profitability and perhaps losses in particular periods or for the entire year.

We recently received information that leads us to believe that two of our historically most important customers may purchase significantly less from us than they had previously indicated. As a result, we now expect that our fiscal second quarter revenue is likely to be in the neighborhood of $100 million. We believe that the decline in purchases by these customers is temporary, we cannot now predict when they can be expected to return to levels more representative of past volumes.

Economic Conditions May Require Us to Reduce the Size of Our Business Further

In November, 2001, and again in February, 2002, we undertook significant reductions in force, accompanied by dispositions of assets, as part of our effort to reduce the size of our operations to better match the reduced sales of our products and services. Weakness in the global economy generally and the telecommunications equipment market in particular continue to affect our business substantially. If those conditions continue, we may be required to undertake further reductions in capacity. Any such steps would likely result in significant charges from write-downs or write-offs of assets, costs of lease terminations, and expenses resulting from the termination of personnel.

Our Results Can Fluctuate Unpredictably

In general, our revenues and operating results in any reporting period may fluctuate significantly due to a variety of factors including:

- fluctuations in demand for our products;

- changes in our pricing policies or the pricing policies of our competitors;

- the timing and size of orders from customers;

- changes in customers' requirements, including changes or cancellations to orders from customers;

- the introduction of new products by us or our competitors;

- changes in the price or availability of components for our products;

- readiness of customer sites for installation;

- satisfaction of contractual customer acceptance criteria and related revenue recognition issues;

- manufacturing and shipment delays and deferrals;

- increased service, installation, warranty or repair costs;

- the timing and amount of employer payroll tax to be paid on employee gains on stock options exercised; and

- changes in general economic conditions as well as those specific to the telecommunications and intelligent optical networking industries.

Our intelligent optical networking products require large investments. We have only a limited number of potential customers in each geographic market, and each has unique needs. Our customers are generally technically sophisticated and demanding. As a result, the sales cycles for our products are long, often as much as a year or two between initial contact with a potential customer and the recognition of revenue from sales to the customer. Our customers' purchases tend to be large and sporadic, depending upon their need to build a customer base, their plans for expanding their networks, the availability of financing, and the effects of regulatory and business conditions in the countries in which they operate. As a result, their purchase decisions can be unpredictable and subject to unanticipated changes. Our results, in turn, tend to fluctuate unpredictably. This tendency has been amplified by conditions arising from the current uncertain economic environment.

Current economic conditions have made it more difficult to make reliable estimates of future revenues. Fluctuations in our revenues can lead to even greater fluctuations in our operating profits. We budget expense levels on our expectations of long-term future revenue. These budgets reflect the substantial investments in financial, engineering, manufacturing and logistics support resources we must make to support large customers, even though we are unsure of the volume, duration or timing of their purchases. In addition, we continue to make substantial expenditures on the development of new and enhanced products. Any substantial adjustment to expenses to account for lower levels of revenue is difficult and takes time. Consequently if our revenue does decline, in the short run our levels of inventory, operating expenses and general overhead would be high relative to our revenue, reducing our profitability, and perhaps resulting in operating losses.

Our Future Success Will Depend on Our Ability to Acquire New Customers

Historically, a large percentage of our sales have been made to emerging carriers, many of which have recently begun to experience

severe financial difficulties. Consequently, we expect our sales to emerging carriers to be reduced, and our future success will depend on our ability to increase our sales to incumbent carriers, including, in the United States, the regional bell operating companies (“RBOCs”), and abroad, the large, traditional telecommunications operators (“TOs”), many of which were formerly government-owned “post, telephone and telegraph” enterprises. These large companies typically require longer sales cycles, many have long-standing supplier relationships with other vendors, and our experience in selling to them is limited. If we do not succeed in penetrating this segment of the market, our business could suffer.

We May Not Be Able to Successfully Complete Development and Achieve Commercial Acceptance of New Products

It is necessary for us to continually enhance our products. Certain enhancements to our products are in the development phase and are not yet ready for commercial manufacturing or deployment. For example, we expect to offer additional feature enhancement releases of the MultiWave CoreDirector product line over the life of the product and we expect to continue to enhance features of our MultiWave CoreStream, MultiWave Metro and MultiWave MetroDirector K2 products over the life of these products. The maturing process from laboratory prototype to customer trials, and subsequently to general availability, involves a number of steps, including:

- completion of product development;
- the qualification and multiple sourcing of critical components, including ASICs;
- validation of manufacturing methods and processes;
- extensive quality assurance and reliability testing, and staffing of testing infrastructure;
- validation of software; and
- establishment of systems integration and systems test validation requirements.

Each of these steps in turn presents serious risks of failure, rework or delay, any one of which could decrease the speed and scope of product introduction and marketplace acceptance of the product. Specialized ASICs and intensive software testing and validation are key to the timely introduction of enhancements to the MultiWave CoreDirector and MultiWave MetroDirector K2 product lines; and schedule delays are common in the final validation phase, as well as in the manufacture of specialized ASICs. In addition, unexpected intellectual property disputes, failure of critical design elements, and a host of other execution risks may delay or even prevent the introduction of these products. If we do not develop and successfully introduce these products in a timely manner, our business, financial condition and results of operations would be harmed.

The markets for our MultiWave CoreDirector and MultiWave MetroDirector K2 product lines are relatively new. We are only beginning to establish commercial acceptance of these products, and we cannot be certain that the substantial sales and marketing efforts necessary to achieve commercial acceptance in traditionally long sales cycles will be successful. If the markets for these products do not develop, or the products are not accepted by the market, our business, financial condition and results of operations would suffer. We have recently written down the value of the goodwill associated with our acquisition of Cyras, the source of our MultiWave MetroDirector K2 product, in recognition of what we believe to be a significant and permanent decline in the market for these types of products.

We Face Intense Competition which Could Hurt Our Sales and Profitability

The market for optical networking equipment is extremely competitive. Competition in the optical networking market is based on varying combinations of price, functionality, software functionality, manufacturing capability, installation, services, scalability and the ability of the system solution to meet customers’ immediate and future network requirements. A small number of very large companies, including Alcatel, Cisco Systems, Fujitsu Group, Hitachi, Lucent Technologies, NEC Corporation, Nortel Networks, Siemens AG and Telefon AB LM Ericsson, have historically dominated the telecommunications equipment industry. They all have substantial financial, marketing, manufacturing and intellectual property resources and greater resources than CIENA, to develop or acquire new technologies than we do. They also often have existing relationships with our potential customers.

Because we sell systems that compete directly with product offerings of these companies, and in some cases displace or replace their equipment, we represent a competitive threat. The continued expansion of our product offerings with the MultiWave CoreDirector and MultiWave MetroDirector K2 product lines and enhancements to our MultiWave CoreStream and MultiWave Metro product lines likely will increase this perceived threat. The recent decline in the market for optical networking equipment has resulted in even greater competitive pressures. We expect that the aggressive tactics we have confronted on the part of many of these competitors will continue, and perhaps become more severe. These tactics include:

- price discounting; particularly when a competitor is selling used equipment or inventory that a competitor has written down or written off;
- early announcements of competing products and other marketing efforts;
- "one-stop shopping" options;
- customer financing assistance;
- marketing and advertising assistance; and
- intellectual property disputes.

