EXTREME NETWORKS INC
Form 10-Q
November 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Form 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 000-25711

EXTREME NETWORKS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	77-0430270
[State or other jurisdiction of incorporation or organization]	[I.R.S Employer Identification No.]

6480 Via Del Oro,

San Jose, California 95119
[Address of principal executive office] [Zip Code]
Registrant's telephone number, including area code: (408) 579-2800

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

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

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

The number of shares of the Registrant's Common Stock, $.001 par value, outstanding at October 30, 2018, was 118,337,479

EXTREME NETWORKS, INC.

FORM 10-Q

QUARTERLY PERIOD ENDED

September 30, 2018

INDEX

		PAGE
PART I. CONDENSED CONSOLIDATED FINANCIAL INFORMATION		
Item 1.	Condensed Consolidated Financial Statements (Unaudited)	3
	Condensed Consolidated Balance Sheets as of September 30, 2018 and June 30, 2018	3
	Condensed Consolidated Statements of Operations for the three months ended September 30, 2018 and 2017	4
	Condensed Consolidated Statements of Comprehensive (Loss) Income for the three months ended September 30, 2018 and 2017	5
	Condensed Consolidated Statements of Cash Flows for the three months ended September 30, 2018 and 2017	6
	Notes to Condensed Consolidated Financial Statements	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	37
Item 4.	Controls and Procedures	38
PART II. OTHER INFORMATION		
Item 1.	Legal Proceedings	40
Item 1A	Risk Factors	40
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	55
Item 3.	Defaults Upon Senior Securities	55

Item 4. Mine Safety Disclosure 55

Item 5. Other Information 55

Item 6. Exhibits 56

Signatures 57

EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(Unaudited)

	September 30, 2018	June 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 140,167	$121,139
Accounts receivable, net of allowance for doubtful accounts of $1,661 at September 30, 2018 and $1,478 at June 30, 2018	164,683	212,423
Inventories	55,580	63,867
Prepaid expenses and other current assets	35,371	30,484
Total current assets	395,801	427,913
Property and equipment, net	76,224	78,519
Intangible assets, net	70,023	77,092
Goodwill	139,082	139,082
Other assets	50,754	47,642
Total assets	$ 731,884	$770,248
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 9,008	$9,007
Accounts payable	43,873	75,689
Accrued compensation and benefits	36,387	50,351
Accrued warranty	12,601	12,807
Deferred revenue	137,991	130,865
Other accrued liabilities	82,180	81,153
Total current liabilities	322,040	359,872
Deferred revenue, less current portion	45,874	43,660
Long-term debt, less current portion	176,498	188,749
Deferred income taxes	6,234	6,135
Other long-term liabilities	64,107	59,100
Commitments and contingencies (Note 9)		
Stockholders' equity:		
Convertible preferred stock, $.001 par value, issuable in series, 2,000 shares authorized; none issued	—	—
Common stock, $.001 par value, 750,000 shares authorized; 118,270 shares	118	116

issued and outstanding at September 30, 2018 and 116,124 shares issued and outstanding at June 30, 2018		
Additional paid-in-capital	956,356	942,397
Accumulated other comprehensive loss	(2,697)	(1,703)
Accumulated deficit	(836,646)	(828,078)
Total stockholders' equity	117,131	112,732
Total liabilities and stockholders' equity	$ 731,884	$770,248

See accompanying notes to condensed consolidated financial statements.

EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended September 30,	
	2018	2017
Net revenues:		
Product	$177,720	$ 164,774
Service	62,166	46,941
Total net revenues	239,886	211,715
Cost of revenues:		
Product	83,543	80,045
Service	24,272	19,289
Total cost of revenues	107,815	99,334
Gross profit:		
Product	94,177	84,729
Service	37,894	27,652
Total gross profit	132,071	112,381
Operating expenses:		
Research and development	51,241	34,285
Sales and marketing	67,582	55,561
General and administrative	12,771	12,185
Acquisition and integration costs	2,546	4,244
Restructuring charges, net of reversals	808	—
Amortization of intangibles	2,141	1,614
Total operating expenses	137,089	107,889
Operating (loss) income	(5,018)	4,492
Interest income	394	647
Interest expense	(3,526)	(2,215)
Other (expense) income, net	487	3,127
(Loss) income before income taxes	(7,663)	6,051
Provision for income taxes	1,402	1,675
Net (loss) income	$(9,065)	$ 4,376
Basic and diluted net (loss) income per share:		
Net (loss) income per share - basic	$(0.08)	$ 0.04
Net (loss) income per share - diluted	$(0.08)	$ 0.04
Shares used in per share calculation - basic	117,368	112,241
Shares used in per share calculation - diluted	117,368	118,431

See accompanying notes to condensed consolidated financial statements.

4

EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

(In thousands)

(Unaudited)

	Three Months Ended	
	September 30, 2018	September 30, 2017
Net (loss) income:	$(9,065)	$ 4,376
Other comprehensive (loss) income, net of tax:		
Available for sale securities:		
Change in unrealized gains on available for sale securities	—	183
Net change in foreign currency translation adjustments	(497)	355
Other comprehensive (loss) income, net of tax:	(497)	538
Total comprehensive (loss) income	$(9,562)	$ 4,914

See accompanying notes to condensed consolidated financial statements.

EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net (loss) income	$(9,065)	$ 4,376
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation	6,783	3,125
Amortization of intangible assets	7,073	4,309
Provision for doubtful accounts	515	489
Stock-based compensation	6,825	4,803
Deferred income taxes	(25)	488
Unrealized/realized (gain) loss on equity investment	(154)	(3,757)
Non-cash interest	995	227
Other non-cash items	(172)	701
Changes in operating assets and liabilities, net of acquisitions		
Accounts receivable	46,661	(5,762)
Inventories	8,287	5,915
Prepaid expenses and other assets	(7,814)	(1,856)
Accounts payable	(31,251)	9,042
Accrued compensation and benefits	(13,964)	(5,360)
Deferred revenue	9,374	4,650
Other current and long-term liabilities	10,262	(2,792)
Net cash provided by operating activities	34,330	18,598
Cash flows from investing activities:		
Capital expenditures	(7,417)	(7,421)
Business acquisitions	—	(68,047)
Proceeds from sale of investment	727	4,922
Net cash used in investing activities	(6,690)	(70,546)
Cash flows from financing activities:		
Borrowings under Term Loan	—	80,000
Repayments of debt	(12,375)	(4,093)
Loan fees on borrowings	(273)	(1,494)
Proceeds from issuance of common stock, net of tax withholding	7,137	42
Capital lease financing	(91)	—
Contingent consideration obligations	(1,577)	—
Deferred payments on an acquisition	(1,000)	—
Net cash (used in) provided by financing activities	(8,179)	74,455
Foreign currency effect on cash	(433)	57

Net increase in cash and cash equivalents	19,028	22,564
Cash and cash equivalents at beginning of period	121,139	130,450
Cash and cash equivalents at end of period	$140,167	$ 153,014

See accompanying notes to the condensed consolidated financial statements.

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Description of Business and Basis of Presentation

Extreme Networks, Inc., together with its subsidiaries (collectively referred to as "Extreme" or the "Company"), is a leader in providing software-driven networking solutions for enterprise customers. The Company conducts its sales and marketing activities on a worldwide basis through distributors, resellers and the Company's field sales organization. Extreme was incorporated in California in 1996 and reincorporated in Delaware in 1999.

The unaudited condensed consolidated financial statements of Extreme included herein have been prepared under the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted under such rules and regulations. The condensed consolidated balance sheet at June 30, 2018 was derived from audited financial statements as of that date but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These interim financial statements and notes should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2018.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition of Extreme at September 30, 2018. The results of operations for the three months ended September 30, 2018 are not necessarily indicative of the results that may be expected for fiscal 2019 or any future periods.

Fiscal Year

The Company uses a fiscal calendar year ending on June 30. All references herein to "fiscal 2019" or "2019" represent the fiscal year ending June 30, 2019. All references herein to "fiscal 2018" or "2018" represent the fiscal year ended June 30, 2018.

Principles of Consolidation

The consolidated financial statements include the accounts of Extreme and its wholly-owned subsidiaries. All inter-company accounts and transactions have been eliminated.

The Company predominantly uses the United States Dollar as its functional currency. The functional currency for certain of its foreign subsidiaries is the local currency. For those subsidiaries that operate in a local currency functional environment, all assets and liabilities are translated to United States Dollars at current month end rates of exchange; and revenue and expenses are translated using the monthly average rate.

Accounting Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates.

2. Business Combinations

Fiscal 2018 Acquisitions

Data Center Business

The Company completed its acquisition of the data center business (the “Data Center Business”) of Brocade Communication Systems, Inc.’s (“Brocade”) on October 27, 2017 (the “Data Center Closing Date”), pursuant to an Asset Purchase Agreement (the “Data Center Business APA”) dated as of October 3, 2017, by and between the Company and Brocade for an aggregate purchase consideration of $84.3 million. Under the terms and conditions of the Data Center Business APA, the Company acquired customers, employees, technology and other assets of the Data Center Business as well as assumed certain contracts and other liabilities of the Data Center Business.

The following table below summarizes the final allocation of the tangible and identifiable intangible assets acquired and liabilities assumed (in thousands):

	Final Allocation
Accounts receivables	$ 33,488
Inventories	19,934
Prepaid expenses and other current assets	988
Property and equipment	18,938
Other assets	4,734
Accounts payable and accrued expenses	(16,494)
Deferred revenue	(33,025)
Net tangible assets acquired	28,563
Identifiable intangible assets	32,800
Goodwill	22,974
Total intangible assets acquired	55,774
Total net assets acquired	$ 84,337

Campus Fabric Business

The Company completed its acquisition of Avaya Inc.'s ("Avaya") fabric-based secure networking solutions and network security solutions business (the "Campus Fabric Business") on July 14, 2017, (the "Campus Fabric Business Closing Date") pursuant to an Asset Purchase Agreement (the "Campus Fabric Business APA") dated March 7, 2017. Under the terms and conditions of the Campus Fabric Business APA, the Company acquired the customers, employees, technology and other assets of the Campus Fabric Business, as well as assumed certain contracts and other liabilities of the Campus Fabric Business, for total consideration of $79.4 million.

The following table below summarizes the final allocation of the tangible and identifiable intangible assets acquired and liabilities assumed (in thousands):

	Final Allocation
Accounts receivables	$ 19,527
Inventories	14,165
Prepaid expenses and other current assets	240
Property and equipment	5,406
Other assets	7,009
Accounts payable and accrued expenses	(31,670)
Deferred revenue	(8,994)
Other long-term liabilities	(5,849)
Net tangible assets acquired	(166)
Identifiable intangible assets	41,300
In-process research and development	2,400
Goodwill	35,892
Total intangible assets acquired	79,592
Total net assets acquired	$ 79,426

Capital Financing Business

On December 1, 2017, Company completed its acquisition of a capital financing business (the "CF Business"), pursuant to a Bill of Sale and Assignment and Assumption Agreement (the "Assumption Agreement") between the Company and Broadcom. Under the terms and conditions of the Assumption Agreement, the Company acquired customers, employees, contracts and lease equipment of the CF Business equal to the earn out payments to Broadcom of 90% of acquired financing receivables to be collected commencing at the closing date.

Net assets acquired included financing receivables of $13.7 million, lease equipment of $3.5 million and identifiable intangible assets of $0.8 million, and the fair value of the contingent consideration was $13.0 million. As the preliminary fair value of the net assets acquired exceeded the fair value of the purchase consideration, the Company recorded a bargain purchase gain of $5.0 million.

Pro forma financial information

The following unaudited pro forma results of operations are presented as though the acquisitions of the Data Center Business, CF Business and Campus Fabric Business had occurred as of the beginning of fiscal 2017 presented after giving effect to purchase accounting adjustments relating to inventories, deferred revenue, depreciation and amortization on acquired property and equipment and intangibles, acquisition costs, interest income and expense and related tax effects.

The pro forma results of operations are not necessarily indicative of the combined results that would have occurred had the acquisition been consummated as of the beginning of fiscal 2017, nor are they necessarily indicative of future operating results. The unaudited pro forma results do not include the impact of synergies, nor any potential impacts on current or future market conditions which could alter the unaudited pro forma results.

The unaudited pro forma financial information for the three months ended September 30, 2017, combines the historical results for Extreme for that period, which includes the results of the Campus Fabric Business subsequent to the acquisition date, with the historical results of the Data Center Business, CF Business and Campus Fabric Business, prior to the acquisition date, for the three months ended September 30, 2017.

Pro forma results of operations from the Data Center Business, CF Business and Campus Fabric Business acquisitions included in the pro forma results of operations for the three months ended September 30, 2017, have not been adjusted for the adoption of Topic 606 because the Company determined that it is impractical to estimate the impact of the adoption.

The following table summarizes the unaudited pro forma financial information (in thousands, except per share amounts):

	Three Months Ended September 30, 2017
Net revenues	$ 284,508
Net loss	$ (8,774)
Net loss per share - basic	$ (0.08)
Net loss per share - diluted	$ (0.08)
Shares used in per share calculation - basic	112,241
Shares used in per share calculation - diluted	112,241

3. Summary of Significant Accounting Policies

For a description of significant accounting policies, see Note 3, Summary of Significant Accounting Policies, to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2018. There have been no material changes to the Company's significant accounting policies since the filing of the Annual Report on Form 10-K.

Recently Adopted Accounting Pronouncements

In January 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, which provides guidance for the recognition, measurement, presentation, and disclosure of financial assets and liabilities. The guidance was adopted effective July 1, 2018 and the Company reclassified a $0.5 million unrealized gain, net of tax, related to its available-for-sale investments from accumulated other comprehensive loss to accumulated deficit as a cumulative-effect adjustment in the accompanying condensed consolidated balance sheets. Future changes in fair value will be included in earnings in each period.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments to provide guidance on the classification of eight cash flow issues in order to reduce diversity in practice. The Company

adopted the new guidance effective July 1, 2018. The amendments in this update have been applied on a retrospective transition method to each period presented. The adoption of this guidance did not have a material effect on the Company's presentation of cash flows.

In October 2016, the FASB issued ASU 2016-16, Income Taxes (Topic 740) - Intra-Entity Transfers of Assets Other Than Inventory, which requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Historical GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold outside the consolidated group. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2017. The Company adopted ASU 2016-16 effective July 1, 2018 on a modified retrospective basis. The adoption of this guidance did not have a material effect on the Company's financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting, which amends the scope of modification accounting for share-based payment arrangements and provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Topic 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The Company adopted this guidance effective July 1, 2018, on a prospective basis. The adoption of this guidance did not have a material effect on the Company's financial statements.

Recently Issued Accounting Pronouncements

In August 2018, the FASB issued ASU 2018-15, Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40), which aligns the requirements for capitalizing implementation costs incurred in a service contract hosting arrangement with those of developing or obtaining internal-use software. This standard is effective for interim and annual reporting periods beginning after December 15, 2019, and early adoption is permitted. The Company is currently evaluating the impact the new standard will have on its condensed consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820), which removes, modifies and adds various disclosure requirements around the topic in order to clarify and improve the cost-benefit nature of disclosures. For example, disclosures around transfers between fair value hierarchy Levels will be removed and further detail around changes in unrealized gains and losses for the period and unobservable inputs determining Level 3 fair value measurements will be added. This standard is effective for interim and annual reporting periods beginning after December 15, 2019, and early adoption is permitted. The Company is currently evaluating the impact the new standard will have on its condensed consolidated financial statements.

In February 2018, the FASB issued ASU 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220), this standard that allows the reclassification from AOCI to retained earnings for stranded tax effects resulting from the 2017 Tax Cuts and Jobs Act ("Tax Reform Act"). The amount of the reclassification is the effect of the change in the U.S. federal corporate income tax rate on the gross deferred tax amounts and related valuation allowances related to items remaining in AOCI. This standard is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period, for reporting periods for which financial statements have not yet been issued. The new standard is to be applied either in the period of adoption or retrospectively to each period (or periods) in which the effects of the change in the income tax rate in the Tax Reform Act are recognized. Management is currently evaluating implementation options and impact on the Company's financial statements and related disclosures.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, which is intended to allow companies to better align risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results by expanding and refining hedge accounting for both nonfinancial and financial risk components and aligning the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The guidance is effective for fiscal years beginning after December 15, 2018. The Company is evaluating the accounting, transition and disclosure requirements of the standard and cannot currently estimate the financial statement impact of adoption. This guidance is effective for the Company beginning with its fiscal year 2020, beginning on July 1, 2019.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires the identification of arrangements that should be accounted for as leases by lessees. In general, for lease arrangements exceeding a twelve-month term, these arrangements must now be recognized as assets and liabilities on the balance sheet of the lessee. Under Topic 842, a right-of-use asset and lease obligation will be recorded for all leases, whether operating or financing, while the statement of operations will reflect lease expense for operating leases and amortization/interest expense for financing leases. The balance sheet amount recorded for existing leases at the date of adoption of Topic 842 must be calculated using the applicable incremental borrowing rate at the date of adoption. In addition, Topic 842 requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented in the consolidated financial statements. The Company is currently assessing the impact that adopting this new accounting standard will have on its consolidated financial statements and footnote disclosures. The Company believes that Topic 842 will have a material impact on its financial position, as a result of recognizing right-of-use assets and lease liabilities on its consolidated balance sheets. The Company continues to evaluate the impact the new

standard will have on its condensed consolidated statement of operations and statement of cash flows. This guidance will become effective for the Company beginning with its fiscal year 2020, beginning on July 1, 2019.

4. Revenues

The Company accounts for revenue in accordance with ASC Topic 606, Revenue from Contracts with Customers, which the Company adopted on July 1, 2017, using the retrospective method. The Company derives the majority of its revenue from sales of its networking equipment, with the remaining revenue generated from service fees relating to maintenance contracts, professional services, and training for its products. The Company sells its products and maintenance contracts direct to customers and to partners in two distribution channels, or tiers. The first tier consists of a limited number of independent distributors that stock its products and sell primarily to resellers. The second tier of the distribution channel consists of a non-stocking distributors and value-added resellers that sell directly to end-users. Products and services may be sold separately or in bundled packages.

Revenue Recognition

Performance Obligations. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in Topic 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Certain of the Company's contracts have multiple performance obligations, as the promise to transfer individual goods or services is separately identifiable from other promises in the contracts and, therefore, is distinct. For contracts with multiple performance obligations, the Company allocates the contract's transaction price to each performance obligation based on its relative standalone selling price. The stand-alone selling prices are determined based on the prices at which the Company separately sells these products. For items that are not sold separately, the Company estimates the stand-alone selling prices using the best estimated selling price approach.

The Company's performance obligations are satisfied at a point in time or over time as work progresses. Substantially all of the Company's product sales revenues as reflected on the condensed consolidated statements of operations for the three months ended September 30, 2018 and 2017 are recognized at a point in time. Substantially all of the Company's service revenue is recognized over time. For revenue recognized over time, the Company uses an input measure, days elapsed, to measure progress.

On September 30, 2018, the Company had $183.9 million of remaining performance obligations, which is comprised of deferred maintenance revenue and services not yet delivered. The Company expects to recognize approximately 65 percent of its remaining performance obligations as revenue in fiscal 2019, an additional 22 percent in fiscal 2020 and 13 percent of the balance thereafter.

Contract Balances. The timing of revenue recognition, billings and cash collections results in billed accounts receivable and deferred revenue in the consolidated balance sheet. Services provided under renewable support arrangements of the Company are billed in accordance with agreed-upon contractual terms, which are typically at periodic intervals (e.g., quarterly or annually). The Company sometimes receives payments from its customers in advance of services being provided, resulting in deferred revenues. These liabilities are reported on the consolidated balance sheet on a contract-by-contract basis at the end of each reporting period.

