

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2016

Or

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

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

Commission file number: 001-36468

**ARISTA NETWORKS, INC.**  
(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**20-1751121**

(I.R.S. Employer  
Identification Number)

5453 Great America Parkway  
Santa Clara, California 95054  
(Address of principal executive offices)

(408) 547-5500  
(Registrant's telephone number, including area code)  
Securities registered pursuant to Section 12(b) of the Act:

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Common Stock, \$0.0001 par value	New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act: None**

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

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

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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant was 3,091,241,753 as of June 30, 2016 based on the closing sale price of the registrant's common stock on the New York Stock Exchange on such date. Shares held by persons who may be deemed affiliates have been excluded. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On February 10, 2017, 71,011,320 shares of the registrant's common stock were outstanding. Portions of the registrant's definitive Proxy Statement relating to its 2017 Annual Stockholders' Meeting to be filed pursuant to Regulation 14A within 120 days after the registrant's fiscal year end of December 31, 2016 are incorporated by reference into Part III of this Annual Report on Form 10-K.

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ARISTA NETWORKS, INC.

TABLE OF CONTENTS

	<b>Page</b>
<b><u>PART I</u></b>	
Item 1. <a href="#"><u>Business</u></a>	<a href="#"><u>5</u></a>
Item 1A. <a href="#"><u>Risk Factors</u></a>	<a href="#"><u>15</u></a>
Item 1B. <a href="#"><u>Unresolved Staff Comments</u></a>	<a href="#"><u>43</u></a>
Item 2. <a href="#"><u>Properties</u></a>	<a href="#"><u>43</u></a>
Item 3. <a href="#"><u>Legal Proceeding</u></a>	<a href="#"><u>43</u></a>
Item 4. <a href="#"><u>Mine Safety Disclosures</u></a>	<a href="#"><u>43</u></a>
<b><u>PART II</u></b>	
Item 5. <a href="#"><u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u></a>	<a href="#"><u>43</u></a>
Item 6. <a href="#"><u>Selected Consolidated Financial Data</u></a>	<a href="#"><u>44</u></a>
Item 7. <a href="#"><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></a>	<a href="#"><u>47</u></a>
Item 7A. <a href="#"><u>Quantitative and Qualitative Disclosures About Market Risk</u></a>	<a href="#"><u>63</u></a>
Item 8. <a href="#"><u>Financial Statements and Supplementary Data</u></a>	<a href="#"><u>64</u></a>
Item 9. <a href="#"><u>Change in and Disagreements With Accountants on Accounting and Financial Disclosure</u></a>	<a href="#"><u>101</u></a>
Item 9A. <a href="#"><u>Controls and Procedures</u></a>	<a href="#"><u>101</u></a>
Item 9B. <a href="#"><u>Other Information</u></a>	<a href="#"><u>103</u></a>
<b><u>PART III</u></b>	
Item 10. <a href="#"><u>Directors, Executive Officers, and Corporate Governance</u></a>	<a href="#"><u>103</u></a>
Item 11. <a href="#"><u>Executive Compensation</u></a>	<a href="#"><u>103</u></a>
Item 12. <a href="#"><u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u></a>	<a href="#"><u>103</u></a>
Item 13. <a href="#"><u>Certain Relationships and Related Transactions and Director Independence</u></a>	<a href="#"><u>103</u></a>
Item 14. <a href="#"><u>Principal Accountant Fees and Services</u></a>	<a href="#"><u>103</u></a>
<b><u>PART IV</u></b>	
Item 15. <a href="#"><u>Exhibits and Financial Statement Schedules</u></a>	<a href="#"><u>103</u></a>
<a href="#"><u>Signatures</u></a>	<a href="#"><u>103</u></a>

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## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including the sections entitled “Business,” “Risk Factors,” “Use of Proceeds,” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, as Section 21E of the Securities Exchange Act of 1934, as amended, which statements involve substantial risks and uncertainties. The words “believe,” “may,” “will,” “potentially,” “estimate,” “continue,” “anticipate,” “intend,” “could,” “would,” “project,” “plan,” “predict,” “expect” and similar expressions that convey uncertainty of future events or outcomes are intended to identify forward-looking statements.

These forward-looking statements include, but are not limited to, statements concerning the following:

- our ability to maintain an adequate rate of revenue growth and our future financial performance, including our expectations regarding our cost of revenue, gross profit or gross margin and operating expenses;
- our belief that the cloud networking market is still in the early stages of adoption and has a significant potential opportunity for growth;
- our business plan and our ability to effectively manage our growth, including the reporting requirements and compliance obligations of a public company;
- costs associated with defending intellectual property infringement and other claims and the potential outcomes of such disputes, such as those claims discussed in “Legal Proceedings,” including the Cisco and Optumsoft litigation matters;
- our ability to comply with any remedial orders issued in connection with the Cisco litigation;
- our ability to satisfy the requirements for cloud networking solutions and to successfully anticipate technological shifts and market needs, innovate new products and bring them to market in a timely manner;
- our ability to retain and increase sales to existing customs and attract new end customers, including large end customers;
- the budgeting cycles and purchasing practices of end customers, including large end customers who may receive lower pricing terms due to volume discounts;
- the buying patterns of our large end customers in which large bulk purchases may or may not occur in certain quarters;
- our inability to fulfill our end customers’ orders due to supply chain delays, access to key commodities or technologies or events that impact our manufacturers or their suppliers;
- the deferral or cancellation of orders by end customers, warranty returns or delays in acceptance of our products;
- our ability to further penetrate our existing customer base and sell more complex and higher-performance configurations of our products;
- our ability to displace existing products in established markets;
- our belief that increasing channel leverage will extend and improve our engagement with a broad set of customers;
- our ability to expand our leadership position in the network switch industry, including the areas of mobility, virtualization, cloud computing and cloud networks;
- our ability to timely and effectively scale and adapt our existing technology;
- the benefits realized by our customers in their use of our products and services including lower total cost of ownership;
- our ability to expand our business domestically and internationally;
- the effects of increased competition in our market and our ability to compete effectively;
- the effects of seasonal and cyclical trends on our results of operations;
- our expectations concerning relationships with third parties;
- the attraction and retention of qualified employees and key personnel;
- our ability to maintain, protect and enhance our brand and intellectual property;
- economic and industry trends;
- estimates and estimate methodologies used in preparing our financial statements;
- future trading prices of our common stock;
- our belief that we have adequately reserved for uncertain tax positions;

- our belief that our existing cash and cash equivalents together with cash flow from operations will be sufficient to meet our working capital requirements and our growth strategies for the foreseeable future; and
- future acquisitions of or investments in complementary companies, products, services or technologies;

These forward-looking statements are subject to a number of risks, uncertainties and assumptions, including those described in the section titled “Risk Factors” and elsewhere in this Annual Report on Form 10-K. Moreover, we operate in a very competitive and rapidly changing environment, and new risks emerge from time to time. It is not possible for our management to predict all risks, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements we may make. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Annual Report on Form 10-K may not occur and actual results could differ materially and adversely from those anticipated or implied in the forward-looking statements. You should not rely upon forward-looking statements as predictions of future events.

The forward-looking statements made in this Annual Report on Form 10-K relate only to events as of the date on which the statements are made. We undertake no obligation to update any forward-looking statements made in this Annual Report on Form 10-K to reflect events or circumstances after the date of this Annual Report on Form 10-K or to reflect new information or the occurrence of unanticipated events, except as required by law. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Our forward-looking statements do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make.

## PART I

### Item 1. Business

We are a leading supplier of cloud networking solutions that use software innovations to address the needs of large-scale Internet companies, cloud service providers and next-generation data centers for enterprise support. Our cloud networking solutions consist of our Extensible Operating System, or EOS, a set of network applications and our Ethernet switching and routing platforms. Our cloud networking solutions deliver industry-leading performance, scalability, availability, programmability, automation and visibility. At the core of our cloud networking platform is EOS, which was purpose-built to be fully programmable and highly modular. The programmability of EOS has allowed us to create a set of software applications that address the requirements of cloud networking, including workflow automation, network visibility and analytics, and has also allowed us to rapidly integrate with a wide range of third-party applications for virtualization, management, automation, orchestration and network services. Since we began shipping our products, we have grown rapidly, and, according to Crehan Research, we have achieved the second largest market share in data center 10/25/40/50/100 Gigabit Ethernet switch ports, excluding blade switching, sold in 2016.

EOS supports leading cloud and virtualization solutions, including VMware NSX, Microsoft System Center, OpenStack and other cloud management frameworks. We have worked with industry leaders to define new open protocols for the virtualized data center. We co-authored the VXLAN protocol specification with VMware and were the first to demonstrate VXLAN integration and have now expanded VXLAN routing and integration.

We use standard Linux as our underlying operating system, providing customers with access to all Linux operating system facilities. This allows customers to extend our EOS software with off-the-shelf Linux applications and a growing number of open source management tools.

EOS has a highly modular architecture, which allows us to prevent network outages in deployments of our cloud networking solutions. This architecture also allows us to rapidly develop new features and protocols without compromising the quality of the existing code base. Because all of our platform products are powered by the same binary image of EOS, we are able to deliver these new innovations to our entire installed base with minimal disruption.

EOS+, a software platform for network programmability and automation, provides an advanced level of programmability, allowing customers to take advantage of pre-built and custom EOS applications as well as integration with a wide range of technology partner solutions.

In 2015, we introduced CloudVision, a network-wide approach for workload orchestration and workflow automation delivering a turnkey solution for cloud networking. We believe CloudVision’s abstraction of the physical network to this broader, network-wide perspective allows for a more efficient approach for several operational use-cases related to automation, visibility, management, security and 3<sup>rd</sup> party controller integration.