These tactics can be particularly effective in a highly concentrated customer base such as ours. Our customers are under increasing competitive pressure to deliver their services at the lowest possible cost. This pressure may result in the pricing of optical networking systems becoming a more important factor in customer decisions, which may favor larger competitors that can spread the effect of price discounts in their optical networking products across a larger array of products and services and across a larger customer base than ours. If we are unable to offset any reductions in the average sales price for our products by a reduction in the cost of our products, our gross profit margins will be adversely affected. Our inability to compete successfully against our competitors and maintain our gross profit margins would harm our business, financial condition and results of operations.

Many of our customers have indicated that they intend to establish a relationship with at least two vendors for optical networking products. With respect to customers for whom we are the only supplier of intelligent optical products, we do not know when or if these customers will select a second vendor or what impact the selection might have on purchases from us. If a second optical networking supplier is chosen, these customers could reduce their purchases from us, which could in turn have a material adverse effect on us.

New competitors are emerging to compete with our existing products as well as our future products. We expect new competitors to continue to emerge as the optical networking market continues to expand. These companies may achieve commercial availability of their products more quickly due to the narrow and exclusive focus of their efforts. Several of these competitors have raised significant cash and they have in some cases offered stock in their companies, positions on technical advisory boards, or have provided significant vendor financing to attract new customers. Our inability to compete successfully against these companies would harm our business, financial condition and results of operations.

If We Fail to Respond Rapidly to Technological Changes, Our Products Will Become Obsolete, Damaging Our Short-Term Prospects and Threatening Our Long-Term Survival

The market for optical networking products is likely to be characterized by rapid technological change, frequent introductions of new products, and recurring changes in customer requirements. To succeed in this market, we must continue to develop new products and new features for existing products. Doing so is difficult and costly, and there is no assurance that we will continue to be successful. In addition, we must be able to identify and gain access to promising new technologies. Failure to keep pace with technological advances would impair the competitiveness of our products and sooner or later do serious harm to our business.

Several of our new products, including the MultiWave CoreDirector, the MultiWave MetroDirector K2 and enhancements to the MultiWave CoreStream and MultiWave Metro, are based on complex technology which could result in unanticipated delays in the development, manufacturing or deployment of these products. Our LightWorks initiative, which involves modifying these products to enable customers to implement a new type of network architecture, entails similar development risks.

Our customers often require extensive testing of new products before accepting them, and we are typically unable to recognize revenue until the tests are completed satisfactorily. The certification process for new telecommunications equipment used in the networks of the RBOCs and TOs tends to be particularly lengthy and difficult. Complying with these certification requirements may involve unanticipated delays that could adversely affect the timing of our ability to sell our products to these larger carriers.

Concentration of Customers

Although the number of customers who make purchases from us continues to grow, a substantial portion of our revenues continues to come from sales to a small number of customers. In fiscal 2001, 50.5% of our revenues came from our two most significant customers, Sprint and Qwest. The loss of, or a substantial reduction in purchases by, either of these customers could reduce our revenues materially. Both of these companies have been affected to some extent by the current economic recession and the even more difficult conditions in

the communications industry. The communications industry is, moreover, undergoing a period of consolidation. It is possible that either of these customers could become a party to a merger or other business combination. The distraction and uncertainty inevitably attendant on such a transaction could delay or alter decisions on network deployments or capital expenditures, and this could result in delayed or reduced purchases from us.

We Are Exposed to the Credit Risk of Our Customers

Industry and economic conditions have weakened the financial position of some of our customers. To sell to some of these customers we may be required to take risks of uncollectable accounts. While we monitor these situations carefully and attempt to take appropriate measures to protect ourselves, it is possible that we may have to write down or write off doubtful accounts. Such write-downs or write-offs, if large, could have a material adverse effect on our operating results and financial condition.

We also continue to experience demands from customers to finance sales to them. While we have done only a limited amount of such financing in the past, the increasingly competitive environment in which we are now operating may require us to engage in more customer financing in the future. Our ability to recognize revenue from financed sales will depend on the relative financial condition of the specific customer, among other factors. Further, we will need to evaluate the collectability of receivables from these customers if their financial condition deteriorates in the future. Any change in the financial condition of customers to which we provide financing could have a material adverse effect on our operating results and financial condition.

Our Strategy Involves Pursuing Strategic Acquisitions and Investments that May Not Be Successful

Our business strategy includes acquiring or making strategic investments in other companies with a view to expanding our portfolio of products and services, acquiring new technologies, and accelerating the development of new or improved products. To do so, we may issue equity that would dilute our current shareholders’ percentage ownership or incur debt or assume indebtedness. In addition, we may incur significant amortization expenses related to intangible assets. In the fourth quarter fiscal 2001 we incurred a significant write-off of goodwill associated with our Cyras acquisition completed in March 2001.

Acquisitions and strategic investments involve numerous risks, including difficulties in integrating the operations, technologies, and products of the acquired companies; diversion of management’s attention from our core business; potential difficulties in completing projects of the acquired company; the potential loss of key employees of the acquired company; and dependence on unfamiliar or relatively small supply partners. In addition acquisitions and strategic investments may involve risks of entering markets in which we have no or limited direct prior experience and where competitors in such markets have stronger market positions and of obtaining insufficient revenues to offset increased expenses associated with acquisitions. Mergers and acquisitions are inherently risky. Not all of those we have made in the past have been successful; and it is possible that acquisitions we make in the future may be unsuccessful, even to the extent of materially and adversely affecting our business.

We May Not Succeed in Completing the Proposed Merger with ONI

On February 17, 2002, we entered into an agreement to merge with ONI Systems Corp. The merger is subject to obtaining approval of federal regulatory authorities under the Hart-Scott-Rodino Anti-trust Improvements Act as well as approval by majority vote of the

shareholders of both companies. It is also subject to certain other closing conditions. There is a risk that we may not be successful in consummating the transaction because of the failure to meet one of these conditions. If the merger is not completed, we could suffer a number of consequences that would adversely affect our business including:

- failure to realize the enhanced financial and competitive position we expect as a result of the acquisition;
- the diversion of management attention from our day-to-day business and the unavoidable disruption to our employees and our relationships with customers as a result of efforts and uncertainties relating to the anticipated merger may detract from our ability to grow revenues and minimize costs, which, in turn may lead to a loss of market position;
- the significant expenses related to the merger we have incurred and will continue to occur prior to closing of the transaction; and
- the possibility that we could, under certain circumstances, be required to pay ONI a substantial termination fee if our Board of Directors were to change recommendations in favor of the merger.

Once the joint proxy statement/prospectus has been declared effective by the SEC, such definitive joint proxy statement/prospectus will be mailed to all holders of CIENA stock and will contain important information about CIENA, ONI and the proposed merger, risks relating to the merger and the combined company, and related matters. CIENA urges all of its stockholders to read the definitive joint proxy statement/prospectus when it becomes available.