Revenue recognized for the three months ended September 30, 2018 and 2017, that was included in the deferred revenue balance at the beginning of each period was $50.6 million and $42.0 million, respectively.

Contract Costs. The Company recognizes the incremental costs of obtaining contracts as an expense when incurred if the amortization period of the assets that the Company otherwise would have recognized is one year or less. Management expects that commission fees paid to sales representative as a result of obtaining service contracts and contract renewals are recoverable and therefore the Company capitalized them as contract costs in the amount of $4.9 million and $2.5 million at September 30, 2018 and 2017, respectively. Capitalized commission fees are amortized on a straight-line basis over the average period of service contracts of approximately three years, and are

included in “Sales and marketing” in the accompanying condensed consolidated statements of operations. Amortization recognized during the three months ended September 30, 2018 and 2017, was $0.7 million and $0.4 million, respectively. There was no impairment loss in relation to the costs capitalized.

Estimated Variable Consideration. There were no material changes in the current period to the estimated variable consideration for performance obligations which were satisfied or partially satisfied during previous periods.

Revenue by Category

The following table sets forth the Company's revenue disaggregated by sales channel and geographic region based on the customer's ship-to locations (in thousands):

	Three Months Ended September 30,			September 30,		
	2018			2017		
	Distributor	Direct	Total	Distributor	Direct	Total
Americas:						
United States	$56,742	$59,936	$116,678	$42,392	$50,990	$93,382
Other	4,493	5,524	10,017	14,336	6,395	20,731
Total Americas	61,235	65,460	126,695	56,728	57,385	114,113
EMEA	61,331	30,838	92,169	51,232	27,903	79,135
APAC	2,349	18,673	21,022	3,264	15,203	18,467
Total net revenues	$124,915	$114,971	$239,886	$111,224	$100,491	$211,715

Customer Concentrations

The Company performs ongoing credit evaluations of its customers and generally does not require collateral in exchange for credit.

The following table sets forth major customers accounting for 10% or more of the Company's net revenues:

	Three Months Ended September 30,	September 30,
	2018	2017
Tech Data Corporation	17%	11%
Westcon Group Inc.	13%	15%
Jenne Corporation	12%	14%

The following table sets forth major customers accounting for 10% or more of the Company's accounts receivable balance:

	September 30,	June 30,
	2018	2018
Tech Data Corporation	21%	17%
Westcon Group Inc.	12%	*
Jenne Corporation	*	13%

* Less than 10% of accounts receivable

5. Balance Sheet Accounts

Cash, Cash Equivalents and Marketable Securities

The following is a summary of cash, cash equivalents and marketable securities (in thousands):

	September 30, 2018	June 30, 2018
Cash	$ 140,167	$121,139
Cash equivalents	—	—
Total cash and cash equivalents	140,167	121,139
Marketable securities (consisting of available-for-sale securities)	887	1,459
Total cash, cash equivalents and marketable securities	$ 141,054	$122,598

The Company considers highly liquid investments with maturities of three months or less at the date of purchase to be cash equivalents. Marketable equity securities are recorded in “Prepaid expense and other current assets” in the accompanying condensed consolidated balance sheets as these securities are publicly-traded with readily determinable values. Marketable equity securities are classified as available-for-sale and reported at fair value with unrealized gains and losses included in “Other (expense) income, net” in the accompanying condensed consolidated statements of operations.

Inventories

The Company values its inventory at lower of cost or net realizable value. Cost is computed using standard cost, which approximates actual cost, on a first-in, first-out basis. The Company has established inventory allowances when conditions exist that suggest that inventory may be in excess of anticipated demand or is obsolete based upon assumptions about future demand. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis. Any written down or obsolete inventory subsequently sold has not had a material impact on gross margin for any of the periods disclosed.

Inventories consist of the following (in thousands):

	September 30, 2018	June 30, 2018
Finished goods	$ 42,150	$49,393
Raw materials	13,430	14,474
Total Inventories	$ 55,580	$63,867

Property and Equipment, Net

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

	September 30, 2018	June 30, 2018
Computers and equipment	$ 63,456	$60,677
Purchased software	21,558	21,389
Office equipment, furniture and fixtures	15,034	14,980
Leasehold improvements	50,959	50,070
Total property and equipment	151,007	147,116
Less: accumulated depreciation and amortization	(74,783)	(68,597)
Property and equipment, net	$ 76,224	$78,519

Intangibles

The following tables summarize the components of gross and net intangible asset balances (dollars in thousands)

	Weighted Average Remaining Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
September 30, 2018				
Developed technology	3.1 years	$ 117,000	$ 63,106	$ 53,894
Customer relationships	2.8 years	51,639	41,578	10,061
Maintenance contracts	0.1 years	17,000	16,717	283
Trade names	3.2 years	9,100	4,506	4,594
License agreements	7.3 years	2,232	1,244	988
Other intangibles	1.3 years	1,382	1,179	203
Total intangibles, net		$ 198,353	$ 128,330	$ 70,023

	Weighted Average Remaining Amortization Period	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
June 30, 2018				
Developed technology	3.3 years	$ 117,000	$ 58,299	$ 58,701
Customer relationships	3.0 years	51,639	40,634	11,005
Maintenance contracts	0.3 years	17,000	15,866	1,134
Trade names	3.4 years	9,100	4,141	4,959
Backlogs	— years	1,800	1,800	—
License agreements	5.8 years	2,445	1,390	1,055
Other intangibles	1.6 years	1,382	1,144	238
Total intangibles, net		$ 200,366	$ 123,274	$ 77,092

The amortization expense of intangibles for the periods presented is summarized below (in thousands):

	Three Months Ended September 30,	
	2018	2017
Amortization in “Cost of revenues: Product”	$4,932	$ 2,695
Amortization of intangibles	2,141	1,614
Total amortization	$7,073	$ 4,309

The amortization expense that is recognized in “Cost of revenues: Product” is comprised of amortization for developed technology, license agreements and other intangibles.

Deferred Revenue

The Company offers for sale to its customers, renewable support arrangements that range from one to five years as well as professional and training services, which results in deferred revenue.

Debt

The Company’s debt is comprised of the following (in thousands):

	September 30, 2018	June 30, 2018
Current portion of long-term debt:		
Term Loan	$ 9,500	$9,500
Less: unamortized debt issuance costs	(492)	(493)
Current portion of long-term debt	$ 9,008	$9,007
Long-term debt, less current portion:		
Term Loan	$ 178,125	$180,500
Revolving Facility	—	10,000
Less: unamortized debt issuance costs	(1,627)	(1,751)
Total long-term debt, less current portion	176,498	188,749
Total debt	$ 185,506	$197,756

On May 1, 2018, the Company entered into a Credit Agreement (the “Credit Agreement”), by and among the Company, as borrower, BMO Harris Bank N.A., as an issuing lender and swingline lender, Bank of Montreal, as administrative and collateral agent, and the financial institutions or entities that are a party thereto as lenders. The Credit Agreement provides for i) $40 million five-year revolving credit facility (the “New Revolving Facility”) ii) a $190 million five-year term loan (the “New Term Loan”) and iii) an uncommitted additional incremental loan facility in the principal amount of up to $100 million (“New Incremental Facility”). On May 1, 2018, the Company borrowed $200 million under the Credit Agreement to pay off existing debt and for general corporate purposes.

Borrowings under the Credit Agreement will bear interest, at the Company’s election, as of May 1, 2018, at a rate per annum equal to LIBOR plus 1.50% to 2.75%, or the adjusted base rate plus 0.50% to 1.75%, based on the Company’s Consolidated Leverage Ratio. In addition, the Company is required to pay a commitment fee of between 0.25% and 0.40% quarterly (currently 0.35%) on the unused portion of the New Revolving Facility, also based on the Company’s

consolidated leverage ratio. Principal installments are payable on the New Term Loan in varying percentages quarterly starting June 30, 2018 and to the extent not previously paid, all outstanding balances are to be paid at maturity. The Credit Agreement is secured by substantially all of the Company's assets.

The Credit Agreement requires the Company to maintain certain minimum financial ratios at the end of each fiscal quarter. The Credit Agreement also includes covenants and restrictions that limit, among other things, the Company's ability to incur additional indebtedness, create liens upon any of its property, merge, consolidate or sell all or substantially all of its assets. The Credit Agreement also includes customary events of default which may result in acceleration of the outstanding balance.

Financing costs incurred in connection with obtaining long-term financing are deferred and amortized over the term of the Credit Agreement. Amortization of deferred financing costs included in "Interest expense" in the accompanying condensed consolidated statements of operations totaled $0.2 million for each of the three month periods ended September 30, 2018 and 2017.

The Company had $38.7 million of availability under the New Revolving Facility as of September 30, 2018. The Company had $1.3 million of outstanding letters of credit as of September 30, 2018.

Guarantees and Product Warranties

Networking products may contain undetected hardware or software errors when new products or new versions or updates of existing products are released to the marketplace. The Company's standard hardware warranty period is typically 12 months from the date of shipment to end-users and 90 days for software. For certain access products, the Company offers a limited lifetime hardware warranty commencing on the date of shipment from the Company and ending five (5) years following the Company's announcement of the end of sale of such product. Upon shipment of products to its customers, the Company estimates expenses for the cost to repair or replace products that may be returned under warranty and accrue a liability in cost of product revenue for this amount. The determination of the Company's warranty requirements is based on actual historical experience with the product or product family, estimates of repair and replacement costs and any product warranty problems that are identified after shipment. The Company estimates and adjusts these accruals at each balance sheet date in accordance with changes in these factors.

Upon issuance of a standard product warranty, the Company discloses and recognizes a liability for the obligations it assumes under the product warranty. The following table summarizes the activity related to the Company's product warranty liability during the three months ended September 30, 2018 and 2017 (in thousands):

	Three Months Ended September 30,	
	2018	2017
Balance beginning of period	$12,807	$ 10,584
Warranties assumed due to acquisitions	—	3,156
New warranties issued	3,722	2,272
Warranty expenditures	(3,928)	(2,513)
Balance end of period	$12,601	$ 13,499

To facilitate sales of its products in the normal course of business, the Company indemnifies its resellers and end-user customers with respect to certain matters. The Company has agreed to hold the customer harmless against losses arising from a breach of intellectual property infringement or other. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material impact on its operating results or financial position.

Other long-term liabilities

The following is a summary of long-term liabilities (in thousands):

	September 30, 2018	June 30, 2018
Acquisition related deferred payments, less current portion	$ 12,350	$13,251
Contingent consideration obligations, less current portion	4,711	4,898
Other contractual obligations, less current portion	31,402	31,200
Other	15,644	9,751
Total other long-term liabilities	$ 64,107	$59,100

Advertising

All advertising costs are expensed as incurred. Advertising expenses for three months ended September 30, 2018 and 2017, were immaterial.

Concentrations

The Company may be subject to concentration of credit risk as a result of certain financial instruments consisting of accounts receivable and marketable securities. The Company does not invest an amount exceeding 10% of its combined cash or cash equivalents in the securities of any one obligor or maker, except for obligations of the United States government, obligations of United States government agencies and money market accounts.

6. Fair Value Measurements

A three-tier fair value hierarchy is utilized to prioritize the inputs used in measuring fair value. The hierarchy gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels are defined as follows:

- Level 1 Inputs - unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 Inputs - quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument; and
- Level 3 Inputs - unobservable inputs reflecting the Company's own assumptions in measuring the asset or liability at fair value.

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

September 30, 2018	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Marketable securities	$887	$ —	$—	$887
Total assets measured at fair value	$887	$ —	$—	$887
Liabilities				
Acquisition-related contingent consideration obligations	$—	$ —	$11,233	$11,233
Total liabilities measured at fair value	$—	$ —	$11,233	$11,233

June 30, 2018	Level 1	Level 2	Level 3	Total
Assets				
Investments:				
Marketable securities	$1,459	$ —	$—	$1,459
Total assets measured at fair value	$1,459	$ —	$—	$1,459
Liabilities				
Acquisition-related contingent consideration obligations	$—	$ —	$12,749	$12,749
Total liabilities measured at fair value	$—	$ —	$12,749	$12,749

Level 1 investments:

The Company holds an investment in marketable equity securities which is classified as available-for-sale marketable securities at Level 1 as the investments have readily determinable fair value (see below, Level 3 investments). An unrealized holding gain on the investments was $0.5 million as of June 30, 2018.

Level 2 assets and liabilities:

The Company includes U.S. government and sovereign obligations, most government agency securities, investment-grade corporate bonds, and state, municipal and provincial obligations for which quoted prices are available as Level 2. There were no transfers of assets or liabilities between Level 1 and Level 2 for the periods presented.

The fair value of the borrowings under the Credit Agreement is estimated based on valuations provided by alternative pricing sources supported by observable inputs which is considered Level 2. Due to the short duration until maturity of the Credit Agreement, the fair value approximates the face amount of the Company's indebtedness of $187.6 million and $200.0 million as of September 30, 2018 and June 30, 2018, respectively. Such differences are immaterial for all periods presented.

Level 3 assets and liabilities:

Certain of the Company's assets, including intangible assets and goodwill are measured at fair value on a non-recurring basis if impairment is indicated.

At June 30, 2018, the Company reflected a liability for contingent consideration related to a certain acquisition completed in Fiscal 2018. The fair value measurement of the contingent consideration obligation is determined using Level 3 inputs. The fair value of contingent consideration obligations is based on a discounted cash flow model. These fair value measurements represent Level 3 measurements as they are based on significant inputs not observable in the market. Significant judgment is employed in determining the appropriateness of these assumptions as of the acquisition date and for each subsequent period. Accordingly, changes in assumptions could have a material impact on the amount of contingent consideration expense the Company records in any given period. Changes in the value of the contingent consideration obligations would be recorded in general and administrative expenses in the accompanying condensed consolidated statements of operations.

The change in the acquisition-related contingent consideration obligations is as follows (in thousands):

	Three Months Ended September 30,	September 30,
	2018	2017
Beginning balance	$ 12,749	$ —
Payments	(1,577)	—
Accretion on discount	61	—
Ending balance	$ 11,233	$ —

There were no transfers of assets or liabilities between Level 2 and Level 3 during the three months ended September 30, 2018 or 2017. There were no impairments recorded for the three months ended September 30, 2018 or 2017.

7.Share-based Compensation

Shares reserved for issuance

The Company had reserved for issuance for the periods noted (in thousands):

	September 30, 2018	June 30, 2018
2013 Equity Incentive Plan shares available for grant	7,804	9,957
Employee stock options and awards outstanding	12,236	12,060
2014 Employee Stock Purchase Plan	4,084	5,365
Total shares reserved for issuance	24,124	27,382

Share-based compensation expense recognized in the condensed consolidated financial statements by line item caption is as follows (in thousands):

	Three Months Ended September 30,	September 30,
	2018	2017
Cost of product revenue	$178	$ 92
Cost of service revenue	345	133
Research and development	2,342	1,051
Sales and marketing	2,359	1,643

General and administrative	1,601	1,884
Total share-based compensation expense	$6,825	$ 4,803

During the three months ended September 30, 2018 or 2017, the Company did not capitalize any share-based compensation expense in inventory, as the amounts were immaterial.

Stock Awards

Stock awards may be granted under the 2013 Equity Incentive Plan (the "2013 Plan") on terms approved by the Compensation Committee of the Board of Directors. Stock awards generally provide for the issuance of restricted stock units ("RSUs") including performance or market-based RSUs which vest over a fixed period of time or based upon the satisfaction of certain performance criteria. The Company uses the straight-line method for expense attribution, and beginning with fiscal 2017, the Company does not estimate forfeitures, but accounts for them as incurred.

The following table summarizes stock award activity for the three months ended September 30, 2018 (in thousands, except grant date fair value):

	Number of Shares	Weighted-Average Grant Date Fair Value	Aggregate Fair Market Value
Non-vested stock awards outstanding at June 30, 2018	7,764	$ 8.60	$ 61,804
Granted	3,337	6.44	
Vested	(1,142)	6.28	
Cancelled	(565)	8.69	
Non-vested stock awards outstanding at September 30, 2018	9,394	$ 8.11	$ 51,479

The following table summarizes stock option activity for the three months ended September 30, 2018 (in thousands, except per share and contractual term):

	Number of Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Options outstanding at June 30, 2018	2,193	$ 3.88	2.90	$ 8,996
Granted	852	6.40		
Exercised	(123)	3.81		
Cancelled	(80)	6.18		
Options outstanding at September 30, 2018	2,842	$ 4.57	3.88	$ 3,343
Vested and expected to vest at September 30, 2018	2,842	$ 4.57	3.88	$ 3,343
Exercisable at September 30, 2018	1,939	$ 3.98	2.68	$ 2,946

The fair value of each stock option grant under the 2013 Plan and 2005 Equity Incentive Plan is estimated on the date of grant using the Black-Scholes-Merton option valuation model with the weighted average assumptions noted in the following table. The Company uses the Monte-Carlo simulation model to determine the fair value and the derived service period of stock awards with market conditions, on the date of the grant. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate is based upon the estimated life of the option and the U.S. Treasury yield curve in effect at the time of grant. Expected volatility is based on the historical volatility on the Company's stock.

The fair value of each RSUs grant with performance-based vesting criteria ("PSUs") under the 2013 Plan is estimated on the date of grant using the Monte-Carlo simulation model to determine the fair value and the derived service period of stock awards with market conditions, on the date of the grant.

During the first quarter of fiscal 2019, the Company approved the grant of 1,269,800 stock awards to its vice president level employees or above ("VPs"), including 278,000 stock awards to its Executive Officers, and 2,067,074 stock awards to its other employees. Fifty percent (50%) of the stock awards granted to the VPs and the chief executive officer, were in the form of PSUs, with grant date fair values of $6.40, and fifty percent (50%) of the stock awards granted were in the form of service-based RSUs. The RSUs vest from the original grant date as to one-third (1/3) on the one-year anniversary and one-twelfth (1/12) each quarter thereafter, subject to continued service to the Company.

For the PSUs referenced in the preceding paragraph, they will be considered earned once the Company's combined earnings per share equals or exceeds $0.20 over two consecutive quarters (the "FY19 Performance Threshold"). Upon satisfying the FY19 Performance Threshold, the PSUs shall vest with respect to the same number of RSUs that have vested which were granted on the same date and thereafter, shall vest on the same schedule as the RSUs, subject to continued service to the Company. If the FY19 Performance Threshold is not met by the third anniversary of the

grant date the award is canceled. In addition, the FY19 Performance Threshold shall be deemed satisfied upon the closing of a Change in Control (within the meaning of the Company's 2013 Equity Incentive Plan) in the event the per share consideration received by the Company's stockholders equals or exceeds $10.00 per share.

During the first quarter of fiscal 2019, the Company granted 851,700 Performance Stock Options ("PSOs") to certain officers and executive vice presidents that will vest if the Company's stock price achieves a price hurdle of $10.00 during the three-year performance period from August 29, 2018 through August 31, 2021. The price hurdle will be deemed to have been achieved if, at any time over the performance period, the Company's stock maintains a price of $10.00 for 30 consecutive days. If the price hurdle is achieved, the PSOs will vest as follows:

If the price hurdle is met before or on August 31, 2019, one-third of the PSOs will vest on August 31, 2019 and the remainder will vest quarterly over two years.

If the price hurdle is met after August 31, 2019, a number of the PSOs will vest (ratably calculated based upon the time elapsed between August 31, 2018 and the date the hurdle is met) and the remainder will vest quarterly through August 31, 2021. The grant date fair value was $2.62.