We sell our products through both our direct sales force and our channel partners. Since shipping our first products in 2008, our cumulative end-customer base has grown rapidly. Between December 31, 2011 and December 31, 2016, our cumulative end-customer base grew from approximately 1,100 to over 4,200. Our end customers span a range of industries and include large Internet companies, service providers, financial services organizations, government agencies, media and entertainment companies and others. Our customers include six of the largest cloud services providers based on annual revenue.

We have experienced rapid revenue growth over the last several years, increasing our revenue at a compound annual growth rate of 51.9% from \$139.8 million in 2011 to \$1.1 billion in 2016. For 2014, 2015, and 2016 our revenue was \$584.1 million, \$837.6 million and \$1.1 billion, respectively, with our 2016 revenue growing 34.8% when compared to 2015. Our net income has grown from \$34.0 million in 2011 to \$86.9 million, \$121.1 million and \$184.2 million in 2014, 2015, and 2016, respectively.

## Industry Background

Cloud computing is fundamentally changing the way IT infrastructure is built and how applications are delivered. In cloud computing, applications are distributed across thousands of servers. These servers are connected with high-speed network switches that, together, form a pool of resources that allows applications to be rapidly deployed and cost-effectively updated. Cloud computing enables ubiquitous and on-demand network access to these applications from Internet-connected devices including personal computers, tablets and smartphones.

Nearly all consumer applications today are delivered as cloud services. Enterprise applications are rapidly moving to the cloud as well, since cloud services are easier and more cost effective to deploy, scale and operate than traditional applications. Internet leaders like Amazon, eBay, Facebook, Google, Microsoft and Yahoo! pioneered the development of large-scale cloud data centers in order to meet the growing demands of their users, including business customers. Enterprises and service providers around the world are adopting cloud computing technologies in order to achieve similar performance improvements and cost reductions.

The aggregate network bandwidth in the cloud can be orders of magnitude higher than typical legacy data center networks. Therefore, the networks in such cloud environments must be architected and built in a new way. We refer to these next-generation data center networks as cloud networks. Cloud networks must deliver high capacity, high availability and predictable performance and must be programmable to allow integration with third-party applications for network, management, automation, orchestration and network services.

## Limitations of Traditional Data Center Networks

In our view, cloud networks and legacy networks are fundamentally different. In a traditional data center, specific applications are installed on a small number of servers, and most network traffic is server-to-client, or “north-south” traffic, which results in perhaps a few terabits/second of aggregate network bandwidth. In the cloud, most network traffic is server-to-server, or “east-west” traffic. The aggregate network bandwidth in the cloud can exceed 1 petabit/second, orders of magnitude higher than that of typical legacy data center networks.

The much larger scale of cloud networks requires much higher network availability since network outages in the cloud are very expensive in terms of customer impact. Traditional network switches have evolved, and the features and capabilities of their operating system have expanded over many years without addressing the structural deficiencies of their underlying software architectures, making it difficult to achieve high network switch reliability.

Some networking vendors have built products that use proprietary protocols to address the scaling needs of next-generation data centers. However, proprietary protocols are generally not acceptable to Internet companies or cloud service providers because they create vendor lock-in.

Legacy networks are not programmable and, as a result, are extremely difficult to integrate with third-party applications for network management, automation, orchestration and network services. This lack of integration forces customers to continue to rely on time consuming, error-prone manual processes that may be cost-prohibitive.

## Requirements for Cloud Networking

Cloud networks differ in many aspects from legacy networks, including capacity, performance, scale, availability, programmability, automation, visibility, security and cost performance. The requirements for cloud networking include the following:

- **Capacity, Performance and Scalability.** Cloud networks must have sufficient capacity to interconnect large numbers of servers, up to hundreds of thousands, with predictable network bandwidth.
- **High Availability.** Cloud networks must overcome hardware and software failures for customers in order to avoid network outages that can result in lost revenue, dissatisfied customers and increased operational cost.
- **Open and Programmable.** Cloud networks must be based on open protocols and be programmable to enable integration with leading network applications and management and data analysis tools.
- **Workflow Automation.** Cloud networks must offer automated provisioning and configuration to enable fast service delivery and to minimize operational costs, avoiding time-consuming and error-prone manual processes for configuring, provisioning, monitoring and managing the network.
- **Network Visibility.** Cloud networks must provide IT administrators with real-time in-depth visibility of network status to proactively monitor, detect and notify when issues arise.
- **Security.** Cloud networks require dynamic security and services from physical-to-physical and physical-to-virtual workloads.

- **Cost Performance.** Cloud networks must deliver high performance while lowering overall cost of ownership, including capital and operational costs.

## **Our Cloud Networking Solutions**

We are a leading supplier of cloud networking solutions that use software innovations to address the needs of large-scale Internet companies, cloud service providers and next-generation enterprise data centers. Our cloud networking platform was purpose-built to address the functional and performance requirements for cloud networks. We deliver our solutions via our industry-leading 10/25/40/50/100 Gigabit Ethernet switches and routers optimized for next-generation data center networks.

Our cloud networking solutions consist of EOS, our Extensible Operating System, a set of networking applications and our Gigabit Ethernet platforms. At the core of our cloud networking platform is EOS, which was architected to be fully programmable and highly modular.

The programmability of EOS has allowed us to create a set of software applications and application programming interfaces, or APIs, that address the requirements of cloud networking, including workflow automation, network visibility and analytics, and has further allowed us to integrate rapidly with a wide range of third-party applications for virtualization, management, automation, orchestration and network services.

The key benefits of our cloud networking solutions are as follows:

### ***Capacity, Performance and Scalability***

Our cloud networking platform enables data center networks to scale to hundreds of thousands of physical servers and millions of virtual machines with the least number of switching tiers. We achieve this by leveraging standard protocols to meet the scale requirements of cloud computing. We have used active-active Layer 2 and Layer 3 network topologies to enable customers to build extremely large and resilient networks.

### ***High Availability***

Our highly modular EOS software architecture was designed to be fault-isolating and self-healing in order to deliver higher stability compared to legacy network operating systems. In addition, our customers can non-disruptively upgrade our switches running in the network using our Smart System Upgrade, or SSU, application.

### ***Open and Programmable***

Our EOS software was purpose-built to offer programmable interfaces throughout all levels of our software. This has allowed us to integrate our cloud networking platform with a wide range of leading third-party applications. For example, we support VMware NSX, OpenStack and Microsoft System Center for orchestration and fast provisioning, enabling true workload mobility and automatic provisioning of physical switches. We enable customers, through application programming interfaces, to write their own scripts to customize and optimize their networks. In addition, we support a wide range of software-defined network controllers via our OpenFlow and DirectFlow interfaces.

### ***Workflow Automation***

Our EOS software enables enterprises to provision networking resources in minutes with no manual intervention through our Zero Touch Provisioning. We also natively support Ansible, CFEngine, Chef, Puppet, virtual network orchestration applications and third-party management tools. CloudVision, a network-wide approach for workload orchestration and workflow automation delivers a turnkey solution for cloud networking. CloudVision extends the same EOS architectural approach across the network for state, topology, monitoring and visibility. This enables enterprises to move to cloud-class automation without needing significant internal development. Finally, EOS embraces the DevOps model, which is a software development method that combines development and operations, to provision and monitor servers, storage and network resources in a unified fashion.

### ***Network Visibility***

Our EOS software provides a set of tools and applications that proactively monitor, detect and notify network managers when network issues arise, delivering real-time data to third-party management applications including Corvil, ExtraHop, Riverbed and Splunk to provide detailed application visibility. Our telemetry applications include VM Tracer, which provides visibility down to the virtual machine level, Path Tracer, which detects errors in provisioned network paths, MapReduce Tracer, which monitors and optimizes the performance of Hadoop workloads, and Health Tracer, which monitors infrastructure resiliency. Our network visibility applications provide real-time insight into the status of the network. They include LANZ, which monitors latency, and DANZ 2017, a set of features previously only available in add-on network visibility devices, which provides advanced traffic monitoring with flow analysis and timestamps, plus the ability to perform tap aggregation for reporting and analysis.

## **Security**

Macro-Segmentation Services (MSS™) is one of the services enabled via Arista CloudVision. Since CloudVision maintains a network-wide database of all state within the network, as well as direct integration with hypervisor resources like VMware vSphere and NSX. It is aware of every workload that is within the network and it learns in real time about new devices or workloads that are added or removed from the network, or moved across ports or servers. Macro-segmentation extends the concept of fine-grained inter-hypervisor security to cloud networks by enabling dynamic security and services for physical to virtual workloads. Macro-segmentation security is a complement to fine-grained security delivered via micro-segmentation that is already implemented in the virtual switch of the physical host on which a VM is running.

## **Lower Total Cost of Ownership**

Our cloud networking platform offers architectural and system advantages that provide our customers with cost-effective and highly available cloud networking solutions. Our programmable, scalable leaf-spine architectures, combined with industry-leading applications, significantly reduce networking costs when compared to legacy network designs, enabling faster time to service and improved availability. Our automation tools reduce the operational costs of provisioning, managing and monitoring a data center network and speed up service delivery. Our visibility tools provide high levels of visibility into complex network environments without the need for additional data collection equipment. As a result, fewer network engineers are needed to operate large networks.

## **Our Market Opportunity**

We compete primarily in the data center switching market for 10 Gigabit Ethernet and above, excluding blade switches.

We believe that cloud computing represents a fundamental shift from traditional legacy data centers and that cloud networking is the fastest growing segment within the data center switching market. As organizations of all sizes are adopting cloud architectures, spending on cloud and next-generation data centers has increased rapidly over the last several years, while traditional legacy IT spending has been growing more slowly. In 2017, our 7150, 7050, 7250, 7300 and 7500 Series platforms are now listed on the U. S. Department of Defense Approved Products Lists Integrated Tracking System by the Defense Information Systems Agency.