We May Not Be Able to Achieve the Benefits We Anticipate from the Merger with ONI

Integrating two businesses of the sizes of ours and ONI's is difficult. We have limited experience with acquisitions and cannot be certain that we can integrate the two businesses successfully or achieve the benefits we envision from the merger. Success will depend, among other things, on our ability

- to assimilate ONI's operations and personnel with ours;
- to maintain uniform standards, controls, procedures and policies in the merged company;
- to integrate ONI's products with ours so that they can operate, and be sold as, part of an integrated system;
- to achieve substantial reductions in manufacturing and operating costs following the merger; and
- to retain key personnel from both companies.

Failure to meet these challenges or other problems we encounter in connection with the merger could have a material adverse effect on our business, results of operations and financial condition. We will also incur substantial non-cash charges in connection with the merger related to goodwill and amortization of other intangibles.

We Depend on a Limited Number of Suppliers, and for Some Items We Do Not Have a Substitute Supplier

We depend on a limited number of suppliers for components of our products, as well as for equipment used to manufacture and test our products. Our products include several high-performance components for which reliable, high-volume suppliers are particularly limited. Furthermore, some key optical and electronic components we use in our optical transport systems are currently available only from sole or limited sources, and in some cases, that source also is a competitor. Any delay in component availability for any of our products could result in delays in deployment of these products and in our ability to recognize revenues. These delays could also harm our customer relationships and our results of operations.

Failures of components affect the reliability and performance of our products and can reduce customer confidence in them, perhaps to the extent of adversely affecting our financial performance. On occasion, we have experienced delays in receipt of components and have received components that do not perform according to their specifications. Any future difficulty in obtaining sufficient and timely delivery of components could result in delays or reductions in product shipments which, in turn, could harm our business. A consolidation among suppliers of these components or adverse developments in their businesses affecting their ability to supply us, could adversely impact the availability of components on which we depend. Delayed deliveries of key components from these sources could adversely affect our business.

Any delays in component availability for any of our products or test equipment could result in delays in deployment of these products and in our ability to recognize revenue from them. These delays could also harm our customer relationships and our results of operations.

We Rely on Contract Manufacturers for Our Products

We rely on a small number of contract manufacturers to manufacture our MultiWave CoreDirector and MultiWave MetroDirector K2 product lines and some of the components for our other products. The qualification of these manufacturers is an expensive and

time-consuming process, and these contract manufacturers build modules for other companies, including our competitors. In addition, we do not have contracts in place with many of these manufacturers. We may not be able to effectively manage our relationships with our manufacturers and we cannot be certain that they will be able to fill our orders in a timely manner. We provide forecasts of our demand to our contract manufacturers several months prior to scheduled delivery of products. If we overestimate our future product requirements, the contract manufacturers may have excess inventory, which would increase our costs. Conversely, if we underestimate our future product requirements the contract manufacturer may not have enough product to meet our customer requirements, and this could result in delays in the shipment of our products and our ability to recognize revenue. If we cannot effectively manage these manufacturers and forecast future demand, or if they fail to deliver components on time, our business may suffer.

Some of Our Suppliers Are Also Competitors

Some of our component suppliers are both primary sources for components and major competitors in the market for system equipment. For example, we buy components from Alcatel, Lucent Technologies, NEC Corporation, Nortel Networks, and Siemens AG. Each of these companies offers optical communications systems and equipment that are competitive with our products. A decline in reliability or other adverse change in these supply relationships could harm our business.

Our Ability to Compete Could Be Harmed If We Are Unable to Protect and Enforce Our Intellectual Property Rights or If We Infringe on Intellectual Property Rights of Others

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. We also enter into non-disclosure and proprietary rights agreements with our employees and consultants, and license agreements with our corporate partners, and control access to and distribution of our products, documentation and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise obtain and use our products or technology. Monitoring unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If competitors are able to use our technology, our ability to compete effectively could be harmed. We are involved in an intellectual property dispute regarding the use of our technology and may become involved with additional disputes in the future. Such lawsuits can be costly and may significantly divert time and attention from some members of our personnel.

We have received, and may receive in the future, notices from holders of patents in the optical technology field that raise issues of possible infringement by our products. Questions of infringement in the optical networking equipment market often involve highly technical and subjective analysis. We cannot assure you that any of these patent holders or others will not in the future initiate legal proceedings against us, or that we will be successful in defending against these actions. We are involved in an intellectual property dispute regarding the possible infringement of our products. In the past, we have been forced to take a license from the owner of the infringed intellectual property, or to redesign or stop selling the product that includes the challenged intellectual property. If we are sued for infringement and are unsuccessful in defending the suit, we could be subject to significant damages, and our business and customer relationships could be adversely affected.

Product Performance Problems Could Limit Our Sales Prospects

The production of new optical networking products and systems with high technology content involves occasional problems as the technology and manufacturing methods mature. If significant reliability, quality or network monitoring problems develop, including those due to faulty components, a number of negative effects on our business could result, including:

- costs associated with reworking our manufacturing processes;
- high service and warranty expenses;
- high inventory obsolescence expense;
- high levels of product returns;
- delays in collecting accounts receivable;
- reduced orders from existing customers; and
- declining interest from potential customers.

Although we maintain accruals for product warranties, actual costs could exceed these amounts. From time to time, there will be interruptions or delays in the activation of our products at a customer's site. These interruptions or delays may result from product performance problems or from aspects of the installation and activation activities, some of which are outside our control. If we experience significant interruptions or delays that we can not promptly resolve, confidence in our products could be undermined, which could harm our business.

We Face Risks Associated with our International Operations

We market, sell and service our products globally. We have established offices around the world, including in North America, Europe, Latin America and in the Asia Pacific region. We will continue to expand our international operations and enter new international markets. This expansion will require significant management attention and financial resources to develop successfully direct and indirect international sales and support channels. We may not be able to maintain or increase international market demand for our products.

International operations are subject to inherent risks, and our future results could be adversely affected by a variety of uncontrollable and changing factors. These include greater difficulty in collecting accounts receivable and longer collection periods; difficulties and costs of staffing and managing foreign operations; the impact of recessions in economies outside the United States; unexpected changes in regulatory requirements; certification requirements, reduced protection for intellectual property rights in some countries; potentially adverse tax consequences; political and economic instability; trade protection measures and other regulatory requirements; service provider and government spending patterns; and natural disasters. Such factors could have a material adverse impact on our operating results and financial condition.

Leverage and Debt Service Obligations May Adversely Affect Our Cash Flow and Our Ability to Repay or Repurchase our Notes

We have approximately $840 million of outstanding principal indebtedness, primarily related to notes offered by us and the assumption of notes from the acquisition of Cyras Systems, Inc. As a result of this indebtedness, we have significant principal and interest payment obligations. There is the possibility that we may be unable to generate sufficient cash to pay the principal of, interest on and other amounts due in respect of our indebtedness, including the notes, when due. We may also add equipment loans and lease lines to finance capital expenditures and may obtain additional long-term debt, working capital lines of credit and lease lines.