2014 Employee Stock Purchase Plan

The fair value of each share purchase option under the Company's 2014 Employee Stock Purchase Plan ("ESPP") is estimated on the date of grant using the Black-Scholes-Merton option valuation model with the weighted average assumptions noted in the following table. The expected term of the ESPP represents the term of the offering period of each option. The risk-free rate is based upon the estimated life and on the U.S. Treasury yield curve in effect at the time of grant. Expected volatility is based on the historical volatility on the Company's stock.

There were 1,280,708 and 1,267,930 shares issued under the ESPP during the three months ended September 30, 2018 and 2017, respectively. The following assumptions were used to calculate the fair value of shares granted under the ESPP during the following periods:

	Employee Stock Purchase Plan Three Months Ended			
	September 30, 2018		September 30, 2017	
Expected life	0.5 years		0.5 years	
Risk-free interest rate	2.20	%	1.15	%
Volatility	63	%	42	%
Dividend yield	—	%	—	%

The weighted-average fair value of shares granted under the ESPP during the three months ended September 30, 2018 and 2017 was $2.73 and $2.41, respectively.

8.Restructuring Charges, net of reversals

Restructuring liabilities consisted of obligations pertaining to the estimated future obligations for non-cancelable lease payments, as well as severance and benefits obligations. The restructuring liabilities are recorded in "Other accrued liabilities" and "Other long-term liabilities" in the accompanying condensed consolidated balance sheets.

The Company recorded $0.8 million of additional restructuring charges, net of reversals during the three months ended September 30, 2018, associated with a reduction-in-force in the fourth quarter of fiscal 2018.

Cash payments of $3.4 million were paid during the first three months of fiscal 2019. The balance of the severance and benefits obligations are expected to be paid by the end of fiscal 2019. The excess facilities obligations will continue through fiscal year 2023.

Total restructuring and related liabilities consist of (in thousands):

	Excess Facilities	Severance Benefits	Total
Balance as of June 30, 2018	$ 1,797	$ 4,658	$6,455
Period charges	—	999	999
Period reversals	—	(191)	(191)
Period payments	—	(3,402)	(3,402)
Balance as of September 30, 2018	$ 1,797	$ 2,064	$3,861
Less: current portion included in Other accrued liabilities			2,601
Restructuring accrual included in Other long-term liabilities			$1,260

9.Commitments and Contingencies

Purchase Commitments

The Company currently has arrangements with contract manufacturers and suppliers for the manufacture of its products. Those arrangements allow the contract manufactures to procure long lead-time component inventory based upon a rolling production forecast provided by the Company. The Company is obligated to purchase long lead-time component inventory that its contract manufacturer procures in accordance with the Company's forecast, unless the Company gives notice of order cancellation outside of applicable component lead-times. As of September 30, 2018, the Company had non-cancelable commitments to purchase $158.7 million of such inventory. As of September 30, 2018 the Company had non-cancelable commitments to purchase $117.5 million of software and new product support services.

Legal Proceedings

The Company may from time to time be party to litigation arising in the course of its business, including, without limitation, allegations relating to commercial transactions, business relationships or intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources. Litigation in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict.

In accordance with applicable accounting guidance, the Company records accruals for certain of its outstanding legal proceedings, investigations or claims when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. The Company evaluates, at least on a quarterly basis, developments in legal proceedings, investigations or claims that could affect the amount of any accrual, as well as any developments that would result in a loss contingency to become both probable and reasonably estimable. When a loss contingency is not both probable and reasonably estimable, the Company does not record a loss accrual. However, if the loss (or an additional loss in excess of any prior accrual) is at least a reasonable possibility and material, then the Company would disclose an estimate of the possible loss or range of loss, if such estimate can be made, or disclose that an estimate cannot be made. The assessment whether a loss is probable or a reasonable possibility, and whether the loss or a range of loss is estimable, involves a series of complex judgments about future events. Even if a loss is reasonably possible, the Company may not be able to estimate a range of possible loss, particularly where (i) the damages sought are substantial or indeterminate, (ii) the proceedings are in the early stages, or (iii) the matters involve novel or unsettled legal theories or a large number of parties. In such cases, there is considerable uncertainty regarding the ultimate resolution of such matters, including the amount of any possible loss, fine or penalty. Accordingly, for current proceedings, except as noted below, the Company is currently unable to estimate any reasonably possible loss or range of possible loss. However, an adverse resolution of one or more of such matters could have a material adverse effect on the Company's results of operations in a particular quarter or fiscal year.

Brazilian Tax Assessment Matter

On May 28, 2007, the Public Treasury Department of the State of Sao Paolo, Brazil (the "Tax Authority") assessed the Company's Brazilian subsidiary, Enterasys Networks do Brasil Ltda. ("Enterasys Brasil"), based on an alleged underpayment of taxes. The Tax Authority also charged interest and penalties with respect to the assessment (collectively, the "ICMS Tax Assessment"). The Tax Authority denied Enterasys Brasil the use of certain presumed tax credits granted by the State of Espirito Santo, Brazil under the terms of the FUNDAP program for the period from February 2003 to December 2004. The value of the disallowed presumed tax credits is BRL 3.4 million (USD $0.8 million), excluding interest and penalties. All currency conversions in this Legal Proceedings section are as of September 30, 2018.

Unable to resolve the matter at the administrative level, on October 1, 2014, Enterasys Brasil filed a lawsuit in the 11th Public Treasury Court of the Sao Paolo State Court of Justice (Judiciary District of Sao Paolo) to overturn or reduce the ICMS Tax Assessment. As part of this lawsuit, Enterasys Brasil requested a stay of execution, so that no tax foreclosure could be filed and no guarantee would be required until the court issued its final ruling. On or about October 6, 2014, the court granted a preliminary injunction staying any execution on the assessment, but requiring that Enterasys Brasil deposit the assessed amount with the court. Enterasys Brasil appealed this ruling and, on or about January 28, 2015, the appellate court ruled that no cash deposit (or guarantee) was required. In a decision dated August 28, 2017, and published on October 3, 2017, the court validated the assessment and penalty imposed by the Tax Authority, but ruled that the Tax Authority was charging an unlawfully high interest rate on the tax assessment and penalty amounts, and ordered the interest rate reduced to the maximum Federal rate. The August 28, 2017 decision, were it to become final, would require Enterasys Brasil to pay a total of BRL 19.6 million (USD $4.8 million), which includes penalties, court costs, attorneys' fees, and accrued interest as of September 30, 2018. The Company believes the ICMS Tax Assessment against Enterasys Brasil is without merit and has appealed the lower court's decision. The appellate court ruled that no cash deposit (or guarantee) is required during the pendency of the appeal.

Based on the currently available information, the Company believes the ultimate outcome of the ICMS Tax Assessment litigation will not have a material adverse effect on the Company's financial position or overall results of operations. However, due to the complexities and uncertainty surrounding the judicial process in Brazil and the nature of the claims asserted, there can be no assurance of a favorable outcome for Enterasys Brasil, which recorded an accrual of BRL 9.4 million (USD $2.3 million) as of the date the Company acquired Enterasys Networks.

The Company made a demand on April 11, 2014 for a defense from, and indemnification by, the former equity holder of Enterasys Networks, Inc. (“Seller”) in connection with the ICMS Tax Assessment. Seller agreed to assume the defense of the ICMS Tax Assessment on May 20, 2014. In addition, through the settlement of an indemnification-related lawsuit with the Seller on June 18, 2015, Seller agreed to continue to defend the Company with respect to the ICMS Tax Assessment and to indemnify the Company for losses related thereto subject to certain conditions. These conditions include the offsetting of foreign income tax benefits realized by the Company in connection with the acquisition of Enterasys. Based upon current projections of the foreign income tax benefits to be realized, and the potential liability in the event of an adverse final judgment in the ICMS Tax Assessment litigation, the Company does not presently anticipate that any amounts under the indemnification will be due from the Seller in connection with the ICMS Tax Assessment.

In re Extreme Networks, Inc. Securities Litigation

On October 23 and 29, 2015, punitive class action complaints alleging violations of securities laws were filed in the U.S. District Court for the Northern District of California against the Company and three of its former officers (Charles W. Berger, Kenneth B. Arola, and John T. Kurtzweil). Subsequently, the cases were consolidated (In re Extreme Networks, Inc. Securities Litigation, No. 3:15-CY-04883-BLF). Plaintiffs allege that defendants violated the securities laws by disseminating materially false and misleading statements and concealing material adverse facts regarding the Company’s financial condition, business operations and growth prospects. Plaintiffs seek unspecified damages on behalf of a purported class of investors who purchased the Company’s common stock from September 12, 2013 through April 9, 2015. On June 28, 2016, the Court appointed a lead plaintiff. On September 26, 2016, the lead plaintiff filed a consolidated complaint. On November 10, 2016, defendants filed a motion to dismiss, which the Court granted with leave to amend on April 27, 2017. On June 2, 2017, the lead plaintiff filed an amended complaint, which, on July 10, 2017, defendants again moved to dismiss. In a March 21, 2018 Order (the “March 2018 Order”), the Court granted in part and denied in part the defendants’ motion. The March 2018 Order narrowed the scope of the case, but allowed certain claims to proceed. The parties have signed a term sheet to settle the litigation and are preparing further documentation for the settlement to submit for court approval.

On February 18, 2016, a shareholder derivative case was filed in the Superior Court of California, Santa Clara County (Shaffer v. Kispert et al., No. 16 CV 291726). The complaint names current and former officers and directors as defendants, and seeks recovery on behalf of the Company based on substantially the same allegations as the securities class action litigation described above. As a result of the March 2018 Order, the stipulated stay of the derivative litigation ended. The parties have reached an agreement in principle to settle the case, and are preparing further documentation for the settlement to submit for court approval.

XR Communications, LLC d/b/a Vivato Technologies v. Extreme Networks, Inc. Patent Infringement Suit

On April 19, 2017, XR Communications, LLC (“XR”) (d/b/a Vivato Technologies) filed a patent infringement lawsuit against the Company in the Central District of California (XR Communications, LLC, dba Vivato Technologies v. Extreme Networks, Inc., No. 2:17-cv-2953-AG). The operative Second Amended Complaint asserts infringement of U.S. Patent Nos. 7,062,296, 7,729,728, and 6,611,231 based on the Company’s manufacture, use, sale, offer for sale,

and/or importation into the United States of certain access points and routers supporting multi-user, multiple-input, multiple-output technology. XR seeks unspecified damages, on-going royalties, pre- and post-judgment interest, and attorneys' fees (but no injunction). In orders dated April 10 and May 22, 2018, the Court stayed the case pending a resolution by the Patent Trial and Appeal Board (PTAB) of inter partes review (IPR) petitions filed by several defendants in other XR-related patent lawsuits challenging the validity of the asserted patents. The PTAB has now instituted IPR proceedings as to all three patents and all patent claims asserted in the litigation. Given the stay, the Court took off calendar all previously scheduled events (including a Markman hearing and potential trial date). During a status conference on October 22, 2018, the Court continued the stay and set a status conference for February 11, 2019. The Company believes the claims are without merit, and intends to defend them vigorously.

Orckit IP, LLC v. Extreme Networks, Inc., Extreme Networks Ireland Ltd., and Extreme Networks GmbH

On February 1, 2018, Orckit IP, LLC (“Orckit”) filed a patent infringement lawsuit against the Company and its Irish and German subsidiaries in the District Court in Dusseldorf, Germany. The lawsuit alleges direct and indirect infringement of the German portion of European Patent EP 1 958 364 B1 based on the offer, distribution, use, possession and/or importation into Germany of certain network switches equipped with the ExtremeXOS operating system. Orckit is seeking injunctive relief, an accounting, and an unspecified declaration of liability for damages and costs of the lawsuit. On May 3, 2018, Extreme Networks GmbH filed a separate nullity action in the Federal Patent Court in Munich, seeking to invalidate the asserted patents, and on May 4, 2018, the defendants answered the complaint, denying any infringement and seeking a stay of the action pending the conclusion of the nullity action. The Company believes the claims are without merit, and intends to defend them vigorously.

Indemnification Obligations

Subject to certain limitations, the Company may be obligated to indemnify its current and former directors, officers and employees. These obligations arise under the terms of its certificate of incorporation, its bylaws, applicable contracts, and applicable law. The obligation to indemnify, where applicable, generally means that the Company is required to pay or reimburse, and in certain circumstances the Company has paid or reimbursed, the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with certain legal matters. For example, the Company currently is paying or reimbursing legal expenses being incurred by certain current and former officers and directors in connection with the shareholder litigation described above. The Company also procures Directors and Officers insurance to help cover its defense and/or indemnification costs, although its ability to recover such costs through insurance is uncertain. While it is not possible to estimate the maximum potential amount that could be owed under these indemnification agreements due to the Company’s limited history with prior indemnification claims, indemnification (including defense) costs could, in the future, have a material adverse effect on the Company’s consolidated financial position, results of operations and cash flows. As of September 30, 2018, the Company has the outstanding indemnification claims described above.

10.Income Taxes

For the three months ended September 30, 2018 and 2017, the Company recorded income tax provision of $1.4 million and $1.7 million, respectively.

The income tax provisions for the three months ended September 30, 2018 and 2017, consisted primarily of taxes on the income of the Company’s foreign subsidiaries as well as tax expense associated with the establishment of a U.S. deferred tax liability for amortizable goodwill resulting from the acquisition of Enterasys Networks, Inc., the WLAN Business, the Campus Fabric Business and for the three months ended September 30, 2018, the Data Center Business. The income tax provisions for both fiscal years were calculated based on the actual results of operations for the three months ended September 30, 2018 and 2017, respectively and therefore may not reflect the annual effective tax rate.

On December 22, 2017, the President of the United States signed and enacted into law H.R. 1, the Tax Cuts and Jobs Act (“TCJA”), which, except for certain provisions, is effective for the Company’s fiscal year ended 2019. As a fiscal year taxpayer, the Company was not subject to the majority of the tax law provisions until the first quarter of fiscal year 2019; however, there were certain significant items of impact that were recognized in fiscal year 2018, the year the TCJA was enacted.

The TCJA’s primary change is a reduction in the U.S. Federal statutory corporate tax rate from 35% to 21%. As a result, the Company recognized a tax benefit in the amount of $2.5 million in the second quarter of fiscal 2018 due to the revaluation of the Company's deferred tax liability related to amortizable goodwill to reflect the lower statutory rate. Because the U.S. deferred tax assets are offset by a full valuation allowance, the reduction in deferred tax assets for the lower rate was fully offset by a corresponding reduction in valuation allowance resulting in no additional tax

provision.

The TCJA moves the U.S. from a global taxation regime to a modified territorial regime. Under the territorial regime, the company's foreign earnings will generally not be subject to tax in the US. As part of transitioning to this new regime, U.S. companies were required to pay tax on historical earnings generated offshore that have not been repatriated to the U.S. ("Transition Tax"). The Company has estimated there will be no incremental tax provision relating to the Transition Tax given the Company's ability to utilize existing tax attributes to offset the impact of the deemed repatriation.

The TCJA makes broad and complex changes to the U.S. tax code, and in certain instances, lacks clarity and is subject to interpretation until additional U.S. Treasury guidance is issued. On December 22, 2017, the SEC issued guidance under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118"), which allows registrants to record provisional amounts during a one year "measurement period" similar to that used when accounting for business combinations. However, the measurement period is deemed to have ended earlier when the registrant has obtained, prepared and analyzed the information necessary to finalize its accounting. During the measurement period, impacts of the law are expected to be recorded at the time a reasonable estimate for all or a portion of the effects can be made, and provisional amounts can be recognized and adjusted as information becomes available, prepared or analyzed. SAB 118 summarizes a three-step process to be applied at each reporting period to account for and qualitatively disclose: (1) the effects of the change in tax law for which accounting is complete; (2) provisional amounts (or adjustments to provisional amounts) for the effects of the tax law where accounting is not complete, but that a reasonable estimate has been determined; and (3) a reasonable estimate cannot yet be made and therefore taxes are reflected in accordance with law prior to the enactment of the TCJA.

Amounts recorded where accounting is complete principally relate to the reduction in the U.S. federal tax rate to 21 percent, which resulted in the Company reporting an income tax benefit of $2.5 million in the fiscal year ended June 30, 2018 to remeasure deferred tax liabilities associated with indefinitely lived intangible assets that will reverse at the new 21% rate. Absent this deferred tax liability, the Company is in a net deferred tax asset position that is offset by a full valuation allowance. Though the impact of the rate change related to net deferred tax assets has a net tax effect of zero, the accounting to determine the gross change in the deferred tax position and the offsetting valuation is not yet complete. In accordance with SAB 118, the estimated income tax impact associated with the Transition Tax of zero represents our best estimate based on interpretation of the U.S. legislation as we are still accumulating data to finalize the underlying calculation. In accordance with SAB 118, estimated income tax impact associated with the Transition Tax is considered provisional and will be finalized prior to the end of the measurement period. The ultimate impact may differ from these provisional amounts, due to, among other things, additional analysis, changes in interpretations and assumptions the Company has made, additional regulatory guidance that may be issued, and actions the Company may take as a result of the TCJA.

With respect to provisions of the TCJA effective for the Company's fiscal year ended 2019, the Company anticipates several new provisions may potentially impact tax provisions in future periods including limitations on the deductibility of interest expense and certain executive compensation, a minimum tax on certain foreign earnings (i.e., global intangible low-taxed income or "GILTI"). The GILTI provisions require the Company to include in its U.S. income tax return foreign subsidiary earnings in excess of an allowable return on the foreign subsidiary's tangible assets. Based on initial assessment and interpretation of the new provision, the Company expects that it will be subject to incremental U.S. tax on GILTI income beginning in fiscal 2019. The Company may elect to account for GILTI tax as a component of tax expense in the period in which it is incurred or account for the GILTI tax in the measurement of deferred taxes. The Company is continuing to evaluate this particular provision and therefore has not yet elected a method but will do so once our analysis is complete. The Base Erosion and Anti-Abuse Tax ("BEAT") provisions in the Tax Reform Act eliminate the deduction of certain base-erosion payments made to related foreign corporations and impose a minimum tax if greater than regular tax. There is a reasonable amount of uncertainty surrounding the interpretation of this new provision, however, based on initial assessment and a reasonable interpretation of the new provision, the Company expects that it will not be subject to the incremental U.S. tax on BEAT income beginning in fiscal 2019, due to a realignment of the Company's international structure.

In the three months ended September 30, 2019, the Company adopted ASU 2016-16, Intra-Entity Transfers of Assets Other Than Inventory, which requires an entity to recognize the income tax consequences of an intra-entity transfer of an asset at the time the transfer occurs. Historically, GAAP has prohibited the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset had been sold outside the consolidated group. Effective as of July 1, 2018, the Company adopted ASU 2016-16 on a modified retrospective basis which requires an

adjustment of the cumulative-effect of the adoption to retained earnings. However, the adjustment was immaterial to the financial statements and no such adjustment was necessary. As a result of adoption, the income tax consequences of future intra-entity transfer of assets will be recognized in earnings in each period rather than be deferred until the assets leave the consolidated group. In the three months ended September 30, 2018, the Company recognized a deferred tax asset relating to a transfer of certain assets from the US parent company to its wholly-owned Irish subsidiary of $5.4 million, which was fully offset by the establishment of a valuation allowance resulting in no impact to Company’s statement of operations.