## **Our Customers**

As of December 31, 2016, we had delivered our cloud networking solutions to over 4,200 end customers worldwide in over 80 countries. Our end customers span a range of industries and include large Internet companies, service providers, financial services organizations, government agencies, media and entertainment companies and others. For each of the years ended December 31, 2016, 2015, and 2014, Microsoft purchases, through our channel partner World Wide Technology, Inc., accounted for more than 10% of our total revenue.

## **Our Competitive Strengths**

We believe the following strengths will allow us to maintain and extend our technology leadership position in cloud networking and next-generation data center Ethernet products:

- **Purpose-Built Cloud Networking Platform.** We have developed a highly scalable cloud networking platform that uses software to address the needs of large-scale Internet companies, cloud service providers, financial services organizations, government agencies and media and entertainment companies, including virtualization, big data and low-latency applications. As a result, our cloud networking platform does not have the inherent limitations of legacy network architectures.
- **Broad and Differentiated Portfolio.** Using multiple silicon architectures, we deliver switches and routers with industry-leading capacity, low latency, port density and power efficiency and have innovated in areas such as deep packet buffers, embedded optics and reversible cooling. Our broad portfolio has allowed us to offer customers products that best match their specific requirements.
- **Single Binary Image Software.** The single binary image of EOS software allows us to maintain feature consistency across our entire product portfolio and enables us to introduce new software innovations into the market that become available to our entire installed base without a “forklift upgrade” (i.e., a broad upgrade of the data center infrastructure).
- **Rapid Development of New Features and Applications.** Our highly modular EOS software has allowed us to rapidly deliver new features and applications while preserving the structural integrity and quality of our network operating system. We believe our ability to deliver new features and capabilities more quickly than legacy switch/router operators, provides us with a strategic advantage given that the requirements in cloud and next-generation data center networking continue to evolve rapidly.
- **Deep Understanding of Customer Requirements.** We have developed close working relationships with many of our largest customers that provide us with insights about their needs and future requirements. This has allowed us to develop and deliver products to market that meet customer demands and expectations as well as to rapidly grow sales to existing customers.
- **Strong Management and Engineering Team with Significant Data Center Networking Expertise.** Our management and engineering team consists of networking veterans with extensive data center networking expertise. Our President and Chief Executive Officer, Jayshree Ullal, with 30+ years of networking expertise from silicon to systems companies. Andy Bechtolsheim,

our Founder and Chief Development Officer, was previously a Founder and chief system architect at Sun Microsystems. Kenneth Duda, our Founder and Chief Technology Officer, led the software development effort of EOS.

- **Significant Technology Lead.** We believe that our networking technology represents a fundamental advance in networking software. Our EOS software is state-driven and the result of more than 1,000 man-years of research and development investment over a ten-year period with 10+ million lines of code as a key cloud networking software stack.

## Our Products and Technology

We offer one of the broadest product lines of data center 10/25/40/50/100 Gigabit Ethernet switches and routers in the industry, comprising our 7010 Series, 7050X Series, 7060X Series, 7160 Series, 7150 Series, 7250X Series, 7260 Series, 7280R Series Universal Leaf products, 7300X Series Spline products, and our 7500R Series Universal Spine products.

We deliver routing and switching platforms with industry-leading capacity, low latency, port density and power efficiency. We have also innovated in areas such as deep packet buffers, embedded optics and reversible cooling. Our products have been recognized with a number of awards, including the Best of Interop Grand Prize that was given to our industry-leading spine switch, the Arista 7500 Series, in 2010 and again, to the Arista 7500E Series, in 2013. An overview of our switching/routing portfolio is shown in the figure below.



We use multiple silicon architectures across our products, which allows us to build a broader range of products optimized for different functions in the network than competitors that utilize fewer silicon architectures. While we use multiple silicon architectures, all of our platforms are powered with the same binary EOS image, which significantly simplifies deployment and ensures the same rich feature set and consistent operation across all our products.

## Our Extensible Operating System

The core of our cloud networking platform is our Extensible Operating System, or EOS, which runs on top of standard Linux and offers programmability at all layers of the stack. All of our 10/25/40/50/100 Gigabit Ethernet platforms run our EOS software.

EOS is based on a new and innovative architecture that is highly modular and consists of more than 100 separate processes that we call agents, each one handling specific protocol processing, device driver or system management functions. Each agent runs in user space as a separate Linux process and is completely protected and isolated from all other agents.

We are constantly investing in our core infrastructure to provide the capabilities required for building modern cloud networks, most recently by extending SysDB into NetDB™ and enhancing scalability. New requirements use in cloud and service provider networks and hybrid cloud deployments in enterprises require on-going upgrades and extensions to our state oriented architecture.

## EOS Attributes

The modular and programmable architecture of EOS enables us to offer a set of attributes, capabilities and features that are essential for cloud networking and next-generation data centers.

### High Availability

EOS is self-healing in the sense that individual processes can be restarted without impacting application traffic. This architectural design principle supports self-healing resiliency in our software, easier software maintenance and module independence, higher software quality overall, and faster time-to-market for new features that customers require.

### Programmable at All Layers

EOS is programmable at all layers from the Linux kernel to switch configuration, provisioning, automation and detailed monitoring of the network. Public cloud providers have leveraged tools such as the EOS Software Development Kit ("SDK") and eAPI to implement fully customized infrastructure automation solutions.

### *Workflow Visibility*

Through EOS, we have developed a wide range of applications available to our customers for purchase as additional licenses that enable enhanced network monitoring and visibility without requiring additional external monitoring devices. This includes (i) DataANalyZer (DANZ), which provides access to raw network data for analysis by security, troubleshooting and performance management tools, (ii) Latency/loss ANalyZer (LANZ), which provides access to internal network performance loads and packet loss and latency occurring at the microsecond level, (iii) Network Telemetry, which provides network state information including correlations with dynamic state of the systems operating on the network such as Hypervisors, distributed job controls and (iv) Network Tracers, which provide active integration and diagnostics for various workload conditions dependent upon network performance.

### *Network Automation*

EOS supports Puppet, Chef and Ansible, which enables automatic network configuration in the same manner as servers and storage. In addition, EOS provides tools that greatly reduce network operational costs. Another major component of network automation is Cloud Vision.

### **CloudVision**

CloudVision's abstraction of the physical network to a broader, network-wide perspective allows for a more efficient approach for several operational use-cases, including the following highlights:

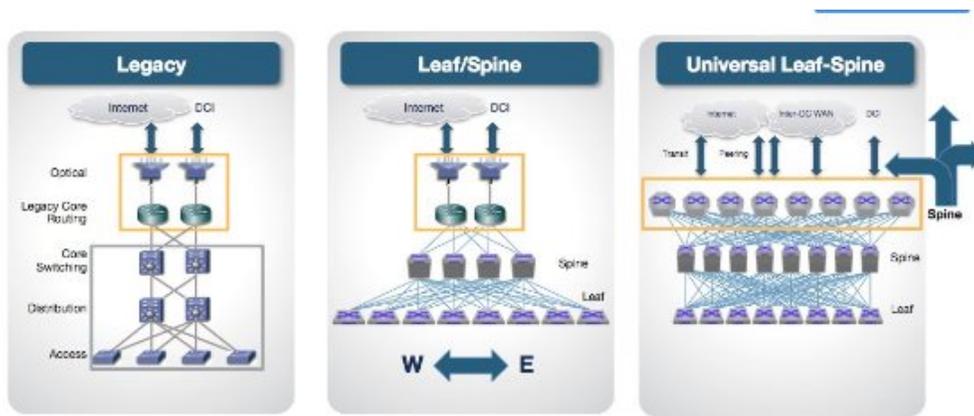
- Centralized representation of distributed network state, allowing for a single point of integration and network-wide visibility and analytics;
- Controller agnostic support for physical and virtual workload orchestration through open APIs such as OVSDB, JSON and Openstack plugins;
- Turn-key automation for zero touch provisioning, configuration management and network-wide upgrades and rollback;
- Compliance Dashboard for Security, Audit and patch management;
- Real-time Streaming for Telemetry and Network Analytics, a modern approach to replace legacy polling per device;
- Provides visibility and troubleshooting for underlay and overlay networks; and
- Enables Macro-Segmentation Services which provides a dynamic and scalable network service to logically insert security devices into the path of traffic, regardless of whether the security device or workload is physical or virtual and with complete flexibility on placement of security devices and workloads.

### **Leaf-Spine Network Designs**

Our customers typically deploy leaf-spine network topologies consisting of leaf switches or top-of-rack switches, located in the server rack connected with uplinks to multiple load-sharing spine switches and routers that provide the backbone. Our leaf-spine network designs scale up to more than 300,000 physical servers and millions of virtual machines using Equal Cost Multiple Path, or ECMP, to load balance Layer 3 network traffic across multiple spine switches and routers. With Multi-Chassis Link Aggregation, or MLAG, we can build an active-active Layer 2 network that can connect more than 25,000 physical servers. Our leaf-spine network designs have been widely deployed and provide predictable network bandwidth and latency. A key advantage of predictable network performance is that it eliminates the need to optimize the network for specific applications, which means a single network design works equally well for all applications.

Enterprise resources commonly span multiple datacenters or Performance Optimized Datacenters or PODs within a data center, including the public cloud. The drive to deliver resources quickly, affordably, and reliably also drives the need for a flexible, cost-effective, scale-out design at the datacenter core, which we refer to as the "spine of spines" or Universal Spine. The Universal Spine is non-blocking, supports large scale ECMP, IP routing and routing convergence. The Universal Spine enables architects to build the network around the spine and collapse legacy networking layers into the Universal Spine.

Examples of our leaf-spine and universal leaf-spine architectures are illustrated below.



### Customer Support and Services

We have designed our customer support offerings to provide our customers with high levels of support. Our global team of support engineers engages directly with client IT teams and is available at all times over e-mail, by phone or through our website.

We offer multiple service options that allow our customers to select the product replacement service level that best meets their needs. We stock spare parts in over 125 locations around the world through our third-party logistics suppliers. All of our service options include unlimited access to bug-fixes, new feature-releases, online case management and our community forums.