Our leverage could have important negative consequences, including:

- increasing our vulnerability to general adverse economic and industry conditions;
- limiting our ability to obtain additional financing;
- requiring the dedication of a substantial portion of our expected cash flow from operations to service our indebtedness, thereby reducing the amount of our expected cash flow available for other purposes, including capital expenditures;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we compete;
- placing us at a possible competitive disadvantage relative to less leveraged competitors and competitors that have better access to capital resources; and
- making it difficult or impossible for us to pay the principal amount of the notes at maturity or the repurchase price of the notes upon a change of control, thereby causing an event of default under the indenture.

Cyras Systems LLC, our wholly owned subsidiary, has $150 million of 4.5% convertible subordinated notes outstanding. In the event that the holders of the Cyras notes convert their notes into our common stock, we would have to issue a significant number of shares of additional common stock. Based on the exchange ratio for the Cyras acquisition of approximately 0.13, we will have to issue approximately 1,037,055 shares of our common stock if holders of the entire $150 million of convertible notes decided to convert their notes. At our current stock price it appears more likely that the holders of the Cyras notes will not elect to convert them into our common stock before March 31, 2002. As a result, it is probable that we will have to make an offer to repurchase the notes at 118.942% of their principal balance on April 30, 2002. If all of the note holders accept that offer, we will have to expend approximately $178 million of our cash and cash equivalents for the repurchase.

If we complete the merger with ONI, we will become obligated on its $300 million issue of 5% convertible subordinated notes, due October 15, 2005. While we will also acquire its cash, cash equivalents, short-term and long-term investments currently approximately $678.8 million, we will be obligated to make semiannual interest payments of $7.5 million on April 15th and October 15th of each year,

and to repay the notes when they mature.

Our Stock Price May Exhibit Volatility

Our common stock price has experienced substantial volatility in the past, and is likely to remain volatile in the future. Volatility can arise as a result of the activities of short sellers and risk arbitrageurs, and may have little relationship to our financial results or prospects. Volatility can also result from any divergence between our actual or anticipated financial results and published expectations of analysts, and announcements that we, our competitors, or our customers may make.

Divergence between our actual results and our anticipated results, analyst estimates and public announcements by us, our competitors, or by customers will occur from time to time in the future, with resulting stock price volatility, irrespective of our overall year-to-year performance or long-term prospects. As long as we continue to depend on a limited customer base, and particularly when a substantial majority of their purchases consist of newly-introduced products, there is substantial chance that our quarterly results will vary widely.

Forward-Looking Statements

Some of the statements contained, or incorporated by reference, in this quarterly report discuss future expectations, contain projections of results of operations or financial condition or state other “forward-looking” information. Those statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The “forward-looking” information is based on various factors and was derived using numerous assumptions. In some cases, you can identify these so-called “forward-looking statements” by words like “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential” or “continue” or the negative of those words and other comparable words. You should be aware that those statements only reflect our predictions. Actual events or results may differ substantially. Important factors that could cause our actual results to be materially different from the forward-looking statements are disclosed throughout this report, particularly under the heading “Risk Factors” above.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The following discussion about the Company’s market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. The Company is exposed to market risk related to changes in interest rates and foreign currency exchange rates. The Company does not use derivative financial instruments for speculative or trading purposes.

Interest Rate Sensitivity. The Company maintains a short-term and long-term investment portfolio. These available-for-sale securities are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10 percent from levels at January 31, 2002, the fair value of the portfolio would decline by approximately $99 million.

Foreign Currency Exchange Risk. As a global concern, the Company faces exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on the Company’s financial results. Historically the Company’s primary exposures have been related to non-dollar denominated operating expenses in Europe and Asia where the Company sells primarily in U.S. dollars. The Company is prepared to hedge against fluctuations in foreign currency if this exposure becomes material. As of January 31, 2002, the assets and liabilities of the Company related to non-dollar denominated currencies were not material. Therefore, we do not expect an increase or decrease of 10 percent in the foreign exchange rate would have a material impact on the Company’s financial position.

PART II. – OTHER INFORMATION

Item 1. Legal Proceedings

On October 3, 2000, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into CIENA's products infringe U.S. Patent No. 4,859,016. We are unable to estimate what impact, if any, an adverse outcome would have on The Company. To date, we have not been served with a complaint in the proceeding. If served, we intend to defend the action vigorously.

On July 19, 2000, CIENA and CIENA Properties, Inc., a wholly owned subsidiary of CIENA, filed a complaint in the United States District Court for the District of Delaware requesting damages and injunctive relief against Corvis Corporation. The complaint charges Corvis Corporation with infringing several patents relating to CIENA's optical networking communication systems and technology. On September 8, 2000, Corvis filed an Answer and Counterclaim alleging invalidity, non-infringement and unenforceability of the asserted patents, and tortuous interference with prospective economic advantage. CIENA believes that Corvis' counterclaims are without merit, and intends to defend itself vigorously. The suit is still in discovery proceedings. The trial of the matter is scheduled to begin on April 1, 2002. On the basis of the proceedings so far, we continue to believe we have a strong case on both our own claim and the counterclaim. Litigation is inherently uncertain, however, and there remains a possibility that we could lose either or both.

Item 6. Exhibits and Reports on Form 8-K

	Exhibit	Description
(a)	10.26	Form of Amendment 1 Transfer of Control/Severance Agreement for named executive officers (other than Gary B. Smith)
	10.27	Transfer of Control/Severance Agreement between CIENA Corporation and Gary B. Smith

(b) Report on Form 8-K: Form 8-K filed November 13, 2001; Form 8-K filed February 5, 2002; Form 8-K filed February 19, 2001.

SIGNATURES

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

CIENA CORPORATION

Date: February 21, 2002	By:	/s/ Gary B. Smith Gary B. Smith President, Chief Executive Officer and Director (Duly Authorized Officer)
Date: February 21, 2002	By:	/s/ Joseph R. Chinnici Joseph R. Chinnici Senior Vice President, Finance and Chief Financial Officer (Principal Financial Officer)

AMENDMENT 1

EXHIBIT 10.26

AMENDMENT NO. 1
TO CIENA CORPORATION
TRANSFER OF CONTROL/SEVERANCE AGREEMENT

This Amendment No. 1 (the “Amendment”) is made this _____ day of ______________, by and between **CIENA Corporation**, a Delaware corporation (together with its subsidiaries, the “Corporation”) and ______________ (the “Executive”) as an amendment to the Transfer of Control/Severance Agreement, dated as of __________________, by and between the Corporation and Executive (hereinafter, the “Agreement”). Except as otherwise indicated, defined terms in this Amendment have the same meaning as set forth in the Agreement.