The Company has provided a full valuation allowance against all of its U.S. federal and state deferred tax assets as well as the deferred tax assets in Australia and a portion of the deferred tax assets in Ireland. A valuation allowance is determined by assessing both negative and positive evidence to determine whether it is “more likely than not” that the deferred tax assets are recoverable; such assessment is required on a jurisdiction by jurisdiction basis. The Company's inconsistent earnings in recent periods, including a cumulative loss over the last three years, coupled with its difficulty in forecasting future revenue trends as well as the cyclical nature of its business represent sufficient negative evidence to require a full valuation allowance against its U.S. federal and state net deferred tax assets as well as the above mentioned foreign jurisdictions. This valuation allowance will be evaluated periodically and can be reversed partially or in whole if business results and the economic environment have sufficiently improved to support realization of some or all of the Company's deferred tax assets.

The acquisition of Enterasys in October 2013 included a U.S. parent company as well as its wholly-owned foreign subsidiaries. The Company elected to treat this stock acquisition as an asset purchase by filing the required election forms under IRC Sec 338(h)(10). In addition, the Company completed asset purchases of the WLAN Business, the Campus Fabric Business and the Data Center Business in October 2016, July 2017 and October 2017, respectively. The Company has estimated the value of the intangible assets from these transactions and is amortizing the amounts over 15 years for tax purposes. During the three months ended September 30, 2018 and 2017, the Company deducted $0.5 million and $1.6 million of tax amortization expense respectively, for each period related to capitalized goodwill resulting from these acquisitions. As of September 30, 2018, the Company recorded a deferred tax liability of $5.9 million related to this goodwill amortization which is not considered a future source of taxable income in evaluating the need for a valuation allowance against its deferred tax assets.

The Company had $17.2 million of unrecognized tax benefits as of September 30, 2018. The future impact of the unrecognized tax benefit of $17.2 million, if recognized, would result in adjustments to deferred tax assets and corresponding adjustments to the valuation allowance. The Company does not anticipate any events to occur during the next twelve months that would reduce the unrealized tax benefit as currently stated in the Company’s balance sheet.

The Company’s policy is to accrue interest and penalties related to the underpayment of income taxes as a component of tax expense in the accompanying condensed consolidated statements of operations.

In general, the Company’s U.S. federal income tax returns are subject to examination by tax authorities for fiscal years 2001 forward due to net operating losses and the Company's state income tax returns are subject to examination for fiscal years 2000 forward due to net operating losses. The Company is in the process of settling examination by the state of North Carolina for fiscal years ended 2014, 2015 and 2016. The settlement will result in an immaterial payment to the state to close all three years.

11.Net Loss Per Share

Basic earnings per share is calculated by dividing net earnings by the weighted average number of common shares outstanding during the period. Dilutive earnings per share is calculated by dividing net earnings by the weighted average number of common shares used in the basic earnings per share calculation plus the dilutive effect of shares subject to repurchase, options, warrants and unvested restricted stock units.

The following table presents the calculation of net loss per share of basic and diluted (in thousands, except per share data):

	Three Months Ended September 30,	
	2018	2017
Net (loss) income	$(9,065)	$ 4,376
Weighted-average shares used in per share calculation - basic	117,368	112,241
Effect of potentially dilutive shares:		
Options to purchase common stock	—	1,760
Restricted stock units	—	4,007
Employee Stock Purchase Plan shares	—	423
Weighted-average shares used in per share calculation - diluted	117,368	118,431
Net (loss) income per share:		

Net (loss) income per share - basic	$(0.08)	$ 0.04
Net (loss) income per share - diluted	$(0.08)	$ 0.04

The following securities were excluded from the computation of net loss per diluted share of common stock for the periods presented as their effect would have been anti-dilutive (in thousands):

	Three Months Ended	
	September 30, 2018	September 30, 2017
Options to purchase common stock	989	—
Restricted stock units	1,913	496
Employee Stock Purchase Plan shares	—	204
Total shares excluded	2,902	700

12. Foreign Exchange Forward Contracts

The Company uses derivative financial instruments to manage exposures to foreign currency. The Company's objective for holding derivatives is to use the most effective methods to minimize the impact of these exposures. The Company does not enter into derivatives for speculative or trading purposes. The fair value of the Company's derivatives in a gain position are recorded in "Prepaid expenses and other current assets" and derivatives in a loss position are recorded in "Other accrued liabilities" in the accompanying condensed consolidated balance sheets. Changes in the fair value of derivatives are recorded in "Other income (expense), net" in the accompanying condensed consolidated statements of operations. The Company enters into foreign exchange forward contracts to mitigate the effect of gains and losses generated by foreign currency transactions related to certain operating expenses and re-measurement of certain assets and liabilities denominated in foreign currencies. These derivatives do not qualify as hedges.

As of September 30, 2018, the Company did not have any forward foreign currency contracts. As of September 30, 2017 forward foreign currency contracts had a notional principal amount of $9.6 million and an immaterial unrealized loss. These contracts typically have maturities of less than 90 days. Changes in the fair value of these foreign exchange forward contracts are offset largely by re-measurement of the underlying assets and liabilities.

Foreign currency transactions gains and losses from operations was a gain of $0.2 million and loss from operations of $0.6 million for the three months ended September 30, 2018 and 2017, respectively.

13. Disclosure about Segments of an Enterprise and Geographic Areas

The Company operates in one segment, the development and marketing of network infrastructure equipment. The Company conducts business globally and is managed geographically. Revenue is attributed to a geographical area based on the location of its customers. The Company operates in three geographical areas: Americas, which includes the United States, Canada, Mexico, Central America and South America; EMEA, which includes Europe, Russia, Middle East and Africa; and APAC which includes Asia Pacific, South Asia, India, Australia and Japan. The Company's chief operating decision maker, who is its CEO, reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance.

See Note 4 Net Revenues for the Company's revenues by geographic regions and channel based on the customer's ship-to location.

The Company's long-lived assets are attributed to the geographic regions as follows (in thousands):

	September 30,	June 30,
Long-lived Assets	2018	2018
Americas	$ 147,276	$178,251
EMEA	46,119	15,106
APAC	9,187	9,896
Total long-lived assets	$ 202,582	$203,253

14.Subsequent Event

On November 2, 2018, the Company announced that its Board of Directors has authorized the Company to repurchase up to $60.0 million of its common stock over the next two years. Purchases may be made from time to time in the open market, in privately negotiated transactions or otherwise. The manner, timing and amount of any purchases will be determined by the Company's management based on their evaluation of market conditions, stock price, Extreme's

ongoing determination that it is the best use of available cash and other factors. The repurchase program does not obligate Extreme to acquire any common stock, may be suspended or terminated at any time without prior notice and will be subject to regulatory considerations. No repurchases were made during the quarter ended September 30, 2018.

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

This quarterly report on Form 10-Q, including the following sections, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including in particular, our expectations regarding market demands, customer requirements and the general economic environment, future results of operations, and other statements that include words such as "may," "will," "should," "expect," "plan," "intend," "anticipate," "believe," "estimate," "potential," "continue" and similar expressions. These forward-looking statements involve risks and uncertainties. We caution investors that actual results may differ materially from those projected in the forward-looking statements as a result of certain risk factors identified in the section entitled "Risk Factors" in this Quarterly Report on Form 10-Q for the first quarter ended September 30, 2018, our Annual Report on Form 10-K for the fiscal year ended June 30, 2018, and other filings we have made with the Securities and Exchange Commission. These risk factors, include, but are not limited to: fluctuations in demand for our products and services; a highly competitive business environment for network switching equipment; our effectiveness in controlling expenses; the possibility that we might experience delays in the development or introduction of new technology and products; customer response to our new technology and products; fluctuations in the global economy; risks related to pending or future litigation; a dependency on third parties for certain components and for the manufacturing of our products and our ability to receive the anticipated benefits of acquired businesses..

Business Overview

The following discussion is based upon our Consolidated Financial Statements included elsewhere in this Report, which have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). In the course of operating our business, we routinely make decisions as to the timing of the payment of invoices, the collection of receivables, the manufacturing and shipment of products, the fulfillment of orders, the purchase of supplies, and the building of inventory and service parts, among other matters. Each of these decisions has some impact on the financial results for any given period. In making these decisions, we consider various factors including contractual obligations, customer satisfaction, competition, internal and external financial targets and expectations, and financial planning objectives. For further information about our critical accounting policies and estimates, see "Critical Accounting Policies and Estimates" section included in this "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Extreme Networks, Inc., together with its subsidiaries (collectively referred to as "Extreme" and as "we", "us" and "our") is a leading provider of network infrastructure equipment and offers related maintenance contracts for extended warranty and maintenance to our enterprise, data center and service provider customers. We were incorporated in California in May 1996 and reincorporated in Delaware in March 1999. Our corporate headquarters are located in San Jose, California. Substantially all of our revenue is derived from the sale of our networking equipment and related maintenance contracts.

Extreme is a leader in providing software-driven networking solutions for enterprise customers. Providing a combined end-to-end solution from the data center to the access point, Extreme designs, develops and manufactures wired and wireless network infrastructure equipment and develops the software for network management, policy, analytics, security and access controls. We strive to help our customers and partners Connect Beyond the Network by building world-class software and network infrastructure solutions that solve the wide range of problems faced by IT departments.

Enterprise network administrators from the data center to the access layer need to respond to the rapid digital transformational trends of cloud, mobility, big data, social business and the ever-present need for network security. Accelerators such as Internet of Things ("IoT"), artificial intelligence ("AI"), bring your own device ("BYOD"), machine learning, cognitive computing, and robotics add complexity to challenge the capabilities of traditional

networks. Technology advances have a profound effect across the entire enterprise network placing unprecedented demands on network administrators to enhance management capabilities, scalability, programmability, agility, and analytics of the enterprise networks they manage.

A trend effecting the Enterprise Network Equipment market is the continued adoption of the cloud-managed enterprise WLAN in the enterprise market. Hybrid cloud is a cloud computing environment which uses a mix of on-premises, private cloud and third-party, public cloud services with orchestration between the two platforms. ExtremeCloud is the only offering in the market that seamlessly integrates the cloud with on-premise infrastructures.

We believe that understanding the following key developments is helpful to an understanding of our operating results for the fiscal quarter ended September 30, 2018.

To facilitate the readers understanding, the following is a list of common terms in our industry used in the discussion of our business:

- Access: Network access is the closest point of entry to a network whether it is a wireless access point, Ethernet connection, or Wi-Fi device.
- Access Point: A wireless access point, or more generally just access point (“AP”), is a networking hardware device that allows a Wi-Fi device to connect to a wired network. (Industry term)

- Aggregation: In computer networking, the term aggregation applies to various methods of combining (aggregating) multiple network connections in parallel in order to increase throughput beyond what a single connection could sustain, and to provide redundancy in case one of the links should fail.
- Artificial Intelligence: Artificial Intelligence ("AI") is a set of technologies that enable computers to simulate the cognitive knowledge-processing capabilities of humans. Because it is artificial, the objective of most work in AI is to augment the capabilities of humans, not to replace them. Just as computers in general are applied to the tedious and repetitive tasks that humans find tedious, AI-based solutions can deal with often large ("Big Data") volumes of digitally-encoded information dispassionately, unemotionally, rapidly, and, depending upon the parameters of a specific application and implementation, accurately. In network administration, AI can be applied to dealing with the "more-variables-than-equations nature" of radio frequency settings in even very- large-scale Wi-Fi installations. The goal is to achieve optimal network-wide performance more accurately and at lower cost than would be possible with humans alone.
- Campus (Network): A campus network, or campus area network, or corporate area network ("CAN") is a computer network made up of an interconnection of local area networks ("LANs") within a limited geographical area, such as a college campus, company campus, hospital, hotel, convention center or sports venue.
- CloudStack: CloudStack is an open source cloud computing software for creating, managing, and deploying infrastructure cloud services. It uses existing hypervisors such as KVM, VMware ESXi and XenServer/XCP for virtualization.
- Core: A core network, or network core, is the central part of a telecommunications network that provides various services to customers who are connected by the access network.
- Data Center: A data center is a facility used to house computer systems and associated components, such as telecommunications and storage systems. It generally includes redundant or backup power supplies, redundant data communications connections, environmental controls (e.g. air conditioning, fire suppression) and various security devices.
- Data Center Fabric technologies: Also known as networking switch fabric, is the basic topology of how a network is laid out and connected to switch traffic on a data or circuit-switched network.
- Edge: An edge device is a device which provides an entry point into enterprise or service provider core networks. Examples include routers, routing switches, integrated access devices ("IADs"), multiplexers, and a variety of metropolitan area network ("MAN") and wide area network ("WAN") access devices.
- Fabric Attach: Avaya's Fabric Attach ("FA") fundamentally introduces autonomic/automatic attachment to network services for end users IoT devices to a network infrastructure. Fabric Attach and Fabric Connect are key building blocks of the Avaya SDN Fx™ architecture.
- Fabric Connect: Fabric Connect is an extended implementation of the IEEE/IEFT standards for Shortest Path Bridging ("SPB"). It offers a full-service network virtualization technology that combines the best of Ethernet and the best of IP.
- Flipped Classroom: Flipped classroom is an instructional strategy and a type of blended learning that reverses the traditional learning environment by delivering instructional content, often online, outside of the classroom.
- Internet Protocol: Internet Protocol ("IP") is the principal set (or communications protocol) of digital message formats and rules for exchanging messages between computers across a single network or a series of interconnected networks, using the Internet Protocol Suite (often referred to as TCP/IP)
- Layer 3 Data Center Interconnect; A Data Center Interconnect ("DCI") refers to the networking of two or more different data centers to achieve business or IT objectives. This interconnectivity between separate data centers enables them to work together, share resources and/or pass workloads between one another. A Layer 3 DCI refers to interconnection made through layer 3 of the commonly-referenced multilayered communication model, Open Systems Interconnection ("OSI").
- Machine Learning: Machine Learning ("ML") is a set of technologies, and itself a branch of AI, that enables computers to simulate human learning, with learning defined here as the ability to change behavior and/or essential capabilities (again, simulated as a digital process on a computer) in response to new information suitably encoded for consumption by the algorithms implementing ML. In other words, ML enables AI-based processes to "learn" from past

behaviors and consequently to improve future results, in much the same way as experiential education benefits humans.

- Network Automation: Network Automation ("NA") is a methodology in which software automatically configures, provisions, manages and tests network devices. It is used by enterprises and service providers to improve efficiency and reduce human error and operating expenses.

- OpenFlow: OpenFlow (“OF”) is considered one of the first software-defined networking (“SDN”) standards. It originally defined the communication protocol in SDN environments that enables the SDN Controller to directly interact with the forwarding plane of network devices such as switches and routers, both physical and virtual (hypervisor-based), so it can better adapt to changing business requirements. (Source: SDx Central)
    - OpenStack: OpenStack software controls large pools of compute, storage, and networking resources throughout a datacenter, managed through a dashboard or via the OpenStack API. OpenStack works with popular enterprise and open source technologies making it ideal for heterogeneous infrastructure. (Source: OpenStack.org)
- Single Pane of Glass: Single pane of glass is a term used to describe a management display console that integrates all parts of a computer infrastructure.
- Stackstorm: A platform for integration and automation across services and tools. It ties existing infrastructure and application environment to automate that environment. It has a particular focus on taking actions in response to events.
- Wi-Fi: Wireless Access points using Radio Frequency and protocols to allow computers, smartphones, or other devices to connect to the Internet or communicate with one another wirelessly within an area.

Industry Background

Enterprises are adopting new IT delivery models and applications that require fundamental network alterations and enhancements spanning from device access point to the network core. AI and ML technologies have the potential to vastly improve the network experience. When AI and ML are used in conjunction with an NA technology, administrators can make significant advances in productivity, availability, accessibility, manageability, security and speed of their network infrastructure. These emerging technologies are driving administrators to a mindset of change toward agile processes that allow a versatile workforce to improve the rate of innovation of the enterprise safely, securely and with confidence.

AI, ML and NA have increased the relevance and importance of the network in the enterprise. Traditional network offerings are not well-suited to fulfill enterprise expectations for rapid delivery of new services, more flexible business models, real-time response and massive scalability.

The networking industry appears to be invigorated by this wave of technological change:

- Ethernet (wired and wireless) has solidified its role in both public and private networks through its scalability, adaptability and cost-effectiveness. At the same time, the enterprises and service providers expect the technology to follow a price-performance curve that mandates continued innovation by Ethernet vendors.
- The mobile workforce continues to proliferate. Employees expect high-quality and secure access to corporate resources in a BYOD world across a diversity of endpoints such as laptops, tablets, smart phones and wearables, whether they are within the corporate firewall or on-the-go. With ExtremeManagement, IT departments focus their investment decisions on this mobile workforce, taking a unified view of wireless access, from the campus core and the data center. Extreme offers end-to-end solutions that permit IT managers to meet employee expectations and to maximize IT return on investment.
- Verticals such as retail, finance, healthcare, education, manufacturing, government and hospitality (which includes sports and entertainment venues) are connecting with their customers and guests beyond the network. These enterprises are investing in guest and location technologies that connect with their customers via their mobile devices over their WLAN. This allows them to obtain rich analytics for contextual marketing, which in turn, enables them to deliver a personalized brand experience. ExtremeGuest and ExtremeLocation have been built on cloud-based technology for simple implementation and fast release to market to better provide necessary insights into guest demographics and location-based analytics.

28

- The Internet of Things. The Internet of Things is having dramatic effects on network infrastructure in healthcare, education, manufacturing, government and retail as more “smart” devices are entering the networks. These devices pose opportunities as well as threats to the network.

- Growing usage of the cloud. Enterprises have migrated increasing numbers of applications and services to either private clouds or public clouds offered by third parties. In either case, the network infrastructure must adapt to this new dynamic environment. Intelligence and automation are key if enterprises are to derive maximum benefit from their cloud deployments. Ethernet speeds, scaling from 10 Gigabits per second ("G") to 100G, provide the infrastructure for both private and public clouds. In addition, there is growing interest in SDN approaches that may include technologies such as OpenFlow, OpenStack, and CloudStack for increased network agility.
- Vendor consolidation is expected to continue. Consolidation of vendors within the enterprise network equipment market and between adjacent markets (storage, security, wireless & voice software and applications) continues to gain momentum. Further, we believe customers are demanding more end-to-end, integrated networking solutions. To address this demand, we acquired the WLAN Business of Zebra in October 2016, the Campus Fabric Business from Avaya in July 2017, and the Data Center Business from Brocade in October 2017.

Our strategy, product portfolio and research and development are closely aligned with what we have identified as the following trends in our industry:

The software segment of the worldwide enterprise network equipment market has continued to evolve and demands for improvements in Network Management will continue.
We announced our Extreme Management Console in Fiscal 2017. This innovative software helps IT network administrators to navigate the unprecedented demands caused by the surge of IoT devices and technology.
Enterprise adoption of the cloud and open-source options are disrupting traditional license and maintenance business models.
We announced cloud offerings in April 2016 and enhanced those offerings in 2017. Extreme began participation in the OpenSwitch program in May 2016 and now participates in the StackStorm community with the acquisition from Brocade in November 2017.
- Enterprise adoption of new financing solutions allows for increased flexibility, limited investment and zero long-term commitments. These offerings are changing the traditional CAPEX model to (OPEX) models using financing purchases over time are disrupting traditional sell-in business models.

We announced Extreme Capital Solutions in April 2018. The offering includes subscription, capital leasing and usage business models that provide flexibility for partners and customers.
Growth of wireless devices continues to outpace hardwire switch growth.
We announced our 802.11ac Wave 2 wireless offering in late 2015 and plans to continue to advance our wireless portfolio of indoor and outdoor access points.