### Sales and Marketing

We market and sell our products through our direct sales force and in partnership with our channel partners, including distributors, value-added resellers, systems integrators and OEM partners. We also sell in conjunction with various technology partners. To facilitate channel coordination and increase productivity, we have created a partner program, the Arista Partner Program, to engage partners who provide value-added services and extend our reach into the marketplace. Authorized training partners perform technical training of our channel partners and end customers. Our partners commonly receive an order from an end customer prior to placing an order with us, and we confirm the identification of the end customer prior to accepting such orders. Our partners generally do not stock inventory received from us.

Our sales organization is supported by systems engineers with deep technical expertise and responsibility for pre-sales technical support and solutions engineering for our end customers, systems integrators, original equipment manufacturers, or OEMs, and channel partners. A pool of shared channel sales and marketing representatives also supports these teams. Each sales team is responsible for a geographical territory, has responsibility for a number of major direct end-customer accounts or has assigned accounts in a specific vertical market. We have field sales teams operating in over 80 countries.

Our marketing activities consist primarily of technology conferences, web marketing, trade shows, product demonstrations, seminars and events, public relations, analyst relations, demand generation and direct marketing to build our brand, increase end-customer awareness, communicate our product advantages and generate qualified leads for our field sales force and channel partners.

### Research and Development

We believe our future success depends on our ability to develop new products and features that address the needs of our end customers. Our in-house engineering personnel are responsible for the development, quality, documentation, support and release of our products. We plan to continue to invest significantly in resources to conduct our research and development efforts. Our research and development expense was \$273.6 million, \$209.4 million and \$148.9 million in 2016, 2015 and 2014 respectively.

### Manufacturing

We subcontract the manufacturing of all of our products to various contract manufacturers. Our primary manufacturing partners are Jabil Circuit, Sanmina Corporation and Foxconn. This approach allows us to reduce our costs, manufacturing overhead and inventory position and allows us to adjust more quickly to changing end-customer demand. We require all of our manufacturing locations to be ISO-9001 certified. Our EOS software is installed on our products at one of three direct fulfillment facilities.

Our contract manufacturing partners procure the majority of the components needed to build our products and assemble our products according to our design specifications. This allows us to leverage the purchasing power of our contract manufacturing partners.

We retain complete control over the bill of material, test procedures and quality assurance programs. Our on-site personnel work closely with our partners and review on an ongoing basis forecasts, inventory levels, processes, capacity, yields and overall quality. Our contract manufacturing partners procure components and assemble our products based on our demand forecasts. These forecasts represent our estimates of future demand for our products based upon historical trends and analyses from our sales and product management functions as adjusted for overall market conditions. We update these forecasts monthly.

Our products rely on key components, including merchant silicon, integrated circuit components and power supplies purchased from a limited number of suppliers, including certain sole source providers. Generally, neither our contract manufacturers nor we have a written agreement with any of these component providers to guarantee the supply of the key components used in our products nor do we have exclusive rights to such key components. Our product development efforts also depend upon continued collaboration with our key suppliers, including our merchant silicon vendors such as Broadcom and Intel. As we develop our product roadmap and continue to expand our relationships with these and other merchant silicon vendors, it is critical that we work in tandem with our key merchant silicon vendors to ensure that their silicon includes improved features and that our products take advantage of such improved features. This enables us to focus our research and development resources on software core competencies and to leverage the investments made by merchant silicon vendors to achieve cost-effective solutions.

Once the completed products are manufactured and tested, our contract manufacturing partners ship them to various theatre direct fulfillment facilities in the United States, the Netherlands and Singapore for final configuration, quality control inspection and shipment to our distribution partners and end customers. After the products are shipped to our end customers, our products are installed by the end customers or by third-party service providers such as system integrators or value added resellers on their behalf.

### **Backlog**

We do not have any long-term purchase commitments from customers. Customers generally order products on an as-needed basis with short lead and delivery times on a per-purchase-order basis. We maintain substantial finished goods inventory to ensure that products can generally be shipped shortly after receipt of an order. A significant portion of our customer shipments in any fiscal year relate to orders received and shipped in that fiscal year. Our customers utilize purchase orders containing non-binding purchase commitments and we allow customers to cancel, change or reschedule orders without penalty at any time prior to shipment, and as a result we do not believe backlog is firm. Due to the foregoing factors, backlog is not a meaningful indicator in any given period of our ability to achieve any particular level of overall revenue or financial performance.

### **Competition**

The markets in which we compete are highly competitive and characterized by rapidly changing technology, changing end-customer needs, evolving industry standards and frequent introductions of new products and services. We expect competition to intensify in the future as the market for cloud networking expands and existing competitors and new market entrants introduce new products or enhance existing products.

The data center networking market has been historically dominated by Cisco Systems, with competition also coming from other large network equipment and system vendors including Brocade Communications Systems (which has entered into an agreement to be acquired by Broadcom), Dell/EMC, Hewlett Packard Enterprises and Juniper Networks. Most of our competitors have made acquisitions and/or have entered into or extended partnerships or other strategic relationships to offer more comprehensive product lines, including cloud networking solutions. For example, in the last few years alone, Dell acquired Force10 and EMC, IBM acquired Blade Network Technology, Hewlett Packard Enterprises purchased Aruba, Juniper acquired Contrail, Cisco acquired Insieme, and Broadcom intends to acquire Brocade. We also face competition from other companies and new market entrants, including “whitebox” switch vendors as well as current technology partners and end customers who may develop network switches and cloud service solutions for internal use and/or to broaden their portfolio of products.

The principal competitive factors applicable to our products include:

- breadth of product offerings and features;
- reliability and product quality;
- ease of use;
- pricing;
- total cost of ownership, including automation, monitoring and integration costs;
- performance and scale;
- programmability and extensibility;
- interoperability with other products;
- ability to be bundled with other vendor offerings; and
- quality of service, support and fulfillment.

We believe our products compete favorably with respect to these factors. Our EOS software offers high reliability, integrates with existing network protocols and is open and programmable. We believe the combination of EOS, a set of network applications and our 10/25/40/50/100 Gigabit Ethernet platforms make our offering highly competitive for both cloud and enterprise data centers. However, many of our competitors have greater name recognition, longer operating histories, larger sales and marketing budgets and resources, broader distribution and established relationships with channel partners and end customers, greater access to larger end-customer bases, greater end-customer support resources, greater manufacturing resources, the ability to leverage their sales efforts across a broader portfolio of products, the ability to leverage purchasing power when purchasing subcomponents, the ability to bundle competitive offerings with other products and services, the ability to develop their own silicon chips, the ability to set more aggressive pricing policies, lower labor and development costs, greater resources to make acquisitions, larger intellectual property portfolios and substantially greater financial, technical, research and development or other resources.

### **Intellectual Property**

Our success and ability to compete depend substantially upon our core technology and intellectual property. We rely on patent, trademark and copyright laws, trade secret protection and confidentiality agreements with our employees, end customers, resellers, systems integrators and others to protect our intellectual property rights. We file U.S. and foreign patent applications to protect our intellectual property and believe that the duration of our issued patents is adequate relative to the expected lives of our products.

We cannot assure you that any of our patent applications will result in the issuance of a patent or whether the examination process will result in patents of valuable breadth or applicability. In addition, any patents that may be issued may be contested, circumvented, found unenforceable or invalidated, and we may not be able to prevent third parties from infringing them. We also license software from third parties for integration into our products, including open source software and other software available on commercially reasonable terms. We also own a number of trademarks in the U.S. and other jurisdictions, including Arista, EOS, CloudVision, CloudStream, CVP, CVX, Health Tracer, MapReduce Tracer, Path Tracer, MXP, MSS, RAIL, Score, SPLINE, SuperSpine, SSU, FlexRoute, NetRollBack, NetDB, OSFP, AlgoMatch, Macro-Segmentation, Macro-Segmentation Service.

We control access to and use of our software, technology and other proprietary information through internal and external controls, including contractual protections with employees, contractors, end customers and partners. Our software is protected by U.S. and international copyright, patent and trade secret laws. Despite our efforts to protect our software, technology and other proprietary information, unauthorized parties may still copy or otherwise obtain and use our software, technology and other proprietary information. In addition, we intend to expand our international operations, and effective patent, copyright, trademark and trade secret protection may not be available or may be limited in foreign countries.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. If we become more successful, we believe that competitors will be more likely to try to develop products that are similar to ours and that may infringe our proprietary rights. It may also be more likely that competitors or other third parties will claim that our products infringe their proprietary rights. In particular, large and established companies in our industry have extensive patent portfolios and are regularly involved in both offensive and defensive litigation. From time to time, third parties, including certain of these large companies and non-practicing entities, may assert patent, copyright, trademark and other intellectual property rights against us, our channel partners or our end customers, whom our standard license and other agreements obligate us to indemnify against such claims. For example, in December 2014, Cisco Systems filed two lawsuits against us in the Northern District of California for alleged patent and copyright infringement. Additionally, Cisco Systems filed two complaints against us in the International Trade Commission (ITC) for patent infringement, and the ITC has initiated an investigation. Please see "Legal Proceedings" included in Part I, Item 3 of this Annual Report on Form 10-K, for a description of this litigation. Successful claims of infringement by a third party, if any, could prevent us from distributing certain products or performing certain services, require us to expend time and money to develop non-infringing solutions or force us to pay substantial damages, royalties or other fees. We cannot assure you that we do not currently infringe, or that we will not in the future infringe, upon any third-party patents or other proprietary rights.

### **Employees**

As of December 31, 2016 we employed approximately 1,500 full-time employees. None of our employees are represented by unions. We consider our relationship with our employees to be good and have not experienced significant interruptions of operations due to labor disagreements.