Recitals

1. Deletion and Replacement of Section 4.4. Section 4.4 of the Agreement shall be deleted and replaced in its entirety with the following:

4.4 Stock Options. All options granted to an Executive to purchase capital stock of the Corporation under any plan, program or arrangement maintained by the Corporation, shall become vested and exercisable upon a Transfer of Control to the extent provided for under the terms of such plan, program or arrangement. In addition to any accelerated vesting of the Executive’s options under such plan, program or arrangement, in the event that:

(i) the Executive’s employment with the Corporation is terminated without Cause by the Corporation, or for Good Reason by the Executive, within one year after the Effective Date,

(ii) the Executive executes a general release and waiver in accordance with Section 7.1, and

(iii) the Executive satisfies the condition precedent set forth in Section 4.5,

then vesting of any of the Executive’s unvested options shall continue during the period of the continuation of the Executive’s salary as provided in Section 4.1; and the period during which unexercised and exercisable options may be exercised shall be extended for thirty days after the end of the salary continuation period; provided that,

(i) if the exercise of any option within this time period is prevented by the requirements of federal or state securities laws as provided under the terms of the applicable plan, program or arrangement, then the option shall remain exercisable until three months after the date the

Executive is notified by the Company that the option is exercisable, but in no event later than ten years after the date of grant of the option; and

(ii) if the exercise of any option within this time period would subject the Executive to suit under Section 16(b) of the Securities Exchange Act of 1934, the period for exercise shall be extended until the earliest to occur of (a) the tenth day following the date on which the Executive would no longer be subject to such suit, (b) the 190th day after the end of the salary continuation period, or (c) ten years after the date of grant of the option.

In all other instances, vesting of any such options shall cease on the last day of the Executive's active employment with the Corporation, irrespective of the existence of salary continuation payments beyond such last day.

2. Addition of Section 4.5. A new Section 4.5 shall be added as follows:

4.5. Condition Precedent. The Parties agree that payment of the severance benefits set forth in this Section 4 shall be conditioned upon and subject to the Executive's agreement that, for a period of twelve months following the Executive's last day of employment with the Corporation, the Executive will not, whether alone or as a partner, officer, director, consultant, agent, employee or stockholder of any company or other commercial enterprise, directly or indirectly, without the prior written consent of the Corporation, engage or invest in, own, manage, operate, finance, control or participate in the ownership, management, operation, financing or control of, be employed by or associated with any business or other commercial activity whose products or activities compete, in whole or in part, with the products or activities of the Corporation; provided, that the Executive may purchase or otherwise acquire as a passive investment up to (but not more than) one percent of any class of security of any enterprise (but without otherwise participating in the activities of such enterprise) if such securities are listed on any national or regional securities exchange or have been registered under Section 12(g) of the Securities Exchange Act of 1934.

3. Addition of Section 4.6. A new Section 4.6 shall be added as follows:

4.6. Remedies. In the event of a breach of Section 4.5 by the Executive, then the Executive shall immediately reimburse the Corporation the entire gross amount of the severance benefits paid to the Executive pursuant to Section 4 up to the date of such breach. The forfeiture provisions of this Section 4.6 shall be in addition to, and not in limitation of, any other remedies available to the Corporation at law or in equity.

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4. Ratification. Other than as set forth in this Amendment, all other terms and conditions of the Agreement remain unchanged. In the event of a conflict between the terms of this Amendment and the Agreement, the terms of this Amendment shall control.

5. Controlling Law. This Amendment shall in all respects be governed by, and construed in accordance with, the laws of the State of Delaware (without regard to the principles of conflicts of laws).

IN WITNESS WHEREOF, the parties have executed and delivered this Amendment on the date first above written.

CIENA CORPORATION

By:______________________________________
Name:
Title:

EXECUTIVE

____
Name:

EXHIBIT 10.27

CIENA CORPORATION
TRANSFER OF CONTROL/SEVERANCE AGREEMENT

This **Transfer of Control/Severance Agreement** (the "Agreement"), dated as of December 11, 2001, between **CIENA Corporation**, a Delaware corporation (together with its subsidiaries, the "Corporation") and **Gary B. Smith** (the "Executive").

WITNESSETH

The Executive has now commenced serving as the President and Chief Executive Officer of the Corporation and will possess an intimate knowledge of the business and affairs of the Corporation. The Corporation recognizes the Executive's potential contribution to its growth and success and desires to enter into this Agreement with the Executive in order to assure to the Corporation the benefits of the Executive's expertise and knowledge. The Executive, in turn, desires an assurance of compensation by the Corporation during the period set forth herein. The Corporation also wants assurance that it will have the continued dedication, loyalty, and service of, and the availability of objective advice and counsel from, the Executive notwithstanding the possibility, threat or occurrence of a bid or other action to take over control of the Corporation.

In the event the Corporation receives any proposals from a third party concerning a possible business combination with the Corporation, or acquisition of the Corporation's equity securities, the Board of Directors of the Corporation (the "Board") believes it imperative that the Corporation and the Board be able to rely upon the Executive to continue in the Executive's position and be available for advice, if requested, without concern that the Executive might be distracted by the personal uncertainties and risks created by such a proposal, or be influenced to consider other employment opportunities or prospects because of such uncertainties or risks.

Should the Corporation receive any such proposals, in addition to the Executive's regular duties, the Executive, in light of the Executive's experience and knowledge gained within that portion of the business in which he or she is principally engaged, may be called upon to assist in the assessment of proposals, advise management and the Board as to whether such proposals would be in the best interest of the Corporation and its shareholders, and to take such other actions as the Board might determine to be appropriate.

Accordingly, in consideration of the mutual covenants and representations contained herein and the mutual benefits derived herefrom, the parties hereto agree as follows:

1. **Certain Definitions.** In addition to those terms defined elsewhere herein, when used herein, the following capitalized terms shall have the meanings indicated:

1.1. “Cause” means (i) the Executive’s willful or continued failure substantially to perform the duties of the Executive’s position (other than as a result of Disability or as a result of termination by the Executive for Good Reason) after written notice to the Executive by the Board specifying such failure, provided that such “cause” shall have been found by a majority vote of the Board after at least 10 days’ written notice to the Executive specifying the failure on the part of the Executive and after an opportunity for the Executive to be heard at a meeting of the Board; (ii) any willful act or omission by the Executive constituting dishonesty, fraud or other malfeasance, or any act or omission by the Executive constituting immoral conduct, which in any such case is injurious to the financial condition or business reputation of the Corporation or any of its affiliates; or (iii) the Executive’s indictment for a felony under the laws of the United States or any state thereof or any other jurisdiction in which the Corporation conducts business. For purposes of this definition, no act or failure to act shall be deemed “willful” unless effected by the Executive not in good faith and without a reasonable belief that such action or failure to act was in or not opposed to the Corporation’s best interests.

1.2. “Disability” means either (i) “total disability” as defined for purposes of the Corporation’s long-term disability benefit plan; or (ii) the Executive’s inability, as a result of physical or mental incapacity, to perform the Executive’s duties for a period of six consecutive months or for an aggregate of six months in any twelve consecutive month period.

1.3. “Effective Date” means the date on which a Transfer of Control occurs. In the event of a subsequent Transfer of Control within one year of the prior Transfer in Control, “Effective Date” shall be adjusted to mean the date on which the subsequent Transfer in Control occurs. Anything in this Agreement to the contrary notwithstanding, if a Transfer of Control occurs, and if the Executive’s employment with the Corporation had terminated prior to the date on which the Transfer of Control occurred, and if it is reasonably demonstrated by the Executive that such termination of employment either was at the request of a third party who had taken steps reasonably calculated to effect the Transfer of Control or otherwise arose in connection with or in anticipation of the Transfer of Control, then, for all purposes of this Agreement, the term “Effective Date” shall mean, with respect to such Executive only, the date immediately prior to the date of such termination of employment.