The Extreme Strategy

We are focused on delivering end-to-end IP networking solutions for today’s enterprise environments. From wireless and wired access technologies, through the campus, core and into the datacenter, Extreme is developing solutions to deliver outstanding business outcomes for our customers. Leveraging a unified management approach, both on premise and in the cloud, we continue to accelerate adoption and delivery of new technologies in support of emerging trends in enterprise networking. We continue to execute on our growth objectives by maximizing customer, partner, and shareholder value.

In fiscal 2017, we completed the acquisition of the WLAN Business from Zebra. In fiscal 2018, we completed the acquisitions of the Campus Fabric Business from Avaya and the Data Center Business from Brocade. These acquisitions support our growth strategy to lead the enterprise network equipment market with end-to-end software-driven solutions for enterprise customers from the data center to the wireless edge. After the closing of the

acquisitions of the Campus Fabric Business and Data Center Business, Extreme immediately became a networking industry leader with more than 30,000 customers. As a network switching leader in enterprise, datacenter and cloud, after closing of the Campus Fabric Business, we combine and extend our world-class products and technologies to provide customers with some of the most advanced, high performance and open solutions in the market as well as a superb overall customer experience. The combination of Extreme, the Campus Fabric Business and the Data Center Business is significant in that it brings together distinct strengths addressing the key areas of the network, from unified wired and wireless edge, to the enterprise core, to the data center and cloud to offer a complete, unified portfolio of software-driven network access solutions.

Provider of high quality, software-driven, secure networking solutions and the industry's #1 customer support organization

- Only multi-vendor network management with "single pane of glass".
- Delivering new releases of next generation portfolio organically and through acquisition.

Key elements of our strategy include:

- Focus on being nimble and responsive to customers and partners, we call this "Customer-Driven Networking™." We work with our customers to deliver software-driven solutions from the enterprise edge to the cloud that are agile, adaptive, and secure to enable digital transformation for our customers. We help our customers move beyond just "keeping the lights on", so they can think strategically and innovate. By allowing customers to access critical decision-making intelligence, we are able reduce their daily tactical work so they can spend their time on learning and understanding how to innovate their business with IT.
- Enable a common fabric to simplify and automate the network. With the acquisition of the Campus Fabric Business, Extreme now has access to field driven Campus and Data Center Fabric technologies. Fabric technologies virtualize the network infrastructure (decoupling network services from physical connectivity) which enables network services to be turned up faster, with lower likelihood of error. They make the underlying network much easier to design, implement, manage and troubleshoot.
- Software-driven networking services-led solutions. Our software-driven solutions provide visibility, control and strategic intelligence from the Edge to the Data Center, across networks and applications. Our solutions include wired switching, wireless switching, wireless access points and controllers. We offer a suite of products that are tightly integrated with access control, network and application analytics as well as network management. All can be managed, assessed and controlled from one single pane of glass.
- Offer customers choice – cloud or on premise. We leverage cloud where it makes sense for our customers and provide on premise solutions where customers need it. Our hybrid approach gives our customers options to adapt the technology to their business. At the same time, all of our solutions have visibility, control and strategic information built in, all tightly integrated with one single pane of glass. Our customers can understand what's going on across the network and applications in real time – who, when, and what is connected to the network, which is critical for BYOD and IoT.
- Enable IoT without additional IT resources. In a recent IoT IT infrastructure survey conducted in December 2016, enterprise IT decision makers across industry verticals indicated their preference to opt for their existing wireless connectivity infrastructure to support IoT devices. These preferences will place unprecedented demand on network administrators to enhance management capabilities, scalability and programmability of the enterprise networks they manage without additional IT resources.
- Provide a strong value proposition for our customers. Our cloud-managed wired and wireless networking solutions that provide additional choice and flexibility with on or off premise network, device and application management coupled with our award-winning services and support provide a strong value proposition to the following customers and applications:

  Enterprises and private cloud data centers use our products to deploy automated next-generation virtualized and high-density infrastructure solutions.

  Enterprises and organizations in education, healthcare, manufacturing, hospitality, transportation and logistics and government agencies use our solutions for their mobile campus and backbone networks.

  Enterprises, universities, healthcare and hospitality organizations use our solutions to enable better visibility and control of their data processing and analytics requirements.
- Provide high-quality customer service and support. We seek to enhance customer satisfaction and build customer loyalty through high-quality service and support. This includes a wide range of standard support programs that provide the level of service our customers require, from standard business hours to global 24-hour-a-day, 365-days-a-year real-time response support.

- Extend switching and routing technology leadership. Our technological leadership is based on innovative switching, routing and wireless products, the depth and focus of our market experience and our operating systems - the software that runs on all of our Ethernet Switches. Our products reduce operating expenses for our customers and enable a more flexible and dynamic network environment that will help them meet the upcoming demands of IoT, mobile, and cloud, etc. Furthermore, our network operating systems, our primary merchant silicon vendor, and select manufacturing partners permit us to leverage our engineering investment. We have invested in engineering resources to create leading-edge technologies to increase the performance and functionality of our products, and as a direct result, the value of our solution to our current and future customers. We look for maximum synergies from our engineering investment in our targeted verticals.
- Expand Wi-Fi technology leadership. Wireless is today's network access method of choice and every business must deal with scale, density and BYOD challenges. The increase in demand being seen today, fueled by more users with multiple devices, increases the expectation that everything will just work. The network edge landscape is changing as the explosion of mobile devices increases the demand for mobile, transparent and always-on wired to wireless edge services. This new "unified access layer" requires distributed intelligent components to ensure that access control and resiliency of business services are available across the entire infrastructure and manageable from a single console. Our unified access layer portfolio provides intelligence for the wired/wireless edge
- Continue to deliver unified management and a common fabric across the wired/wireless environment from the Data Center to the mobile Edge. Our rich set of integrated management capabilities provides centralized visibility and highly efficient anytime, anywhere control of enterprise wired and wireless network resources.
- Offer a superior quality of experience. Our network-powered application analytics provide actionable business insight by capturing and analyzing context-based data about the network and applications to deliver meaningful intelligence about applications, users, locations and devices. With an easy to comprehend dashboard, our applications help businesses to turn their network into a strategic business asset that helps executives make faster and more effective decisions.

Data can be mined to show how applications are being used enabling a better understanding of user behavior on the network, identifying the level of user engagement and assuring business application delivery to optimize the user experience. Application adoption can be tracked to determine the return on investment associated with new application deployment.

Visibility into network and application performance enables our customers to pinpoint and resolve performance bottlenecks in the infrastructure whether they are caused by the network, application or server. This saves both time and money for the business and ensures critical applications are running at the best possible performance.

- Software-driven networking solutions for the enterprise. We are a software-driven networking solution company focused on the enterprise. We focus our R&D team and our sales teams to execute against a refined set of requirements for optimized return on investment, faster innovation, and clearer focus on mega trends and changes in the industry. As a software-driven networking company, we offer solutions for the entire enterprise network, the data center, the campus, the core and the WLAN.
- Expand market penetration by targeting high-growth market segments. Within the Campus, we focus on the mobile user, leveraging our automation capabilities and tracking WLAN growth. Our Data Center approach leverages our product portfolio to address the needs of public and private Cloud Data Center providers. Within the Campus we also target the high-growth physical security market, converging technologies such as Internet Protocol ("IP") video across a common Ethernet infrastructure in conjunction with technology partners.
- Leverage and expand multiple distribution channels. We distribute our products through select distributors, a large number of resellers and system-integrators worldwide, and several large strategic partners. We maintain a field sales force to support our channel partners and to sell directly to certain strategic accounts. As an independent Ethernet switch vendor, we seek to provide products that, when combined with the offerings of our channel partners, create compelling solutions for end-user customers.
-

Maintain and extend our strategic relationships. We have established strategic relationships with a number of industry-leading vendors to both provide increased and enhanced routes to market, but also to collaboratively develop unique solutions.

Key Financial Metrics

During the first quarter of fiscal 2019, we reflected the following results:

- Net revenues of $239.9 million compared to $211.7 million in the first quarter of fiscal 2018.
- Product revenue of $177.7 million compared to $164.8 million in the first quarter of fiscal 2018.

- Service revenue of $62.2 million compared to $46.9 million in the first quarter of fiscal 2018.
- Total gross margin of 55.1% of net revenues compared to 53.1% of net revenues in the first quarter of fiscal 2018.
- Operating loss of $5.0 million compared to operating profit $4.5 million in the first quarter of fiscal 2018.
- Net loss of $9.1 million compared to a net income of $4.4 million in the first quarter of fiscal 2018.
- Cash flow provided by operating activities of $34.3 million compared to $18.6 million in the three months ended September 30, 2017. Cash, cash equivalents and marketable securities of $141.1 million compared to $130.5 million as of June 30, 2018.

Net Revenues

The following table presents net product and service revenue for the periods presented (dollars in thousands):

	Three Months Ended September 30,		September 30,		$	%
	2018		2017		Change	Change
Net Revenues:						
Product	$177,720		$ 164,774		$12,946	7.9 %
Percentage of net revenue	74.1	%	77.8	%		
Service	62,166		46,941		15,225	32.4 %
Percentage of net revenue	25.9	%	22.2	%		
Total net revenues	$239,886		$ 211,715		$28,171	13.3 %

Product revenue increased $12.9 million or 7.9% for the three months ended September 30, 2018 as compared to the corresponding period of fiscal 2018. The growth in product revenues was attributable to the acquisition of the Data Center Business, partial offset by longer customer buying cycles and growth in our backlog.

Service revenue increased $15.2 million, or 32.4% for the three months ended September 30, 2018 as compared to the corresponding period of fiscal 2018. The growth in service revenue was primarily due to the increased number of service contracts acquired with the acquisition of the Data Center Business.

The following table presents the product and service, gross profit and the respective gross profit percentages for the periods presented (dollars in thousands):

	Three Months Ended September 30,		September 30,		$	%
	2018		2017		Change	Change
Gross profit:						
Product	$94,177		$ 84,729		$9,448	11.2 %
Percentage of product revenue	53.0	%	51.4	%		
Service	37,894		27,652		10,242	37.0 %
Percentage of service revenue	61.0	%	58.9	%		
Total gross profit	$132,071		$ 112,381		$19,690	17.5 %
Percentage of net revenues	55.1	%	53.1	%		

Product gross profit increased $9.4 million or 11.2% for the three months ended September 30, 2018 as compared to the corresponding period in fiscal 2018. The increase was due to higher revenues and more favorable manufacturing costs due to our cost reduction efforts in addition to lower acquired inventory purchase accounting adjustments of $2.9 million incurred in the first fiscal quarter of 2018. Increases in product gross margin were partially offset by increased distribution costs of $3.3 million, amortization of developed technology intangibles of $2.3 million due to the acquisition of the Data Center Business, and warranty charges of $1.4 million.

Service gross profit increased $10.2 million or 37.0% for the three months ended September 30, 2018 as compared to the corresponding period in fiscal 2018, primarily due to a higher number of maintenance contracts related to the acquisition of the Data Center Business.

Operating Expenses

The following table presents operating expenses for the periods presented (dollars in thousands):

	Three Months Ended September 30,		$	%
	2018	2017	Change	Change
Research and development	$51,241	$ 34,285	$16,956	49.5 %
Sales and marketing	67,582	55,561	12,021	21.6 %
General and administrative	12,771	12,185	586	4.8 %
Acquisition and integration costs	2,546	4,244	(1,698)	(40.0)%
Restructuring charges, net of reversals	808	—	808	—
Amortization of intangibles	2,141	1,614	527	32.7 %
Total operating expenses	$137,089	$ 107,889	$29,200	27.1 %

Research and Development Expenses

Research and development expenses consist primarily of personnel costs (which consists of compensation, benefits and stock-based compensation), consultant fees and prototype expenses related to the design, development, and testing of our products.

Research and development expenses increased by $17.0 million or 49.5% for the three months ended September 30, 2018 as compared to the corresponding period of fiscal 2018. The increase in research and development expenses was due to higher personnel costs of $7.3 million due to increased headcount related to the acquisition of the Data Center Business, $2.4 million in increased facility and information technology costs, $3.9 million in increased supplies and equipment costs and $3.0 million in increased contractor and professional fees.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of personnel costs (which consists of compensation, benefits and stock-based compensation), as well as trade shows and promotional expenses.

Sales and marketing expenses increased by $12.0 million or 21.6% for the three months ended September 30, 2018 as compared to the corresponding period of fiscal 2018 primarily as a result of the acquisition of the Data Center Business. The increase consisted of higher personnel costs of $10.1 million, $0.5 million in increased travel, marketing, meeting and conference costs, $0.4 million in increased facility and information technology costs and $1.0 million in increased software, supplies and equipment costs.

General and Administrative Expenses

General and administrative expense consists primarily of personnel costs (which consists of compensation, benefits and stock-based compensation), legal and professional service costs, travel and facilities and information technology costs.

General and administrative expenses increased by $0.6 million or 4.8% for the three months ended September 30, 2018 as compared to the corresponding period of fiscal 2018 primarily due to $0.6 million in higher personnel costs and $0.4 million in higher facility and information technology costs, offset by $0.5 million in reduced professional fees.

Acquisition and Integration Costs

For the three months ended September 30, 2018, we incurred $2.5 million of integration costs related to the acquisitions of the Campus Fabric and Data Center Businesses.

For the three months ended September 30, 2017, we incurred $1.2 million of acquisition and $1.7 million of integration costs related to the acquisition of the Campus Fabric Business and $1.3 million of acquisition costs related to the future acquisition of the Data Center Business.

Restructuring Charges, Net of Reversals

For the three months ended September 30, 2018, we recorded restructuring charges of $0.8 million associated with a reduction-in-force in the fourth quarter of fiscal 2018.

Amortization of Intangibles

During the three months ended September 30, 2018 and 2017, we recorded $2.1 million and $1.6 million, respectively, of amortization expense as operating expenses in the accompanying condensed consolidated statements of operations. The increase was mainly due to additional amortization related to the acquired intangibles from the Data Center Business.

Interest Expense

During the three months ended September 30, 2018 and 2017, we recorded $3.5 million and $2.2 million, respectively, in interest expense. The increase in interest expense was due to the increased balance of our Credit Agreement and higher interest rates as compared to the corresponding period of fiscal 2018 as well as additional imputed interest charges associated with various long-term contracts.

Other Income (Expense), Net

During the three months ended September 30, 2018 and 2017, we recorded income of $0.5 million and $3.1 million, respectively, in other income (expense), net. The change was primarily due to foreign exchange gains and losses from the revaluation of certain assets and liabilities denominated in foreign currencies into U.S. Dollars.

Provision for Income Taxes

For the three months ended September 30, 2018 and 2017, we recorded an income tax provision of $1.4 million and $1.7 million, respectively, which consisted primarily of taxes on the income of our foreign subsidiaries as well as tax expense associated with the establishment of a U.S. deferred tax liability for amortizable goodwill resulting from the acquisition of Enterasys, the WLAN Business and the Campus Fabric Business. The income tax provisions for the three months ended September 30, 2018 and 2017 were calculated based on actual results of operations three months ended September 30, 2018 and 2017and therefore may not reflect the annual effective tax rate.

On December 22, 2017, the President of the United States signed and enacted into law H.R. 1, the Tax Cuts and Jobs Act (“TCJA”), which, except for certain provisions, is effective for tax years beginning on or after January 1, 2018. As a fiscal year taxpayer, we were not subject to the majority of the tax law provisions until fiscal year 2019; however, there are certain significant items of impact that were recognized in fiscal year 2018. Because a change in tax law is accounted for in the period of enactment, the effects of the TCJA, a tax benefit of $2.5 million, have been reflected in the second quarter of fiscal 2018. See Note 10 to the condensed consolidated financial statements which includes a detailed discussion of the various provisions of the new U.S. tax legislation.

Critical Accounting Policies and Estimates

Our unaudited condensed consolidated financial statements and the related notes included elsewhere in this report are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, costs and expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. In many instances, we could have reasonably used different accounting estimates, and in other instances changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. On an ongoing basis, we evaluate our estimates and assumptions. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

As discussed in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the year ended June 30, 2018, we consider the following accounting policies to be the most critical in understanding the judgments that are involved in preparing our consolidated financial statements:

- Revenue Recognition
- Business Combinations
- Inventory Valuation and Purchase Commitments

The have been no changes to our critical accounting policies since the filing of our last Annual Report on Form 10-K.

New Accounting Pronouncements

See Note 3 of the accompanying condensed consolidated financial statements for a full description of new accounting pronouncements, including the respective expected dates of adoption and effects on results of operations and financial condition.

Liquidity and Capital Resources

The following summarizes information regarding our cash, cash equivalents, marketable securities and working capital (in thousands):

	September 30, 2018	June 30, 2018
Cash and cash equivalents	$ 140,167	$121,139
Marketable securities	887	1,459
Total cash, cash equivalent and marketable securities	$ 141,054	$122,598
Working capital	$ 73,761	$68,041

As of September 30, 2018, our principal sources of liquidity consisted of cash, cash equivalents and marketable securities of $141.1 million, accounts receivable, net of $164.7 million and availability of borrowings from our five-year New Revolving Facility of $39.1 million. Our principal uses of cash include the purchase of finished goods inventory from our contract manufacturers, payroll and other operating expenses related to the development, marketing of our products, purchases of property and equipment and include repayments of debt and related interest. We believe that our $141.1 million of cash, cash equivalents and marketable securities at September 30, 2018 and the availability of borrowings from the New Revolving Facility will be sufficient to fund our principal uses of cash for at least the next 12 months.

On November 2, 2018, the Company announced that its Board of Directors has authorized the Company to repurchase up to $60.0 million of its common stock over the next two years. Purchases may be made from time to time in the open market or in privately negotiated transactions. The manner, timing and amount of any purchases will be determined by the Company's management based on their evaluation of market conditions, stock price, Extreme’s ongoing determination that it is the best use of available cash and other factors. The repurchase program does not obligate Extreme to acquire any common stock, may be suspended or terminated at any time without prior notice and will be subject to regulatory considerations.

On May 1, 2018, the Company entered into a Credit Agreement (the “Credit Agreement”), by and among the Company, as borrower, BMO Harris Bank N.A., as an issuing lender and swingline lender, Bank of Montreal, as administrative and collateral agent, and the financial institutions or entities that are a party thereto as lenders. The Credit Agreement provides for i) a $40 million five-year revolving credit facility (the “New Revolving Facility”), ii) a $190 million five-year term loan (the “New Term Loan”) and, iii) an uncommitted additional incremental loan facility in the principal amount of up to $100 million (“New Incremental Facility”). On May 1, 2018, the Company borrowed $200 million under the Credit Agreement.

Borrowings under the Credit Agreement will bear interest, at the Company’s election, as of May 1, 2018, at a rate per annum equal to LIBOR plus 1.50% to 2.75%, or the adjusted base rate plus 0.50% to 1.75%, based on the Company’s

consolidated leverage ratio. In addition, the Company is required to pay a commitment fee of between 0.25% and 0.40% quarterly (currently 0.35%) on the unused portion of the New Revolving Facility, also based on the Company's consolidated leverage ratio. Principal installments are payable on the New Term Loan in varying percentages quarterly starting September 30, 2018 and to the extent not previously paid, all outstanding balances are to be paid at maturity. The obligations under the Credit Agreement is secured by substantially all of the Company's assets.

Financial covenants under the Credit Agreement require the Company to maintain a minimum consolidated fixed charge and consolidated leverage ratio at the end of each fiscal quarter through maturity. The Credit Agreement also includes covenants and restrictions that limit, among other things, the Company's ability to incur additional indebtedness, create liens upon any of its property, merge, consolidate or sell all or substantially all of its assets. The Credit Agreement also includes customary events of default which may result in acceleration of the outstanding balance. At September 30, 2018, we were in compliance with the covenants of the Credit Agreement.