### **Segment and Geographic Information**

We are organized and operate as one reportable segment, with 77.5% of our total revenue from the Americas, 14.9% from Europe, the Middle East, and Africa ("EMEA"), and 7.6% from the Asia Pacific region in 2016. Refer to Note 9. Segment Information in the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K for more information about segments and revenue and assets by geographic region.

## **Corporate Information**

We were incorporated in the State of California as Arastra, Inc. in October 2004. We reincorporated in the State of Nevada in March 2008, and we changed our name to Arista Networks, Inc. in October 2008. We reincorporated in the State of Delaware in March 2014.

## **Available Information**

Our website is located at [www.arista.com](http://www.arista.com) and our investor relations website is located at [www.investors.arista.com](http://www.investors.arista.com). Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed or furnished pursuant to Sections 13(a) and 15(d) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are available free of charge on the Investors portion of our web site as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission (SEC). Further, a copy of this Annual Report on Form 10-K is located at the SEC’s Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. Information on the operation of the Public Reference Room can be obtained by calling the SEC at 1-800-SEC-0330.

Webcasts of our earnings calls and certain events we participate in or host with members of the investment community are on our investor relations website. Additionally, we announce investor information, including news and commentary about our business and financial performance, SEC filings, notices of investor events, and our press and earnings releases, on our investor relations website. Investors and others can receive notifications of new information posted on our investor relations website in real time by signing up for email alerts and RSS feeds. Further corporate governance information, including our corporate governance guidelines, board committee charters, and code of conduct, is also available on our investor relations website under the heading “Corporate Governance.” The contents of our websites, or information that can be accessed through our websites, are not incorporated by reference into this Annual Report on Form 10-K or in any other report or document we file with the SEC, and any references to our websites are intended to be inactive textual references only.

## Item 1A. Risk Factors

*You should consider carefully the risks and uncertainties described below, together with all of the other information in this Annual Report on Form 10-K, which could materially affect our business, financial condition, results of operations and prospects. The risks described below are not the only risks facing us. Risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially affect our business, financial condition, results of operations and prospects.*

### **Risks Related to Our Business and Our Industry**

**Our business and operations have experienced rapid growth, and if we do not appropriately manage any future growth or are unable to improve our systems and processes, our business, financial condition, results of operations and prospects will be adversely affected.**

We have experienced rapid growth and increased demand for our products over the last several years, which has placed a strain on our management, administrative, operational and financial infrastructure. Our employee headcount and number of end customers have increased, and we expect both to continue to grow over the next year. For example, between December 31, 2011 and December 31, 2016, our headcount grew from approximately 250 employees to approximately 1,500 employees, and our cumulative number of end customers grew from approximately 1,100 to over 4,200. As we have grown, we have had to manage an increasingly large and more complex array of internal systems and processes to scale with all aspects of our business, including our hardware and software development, contract manufacturing and purchasing, logistics and fulfillment and maintenance and support. Our success will depend in part upon our ability to manage our growth effectively. To do so, we must continue to increase the productivity of our existing employees and continue to hire, train and manage new employees as needed. To manage domestic and international growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls and our reporting processes and procedures and implement more extensive and integrated financial and business information systems. We may not be able to successfully implement these or other improvements to our systems and processes in an efficient or timely manner, and we may discover deficiencies in their capabilities or effectiveness. We may experience difficulties in managing improvements to our systems and processes or in connection with third-party technology. In addition, our systems and processes may not prevent or detect all errors, omissions or fraud. Our failure to improve our systems and processes, or their failure to operate effectively and in the intended manner, may result in disruption of our current operations and end-customer relationships, our inability to manage the growth of our business and our inability to accurately forecast our revenue, expenses and earnings and prevent certain losses.

**Our limited operating history makes it difficult to evaluate our current business and future prospects and may increase the risk associated with your investment.**

We shipped our first products in 2008 and the majority of our revenue growth has occurred since the beginning of 2010. Our limited operating history makes it difficult to evaluate our current business and our future prospects, including our ability to plan for and model future growth. We have encountered and will continue to encounter risks and difficulties frequently experienced by rapidly growing companies in constantly evolving industries, including the risks described elsewhere in this Annual Report on Form 10-K. If we do not address these risks successfully, our business, financial condition, results of operations and prospects will be adversely affected, and the market price of our common stock could decline. Further, we have limited historical financial data, and we operate in a rapidly evolving market. As such, any predictions about our future revenue and expenses may not be as accurate as they would be if we had a longer operating history or operated in a more predictable market.

**Our results of operations are likely to vary significantly from period to period and be unpredictable and if we fail to meet the expectations of analysts or investors or our previously issued financial guidance, or if any forward-looking financial guidance does not meet the expectation of analysts or investors, the market price of our common stock could decline substantially**

Our results of operations have historically varied from period to period, and we expect that this trend will continue. As a result, you should not rely upon our past financial results for any period as indicators of future performance. Our results of operations in any given period can be influenced by a number of factors, many of which are outside of our control and may be difficult to predict, including:

- our ability to increase sales to existing customers and attract new end customers, including large end customers;
- the budgeting cycles and purchasing practices of end customers, including large end customers who may receive lower pricing terms due to volume discounts;
- the buying patterns of our large end customers in which large bulk purchases may or may not occur in certain quarters;
- the cost and potential outcomes of existing and future litigation, including Cisco and Optumsoft litigation matters;
- our ability to comply with any remedial orders issued in connection with the Cisco litigation;
- the rate of expansion and productivity of our sales force;
- changes in our pricing policies, whether initiated by us or as a result of competition;
- our inability to fulfill our end customers' orders due to supply chain delays, access to key commodities or technologies or events that impact our manufacturers or their suppliers;
- the amount and timing of operating costs and capital expenditures related to the operation and expansion of our business;
- changes in end-customer, distributor or reseller requirements or market needs;

- deferral or cancellation of orders from end customers, including in anticipation of new products or product enhancements announced by us or our competitors, or warranty returns;
- the inclusion of any acceptance provisions in our customer contracts or any delays in acceptance of those products;
- changes in the growth rate of the networking market;
- the actual or rumored timing and success of new product and service introductions by us or our competitors or any other change in the competitive landscape of our industry, including consolidation among our competitors or end customers;
- our ability to successfully expand our business domestically and internationally;
- our ability to increase the size of our distribution channel;
- decisions by potential end customers to purchase cloud networking solutions from larger, more established vendors, white box vendors or their primary network equipment vendors;
- price competition;
- insolvency or credit difficulties confronting our end customers, which could adversely affect their ability to purchase or pay for our products and services, or confronting our key suppliers, including our sole source suppliers, which could disrupt our supply chain;
- any disruption in our sales channel or termination of our relationship with important channel partners;
- seasonality or cyclical fluctuations in our markets;
- future accounting pronouncements or changes in our accounting policies;
- stock-based compensation expense;
- our overall effective tax rate, including impacts caused by any reorganization in our corporate structure, any changes in our valuation allowance for domestic deferred tax assets and any new legislation or regulatory developments;
- increases or decreases in our expenses caused by fluctuations in foreign currency exchange rates, as an increasing portion of our expenses are incurred and paid in currencies other than the U.S. dollar;
- general economic conditions, both domestically and in foreign markets; and
- other risk factors described in this Annual Report on Form 10-K.

Any one of the factors above or the cumulative effect of several of the factors described above may result in significant fluctuations in our financial and other results of operations. This variability and unpredictability could result in our failure to meet our revenue, gross margins, results of operations or other expectations contained in any forward looking financial guidance we have issued or the expectations of securities analysts or investors for a particular period. If we fail to meet or exceed such guidance or expectations for these or any other reasons, the market price of our common stock could decline substantially, and we could face costly lawsuits, including securities class action suits.

**We expect large purchases by a limited number of end customers to continue to represent a substantial portion of our revenue, and any loss or delay of expected purchases could result in material quarter-to-quarter fluctuations of our revenue or otherwise adversely affect our results of operations.**

Historically, large purchases by a relatively limited number of end customers have accounted for a significant portion of our revenue. Many of these end customers make large purchases to complete or upgrade specific data center installations and are typically made on a purchase-order basis rather than pursuant to long-term contracts. Revenue from sales to Microsoft, through our channel partner, World Wide Technology, Inc., accounted for 16% of our revenue for the year ended December 31, 2016, 12% of our revenue for the year ended December 31, 2015 and 15% of our revenue for the year ended December 31, 2014.

As a consequence of the concentrated nature of our customer base and their purchasing behavior, our quarterly revenue and results of operations may fluctuate from quarter to quarter and are difficult to estimate. For example, any cancellation of orders or any acceleration or delay in anticipated product purchases or the acceptance of shipped products by our larger end customers could materially affect our revenue and results of operations in any quarterly period. We may be unable to sustain or increase our revenue from our large end customers or offset the discontinuation of concentrated purchases by our larger end customers with purchases by new or existing end customers. We expect that such concentrated purchases will continue to contribute materially to our revenue for the foreseeable future and that our results of operations may fluctuate materially as a result of such larger end customers' buying patterns. In addition, we may see consolidation of our customer base, such as among Internet companies and cloud service providers, which could result in loss of end customers. The loss of such end customers, or a significant delay or reduction in their purchases, could materially harm our business, financial condition, results of operations and prospects.

**We face intense competition, especially from larger, well-established companies, and we may lack sufficient financial or other resources to maintain or improve our competitive position.**

The market for data center networking, including the market for cloud networking, is intensely competitive, and we expect competition to increase in the future from established competitors and new market entrants. This competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and our failure to increase, or the loss of, market share, any of which would likely seriously harm our business, financial condition, results of operations and prospects.