1.4. “Good Reason” means (i) removal from, or failure to be appointed or elected to, or failure to be reappointed or reelected to, the position of Chief Executive Officer of the parent entity of the surviving enterprise following a Transfer of Control; (ii) any other material diminution in the Executive’s title, position, duties or responsibilities, or the assignment to the Executive of duties that are inconsistent, in a material respect, with the scope of duties and responsibilities normally associated with those of a Chief Executive Officer; (iii) reduction in base salary or Incentive Compensation opportunity, or a reduction in level of participation in long term incentive, benefit and other plans for senior executives as in effect immediately preceding the Effective Date, or their equivalents; (iv) relocation of

the Executive's principal workplace without the Executive's consent to a location which is more than 50 miles from the Executive's principal workplace on the Effective Date (provided that, if the Executive becomes Chief Executive Officer of an entity that acquires the Corporation, he may be required to relocate to the headquarters office of that entity); or (v) any failure by the Corporation to comply with and satisfy the requirements of Section 7.3, provided that the successor shall have received at least ten days prior written notice from the Corporation or the Executive of the requirements of Section 7.3. For purposes of clauses (i), (ii) or (iii) of the preceding sentence, an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by the Corporation promptly after receipt of notice thereof given by the Executive shall be excluded.

1.5. "Incentive Compensation" includes any bonus or award received, or which the Executive is eligible to receive, under any corporate incentive plan or under any corporate long-term incentive plan maintained by the Corporation (or any successor to any such plan).

1.6. "Transfer of Control" shall be deemed to have taken place on the earliest of the date of (a) the direct or indirect sale or exchange by the stockholders of the Corporation of all or substantially all of the stock of the Corporation where the stockholders of the Corporation before such sale or exchange do not retain, directly or indirectly, at least a majority of the beneficial interest in the voting stock of the surviving, continuing, successor, or purchasing corporation or parent corporation thereof, as the case may be (the "Acquiring Corporation") after such sale or exchange; (b) a merger or consolidation where the stockholders of the Corporation before such merger or consolidation do not retain, directly or indirectly, at least a majority of the beneficial interest in the voting stock of the Acquiring Corporation after such merger or consolidation; (c) the sale, exchange, or transfer of all or substantially all of the assets of the Corporation (other than a sale, exchange, or transfer to one (1) or more subsidiary corporations of the Corporation); (d) a liquidation or dissolution of the Corporation; or (e) any other event that the Board, in its sole discretion, shall determine constitutes a Transfer of Control. In each case the determination of whether or not a "Transfer of Control" is deemed to have taken place shall be made without regard to whether such events or occurrences constituting the Transfer of Control were hostile or against the position of the Board, or were approved or concurred in by the Board.

2. Term of Agreement.

Upon execution by the Executive, this Agreement shall commence as of December 11, 2001. This Agreement shall continue in effect through December 11, 2002; provided, however, that commencing on December 11, 2002, and every annual anniversary of such date, the term of this Agreement shall automatically be extended for an additional year unless, not later than ninety (90) calendar days prior to the anniversary on which this Agreement otherwise automatically would be extended, the Corporation shall have given notice to the Executive that it does not wish to extend this Agreement; provided further, however, that if a Transfer of Control shall have occurred during the original or any extended term of this Agreement, this Agreement shall continue in effect for a period of twelve (12) months beyond the month in which the Transfer of Control occurred. No termination or expiration of this Agreement shall affect any rights,

obligations or liabilities of either party that shall have accrued on or prior to the date of such termination or expiration.

3. Triggering Event.

In the event the Executive's employment with the Corporation is terminated without Cause by the Corporation, or for Good Reason by the Executive, on or within one year after the Effective Date, the Corporation shall (in addition to any compensation or benefits to which the Executive may otherwise be entitled under any other agreement, plan or arrangement with the Corporation, other than amounts excluded by Section 6.2) make the payments and shall provide the benefits to the Executive specified under Section 4 hereof, and, if applicable, the payments contemplated under Section 5 of this Agreement. For purposes of this Section 3, an Executive's employment with the Corporation will be deemed to have terminated on the earlier of the date the Executive's employment with the Corporation ceases or the date that written notice of any such termination is received by the Executive or by the Corporation, as the case may be, even though the parties may agree in connection therewith that the Executive's employment with the Corporation will continue for a specified period thereafter. The failure by the Executive or the Corporation to set forth in any such notice sufficient facts or circumstances showing Good Reason or Cause, as the case may be, shall not waive any right of the Executive or the Corporation or preclude either party from asserting such facts or circumstances in the enforcement of any such right.

4. Severance Benefits.

4.1. Severance Payment. Within thirty days of the Executive's termination of employment with the Corporation, it shall pay to the Executive, in a lump sum, the greater of (i) Three Million Dollars ($3,000,000), or (ii) an amount equal to three times the sum of (x) Executive's actual annual rate of base salary as in effect immediately prior to either the date of the Executive's termination of employment with the Corporation or the Effective Date, whichever is higher, and (y) the Executive's annual bonus amount under any incentive plan(s) or program(s) in which the Executive participated immediately prior to either the date of the Executive's termination of employment or the Effective Date, whichever annual bonus amount is higher, subject to any applicable payroll or other taxes required to be withheld. In determining actual annual rate of base salary, such sums shall be adjusted to include the dollar value of any compensation that would have been paid to the Executive but was deferred or excluded for federal income tax purposes pursuant to any deferred compensation program approved by the Corporation. The annual bonus amount shall be based on an assumed achievement of 100% of the targeted performance goal for such award. Upon receipt of the amount specified under this Section 4.1, neither the Executive nor any other person claiming any payment by reason of the Executive's participation in the applicable annual bonus plan, shall have any right to any payment under such plan(s) or program(s) with respect to any applicable award thereunder.

4.2. Welfare Benefit and Director and Officer Insurance Continuation. The Executive's (and, where applicable, members of the Executive's family's) participation in the group medical, dental, life and disability plans maintained by the Corporation shall be

continued on substantially the same basis as if the Executive were an employee of the Corporation until the earlier of the third anniversary of the Executive's termination or the last day of the month in which the Executive commences employment with another employer (the "Coverage Period"). In the event that the Corporation is unable for any reason to provide for the Executive's (and, where applicable, the Executive's family's) continued participation in one or more of such plans during the Coverage Period, the Corporation shall pay or provide at its expense equivalent benefit coverage for the remainder of the Coverage Period. The Corporation shall also pay to the Executive at least annually an amount which shall be sufficient on an after tax basis to compensate the Executive for all additional taxes incurred by reason of any income realized as a result of the continued coverage under this subparagraph, to the extent such taxes result from the Executive's status as a non-employee and would not be incurred if the Executive was an employee of the Corporation, on a grossed-up basis at the highest marginal income tax rate for individuals. The Coverage Period shall be taken into account as a period of continuation coverage for purposes of Part 6 of Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), or for purposes of any other obligation of the Corporation to provide any continued coverage to the Executive (and, where applicable, members of the Executive's family) under any group medical, dental, life or disability plan. The Corporation shall continue to maintain director and officer insurance covering the Executive, and shall maintain in effect any indemnification agreements providing for indemnification of the Executive by the Corporation, until the period under the applicable statute of limitations has ended.