Key Components of Cash Flows and Liquidity

A summary of the sources and uses of cash and cash equivalents is as follows (in thousands):

	Three Months Ended September 30,	
	2018	2017
Net cash provided by operating activities	$34,330	$ 18,598
Net cash used in investing activities	(6,690)	(70,546)
Net cash (used in) provided by financing activities	(8,179)	74,455
Foreign currency effect on cash	(433)	57
Net increase in cash and cash equivalents	$19,028	$ 22,564

Net Cash Provided by Operating Activities

Cash flows provided by operations in the three months ended September 30, 2018 were $34.3 million, including our net loss of $9.1 million and non-cash expenses of $21.8 million for items such as amortization of intangibles, stock-based compensation, depreciation, deferred income taxes and imputed interest. Other sources of cash for the current quarter included a decrease in accounts receivables and inventories and increases in deferred revenues and other current and long-term liabilities. This was partially offset by decreases in accounts payable and accrued compensation.

Cash flows provided by operations in the three months ended September 30, 2017 were $18.6 million, including net income of $4.4 million and non-cash expenses of $10.4 million for items such as amortization of intangibles, stock-based compensation expense, depreciation and gain on sale of non-marketable equity investment as well as a decrease in inventory and increases in accounts and deferred revenue. This was partially offset by an increase in accounts receivable and decreases in accrued compensation and current and noncurrent liabilities.

Net Cash Used in Investing Activities

Cash flows used in investing activities in the three months ended September 30, 2018 were $6.7 million which consisted of purchases of property and equipment of $7.4 million and proceeds of $0.7 million related to the sale of marketable equity securities.

Cash flows used in investing activities in the three months ended September 30, 2017, were $70.5 million. For the three months ended September 30, 2017, cash flows consisted of expenditures for acquisitions of $68.0 million consisting of $69.6 million for the Campus Fabric Business acquisition less receipt of $1.6 million as final settlement of a working capital adjustment related to the WLAN Business acquisition, $7.4 million of purchases of property and equipment and proceeds of $4.9 million related to the sale of non-marketable equity investment.

Net Cash (Used in) Provided by Financing Activities

Cash flows used in financing activities in the three months ended September 30, 2018 were $8.2 million, due to repayments of debt totaling $12.4 million and $1.6 million of contingent consideration and $1.0 million for deferred payments on acquisitions. This was partially offset by $7.1 million proceeds from issuance of shares of our common stock under our Employee Stock Purchase Plan (“ESPP”), the exercise of stock options and net of taxes paid on vested and released stock awards,

Cash flows provided by financing activities in the three months ended September 30, 2017 were $74.5 million, including new borrowings of $80.0 million to fund our acquisition of the Campus Fabric Business, $4.9 million proceeds from issuance of shares of our common stock under our ESPP and the exercise of stock options less $4.8

million of taxes paid on vested and released stock awards, partially offset by repayment of debt totaling $4.1 million and $1.5 million of loan fees incurred in connection with the Second Amendment of our Credit Facility.

Foreign Currency Effect on Cash

Foreign currency effect on cash increased in the three months ended September 30, 2018, primarily due to changes in foreign currency exchange rates between the U.S. Dollar and particularly the Brazilian Real, British Pound, Indian Rupee and the EURO.

Contractual Obligations

The following summarizes our contractual obligations as of September 30, 2018, and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

		Less than		
	Total	1 Year	1-3 years	3-5 years
Contractual Obligations:				
Debt obligations	$187,625	$9,500	$24,938	$153,187
Interest on debt obligations	31,638	8,537	15,614	7,487
Non-cancellable inventory purchase commitments	158,697	158,697	—	—
Contractual commitments	117,500	29,375	47,000	41,125
Non-cancellable operating lease obligations	99,856	19,611	34,759	45,486
Deferred payments for an acquisition	18,000	5,000	8,000	5,000
Contingent consideration for an acquisition	11,233	6,592	4,218	423
Other liabilities	518	136	273	109
Total contractual cash obligations	$625,067	$237,448	$134,802	$252,817

The contractual obligations referenced above are more fully defined as follows:

Debt obligations relate to amounts owed under our Credit Agreement.

Non-cancelable inventory purchase commitments represent the purchase of long lead-time component inventory that our contract manufacturers procure in accordance with our forecast. We expect to honor the inventory purchase commitments within the next 12 months.

Non-cancellable contractual commitments to suppliers for future services.

Non-cancelable operating lease obligations represent base rents and operating expense obligations to landlords for facilities we occupy at various locations.

Deferred payments for the acquisition of the Data Center Business represent a $1.0 million per quarter.

Contingent consideration for the Capital Financing Business acquisition, at fair value. Actual payments could be different.

Other liabilities include our commitments towards debt related fees and specific arrangements other than inventory.

The amounts in the table above exclude immaterial income tax liabilities related to uncertain tax positions as we are unable to reasonably estimate the timing of settlement.

We did not have any material commitments for capital expenditures as of September 30, 2018.

Off-Balance Sheet Arrangements

We did not have any off-balance sheet arrangements as of September 30, 2018.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity

Our exposure to market risk for changes in interest rates relates primarily to our financial investments and debt. We usually invest our cash in investments with short maturities or with frequent interest reset terms. Accordingly, our interest income fluctuates with short-term market conditions. As of September 30, 2018, we did not have any financial investments that were exposed to interest rate risk.

Debt

At certain points in time we are exposed to the impact of interest rate fluctuations, primarily in the form of variable rate borrowings from our credit facility.

At certain points in time we are exposed to the impact of interest rate fluctuations, primarily in the form of variable rate borrowings from our Credit Agreement. Our debt and Credit Agreement, are fully described in the Note 8, Debt, of our Notes to the Consolidated Financial Statements in our annual report on Form 10-K. At September 30, 2018, we had $187.6 million of debt outstanding, all of which was from our Credit Agreement. Through the first quarter of fiscal 2019, the average daily outstanding amount was $199.7 million with a high of $200.0 million and a low of $187.6 million.

The following table presents hypothetical changes in interest expense for the quarter ended September 30, 2018, on outstanding Credit Agreement borrowings as of September 30, 2018, that are sensitive to changes in interest rates (in thousands):

Change in interest expense given a decrease in interest rate of X bps*		Average daily outstanding debt	Change in interest expense given an increase in interest rate of X bps	
(100 bps)	(50 bps)		100 bps	50 bps
$ (499)	$ (250)	$ 199,728	$ 499	$ 250

* Underlying interest rate was 4.63% during the quarter.

Exchange Rate Sensitivity

A majority of our sales and expenses are denominated in United States Dollars. While we conduct some sales transactions and incur certain operating expenses in foreign currencies and expect to continue to do so, we do not anticipate that foreign exchange gains or losses will be significant, in part because of our foreign exchange risk management process discussed below.

Foreign Exchange Forward Contracts

We record all derivatives on the balance sheet at fair value. Changes in the fair value of derivatives are recognized in earnings as Other expense, net. From time to time, we enter into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the foreign currency forecast transactions related to certain operating expenses and re-measurement of certain assets and liabilities denominated in foreign currencies. These derivatives do not qualify as hedges. Changes in the fair value of these foreign exchange forward contracts are offset largely by re-measurement of the underlying assets and liabilities. At September 30, 2018, we did not have any forward foreign currency contracts outstanding.

Foreign currency transaction gains and losses from operations was a gain of $0.2 million and loss of $0.6 million for the three months ended September 30, 2018 and 2017, respectively.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 as amended, such as this

Report, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer (“CEO”) and the Interim Chief Financial Officer (“CFO”), as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our CEO and CFO, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Report. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Report.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a – 15(f) and 15(d) – 15(f) during the September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We implemented internal controls to ensure we adequately evaluated our contracts and properly assessed the impact of the new accounting standards related to revenue recognition to facilitate its adoption on July 1, 2017. There were no significant changes to our internal control over financial reporting due to the adoption of this new standard.

Inherent Limitations on Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Our controls and procedures are designed to provide reasonable assurance that our control system's objective will be met and our CEO and CFO have concluded that our disclosure controls and procedures are effective at the reasonable assurance level. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within Extreme Networks have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events. Projections of any evaluation of the effectiveness of controls in future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Notwithstanding these limitations, our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. Our CEO and CFO have concluded that our disclosure controls and procedures are, in fact, effective at the "reasonable assurance" level.

PART II. Other Information

Item 1. Legal Proceedings

For information regarding litigation matters required by this item, refer to Part I, Item 3, Legal Proceedings of our Annual Report on Form 10-K for the fiscal year ended June 30, 2018, and Note 9 to our Notes to Condensed Consolidated Financial Statements, included in Part I, Item 1 of this Report which are incorporated herein by reference.

Item 1A. Risk Factors

The following is a list of risks and uncertainties which may have a material and adverse effect on our business, operations, industry, financial condition, results of operations or future financial performance. While we believe we have identified and discussed below the key risk factors affecting our business, there may be additional risks and uncertainties that are not presently known or that are not currently believed to be significant that may adversely affect our business, results of operations, industry, financial position and financial performance in the future

We may not realize anticipated benefits of past or future acquisitions and strategic investments, and the integration of acquired companies or technologies may negatively impact our business and financial results or dilute the ownership interests of our stockholders.

As part of our business strategy, we review acquisition and strategic investment prospects that we believe would complement our current product offerings, augment our market coverage or enhance our technical capabilities, or otherwise offer growth opportunities. In the event of any future acquisitions, we could:

- issue equity securities which would dilute current stockholders' percentage ownership;
- incur substantial debt;
- assume contingent liabilities; or
- expend significant cash.

These actions could have a material adverse effect on our operating results or the price of our common stock.

For example, on July 14, 2017, we completed the acquisition of the Campus Fabric Business and on October 27, 2017, we completed our acquisition of the Data Center Business. Upon the terms and subject to the conditions of the respective Asset Purchase Agreements, we acquired customers, employees, technology and other assets, as well as assumed certain contracts and other liabilities of the Campus Fabric and Data Center Businesses. As of September 30, 2018, we had $187.6 million of indebtedness outstanding.

There can be no assurance we will achieve the revenues, growth prospects and synergies expected from any acquisition or that we will achieve such revenue, growth prospects and synergies in the anticipated time period and our failure to do so could have a material adverse effect on our business, operating results and financial condition. Moreover, even if we do obtain benefits in the form of increased sales and earnings, these benefits may be recognized much later than the time when the expenses associated with an acquisition are incurred. This is particularly relevant in cases where it would be necessary to integrate new types of technology into our existing portfolio and new types of products may be targeted for potential customers with which we do not have pre-existing relationships.

Our ability to realize the anticipated benefits of any future acquisitions and investment activities also entail numerous risks, including, but not limited to:

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difficulties in the assimilation and successful integration of acquired operations, sales functions, technologies and/or products;

- unanticipated costs, litigation or other contingent liabilities associated with the acquisition or investment transaction;
- incurrence of acquisition- and integration-related costs, goodwill or in-process research and development impairment charges, or amortization costs for acquired intangible assets, that could negatively impact our operating results and financial condition;
- the diversion of management's attention from other business concerns;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience;
- the potential loss of key employees of acquired organizations and inability to attract or retain other key employees; and

- substantial charges for the amortization of certain purchased intangible assets, deferred stock compensation or similar items.

In addition, we may not be able to successfully integrate any businesses, products, technologies, or personnel that we might acquire in the future, and our failure to do so could have a material adverse effect on our business, operating results and financial condition.

We cannot assure future profitability, and our financial results may fluctuate significantly from period to period.

We have reported losses in each of our five most recent fiscal years. In addition, in years when we reported profits, we were not profitable in each quarter during those years. We anticipate continuing to incur significant sales and marketing, product development and general and administrative expenses. Any delay in generating or recognizing revenue could result in a loss for a quarter or full year. Even if we are profitable, our operating results may fall below our expectations and those of our investors, which could cause the price of our stock to fall.

We may experience challenges or delays in generating or recognizing revenue for a number of reasons and our revenue and operating results have varied significantly in the past and may vary significantly in the future due to a number of factors, including, but not limited to, the following:

- our dependence on obtaining orders during a quarter and shipping those orders in the same quarter to achieve our revenue objectives;
- decreases in the prices of the products we sell;
- the mix of products sold and the mix of distribution channels through which products are sold;
- acceptance provisions in customer contracts;
- our ability to deliver installation or inspection services by the end of the quarter;
- changes in general and/or specific economic conditions in the networking industry;
- seasonal fluctuations in demand for our products and services;
- a disproportionate percentage of our sales occurring in the last month of the quarter;
- our ability to ship products by the end of a quarter;
- reduced visibility into the implementation cycles for our products and our customers' spending plans;
- our ability to forecast demand for our products, which in the case of lower-than-expected sales, may result in excess or obsolete inventory in addition to non-cancelable purchase commitments for component parts;
- our sales to the telecommunications service provider market, which represents a significant source of large product orders, being especially volatile and difficult to forecast;
- product returns or the cancellation or rescheduling of orders;
- announcements and new product introductions by our competitors;
- our ability to develop and support relationships with enterprise customers, service providers and other potential large customers;
- our ability to achieve and maintain targeted cost reductions;
- fluctuations in warranty or other service expenses actually incurred;
- our ability to obtain sufficient supplies of sole- or limited-source components for our products on a timely basis;
- increases in the price of the components we purchase; and
- changes in funding for customer technology purchases in our markets.

Due to the foregoing and other factors, many of which are described herein, period-to-period comparisons of our operating results should not be relied upon as an indicator of our future performance.

The global economic environment has and may continue to negatively impact our business and operating results.

The challenges and uncertainty currently affecting global economic conditions may negatively impact our business and operating results in the following ways:

- customers may delay or cancel plans to purchase our products and services;
- customers may not be able to pay, or may delay payment of, the amounts they owe us, which may adversely affect our cash flow, the timing of our revenue recognition and the amount of our revenue;
- increased pricing pressure may result from our competitors aggressively discounting their products;
- accurate budgeting and planning will be difficult due to low visibility into future sales;
- forecasting customer demand will be more difficult, increasing the risk of either excess and obsolete inventory if our forecast is too high or insufficient inventory to meet customer demand if our forecast is too low; and
- our component suppliers and contract manufacturers have been negatively affected by the economy, which may result in product delays and changes in pricing and service levels.

If global economic conditions do not show continued improvement, we believe we could experience material adverse impacts to our business and operating results.

Our dependence on a few manufacturers for our manufacturing requirements could harm our operating results.

We primarily rely on our manufacturing partners: Alpha Networks; Senao Networks; Foxconn; Delta Networks and Wistron NeWeb Corporation and select other partners to manufacture our products. We have experienced delays in product shipments from some of our manufacturing partners in the past, which in turn delayed product shipments to our customers. These or similar problems may arise in the future, such as delivery of products of inferior quality, delivery of insufficient quantity of products, or the interruption or discontinuance of operations of a manufacturer, any of which could have a material adverse effect on our business and operating results. In addition, any natural disaster or business interruption to our manufacturing partners could significantly disrupt our business. While we maintain strong relationships with our manufacturing partners, our agreements with these manufacturers are generally of limited duration and pricing, quality and volume commitments are negotiated on a recurring basis. The failure to maintain continuing agreements with our manufacturing partners could adversely affect our business. We intend to introduce new products and product enhancements, which will require that we rapidly achieve volume production by coordinating our efforts with those of our suppliers and contract manufacturers.

As part of our cost-reduction efforts, we will need to realize lower per unit product costs from our manufacturing partners by means of volume efficiencies and the utilization of manufacturing sites in lower-cost geographies. However, we cannot be certain when or if such price reductions will occur. The failure to obtain such price reductions would adversely affect our operating results.

In addition, a portion of our manufacturing is performed in China and is therefore subject to risks associated with doing business outside of the United States, including the possibility of additional import tariffs. The United States government has recently announced import tariffs on goods manufactured in China. These tariffs, depending upon their ultimate scope, duration and how they are implemented, could negatively impact our business by continuing to increase our costs and by making our products less competitive. We may not be able to pass such increased costs on to our customers. In addition, any relocation of contract manufacturing facilities to locations outside of China may increase our costs and could impact the global competitiveness of our products.

We depend upon international sales for a significant portion of our revenue which imposes a number of risks on our business.

International sales constitute a significant portion of our net revenue. Our ability to grow will depend in part on the expansion of international sales. Our international sales primarily depend on the success of our resellers and distributors. The failure of these resellers and distributors to sell our products internationally would limit our ability to sustain and grow our revenue. There are a number of risks arising from our international business, including:

- longer accounts receivable collection cycles;
- difficulties in managing operations across disparate geographic areas;
- difficulties associated with enforcing agreements through foreign legal systems;
- reduced or limited protection of intellectual property rights, particularly in jurisdictions that have less developed intellectual property regimes, such as China and India;
- higher credit risks requiring cash in advance or letters of credit;

- potential adverse tax consequences;
- compliance with regulatory requirements of foreign countries, including compliance with rapidly evolving environmental regulations;
- compliance with U.S. laws and regulations pertaining to the sale and distribution of products to customers in foreign countries, including export controls and the Foreign Corrupt Practices Act;
- the payment of operating expenses in local currencies, which exposes us to risks of currency fluctuations:
- political and economic turbulence or uncertainty, such as the United Kingdom's 2016 referendum, commonly referred to as "Brexit" that has created economic and political uncertainty in the European Union;
- terrorism, war or other armed conflict;
- compliance with U.S. and other applicable government regulations prohibiting certain end-uses and restrictions on trade with embargoed or sanctioned countries, such as Russia, and with denied parties;
- potential import tariffs imposed by the United States and the possibility of reciprocal tariffs by foreign countries;
- difficulty in conducting due diligence with respect to business partners in certain international markets;
- increased complexity of accounting rules and financial reporting requirements;
- fluctuations in local economies; and
- natural disasters and epidemics.

Any or all of these factors could have a material adverse impact on our business, financial condition, and results of operations.

Substantially all of our international sales are United States dollar-denominated. The continued strength and future increases in the value of the United States dollar relative to foreign currencies could make our products less competitive in international markets. In the future, we may elect to invoice some of our international customers in local currency, which would expose us to fluctuations in exchange rates between the United States dollar and the particular local currency. If we do so, we may decide to engage in hedging transactions to minimize the risk of such fluctuations.

We have entered into foreign exchange forward contracts to offset the impact of payment of operating expenses in local currencies to some of our operating foreign subsidiaries. However, if we are not successful in managing these foreign currency transactions, we could incur losses from these activities.

Local laws and customs in many countries differ significantly from, or conflict with, those in the United States or in other countries in which we operate. In many foreign countries, it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. regulations applicable to us. Although we have implemented policies, procedures and training designed to ensure compliance with these U.S. and foreign laws and policies, there can be no complete assurance that any individual employee, contractor, channel partner, or agents will not violate our policies and procedures. Violations of laws or key control policies by our employees, contractors, channel partners, or agents could result in termination of our relationship, financial reporting problems, fines, and/or penalties for us, or prohibition on the importation or exportation of our products, and could have a material adverse effect on our business, financial condition and results of operations.

Although we recently increased prices, over time we expect the average selling price of our products to decrease, which is likely to reduce gross margin and/or revenue.

The network equipment industry has traditionally experienced an erosion of average selling prices due to a number of factors, including competitive pricing pressures, promotional pricing and technological progress. Although we have recently increased prices, over time we anticipate the average selling prices of our products will decrease in the future in response to competitive pricing pressures, excess inventories, increased sales discounts and new product introductions by us or our competitors. We may experience decreases in future operating results due to the erosion of our average selling prices. To maintain our gross margin, we must develop and introduce on a timely basis new

products and product enhancements and continually reduce our product costs. Our failure to do so would likely cause our revenue and gross margin to decline.