The data center networking market has been historically dominated by Cisco Systems, with competition also coming from other large network equipment and system vendors, including Brocade Communications Systems (which has entered into an agreement to be acquired by Broadcom), Dell/EMC, Hewlett Packard Enterprise and Juniper Networks. Most of our competitors have made acquisitions and/or have entered into or extended partnerships or other strategic relationships to offer more comprehensive product lines, including cloud networking solutions. For example, in the last few years alone Dell acquired Force10 and EMC, IBM acquired Blade Network Technology, Hewlett Packard Enterprises purchased Aruba, Juniper acquired Contrail, Cisco acquired Insieme, and Broadcom who intends to acquire Brocade. We also face competition from other companies and new market entrants, including "white box" switch vendors as well as current technology partners and end customers who may develop network switches and cloud service solutions for internal use and/or to broaden their portfolio of products. Many of our existing and potential competitors enjoy substantial competitive advantages, such as:

- greater name recognition and longer operating histories;
- larger sales and marketing budgets and resources;
- broader distribution and established relationships with channel partners and end customers;
- greater access to larger end-customer bases;
- greater end-customer support resources;
- greater manufacturing resources;
- the ability to leverage their sales efforts across a broader portfolio of products;
- the ability to leverage purchasing power with vendor subcomponents;
- the ability to bundle competitive offerings with other products and services;
- the ability to develop their own silicon chips;
- the ability to set more aggressive pricing policies;
- lower labor and development costs;
- greater resources to make acquisitions;
- larger intellectual property portfolios; and
- substantially greater financial, technical, research and development or other resources.

Our competitors also may be able to provide end customers with capabilities or benefits different from or greater than those we can provide in areas such as technical qualifications or geographic presence or may be able to provide end customers a broader range of products, services and prices. In addition, large competitors may have more extensive relationships with and within existing and potential end customers that provide them with an advantage in competing for business with those end customers. For example, certain large competitors encourage end customers of their other products and services to adopt their data networking solutions through discounted bundled product packages. Our ability to compete will depend upon our ability to provide a better solution than our competitors at a more competitive price. We may be required to make substantial additional investments in research, development, marketing and sales in order to respond to competition, and we cannot assure you that these investments will achieve any returns for us or that we will be able to compete successfully in the future.

We also expect increased competition if our market continues to expand. Conditions in our market could change rapidly and significantly as a result of technological advancements or other factors. Current or potential competitors may be acquired by third parties that have greater resources available than we do. Our current or potential competitors might take advantage of the greater resources of the larger organization resulting from these acquisitions to compete more vigorously or broadly with us. In addition, continued industry consolidation might adversely affect end customers' perceptions of the viability of smaller and even medium-sized networking companies and, consequently, end customers' willingness to purchase from those companies. Further, certain large end customers may develop network switches and cloud service solutions for internal use and/or to broaden their portfolio of products, which could allow these end customers to become new competitors in the market.

## **We are currently involved in litigation with Cisco Systems, Inc.**

We are currently involved in several litigation matters with Cisco Systems, Inc. These matters are summarized below.

### *Cisco Systems, Inc. v. Arista Networks, Inc. (Case No. 4:14-cv-05343) (“’43 Case”)*

On December 5, 2014, Cisco filed a complaint against us in the District Court for the Northern District of California alleging that we infringe U.S. Patent Nos. 6,377,577; 6,741,592; 7,023,853; 7,061,875; 7,162,537; 7,200,145; 7,224,668; 7,290,164; 7,340,597; 7,460,492; 8,051,211; and 8,356,296 (respectively, “the ’577 patent,” “the ’592 patent,” “the ’853 patent,” “the ’875 patent,” “the ’537 patent,” “the ’145 patent,” “the ’668 patent,” “the ’164 patent,” “the ’597 patent,” “the ’492 patent,” “the ’211 patent,” and “the ’296 patent”). Cisco seeks, as relief for our alleged infringement in the ’43 Case, lost profits and/or reasonable royalty damages in an unspecified amount, including treble damages, attorney’s fees, and associated costs. Cisco also seeks injunctive relief in the ’43 Case. On February 10, 2015, the Court granted our unopposed motion to stay the ’43 Case until the proceedings before the United States International Trade Commission (“USITC”) pertaining to the same patents (as discussed below) became final. Trial has not been scheduled in the ’43 Case.

### *Cisco Systems, Inc. v. Arista Networks, Inc. (Case No. 5:14-cv-05344) (“’44 Case”)*

On December 5, 2014, Cisco filed a complaint against us in the District Court for the Northern District of California alleging that we infringe numerous copyrights pertaining to Cisco’s “Command Line Interface” or “CLI” and U.S. Patent Nos. 7,047,526 and 7,953,886 (respectively, “the ’526 patent” and “the ’886 patent”). As relief for our alleged patent infringement in the ’44 Case, Cisco seeks lost profits and/or reasonable royalty damages in an unspecified amount including treble damages, attorney’s fees, and associated costs as well as injunctive relief. As relief for our alleged copyright infringement, Cisco seeks monetary damages for alleged lost profits, profits from our alleged infringement, statutory damages, attorney’s fees, and associated costs.

On February 13, 2015, we answered the complaint in the ’44 Case, denying the patent and copyright infringement allegations and raising numerous affirmative defenses. On March 6, 2015, Cisco filed an amended complaint against us in the ’44 Case. In response, we moved to dismiss Cisco’s allegations of willful patent infringement and pre-suit indirect patent infringement. The Court granted the motion with leave to amend on July 2, 2015. On July 23, 2015, Cisco filed an amended complaint.

As described below, on May 25, 2016, our petition for Inter Partes Review (“IPR”) of the ’886 patent was instituted by the United States Patent Trial and Appeal Board (“PTAB”). Cisco subsequently agreed to dismiss its claims as to the ’886 patent with prejudice.

Summary judgment cross-motions in the ’44 Case were heard on August 4, 2016, and the Court denied all motions brought by both sides. Trial began on November 28, 2016, and the jury rendered its verdict on December 14, 2016. The jury found that we had proven our copyright defense of *scenes a faire* and that Cisco had failed to prove infringement of the ’526 patent, and on that basis judgment was entered in Arista’s favor on all claims on December 19, 2016.

On January 17, 2017, Cisco filed a motion for judgment as a matter of law, challenging the sufficiency of the evidence in support of our *scenes a faire* defense. Cisco did not file any post-trial motion regarding the ’526 patent, nor did it file a motion for a new trial. We also filed a motion for judgment as a matter of law on several issues. The hearing on both parties’ motions is currently set for April 27, 2017.

### *Arista Networks, Inc. v. Cisco Systems, Inc. (Case No. 5:16-cv-00923) (“’23 Case”)*

On February 24, 2016, we filed a complaint against Cisco in the District Court for the Northern District of California alleging antitrust violations and unfair competition. On April 13, 2016, Cisco filed a motion to stay the ’23 Case, or in the alternative, to dismiss the complaint. On August 23, 2016, the Court granted Cisco’s motion to stay the ’23 Case until judgment has been entered on Cisco’s copyright claims in the ’44 Case, which the Court anticipated by December 22, 2016. Following the jury’s verdict in Arista’s favor in the ’44 Case, the parties filed a stipulation continuing the Case Management Conference until March 2, 2017. Trial in the ’23 Case is set for August 3, 2018, and is not affected by the Court’s granting of the interim stay.

### *Certain Network Devices, Related Software, and Components Thereof (Inv. No. 337-TA-944) (“944 Investigation”)*

On December 19, 2014, Cisco filed a complaint against us in the USITC alleging that Arista has violated Section 337 of the Tariff Act of 1930, as amended. The USITC instituted Cisco’s complaint as Investigation No. 337-TA-944. Cisco initially alleged that certain Arista switching products infringe the ’592, ’537, ’145, ’164, ’597, and ’296 patents. Cisco subsequently dropped the ’296 patent from the 944 Investigation. Cisco sought, among other things, a limited exclusion order barring entry into the United States of accused switch products (including Arista’s 7000 Series of switches) and components and software therein and a cease and desist order against us restricting our activities with respect to our imported accused switch products and components and software therein. On February 11, 2015, we responded to the complaint in the 944 Investigation by, among other things, denying the patent infringement allegations and raising numerous affirmative defenses.

The Administrative Law Judge (“ALJ”) assigned to the 944 Investigation issued a procedural schedule calling for, among other events: an evidentiary hearing on September 9-11 and 15-17, 2015; issuance of an initial determination regarding our alleged violations on January 27, 2016; and a Target Date for completion of the investigation on May 27, 2016. On January 27, 2016, the ALJ issued a

revised procedural schedule extending the date for issuance of an initial determination to February 2, 2016 and extending the Target Date to June 2, 2016.

On February 2, 2016, the ALJ issued his initial determination finding a violation of section 337 of the Tariff Act. More specifically, the ALJ found that a violation has occurred in the importation into the United States, the sale for importation, or the sale within the United States after importation, of certain network devices, related software, and components thereof that the ALJ found infringe asserted claims 1, 2, 8-11, and 17-19 of the '537 patent; asserted claims 6, 7, 20, and 21 of the '592 patent; and asserted claims 5, 7, 45, and 46 of the '145 patent. The ALJ did not find a violation of section 337 with respect to any asserted claims of the '597 and '164 patents. On April 11, 2016, the Commission decided to review certain findings contained in the initial determination. On June 23, 2016, the Commission issued its Final Determination, which found a violation with respect to the '537, '592, and '145 patents, and found no violation with respect to the '597 and '164 patents. The Commission also issued a limited exclusion order and a cease and desist order pertaining to network devices, related software and components thereof that infringe one or more of claims 1, 2, 8-11, and 17-19 of the '537 patent; claims 6, 7, 20, and 21 of the '592 patent; and claims 5, 7, 45, and 46 of the '145 patent. On August 22, 2016, the Presidential review period for the 944 investigation expired. The USITC orders will be in effect until the expiration of the '537, '592, and '145 patents.