4.3. Stock Options. All options granted to the Executive to purchase capital stock of the Corporation under any plan, program or arrangement maintained by the Corporation, shall become vested and exercisable upon a Transfer of Control to the extent provided for under the terms of such plan, program or arrangement. In addition to any accelerated vesting of the Executive's options under such plan, program or arrangement, in the event that:

(i) the Executive's employment with the Corporation is terminated without Cause by the Corporation, or for Good Reason by the Executive, within one year after the Effective Date,

(ii) the Executive executes a general release and waiver in accordance with Section 7.1, and

(iii) the Executive satisfies the condition precedent set forth in Section 4.4,

then all of the Executive's unvested options shall become immediately vested and exercisable. In all other instances, vesting of any such options shall cease on the last day of the Executive's active employment with the Corporation, irrespective of the existence of salary continuation payments beyond such last day.

4.4. Condition Precedent. The Parties agree that payment of the severance benefits set forth in this Section 4 shall be conditioned upon and subject to the Executive's agreement that, for a period of twelve months following the Executive's last day of employment

with the Corporation, the Executive will not, whether alone or as a partner, officer, director, consultant, agent, employee or stockholder of any company or other commercial enterprise, directly or indirectly, without the prior written consent of the Corporation, engage or invest in, own, manage, operate, finance, control or participate in the ownership, management, operation, financing or control of, be employed by or associated with any business or other commercial activity whose products or activities compete, in whole or in part, with the products or activities of the Corporation; provided, that the Executive may purchase or otherwise acquire as a passive investment up to (but not more than) one percent of any class of security of any enterprise (but without otherwise participating in the activities of such enterprise) if such securities are listed on any national or regional securities exchange or have been registered under Section 12(g) of the Securities Exchange Act of 1934.

4.5. Remedies. In the event of a breach of Section 4.4 by the Executive, then the Executive shall immediately reimburse the Corporation the entire gross amount of the severance benefits paid to the Executive pursuant to Section 4 up to the date of such breach. The forfeiture provisions of this Section 4.5 shall be in addition to, and not in limitation of, any other remedies available to the Corporation at law or in equity.

5. Certain Additional Payments by the Corporation.

5.1. Excise Tax Protection. In the event it shall be determined that any payment or distribution by the Corporation to or for the benefit of the Executive (whether paid or payable or distributed or distributable pursuant to the terms of this Agreement or otherwise, but determined without regard to any additional payments required under this Section 5) (a “Payment”) would be subject to the excise tax imposed by Section 4999 (or any successor provision) of the Code or any interest or penalties are incurred by the Executive with respect to such excise tax (such excise tax, together with any such interest and penalties, are hereinafter collectively referred to as the “Excise Tax”), then the Corporation shall pay to the Executive an additional amount (a “Gross-Up Payment”) equal to the Excise Tax imposed upon such Payment.

5.2. Determinations. Subject to the provisions of Section 5.3 below, all determinations required to be made under this Section 5, including whether and when a Gross-Up Payment is required, the amount of such Gross-Up Payment and the assumptions to be utilized in arriving at such determination, shall be made by the Corporation’s then acting independent certified public accounting firm at the Effective Date (the “Tax Firm”), which shall provide detailed supporting calculations both to the Corporation and the Executive within 15 business days of the receipt of notice from the Executive that there has been a Payment, or such earlier time as may be requested by the Corporation. The Tax Firm may employ and rely upon the opinions of actuarial or legal professionals to the extent it deems necessary or advisable. In the event that the Tax Firm determines for any reason that it is unable to perform such services, or declines to do so, the Corporation shall select another nationally recognized law or accounting firm to make the determinations required under this section (which firm shall then be referred to as the Tax Firm hereunder). All fees and expenses of the Tax Firm shall be borne solely by the

Corporation. Any Gross-Up Payment determined pursuant to this Section 5 shall be paid by the Corporation to the Executive within five business days of the Corporation's receipt of the Tax Firm's determinations. If the Tax Firm determines that no Excise Tax should be payable by the Executive, the Tax Firm shall be requested to furnish the Executive with a written opinion that failure to report the Excise Tax on the Executive's applicable federal income tax return would not result in the imposition of a negligence or similar penalty. Any determination by the Tax Firm shall be binding upon the Corporation and the Executive. As a result of possible uncertainty in the application of Section 4999 of the Code at the time of the initial determination by the Tax Firm hereunder, it is possible that Gross-Up Payments which will not have been made by the Corporation should have been made or that the Gross-Up Payments which are made by the Corporation will be insufficient to satisfy the Excise Tax (an "Underpayment"), consistent with the calculations required to be made hereunder. In the event that the Corporation exhausts its remedies pursuant to Section 5.3, and the Executive thereafter is required to make a payment of any Excise Tax, the Tax Firm shall determine the amount of the Underpayment that has occurred and any such Underpayment shall be promptly paid by the Corporation to or for the benefit of the Executive.

5.3. Underpayments. The Executive shall notify the Corporation in writing of any claim by the Internal Revenue Service that, if successful, would result in the assessment or collection of any Underpayment with respect to the Executive. Such notification shall be given as soon as practicable but no later than ten business days after the Executive is informed in writing of such claim and shall apprise the Corporation of the nature of such claim and the date on which such claim is requested to be paid; provided, however, that a failure by the Executive to give notice timely shall not relieve the Corporation of its obligations hereunder except to the extent it shall have been materially prejudiced. The Executive shall not pay such claim prior to the expiration of the 30-day period following the date on which it gives such notice to the Corporation (or such shorter period ending on the date that any payment of taxes with respect to such claim is due). If the Corporation notifies the Executive in writing prior to the expiration of such period that it desires to contest such claim, the Executive shall:

(i) give the Corporation any information reasonably requested by the Corporation relating to such claim,

(ii) take such action in connection with contesting such claim as the Corporation shall reasonably request in writing from time to time, including, without limitation, accepting legal representation with respect to such claim by the Tax Firm or any other law firm selected by the Corporation,

(iii) cooperate with the Corporation in good faith in order effectively to contest such claim, and

(iv) permit the Corporation to participate in any proceedings relating to such claim;

provided, however, that the Corporation shall bear and pay directly all costs and expenses (including additional interest and penalties) incurred in connection with such contest and shall indemnify and hold the Executive harmless, on an after-tax basis, for any Excise Tax

or income and employment tax (including interest and penalties with respect thereto) imposed as a result of such representation and payment of costs and expenses.

5.4. Refunds. If, after the receipt by the Executive of any amount paid or advanced by the Corporation in connection with a contest undertaken pursuant to Section 5.3, the Executive becomes entitled to receive any refund or credit with respect thereto, the Executive shall (subject to the Corporation's complying with the requirements of Section 5.3) promptly pay to the Corporation the amount of such refund or credit (together with any interest paid or credited thereon after taxes applicable thereto).