We purchase several key components for products from single or limited sources and could lose sales if these suppliers fail to meet our needs.

We currently purchase several key components used in the manufacturing of our products from single or limited sources and are dependent upon supply from these sources to meet our needs. Certain components such as tantalum capacitors, SRAM, DRAM, and printed circuit boards, have been in the past, and may in the future be, in short supply. We have encountered, and are likely in the future to encounter, shortages and delays in obtaining these or other components, and this could have a material adverse effect on our ability to meet customer orders. Our principal sole-source components include:

- ASICs - merchant silicon, Ethernet switching, custom and physical interface;
- microprocessors;
- programmable integrated circuits;
- selected other integrated circuits;
- custom power supplies; and
- custom-tooled sheet metal.

Our principal limited-source components include:

- flash memory;
- DRAMs and SRAMs;
- printed circuit boards;
- CAMs;
- connectors; and
- timing circuits (crystals & clocks).

We use our forecast of expected demand to determine our material requirements. Lead times for materials and components we order vary significantly, and depend on factors such as the specific supplier, contract terms and demand for a component at a given time. If forecasts exceed orders, we may have excess and/or obsolete inventory, which could have a material adverse effect on our operating results and financial condition. If orders exceed forecasts, we may have inadequate supplies of certain materials and components, which could have a material adverse effect on our ability to meet customer delivery requirements and to recognize revenue.

Our top ten suppliers accounted for a significant portion of our purchases during the quarter. Given the significant concentration of our supply chain, particularly with certain sole or limited source providers, any significant interruption by any of the key suppliers or a termination of a relationship could temporarily disrupt our operations. Additionally, our operations are materially dependent upon the continued market acceptance and quality of these manufacturers' products and their ability to continue to manufacture products that are competitive and that comply with laws relating to environmental and efficiency standards. Our inability to obtain products from one or more of these suppliers or a decline in market acceptance of these suppliers' products could have a material adverse effect on our business, results of operations and financial condition. Other than pursuant to an agreement with a key component supplier which includes pricing based on a minimum volume commitment, generally we do not have agreements fixing long-term prices or minimum volume requirements from suppliers. From time to time we have experienced shortages and allocations of certain components, resulting in delays in filling orders. Qualifying new suppliers to compensate for such shortages may be time-consuming and costly and may increase the likelihood of errors in design or production. In addition, during the development of our products, we have experienced delays in the prototyping of our chipsets, which in turn has led to delays in product introductions. Similar delays may occur in the future. Furthermore, the performance of the components from our suppliers as incorporated in our products may not meet the quality requirements of our customers.

To successfully manage our business or achieve our goals, we must attract, retain, train, motivate, develop and promote key employees, and failure to do so can harm us.

Our success depends to a significant degree upon the continued contributions of our key management, engineering, sales and marketing, service and operations personnel, many of whom would be difficult to replace. We do not have employment contracts with these individuals that mandate that they render services for any specific term, nor do we carry life insurance on any of our key personnel. We have experienced and may in the future experience significant turnover in our executive personnel. Changes in our management and key employees could affect our financial results, and a recent reduction in force, may impede our ability to attract and retain highly skilled personnel. We believe our future success will also depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing, service, finance and operations personnel. The market for these personnel is competitive particularly in certain locations such as in San Jose, California, and we have had difficulty in hiring employees, particularly engineers, in the time-frame we desire.

A number of our employees are foreign nationals who rely on visas and entry permits in order to legally work in the United States and other countries. In recent years, the United States has increased the level of scrutiny in granting H-1(B), L-1 and other business visas. In addition, the current U.S. administration has indicated that immigration reform is a priority. Compliance with United States immigration and labor laws could require us to incur additional unexpected labor costs and expenses or could restrain our ability to retain skilled professionals. Any of these restrictions could have a material adverse effect on our business, results of operations and financial conditions.

Our stock price has been volatile in the past and may significantly fluctuate in the future.

In the past, our common stock price has fluctuated significantly. This could continue as we or our competitors announce new products, our results or those of our customers or competition fluctuate, conditions in the networking or semiconductor industry change, or when investors, change their sentiment toward stocks in the networking technology sector.

In addition, fluctuations in our stock price and our price-to-earnings multiple may make our stock attractive to momentum, hedge or day-trading investors who often shift funds into and out of stock rapidly, exacerbating price fluctuations in either direction, particularly when viewed on a quarterly basis. These fluctuations may adversely affect the trading price or liquidity of our common stock. Some companies, including us, that have had volatile market prices for their securities have had securities class action lawsuits filed against them. If a suit were filed against us, regardless of its merits or outcome, it could result in substantial costs and divert management’s attention and resources.

Intense competition in the market for networking equipment and Cloud platform companies could prevent us from increasing revenue and attaining profitability.

The market for network switching solutions is intensely competitive and dominated primarily by Cisco Systems Inc., Dell, Inc. Hewlett-Packard Enterprise Company, Huawei Technologies Co. Ltd., Arista Networks, Inc., Arris Corporation and Juniper Networks, Inc. Most of our competitors have longer operating histories, greater name recognition, larger customer bases, broader product lines and substantially greater financial, technical, sales, marketing and other resources. As a result, these competitors are able to devote greater resources to the development, promotion, sale and support of their products. In addition, they have larger distribution channels, stronger brand names, access to more customers, a larger installed customer base and a greater ability to make attractive offers to channel partners and customers than we do. Some of our customers may question whether we have the financial resources to complete their projects and future service commitments.

We may also face increased competition from both traditional networking solutions companies and Cloud platform companies offering IaaS and PaaS products to enterprise customers. In particular, AWS, Microsoft Azure and the Google Cloud Platform may provide enterprise customers with a cloud-based platform of data center compute and networking services.

For example, we have encountered, and expect to continue to encounter in the future, many potential customers who are confident in and committed to the product offerings of our principal competitors. Accordingly, these potential customers may not consider or evaluate our products. When such potential customers have considered or evaluated our products, we have in the past lost, and expect in the future to lose, sales to some of these customers as large competitors have offered significant price discounts to secure these sales.

The pricing policies of our competitors impact the overall demand for our products and services. Some of our competitors are capable of operating at significant losses for extended periods of time, increasing pricing pressure on our products and services. If we do not maintain competitive pricing, the demand for our products and services, as well as our market share, may decline. From time to time, we may lower the prices of our products and services in response to competitive pressure. When this happens, if we are unable to reduce our component costs or improve operating efficiencies, our revenue and gross margins will be adversely affected.

We may not fully realize the anticipated positive impacts to future financial results from our restructuring efforts.

We have undertaken restructuring efforts in the past to streamline operations and reduce operating expenses. Our ability to achieve the anticipated cost savings and other benefits from our restructuring efforts within expected time frames is subject to many estimates and assumptions and may vary materially based on factors such as market conditions and the effect of our restructuring efforts on our work force. These estimates and assumptions are subject to significant economic, competitive and other uncertainties, some of which are beyond our control. We cannot assure that we will fully realize the anticipated positive impacts to future financial results from our current or future restructuring efforts. If our estimates and assumptions are incorrect or if other unforeseen events occur, we may not achieve the cost savings expected from such restructurings, and our business and results of operations could be adversely affected.

Industry consolidation may lead to stronger competition and may harm our operating results.

There has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions in an evolving industry and as companies are acquired or are unable to continue operations. For example, some of our current and potential competitors for enterprise data center business have made acquisitions or announced new strategic alliances, designed to position them with the ability to provide end-to-end technology solutions for the enterprise data center. Companies that are strategic alliance partners in some areas of our business may acquire or form alliances with our competitors, thereby reducing their business with us. We believe industry consolidation may result in stronger competitors that are better able to compete as sole-source vendors for customers. This could lead to more variability in our operating results and could have a material adverse effect on our business, operating results, and financial condition. Furthermore, particularly in the service provider market, rapid consolidation will lead to fewer customers, with the effect that loss of a major customer could have a material impact on results not anticipated in a customer marketplace composed of more numerous participants.

We intend to invest in engineering, sales, services, marketing and manufacturing on a long-term basis, and delays or inability to attain the expected benefits may result in unfavorable operating results.

While we intend to focus on managing our costs and expenses, over the long term, we also intend to invest in personnel and other resources related to our engineering, sales, services, marketing and manufacturing functions as we focus on our foundational priorities, such as leadership in our core products and solutions and architectures for business transformation. We are likely to recognize the costs associated with these investments earlier than some of the anticipated benefits and the return on these investments may be lower, or may develop more slowly, than we expect. If we do not achieve the benefits anticipated from these investments, or if the achievement of these benefits is delayed, our operating results may be adversely affected.

Our success is dependent on our ability to continually introduce new products and features that achieve broad market acceptance.

The network equipment market is characterized by rapid technological progress, frequent new product introductions, changes in customer requirements and evolving industry standards. If we do not regularly introduce new products in this dynamic environment, our product lines will become obsolete. These new products must be compatible and inter-operate with products and architectures offered by other vendors. We have and may in the future experience delays in product development and releases, and such delays have and could in the future adversely affect our ability to compete and our operating results.

When we announce new products or product enhancements that have the potential to replace or shorten the life cycle of our existing products, customers may defer or cancel orders for our existing products; in addition, ending sales of existing products may cause customers to cancel or defer orders for our existing products. These actions could have a material adverse effect on our operating results by unexpectedly decreasing sales, increasing inventory levels of older products and exposing us to greater risk of product obsolescence.

Even if we introduce new switching products, alternative technologies could achieve widespread market acceptance and displace the Ethernet technology on which we have based our product architecture. For example, developments in routers and routing software could significantly reduce demand for our products. As a result, we may not be able to achieve widespread market acceptance of our current or future products.

If we do not successfully anticipate technological shifts, market needs and opportunities, and develop products, product enhancements and business strategies that meet those technological shifts, needs and opportunities, or if those products are not made available or strategies are not executed in a timely manner or do not gain market acceptance, we may not be able to compete effectively and our ability to generate revenues will suffer.

The markets for our products are constantly evolving and characterized by rapid technological change, frequent product introductions, changes in customer requirements, and continuous pricing pressures. We cannot guarantee that we will be able to anticipate future technological shifts, market needs and opportunities or be able to develop new products, product enhancements and business strategies to meet such technological shifts, needs or opportunities in a timely manner or at all. For example, the move from traditional network infrastructures towards SDN has been receiving considerable attention. In our view, it will take several years to see the full impact of SDN, and we believe the successful products and solutions in this market will combine hardware and software elements together. If we fail to anticipate market requirements or opportunities or fail to develop and introduce new products, product enhancements or business strategies to meet those requirements or opportunities in a timely manner, it could cause us to lose customers, and such failure could substantially decrease or delay market acceptance and sales of our present and future products and services, which would significantly harm our business, financial condition, and results of operations. Even if we are able to anticipate, develop and commercially introduce new products and enhancements, we cannot assure that new products or enhancements will achieve widespread market acceptance.

Our employees may engage in misconduct or other improper activities, including noncompliance with regulatory standards and requirements, which could have a material adverse effect on our business.

We are exposed to the risk of employee fraud or other misconduct. Misconduct by employees could include intentional failures to:

- comply with securities laws and regulations or similar regulations of comparable foreign regulatory authorities;
- comply with export controls and sanctions laws and regulations or similar regulations of comparable foreign regulatory authorities;
- comply with anti-corruption laws and regulations or similar regulations of comparable foreign regulatory authorities;
- comply with internal controls that we have established;
- report financial information or data accurately; or
- disclose unauthorized activities to us.

The precautions we take to detect and prevent misconduct may not be effective in controlling unknown or unmanaged risks or losses or in protecting us from governmental investigations or other actions or lawsuits stemming from a failure to be in compliance with such laws or regulations. If any such actions are instituted against us, and we are not successful in defending ourselves or asserting our rights, those actions could have a significant impact on our business and results of operations, including the imposition of significant fines or other sanctions.

The cloud networking market is still in its early stages and is rapidly evolving. If this market does not evolve as we anticipate or our target end customers do not adopt our cloud networking solutions, we may not be able to compete effectively, and our ability to generate revenue will suffer.

The cloud networking market is still in its early stages. The market demand for cloud networking solutions has increased in recent years as end customers have deployed larger networks and have increased the use of virtualization and cloud computing. Our success may be impacted by our ability to provide successful cloud networking solutions that address the needs of our channel partners and end customers more effectively and economically than those of other competitors or existing technologies. If the cloud networking solutions market does not develop in the way we anticipate, if our solutions do not offer significant benefits compared to competing legacy network switching products or if end customers do not recognize the benefits that our solutions provide, then our potential for growth in this cloud

market could be adversely affected.

Claims of infringement by others may increase and the resolution of such claims may adversely affect our operating results.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patents, copyrights (including rights to "open source" software) and other intellectual property rights. As we have grown it has, and may continue to, experience greater revenues and increased public visibility, which may cause competitors, customers, and governmental authorities to be more likely to initiate litigation against us. Because of the existence of a large number of patents in the networking field, the secrecy of some pending patents and the issuance of new patents at a rapid pace, it is not possible to determine in advance if a product or component might infringe the patent rights of others. Because of the potential for courts awarding substantial damages, the lack of predictability of such awards and the high legal costs associated with the defense of such patent infringement matters that would be expended to prove lack of infringement, it is not uncommon for companies in our industry to settle even potentially unmeritorious claims for very substantial amounts. Furthermore, the entities with whom we have or could have disputes or discussions include entities with extensive patent portfolios and substantial financial assets. These entities are actively engaged in programs to generate substantial revenue from their patent portfolios and are seeking or may seek significant payments or royalties from us and others in our industry.

Litigation resulting from claims that we are infringing the proprietary rights of others has resulted and could in the future result in substantial costs and a diversion of resources, and could have a material adverse effect on our business, financial condition and results of operations. We previously received notices from entities alleging that we were infringing their patents and have been party to patent litigation in the past.

Without regard to the merits of these or any other claims, an adverse court order or a settlement could require us, among other actions, to:

- stop selling our products that incorporate the challenged intellectual property;
- obtain a royalty bearing license to sell or use the relevant technology, and that license may not be available on reasonable terms or available at all;
- pay damages;
- redesign those products that use the disputed technology; or
- face a ban on importation of our products into the United States.

In addition, our products include so-called "open source" software. Open source software is typically licensed for use at no initial charge, but imposes on the user of the open source software certain requirements to license to others both the open source software as well as modifications to the open source software under certain circumstances. Our use of open source software subjects us to certain additional risks for the following reasons:

- open source license terms may be ambiguous and may result in unanticipated obligations regarding the licensing of our products and intellectual property;
- open source software cannot be protected under trade secret law;
- suppliers of open-source software do not provide the warranty, support and liability protections typically provided by vendors who offer proprietary software; and
- it may be difficult for us to accurately determine the developers of the open source code and whether the acquired software infringes third-party intellectual property rights.

We believe even if we do not infringe the rights of others, we will incur significant expenses in the future due to defense of legal claims, disputes or licensing negotiations, though the amounts cannot be determined. These expenses may be material or otherwise adversely affect our operating results.

Our credit facilities impose financial and operating restrictions on us.

Our debt instruments, including our Credit Agreement, impose, and the terms of any future debt may impose, operating and other restrictions on us. These restrictions could affect, and in many respects limit or prohibit, among other items, our ability to:

- incur additional indebtedness;
- create liens;
- make investments;

- enter into transactions with affiliates;
- sell assets;
- guarantee indebtedness;
- declare or pay dividends or other distributions to stockholders;
- repurchase equity interests;
- change the nature of our business;
- enter into swap agreements;
- issue or sell capital stock of certain of our subsidiaries; and
- consolidate, merge, or transfer all or substantially all of our assets and the assets of our subsidiaries on a consolidated basis.

The agreements governing our Credit Agreement also require us to achieve and maintain compliance with specified financial ratios. A breach of any of these restrictive covenants or the inability to comply with the required financial ratios could result in a default under our debt instruments. If any such default occurs, the lenders under our Credit Agreement may elect to declare all outstanding borrowings, together with accrued interest and other fees, to be immediately due and payable. The lenders under our credit agreement also have the right in these circumstances to terminate any commitments they have to provide further borrowings.

If we fail to meet our payment or other obligations under our Credit Agreement the lenders under such Credit Agreement, as amended, could foreclose on, and acquire control of, substantially all of our assets.

Our Credit Agreement is jointly and severally guaranteed by us and certain of our subsidiaries. Borrowings under our Credit Agreement are secured by liens on substantially all of our assets, including the capital stock of certain of our subsidiaries, and the assets of our subsidiaries that are loan party guarantors. If we are unable to repay outstanding borrowings when due, the lenders under our Credit Agreement will have the right to proceed against this pledged capital stock and take control of substantially all of our assets.

Our operating results may be negatively affected by legal proceedings.

We have in the past, currently are and will likely in the future pursue or be subject to claims or lawsuits in the normal course of our business. In addition to the risks related to the intellectual property lawsuits described above, we are currently parties to other litigation as described in Note 9 to our Notes to Consolidated Financial Statements included elsewhere in this Annual Report. Regardless of the result, litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a lawsuit in which we are a defendant could result in a court order against us or payments to other parties that would have an adverse effect on our business, results of operations or financial condition. Even if we are successful in prosecuting claims and lawsuits, we may not recover damages sufficient to cover our expenses incurred to manage, investigate and pursue the litigation. In addition, subject to certain limitations, we may be obligated to indemnify our current and former customers, suppliers, directors, officers and employees in certain lawsuits. We may not have adequate insurance coverage to cover all of our litigation costs and liabilities.

Failure to protect our intellectual property could affect our business.

We rely on a combination of patent, copyright, trademark and trade secret laws and restrictions on disclosure to protect our intellectual property rights. However, we cannot ensure that the actions we have taken will adequately protect our intellectual property rights or that other parties will not independently develop similar or competing products that do not infringe on our patents. We generally enter into confidentiality, invention assignment or license agreements with our employees, consultants and other third parties with whom we do business, and control access to and distribution of our intellectual property and other proprietary information. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy or otherwise misappropriate or use our products or

technology, which would adversely affect our business.

When our products contain undetected errors, we may incur significant unexpected expenses and could lose sales.

Network products frequently contain undetected errors when new products or new versions or updates of existing products are released to the marketplace. In the past, we have experienced such errors in connection with new products and product updates. We have experienced component problems in prior years that caused us to incur higher than expected warranty, service costs and expenses, and other related operating expenses. In the future, we expect that, from time to time, such errors or component failures will be found in new or existing products after the commencement of commercial shipments. These problems may have a material adverse effect on our business by causing us to incur significant warranty, repair and replacement costs, diverting the attention of our engineering personnel from new product development efforts, delaying the recognition of revenue and causing significant customer relations problems. Further, if products are not accepted by customers due to such defects, and such returns exceed the amount we accrued for defective returns based on our historical experience, our operating results would be adversely affected.

Our products must successfully inter-operate with products from other vendors. As a result, when problems occur in a network, it may be difficult to identify the sources of these problems. The occurrence of system errors, whether or not caused by our products, could result in the delay or loss of market acceptance of our products and any necessary revisions may cause us to incur significant expenses. The occurrence of any such problems would likely have a material adverse effect on our business, operating results and financial condition.

We must continue to develop and increase the productivity of our indirect distribution channels to increase net revenue and improve our operating results.

Our distribution strategy focuses primarily on developing and increasing the productivity of our indirect distribution channels. If we fail to develop and cultivate relationships with significant channel partners, or if these channel partners are not successful in their sales efforts, sales of our products may decrease and our operating results could suffer. Many of our channel partners also sell products from other vendors that compete with our products. Our channel partners may not continue to market or sell our products effectively or to devote the resources necessary to provide us with effective sales, marketing and technical support. We may not be able to successfully manage our sales channels or enter into additional reseller and/or distribution agreements. Our failure to do any of these could limit our ability to grow or sustain revenue.