Both we and Cisco filed petitions for review of the USITC's Final Determination to the U.S. Court of Appeals for the Federal Circuit ("Federal Circuit"). On August 26, 2016, the Federal Circuit consolidated the appeals, and on September 23, 2016, it issued an order setting an expedited briefing schedule. The appeal is fully briefed and oral argument has not been scheduled.

On August 26, 2016, Cisco filed an enforcement complaint under Section 337 of the Tariff Act of 1930, as amended, with the USITC. Cisco alleges that we are violating the cease and desist and limited exclusion orders issued in the 944 Investigation by engaging in the "marketing, distribution, offering for sale, selling, advertising, and/or aiding or abetting other entities in the sale and/or distribution of products that Cisco alleges continue to infringe claims 1-2, 8-11, and 17-19 of the '537 patent," despite the design changes we have made to those products. Cisco asks the USITC to (1) enforce the cease and desist order; (2) modify the Commission's limited exclusion order and/or cease and desist order "in any manner that would assist in the prevention of the unfair practices that were originally the basis for issuing such Order or assist in the detection of violations of such Order"; (3) impose the maximum statutory civil penalties for violation of the cease and desist order "including monetary sanctions for each day's violation of the cease and desist order of the greater of \$100,000.00 or twice the domestic value of the articles entered or sold, whichever is higher"; (4) bring a civil action in U.S. district court "requesting collection of such civil penalties and the issuance of a mandatory injunction preventing further violation of Cease and Desist Order"; and (5) impose "such other remedies and sanctions as are appropriate and within the Commission's authority." On September 28, 2016, the Commission instituted the enforcement proceeding. The proceeding has been assigned to Administrative Law Judge Shaw, who presided over the underlying investigation. On October 14, 2016, we responded to the complaint by, among other things, denying the patent infringement allegations and raising affirmative defenses. On November 2, 2016, the ALJ issued an order setting the deadline for the initial determination for June 20, 2017 and the Target Date for September 20, 2017. On November 3, 2016, the ALJ issued a scheduling order setting the evidentiary hearing in this proceeding for April 5, 2017.

*Certain Network Devices, Related Software, and Components Thereof (Inv. No. 337-TA-945) ("945 Investigation")*

On December 19, 2014, Cisco filed a complaint against us in the USITC alleging that Arista violated Section 337 of the Tariff Act of 1930, as amended. The USITC instituted Cisco's complaint as Investigation No. 337-TA-945. Cisco alleges that certain Arista switching products infringe the '577, '853, '875, '668, '492, and '211 patents. Cisco seeks, among other things, a limited exclusion order barring entry into the United States of accused switch products (including Arista's 7000 Series of switches), related software, and components thereof and a cease and desist order against us restricting our activities with respect to our imported accused switch products, related software, and components thereof. On February 11, 2015, we responded to the notice of investigation and complaint in the 945 Investigation by, among other things, denying the patent infringement allegations and raising numerous affirmative defenses.

The ALJ issued a procedural schedule calling for, among other events: an evidentiary hearing on November 9-20, 2015; issuance of an initial determination regarding our alleged violations on April 26, 2016; and a Target Date for completion on August 26, 2016. On March 29, 2016, the ALJ issued a revised procedural schedule extending the deadline for issuance of an initial determination to August 26, 2016, and extending the Target Date to December 26, 2016. On August 24, 2016, the ALJ issued a revised procedural schedule extending the deadline for issuance of an initial determination to November 7, 2016, and extending the Target Date to March 7, 2017. On November 4, 2016, the ALJ issued a revised procedural schedule extending the deadline for issuance of an initial determination to December 7, 2016, and extending the Target Date to April 7, 2017. On December 7, 2016, the ALJ issued a revised procedural schedule extending the deadline for issuance of an initial determination to December 9, 2016, and extending the Target Date to April 9, 2017.

On December 9, 2016, the ALJ issued her initial determination finding a violation of section 337 of the Tariff Act. More specifically, the ALJ found that a violation has occurred in the importation into the United States, the sale for importation, or the sale within the United States after importation, of certain network devices, related software, and components thereof that the ALJ found infringe asserted claims 1, 7, 9, 10, and 15 of the '577 patent; and asserted claims 1, 2, 4, 5, 7, 8, 10, 13, 19, 56, and 64 of the '668 patent. The ALJ did not find a violation of section 337 with respect to asserted claim 2 of the '577 patent or any asserted claims of the '853, '492, '875, and '211 patents. On December 29, 2016, Arista, Cisco and the Office of Unfair Import Investigation ("OUII") filed petitions for review of certain findings contained in the initial determination. On January 3, 2017, the Commission extended the Target Date to April 17, 2017, and set the deadline for determining whether to review the final initial determination to February 15, 2017. On January

27, 2017, the Commission further extended the Target Date to May 1, 2017, and set the deadline for determining whether to review the final initial determination to March 1, 2017. If the Commission finds a violation in its Final Determination, that finding will be subject to a 60-day Presidential review period.

#### Inter Partes Reviews

We have filed petitions for Inter Partes Review (“IPR”) of the ’597, ’211, ’668, ’853, ’537, ’577, ’886, and ’526 patents.

IPRs relating to the ’597 (IPR No. 2015-00978) and ’211 (IPR No. 2015-00975) patents were instituted in October 2015 and hearings on these IPRs were completed in July 2016. On September 28, 2016, the PTAB issued a final written decision finding claims 1, 14, 39-42, 71, 72, 84, and 85 of the ’597 patent unpatentable. The PTAB also found that claims 29, 63, 64, 73, and 86 of the ’597 patent had not been shown to be unpatentable. Cisco requested rehearing of the PTAB’s Final Written Decision on October 28, 2016, which the PTAB denied on January 13, 2017. On January 23, 2017, we filed a notice of appeal with respect to this decision regarding claims 29, 63, 64, 73, and 86 of the ’597 patent. On October 5, 2016, the PTAB issued a final written decision finding claims 1 and 12 of the ’211 patent unpatentable. The PTAB also found that claims 2, 6-9, 13, 17-20 of the ’211 patent had not been shown to be unpatentable. On December 5, 2016, we filed a notice of appeal with respect to this decision regarding claims 2, 6-9, 13, 17-20, which was docketed as Appeal No. 17-1313. Cisco filed a notice of cross-appeal with respect to claims 1 and 12 on December 19, 2016, which was docketed as Appeal No. 17-1380. The Court of Appeals for the Federal Circuit consolidated these appeals on December 20, 2016. The briefing is set to be completed in July 2017.

The IPR relating to the ’886 patent was instituted on May 25, 2016. Following that decision, Cisco agreed to dismiss its claims as to the ’886 patent with prejudice, and we dismissed our counterclaims as to the ’886 patent without prejudice.

IPRs relating to the ’668 (IPR No. 2016-00309), ’577 (IPR No. 2016-00303), ’853 (IPR No. 2016-0306), and ’537 (IPR No. 2016-0308) patents were instituted in June 2016 and are set for hearing in March 2017. Final Written Decisions on these IPRs will be issued by June 2017.

\* \* \* \* \*

We intend to vigorously defend against each of the Cisco’s lawsuits, as summarized in the preceding paragraphs. However, we cannot be certain that any claims by Cisco would be resolved in our favor regardless of the merit of the claims. Any adverse litigation ruling could result in the above described injunctive relief, could require a significant damages award against us or a requirement that we make substantial royalty payments to Cisco, and/or could require that we modify our products to the extent that we are found to infringe any valid claims asserted against us by Cisco.

For example, in the 944 Investigation, the USITC has issued a limited exclusion order barring entry into the United States of our network devices (including our 7000 Series of switches), related software, and components thereof that infringe one or more of the claims of the ’537, ’592, and ’145 patents specified above and a cease and desist order restricting our activities with respect to such imported products. In addition, in the 945 Investigation, the ALJ has issued her initial determination finding a violation of section 337 of the Tariff Act with respect to the ’668 and ’577 patents, which is now subject to review by the Commission.

To comply with these orders, we have sought to develop technical design-arounds that no longer infringe the patents that are the subject of the orders. In any efforts to develop technical design-arounds for our products, we may be unable to do so in a manner that does not continue to infringe the patents or that is acceptable to our customers. These development efforts could be extremely costly and time consuming as well as disruptive to our other development activities and distracting to management. Moreover, in the 944 Investigation and 945 Investigation, such design-arounds would require us to obtain approval of either the USITC or U.S. Customs and Border Protection (“CBP”) to resume the importation of the redesigned products into the United States. We may not be successful in our efforts to obtain such approvals to import such modified products in a timely manner, or at all. While a favorable ruling from the CBP would allow us to resume importation of our redesigned products into the United States, the USITC could still determine in an enforcement action that our redesigned products continue to infringe the patents that are the subject of any USITC orders. Any failure to effectively redesign our products, to obtain timely clearance from USITC or CBP to import such redesigned products, or to address the USITC findings in a manner that complies with the USITC orders, may cause a disruption to our product shipments and materially and adversely affect our business, prospects, reputation, results of operations, and financial condition.

Specifically, in response to the USITC’s findings in the 944 Investigation, we have made design changes to our products for sale in the United States to address the features that were found to infringe the ’537, ’592, ’145 patents. Following the issuance of the final determination in the 944 Investigation, we submitted a Section 177 ruling request to CBP seeking approval to import these redesigned products into the United States. On November 18, 2016, we received a 177 ruling from CBP finding that our redesigned products did not infringe the ’537, ’592, and ’145 patents, and approving the importation of these redesigned products into the United States. However, on January 13, 2017, at the request of Cisco Systems and without our input, CBP issued a letter to us revoking its prior November 18 ruling. Due to this revocation, Arista can no longer import its products into the United States. The CBP has informed us that it currently takes no position on whether Arista’s redesigned products infringe and will conduct an *inter partes* proceeding between Arista and Cisco to determine whether Arista’s redesigned products infringe and whether to approve them for importation into the United States. We do

not yet know when CBP will complete the process and provide that ruling. The CBP may not rule in a timely fashion, and we may not receive a favorable ruling at the end of the process.