6. Terms and Conditions of Participation.

6.1. Conditions of Participation. As a condition to being covered by this Agreement, the Executive acknowledges and agrees that (i) except as may otherwise be expressly provided under any other executed agreement between the Executive and the Corporation, nothing contained in this Agreement (including, but not limited to using the term "Cause" to determine benefits under this Agreement) is intended to change the fact that the employment of the Executive by the Corporation is "at will" and, prior to the Effective Date, may be terminated by either the Executive or the Corporation at any time, and (ii) disputes regarding the Executive's employment with the Corporation (regardless of whether such dispute involves the terms of this Agreement) shall be subject to arbitration as provided in Section 7.5 of this Agreement.

6.2. Non-Duplication. As a condition of being covered by this Agreement, and notwithstanding any agreement to the contrary, the Executive agrees that (i) the payments under this Agreement shall be the only severance or similar payments that are payable by the Corporation under any plan, program, policy or agreement, other than that certain Executive Incentive Agreement, dated August 18, 1999, by and between the Executive and the Corporation, and (ii) except for amounts payable under any retirement plans, stock purchase plans or deferred compensation plans of the Corporation in which the Executive may participate, the payments under this Agreement are in full and complete satisfaction of all liabilities of the Corporation with respect to the Executive under all such other plans, programs and agreements.

6.3 No Effect on Other Agreements;Inconsistent Provisions. This Agreement shall be in addition to, and have no effect on, the provisions of any other agreements, including without limitation indemnification agreements and proprietary inventions/confidentiality agreements that may exist between the Corporation and the Executive. Notwithstanding the foregoing, to the extent that the terms and conditions of this Agreement are inconsistent with those found in any other agreement or plan to which the Corporation and the Executive are each a party, the terms and conditions of this Agreement shall be controlling.

6.4. Amendment and Termination. This Agreement may not be amended or terminated after the Effective Date. Prior to the Effective Date, the Board may, in its sole discretion, modify or amend this Agreement in any respect, or terminate the Agreement, provided

such actions do not reduce the amount or defer the receipt of any payment or benefit provided under this Agreement.

6.5 Superseding Effect. This Agreement will supersede in its entirety that certain Transfer of Control/Severance Agreement by and between the Corporation and the Executive, dated November 11, 1998, as amended, which agreement shall be rendered null and void and of no further force and effect.

7. General.

7.1. Payment Obligations; Overdue Payments. The Corporation's obligations to make the payments and provide the benefits to the Executive under this Agreement shall be absolute and unconditional and shall not be affected in any way by any circumstances, including, without limitation, any offset, counterclaim, recoupment, defense or other right which the Corporation may have against the Executive or anyone else, provided, however, that as a condition to payment of amounts under this Agreement, the Executive shall execute a general release and waiver ("Waiver"), in form and substance reasonably satisfactory to the Corporation, of all claims relating to the Executive's employment by the Corporation and the termination of such employment, including, but not limited to, discrimination claims, employment-related tort claims, contract claims and claims under this Agreement (other than claims with respect to benefits under the Corporation's tax-qualified retirement plans, continuation of coverage or benefits solely as required by Part 6 of Title I of ERISA, or any obligation of the Corporation to provide future performance under Section 4 and Section 5). All amounts payable by the Corporation hereunder shall be paid without requiring notice or demand from the Executive, except as may be required with respect to the Waiver. Each and every payment made hereunder by the Corporation shall be final and the Corporation will not seek to recover all or any part of such payment from the Executive or from whosoever may be entitled thereto, for any reason whatsoever (other than as provided in Section 5.4). The Executive shall be entitled to receive interest at the prime rate of interest published from time to time by The Wall Street Journal (the "Prime Rate") on any payments under this Agreement that are thirty days overdue, provided, however, that no payments shall be deemed to be overdue until the Executive executes the Waiver and any recision period with respect to such Waiver has expired.

7.2 No Mitigation. The Executive shall not be obligated to seek other employment in mitigation of the amounts payable or arrangements made under any provision of this Agreement, and the obtaining of any such other employment shall in no event effect any reduction of the Corporation's obligations to make the payments and provide the benefits required under this Agreement, except as provided in the first sentence of Section 4.3.

7.3. Successors. All rights under this Agreement are personal to the Executive and, without the prior written consent of the Corporation, shall not be assignable by the Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable in the event of the Executive's death or disability by the Executive's legal representative.

This Agreement shall inure to the benefit of and be binding upon the Corporation and its successors and assigns. The Corporation will require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Corporation to assume expressly and agree to perform this Agreement in the same manner and to the same extent that the Corporation would be required to perform it if no such event resulting in a successor had taken place. As used in this Agreement, “Corporation” shall mean the Corporation and any successor to its business and/or assets as aforesaid which assumes and agrees, or is otherwise obligated, to perform this Agreement by operation of law, or otherwise.

7.4. Controlling Law. This Agreement shall in all respects be governed by, and construed in accordance with, the laws of the State of Delaware (without regard to the principles of conflicts of laws).

7.5. Arbitration. DISPUTES REGARDING THE EXECUTIVE’S EMPLOYMENT WITH THE CORPORATION, INCLUDING, WITHOUT LIMITATION, ANY DISPUTE HEREUNDER, WHICH CANNOT BE RESOLVED BY NEGOTIATIONS BETWEEN THE CORPORATION AND THE EXECUTIVE SHALL BE SUBMITTED TO, AND SOLELY DETERMINED BY, FINAL AND BINDING ARBITRATION CONDUCTED BY JAMS/ENDISPUTE, INC. OR ANY SUCCESSOR THERETO, IN ACCORDANCE WITH JAMS/ENDISPUTE, INC.’S ARBITRATION RULES APPLICABLE TO EMPLOYMENT DISPUTES, AND THE PARTIES AGREE TO BE BOUND BY THE FINAL AWARD OF THE ARBITRATOR IN ANY SUCH PROCEEDING. THE ARBITRATOR SHALL APPLY THE LAWS OF THE STATE OF DELAWARE WITH RESPECT TO THE INTERPRETATION OR ENFORCEMENT OF ANY MATTER RELATING TO THIS AGREEMENT. ARBITRATION MAY BE HELD IN BALTIMORE, MARYLAND OR SUCH OTHER PLACE AS THE PARTIES HERETO MAY MUTUALLY AGREE, AND SHALL BE CONDUCTED SOLELY BY A FORMER JUDGE. JUDGMENT UPON THE AWARD BY THE ARBITRATOR MAY BE ENTERED IN ANY COURT HAVING JURISDICTION THEREOF. THE PREVAILING PARTY IN THE ARBITRATION, AS DETERMINED BY THE ARBITRATOR, SHALL BE ENTITLED TO REIMBURSEMENT OF HIS REASONABLE ATTORNEY’S FEES AND DISBURSEMENTS INCURRED IN SUCH PROCEEDINGS BY THE NON-PREVAILING PARTY.

7.6. Severability. Any provision in this Agreement which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective only to the extent of such prohibition or unenforceability without invalidating or affecting the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

7.7. Counterparts. This Agreement may be executed in counterparts, each of which shall be deemed an original, but all of which together will constitute one and the same instrument.

IN WITNESS WHEREOF, the parties have executed and delivered this Agreement on the date first above written.

CIENA CORPORATION

By: ______________________________
Name:______________________________
Title: ______________________________

EXECUTIVE

____
Gary B. Smith