Our operating results for any given period have and will continue to depend to a significant extent on large orders from a relatively small number of channel partners and other customers. However, we do not have binding purchase commitments from any of them. A substantial reduction or delay in sales of our products to a significant reseller, distributor or other customer could harm our business, operating results and financial condition because our expense levels are based on our expectations as to future revenue and to a large extent are fixed in the short term. Under specified conditions, some third-party distributors are allowed to return products to us and unexpected returns could adversely affect our results.

The sales cycle for our products is long and we may incur substantial non-recoverable expenses or devote significant resources to sales that do not occur when anticipated.

The purchase of our products represent a significant strategic decision by a customer regarding its communications infrastructure. The decision by customers to purchase our products is often based on the results of a variety of internal procedures associated with the evaluation, testing, implementation and acceptance of new technologies. Accordingly, the product evaluation process frequently results in a lengthy sales cycle, typically ranging from three months to longer than a year, and as a result, our ability to sell products is subject to a number of significant risks, including risks that:

- budgetary constraints and internal acceptance reviews by customers will result in the loss of potential sales;
- there may be substantial variation in the length of the sales cycle from customer to customer, making decisions on the expenditure of resources difficult to assess;
- we may incur substantial sales and marketing expenses and expend significant management time in an attempt to initiate or increase the sale of products to customers, but not succeed;
- if a sales forecast from a specific customer for a particular quarter is not achieved in that quarter, we may be unable to compensate for the shortfall, which could harm our operating results; and
- downward pricing pressures could occur during the lengthy sales cycle for our products.

Failure to successfully expand our sales and support teams or educate them in regard to technologies and our product families may harm our operating results.

The sale of our products and services requires a concerted effort that is frequently targeted at several levels within a prospective customer's organization. We may not be able to increase net revenue unless we expand our sales and support teams in order to address all of the customer requirements necessary to sell our products.

We cannot assure that we will be able to successfully integrate employees into our Company or to educate and train current and future employees in regard to rapidly evolving technologies and our product families. A failure to do so may hurt our revenue growth and operating results.

Failure of our products to comply with evolving industry standards and complex government regulations may adversely impact our business.

If we do not comply with existing or evolving industry standards and government regulations, we may not be able to sell our products where these standards or regulations apply. The network equipment industry in which we compete is characterized by rapid changes in technology and customers' requirements and evolving industry standards. As a result, our success depends on:

- the timely adoption and market acceptance of industry standards, and timely resolution of conflicting U.S. and international industry standards; and
- our ability to influence the development of emerging industry standards and to introduce new and enhanced products that are compatible with such standards.

In the past, we have introduced new products that were not compatible with certain technological standards, and in the future, we may not be able to effectively address the compatibility and interoperability issues that arise as a result of technological changes and evolving industry standards.

Our products must also comply with various U.S. federal government regulations and standards defined by agencies such as the Federal Communications Commission, standards established by governmental authorities in various foreign countries and recommendations of the International Telecommunication Union. In some circumstances, we must obtain regulatory approvals or certificates of compliance before we can offer or distribute our products in certain jurisdictions or to certain customers. Complying with new regulations or obtaining certifications can be costly and disruptive to our business.

If we do not comply with existing or evolving industry standards or government regulations, we will not be able to sell our products where these standards or regulations apply, which may prevent us from sustaining our net revenue or achieving profitability.

If we do not adequately manage and evolve our financial reporting and managerial systems and processes, our ability to manage and grow our business may be harmed.

Our ability to successfully implement our business plan and comply with regulations requires an effective planning and management process. We need to continue improving our existing, and implement new, operational and financial systems, procedures and controls. We need to ensure that any businesses acquired, including the WLAN Business, the Campus Fabric Business, and the Data Center Business are appropriately integrated in our financial systems. Any delay in the implementation of, or disruption in the integration of acquired businesses, or delay and disruption in the transition to, new or enhanced systems, procedures or controls, could harm our ability to record and report financial and management information on a timely and accurate basis, or to forecast future results.

Recent U.S. tax legislation may materially adversely affect our financial condition, results of operations and cash flows.

Recently enacted U.S. tax legislation has significantly changed the U.S. federal income taxation of U.S. corporations, including by reducing the U.S. corporate income tax rate, limiting interest deductions, permitting immediate expensing of certain capital expenditures, adopting elements of a territorial tax system, imposing a one-time transition tax (or "repatriation tax") on all undistributed earnings and profits of certain U.S.-owned foreign corporations, revising the rules governing net operating losses and the rules governing foreign tax credits, and introducing new anti-base erosion provisions. Many of these changes are effective immediately, without any transition periods or grandfathering for existing transactions. The legislation is unclear in many respects and could be subject to potential amendments and technical corrections, as well as interpretations and implementing regulations by the Treasury and Internal Revenue Service ("IRS"), any of which could lessen or increase certain adverse impacts of the legislation. In addition, it is unclear how these U.S. federal income tax changes will affect state and local taxation, which often uses federal taxable income as a starting point for computing state and local tax liabilities.

Our analysis and interpretation of this legislation is largely complete and based on our current evaluation, we do not expect the reduction of the U.S. corporate income tax rate will have a materially adverse impact to our earnings given our U.S. valuation allowance. We also do not currently believe the one-time transition tax will have a materially adverse impact given our ability to utilize existing tax attributes. An estimate of the impact was recorded in the second quarter of the fiscal year ended June 30, 2018, the period in which the tax legislation was enacted, however, these amounts may be subject to potential further adjustment in our second quarter of the fiscal year ended June 30, 2019 in accordance with interpretive guidance issued by the SEC as well as future regulatory guidance. We believe the limitation on interest deductions, the expanded limitation on executive compensation deductions and the anti-base erosion provisions in the legislation may negatively impact our cash flows going forward. There may be other material adverse effects resulting from the legislation that we have not yet identified.

Changes in the effective tax rate including from the release of the valuation allowance recorded against our net U.S. deferred tax assets, or adverse outcomes resulting from examination of our income or other tax returns or change in ownership, could adversely affect our results.

Our future effective tax rates may be volatile or adversely affected by changes in our business or U.S. or foreign tax laws, including: the partial or full release of the valuation allowance recorded against our net U.S. deferred tax assets; expiration of or lapses in the research and development tax credit laws; transfer pricing adjustments; tax effects of stock-based compensation; or costs related to restructuring. In addition, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities. Although we regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes, there is no assurance that such determinations by us are in fact adequate. Changes in our effective tax rates or amounts assessed upon examination of our tax returns may have a material, adverse impact on our cash flows and our financial condition.

Our future effective tax rate in particular could be adversely affected by a change in ownership pursuant to U.S. Internal Revenue Code Section 382. If a change in ownership occurs, it may limit our ability to utilize our net operating losses to offset our U.S. taxable income. If U.S. taxable income is greater than the change in ownership limitation, we will pay a higher rate of tax with respect to the amount of taxable income that exceeds the limitation. This could have a material adverse impact on our results of operations. On April 26, 2012, we adopted an Amended and Restated Rights Agreement to help protect our assets (the “Rights Agreement”). In general, this does not allow a stockholder to acquire more than 4.95% of our outstanding common stock without a waiver from our board of directors, who must take into account the relevant tax analysis relating to potential limitation of our net operating losses. Our Rights Agreement is effective through May 31, 2019, subject to ratification by a majority of our stockholders at the next annual shareholders meeting, expected to be held on November 8, 2018.

Provisions in our charter documents and Delaware law and our adoption of a stockholder rights plan may delay or prevent an acquisition of Extreme, which could decrease the value of our Common Stock.

Our certificate of incorporation and bylaws and Delaware law contain provisions that could make it more difficult for a third party to acquire us without the consent of our Board of Directors. Delaware law also imposes some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock. In addition, our Board of Directors has the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer. Although we believe these provisions of our certificate of incorporation and bylaws and Delaware law will provide for an opportunity to receive a higher bid by requiring potential acquirers to negotiate with our Board of Directors, these provisions apply even if the offer may be considered beneficial by some of our stockholders.

Our Rights Agreement provides that if a single stockholder (or group) acquires more than 4.95% of our outstanding common stock without a waiver from our Board of Directors, each holder of one share of our common stock (other than the stockholder or group who acquired in excess of 4.95% of our common stock) may purchase a fractional share of our preferred stock that would result in substantial dilution to the triggering stockholder or group. Accordingly, although this plan is designed to prevent any limitation on the utilization of our net operating losses by avoiding issues raised under Section 382 of the U.S. Internal Revenue Code, the Rights Agreement could also serve as a deterrent to stockholders wishing to effect a change of control.

Compliance with laws, rules and regulations relating to corporate governance and public disclosure may result in additional expenses.

Federal securities laws, rules and regulations, as well as NASDAQ Stock Market rules and regulations, require companies to maintain extensive corporate governance measures, impose comprehensive reporting and disclosure requirements, set strict independence and financial expertise standards for audit and other committee members and impose civil and criminal penalties for companies and their Chief Executive Officers, Chief Financial Officers and directors for securities law violations. These laws, rules and regulations and the interpretation of these requirements are evolving, and we are making investments to evaluate current practices and to continue to achieve compliance, which investments may have a material impact on our financial condition.

We are required to evaluate the effectiveness of our internal control over financial reporting on an annual basis and publicly disclose any material weaknesses in our controls. Any adverse results from such evaluation could result in a loss of investor confidence in our financial reports and significant expense to remediate, and ultimately could have an adverse effect on our stock price.

Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to assess the effectiveness of our internal control over financial reporting and to disclose if such controls were unable to provide assurance that a material error would be prevented or detected in a timely manner. We have an ongoing program to review the design of our internal controls framework in keeping with changes in business needs, implement necessary changes to our controls design and test the system and process controls necessary to comply with these requirements. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our Company will have been detected.

If we or our independent registered public accounting firm identifies material weaknesses in our internal controls, the disclosure of that fact, even if quickly remedied, may cause investors to lose confidence in our financial statements and its stock price may decline. Remediation of a material weakness could require us to incur significant expenses and, if we fail to remedy any material weakness, our ability to report our financial results on a timely and accurate basis may be adversely affected, our access to the capital markets may be restricted, our stock price may decline, and we may be subject to sanctions or investigation by regulatory authorities, including the U.S. Securities and Exchange Commission or the NASDAQ Stock Market LLC. We may also be required to restate our financial statements from prior periods. Execution of restatements create a significant strain on our internal resources and could cause delays in our filing of quarterly or annual financial results, increase our costs and cause management distraction. Restatements may also significantly affect our stock price in an adverse manner.

We rely on the availability of third-party licenses.

Some of our products are designed to include software or other intellectual property, including open source software, licensed from third parties. It may be necessary in the future to seek or renew licenses relating to various aspects of these products. There can be no assurance that the necessary licenses would be available on acceptable terms, if at all. The inability to obtain certain licenses or other rights or to obtain such licenses or rights on favorable terms, could have a material adverse effect on our business, operating results, and financial condition. Moreover, the inclusion in our products of software or other intellectual property licensed from third parties on a nonexclusive basis could limit our ability to protect our proprietary rights in our products. Further, the failure to comply with the terms of any license, including free open source software, may result in our inability to continue to use such license. Our inability to maintain or re-license any third-party licenses required in our products or our inability to obtain third-party licenses necessary to develop new products and product enhancements, could require us, if possible, to develop substitute technology or obtain substitute technology of lower quality or performance standards or at a greater cost, any of which could delay or prevent product shipment and harm our business, financial condition, and results of operations.

System security risks, data protection breaches, and cyber-attacks could compromise our proprietary information, disrupt our internal operations and harm public perception of our products, which could adversely affect our business.

In the ordinary course of business, we store sensitive data, including intellectual property, our proprietary business information and that of our customers, suppliers and business partners on our networks. In addition, we store sensitive or classified information through cloud-based services that may be hosted by third parties and in data center infrastructure maintained by third parties. The secure maintenance of this information is critical to our operations and business strategy. Increasingly, companies, including us, are subject to a wide variety of attacks on their networks on an ongoing basis. Despite our security measures, our information technology and infrastructure may be vulnerable to

penetration or attacks by computer programmers and hackers, or breached due to employee error, malfeasance or other disruptions. In addition, as a provider of products and services to the government, our products and services may be the targets of cyber attacks that attempted to sabotage or otherwise disable them, or our cybersecurity and other products and services ultimately may not be able to effectively detect, prevent, or protect against or otherwise mitigate losses from all cyber attacks. Any such breach could compromise our networks, creating system disruptions or slowdowns and exploiting security vulnerabilities of our products, and the information stored on our networks could be accessed, publicly disclosed, lost or stolen, which could subject us to liability to our customers, suppliers, business partners and others, could require significant management attention and resources, could result in the loss of business, regulatory actions and potential liability, and could cause us reputational and financial harm. In addition, sophisticated hardware and operating system software and applications that we produce or procure from third parties may contain defects in design or manufacture, including "bugs" and other problems that could unexpectedly interfere with the operation of our networks. This can be true even for “legacy” products that have been determined to have reached an end of life engineering status but will continue to operate for a limited amount of time.

If an actual or perceived breach of network security occurs in our network or in the network of a customer of our networking products, regardless of whether the breach is attributable to our products, the market perception of the effectiveness of our products could be harmed. In addition, the economic costs to us to eliminate or alleviate cyber or other security problems, bugs, viruses, worms, malicious software systems and security vulnerabilities could be significant and may be difficult to anticipate or measure. Because the techniques used by computer programmers and hackers, many of whom are highly sophisticated and well-funded, to access or sabotage networks change frequently and generally are not recognized until after they are used, we may be unable to anticipate or immediately detect these techniques. This could impede our sales, manufacturing, distribution or other critical functions, which could adversely affect our business.

Market conditions and changes in the industry could lead to discontinuation of our products or businesses resulting in asset impairments.

In response to changes in industry and market conditions, we may be required to strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses. Any decision to limit investment in or dispose of or otherwise exit businesses may result in the recording of special charges, such as inventory and technology-related write-offs, workforce reduction costs, charges relating to consolidation of excess facilities, or claims from third parties who were resellers or users of discontinued products. Our estimates with respect to the useful life or ultimate recoverability of our carrying basis of assets, including purchased intangible assets, could change as a result of such assessments and decisions. Although in certain instances, our supply agreements allow us the option to cancel, reschedule, and adjust our requirements based on our business needs prior to firm orders being placed, our loss contingencies may include liabilities for contracts that we cannot cancel with contract manufacturers and suppliers. Further, our estimates relating to the liabilities for excess facilities are affected by changes in real estate market conditions.

If our products do not effectively inter-operate with our customers' networks and result in cancellations and delays of installations, our business could be harmed.

Our products are designed to interface with our customers' existing networks, each of which have different specifications and utilize multiple protocol standards and products from other vendors. Many of our customers' networks contain multiple generations of products that have been added over time as these networks have grown and evolved. Our products must inter-operate with many or all of the products within these networks as well as future products in order to meet our customers' requirements. If we find errors in the existing software or defects in the hardware used in our customers' networks, we may need to modify our software networking solutions to fix or overcome these errors so that our products will inter-operate and scale with the existing software and hardware, which could be costly and could negatively affect our business, financial condition, and results of operations. In addition, if our products do not inter-operate with those of our customers' networks, demand for our products could be adversely affected or orders for our products could be canceled. This could hurt our operating results, damage our reputation, and seriously harm our business and prospects. Our revenues may decline as a result of changes in public funding of educational institutions.

A portion of our revenues comes from sales to both public and private K-12 educational institutions. Public schools receive funding from local tax revenue, and from state and federal governments through a variety of programs, many of which seek to assist schools located in underprivileged or rural areas. The funding for a portion of our sales to educational institutions comes from a federal funding program known as the E-Rate program. E-Rate is a program of the Federal Communications Commission that subsidizes the purchase of approved telecommunications, Internet access, and internal connection costs for eligible public educational institutions. The E-Rate program, its eligibility criteria, the timing and specific amount of federal funding actually available and which Wi-Fi infrastructure and product sectors will benefit, are uncertain and subject to final federal program approval and funding appropriation

continues to be under review by the Federal Communications Commission, and we cannot assure that this program or its equivalent will continue, and as a result, our business may be harmed. Furthermore, if state or local funding of public education is significantly reduced because of legislative or policy changes or by reductions in tax revenues due to changing economic conditions, our sales to educational institutions may be negatively impacted by these changed conditions. Any reduction in spending on information technology systems by educational institutions would likely materially and adversely affect our business and results of operations. This is a specific example of the many factors which add additional uncertainty to our future revenue from our education end-customers.

Our headquarters and some significant supporting businesses are located in Northern California and other areas subject to natural disasters that could disrupt our operations and harm our business.

Our corporate headquarters are located in Silicon Valley in Northern California. Historically, this region as well as our R&D centers in North Carolina and New Hampshire have been vulnerable to natural disasters and other risks, such as earthquakes, fires, floods and tropical storms, which at times have disrupted the local economy and posed physical risks to our property. We have contract manufacturers located in Taiwan where similar natural disasters and other risks may disrupt the local economy and pose physical risks to our property and the property of our contract manufacturer.

In addition, the continued threat of terrorism and heightened security and military action in response to this threat, or any future acts of terrorism, may cause further disruptions to the economies of the United States and other countries. If such disruptions result in delays or cancellations of customer orders for our products, our business and operating results will suffer.

We currently do not have redundant, multiple site capacity in the event of a natural disaster, terrorist act or other catastrophic event. In the event of such an occurrence, our business would suffer.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds – Not applicable

Item 3. Defaults Upon Senior Securities - Not applicable

Item 4. Mine Safety Disclosure - Not Applicable

Item 5. Other Information – Not Applicable

Item 6. Exhibits

(a) Exhibits:

Exhibit Number	Description of Document	Incorporated by Reference			Filed Herewith
		Form	Filing Date	Number	
10.1*	Transition and Separation Agreement dated September 18, 2018 between Extreme Networks, Inc. and Drew Davies.				X
10.2	Second Amendment to the Credit Agreement and First Amendment to the Pledge Agreement Dated September 30, 2018, by and among the Company, as borrower, the several banks and other financial institutions or entities party thereto as lenders, BMO Harris Bank, N.A., as an issuing lender and swingline lender, and Bank of Montreal, as administrative agent.				X
10.3*	Form of Notice of Grant and Grant Agreement for Performance Stock Option				X
10.4*	Form of Notice of Grant and Grant Agreement for Performance Vesting Restricted Stock Units				X
10.5*	Summary of FY19 Executive Compensation Arrangements				X
31.1	Section 302 Certification of Chief Executive Officer.				X
31.2	Section 302 Certification of Chief Financial Officer.				X
32.1*	Section 906 Certification of Chief Executive Officer.				X
32.2*	Section 906 Certification of Chief Financial Officer.				X
101.INS	XBRL Instance Document.				X
101.SCH	XBRL Taxonomy Extension Schema Document.				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				X

*Indicates management or board of directors contract or compensatory plan or arrangement

** Furnished herewith. Exhibits 32.1 and 32.2 are being furnished and shall not be deemed to be “filed” for purposes of section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), or otherwise subject to the liability of that section, nor shall such exhibits be deemed to be incorporated by reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as otherwise specifically stated in such filing.

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.

EXTREME NETWORKS, INC.

(Registrant)

/ S / MATTHEW H. CLEAVER
Matthew H. Cleaver
Vice President, Interim Chief Financial Officer

(Principal Accounting Officer)
November 2, 2018

57