Similarly, if the USITC finds in a Final Determination that we infringe any patent in the 945 Investigation, the USITC will likely issue remedial orders in that investigation as well. If such orders are not disapproved by the United States Trade Representative, we would need to further modify our products to take our products outside the scope of any patents we are found to have infringed in the 945 Investigation and obtain the USITC and/or CBP approvals described above in order to resume importation of our redesigned products into the United States.

If the USITC determines that our redesigned products continue to infringe the patents subject to any USITC limited exclusion order or cease and desist order in an enforcement action for either the 944 Investigation or the 945 Investigation, the USITC may impose the maximum statutory civil penalties for violation of the cease and desist order “including monetary sanctions for each day’s violation of the cease and desist order of the greater of \$100,000.00 or twice the domestic value of the articles entered or sold, whichever is higher,” bring a civil action in U.S. district court “requesting collection of such civil penalties and the issuance of a mandatory injunction preventing further violation of Cease and Desist Order” or impose “such other remedies and sanctions as are appropriate and within the Commission’s authority.”

In order to comply with the USITC’s remedial orders, we have also made certain changes to our manufacturing, importation, and shipping workflows. These changes have included shifting manufacturing and integration of our products to be sold in the United States to U.S. facilities. Such changes may be extremely costly, time consuming, and we may not be able to implement such changes successfully. Any failure to successfully change our manufacturing and importation processes or shipping workflows in a manner that is compliant with the limited exclusion order and cease and desist order may cause a disruption in our product shipments and materially and adversely affect our business, prospects, reputation, results of operations, and financial condition.

In connection with these changes, to the extent that we are required to make further modifications to our supply chain to obtain alternative U.S. sources for subcomponents, we may be unable to obtain a sufficient quantity of these components on commercially reasonable terms or in a timely manner, if at all, which could delay or halt entirely production of our products or require us to make further modifications to our products to incorporate new components that are available in the United States. Any of these events could result in lost sales, reduced gross margins or damage to our end-customer relationships, which would materially and adversely impact our business, financial condition, results of operations and prospects.

Additionally, the existence of Cisco’s lawsuits against us could cause concern among our customers and partners and could adversely affect our business and results of operations. Many of our customers and partners require us to indemnify and defend them against third party infringement claims and pay damages in the case of adverse rulings. These claims could harm our relationships with our customers or channel partners, cause them to delay or defer purchasing decisions or deter them from doing business with us. From time to time, we may also be required to provide additional assurances beyond our standard terms. Whether or not we prevail in the lawsuit, we expect that the litigation will be expensive, time-consuming and a distraction to management in operating our business.

#### **We are currently involved in a license dispute with OptumSoft, Inc.**

On April 4, 2014, OptumSoft filed a lawsuit against us in the Superior Court of California, Santa Clara County titled *OptumSoft, Inc. v. Arista Networks, Inc.*, in which it asserts (i) ownership of certain components of our EOS network operating system pursuant to the terms of a 2004 agreement between the companies; and (ii) breaches of certain confidentiality and use restrictions in that agreement. Under the terms of the 2004 agreement, OptumSoft provided us with a non-exclusive, irrevocable, royalty-free license to software delivered by OptumSoft comprising a software tool used to develop certain components of EOS and a runtime library that is incorporated into EOS. The 2004 agreement places certain restrictions on our use and disclosure of the OptumSoft software and gives OptumSoft ownership of improvements, modifications and corrections to, and derivative works of, the OptumSoft software that we develop.

In its lawsuit, OptumSoft has asked the Court to order us to (i) give OptumSoft access to our software for evaluation by OptumSoft; (ii) cease all conduct constituting the alleged confidentiality and use restriction breaches; (iii) secure the return or deletion of OptumSoft’s alleged intellectual property provided to third parties, including our customers; (iv) assign ownership to OptumSoft of OptumSoft’s alleged intellectual property currently owned by us; and (v) pay OptumSoft’s alleged damages, attorney’s fees, and costs of the lawsuit. David Cheriton, one of our founders and a former member of our board of directors, who resigned from our board of directors on March 1, 2014 and has no continuing role with us, is a founder and, we believe, the largest stockholder and director of OptumSoft. The 2010 David R. Cheriton Irrevocable Trust dtd July 28, 2010, a trust for the benefit of the minor children of Mr. Cheriton, is one of our largest stockholders.

On April 14, 2014, we filed a cross-complaint against OptumSoft, in which we assert our ownership of the software components at issue and our interpretation of the 2004 agreement. Among other things, we assert that the language of the 2004 agreement and the parties’ long course of conduct support our ownership of the disputed software components. We ask the Court to declare our ownership of those software components, all similarly-situated software components developed in the future and all related intellectual property. We also assert that, even if we are found not to own certain components, such components are licensed to us under the terms of the 2004 agreement. However, there can be no assurance that our assertions will ultimately prevail in litigation. On the same day, we also filed an answer to OptumSoft’s claims, as well as affirmative defenses based in part on OptumSoft’s failure to maintain the confidentiality of

its claimed trade secrets, its authorization of the disclosures it asserts and its delay in claiming ownership of the software components at issue. We have also taken additional steps to respond to OptumSoft's allegations that we improperly used and/or disclosed OptumSoft confidential information. While we believe we have meritorious defenses to these allegations, we believe we have (i) revised our software to remove the elements we understand to be the subject of the claims relating to improper use and disclosure of OptumSoft confidential information and made the revised software available to our customers and (ii) removed information from our website that OptumSoft asserted disclosed OptumSoft confidential information.

The parties tried Phase I of the case, relating to contract interpretation and application of the contract to certain claimed source code, in September 2015. On December 16, 2015, the Court issued a Proposed Statement of Decision Following Phase I Trial, and on January 8, 2016, OptumSoft filed objections to that Proposed Statement of Decision. On March 23, 2016, the Court issued a Final Statement of Decision Following Phase I Trial, in which it agreed with and adopted our interpretation of the 2004 agreement and held that we, and not OptumSoft, own all the software at issue in Phase I. The remaining issues that were not addressed in the Phase I trial are set to be tried in Phase II including the application of the Court's interpretation of the 2004 agreement as set forth in the Final Statement of Decision Following Phase I Trial to any other source code that OptumSoft claims to own following a review. Phase II was previously scheduled to be tried in April 2016; however, that trial date has been vacated and a new trial date has not yet been set.

We intend to vigorously defend against any claims brought against us by OptumSoft. However, we cannot be certain that, if litigated, any claims by OptumSoft would be resolved in our favor. For example, if it were determined that OptumSoft owned components of our EOS network operating system, we would be required to transfer ownership of those components and any related intellectual property to OptumSoft. If OptumSoft were the owner of those components, it could make them available to our competitors, such as through a sale or license. An adverse litigation ruling could result in a significant damages award against us and injunctive relief. In addition, OptumSoft could assert additional or different claims against us, including claims that our license from OptumSoft is invalid.

**Our revenue growth rate in recent periods may not be indicative of our future performance.**

Our revenue growth rate in recent periods may not be indicative of our future performance. We experienced annual revenue growth rates of 34.8% , 43.4%, and 61.7% in 2016 , 2015 , and 2014 , respectively. We may not achieve similar revenue growth rates in future periods, especially as we enter and expand into the cloud services and application services provider markets. You should not rely on our revenue for any prior quarterly or annual period as any indication of our future revenue or revenue growth. If we are unable to maintain consistent revenue or revenue growth, our business, financial condition, results of operations and prospects could be materially adversely affected.

**Some of our large end customers require more favorable terms and conditions from their vendors and may request price concessions. As we seek to sell more products to these end customers, we may be required to agree to terms and conditions that may have an adverse effect on our business or ability to recognize revenue.**

Our large end customers have significant purchasing power and, as a result, may receive more favorable terms and conditions than we typically provide to other end customers, including lower prices, bundled upgrades, extended warranties, acceptance terms, indemnification terms and extended return policies and other contractual rights. As we seek to sell more products to these large end customers, an increased mix of our shipments may be subject to such terms and conditions, which may reduce our margins or affect the timing of our revenue recognition and thus may have an adverse effect on our business, financial condition, results of operations and prospects.

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

The cloud networking market can be characterized by rapid technological shifts and increasingly complex end-customer requirements to achieve scalable and more programmable networks that facilitate virtualization, big data, public/private cloud and web scale computing. We must continue to develop new technologies and products that address emerging technological trends and changing end-customer needs. The process of developing new technology is complex and uncertain, and new offerings requires significant upfront investment that may not result in material design improvements to existing products or result in marketable new products or costs savings or revenue for an extended period of time, if at all. The success of new products depends on several factors, including appropriate new product definition, component costs, timely completion and introduction of these products, differentiation of new products from those of our competitors and market acceptance of these products.

In addition, new technologies could render our existing products obsolete or less attractive to end customers, and our business, financial condition, results of operations and prospects could be materially adversely affected if such technologies are widely adopted. For example, end customers may prefer to address their network switch requirements by licensing software operating systems separately and placing them on industry-standard servers or develop their own networking products rather than purchasing integrated hardware products as has occurred in the server industry.

We may not be able to successfully anticipate or adapt to changing technology or end-customer requirements on a timely basis, or at all. If we fail to keep up with technology changes or to convince our end customers and potential end customers of the value of our

solutions even in light of new technologies, our business, financial condition, results of operations and prospects could be materially adversely affected.

**Product quality problems, defects, errors or vulnerabilities in our products or services could harm our reputation and adversely affect our business, financial condition, results of operations and prospects.**

We produce highly complex products that incorporate advanced technologies, including both hardware and software technologies. Despite testing prior to their release, our products may contain undetected defects or errors, especially when first introduced or when new versions are released. Product defects or errors could affect the performance of our products and could delay the development or release of new products or new versions of products. Allegations of unsatisfactory performance could cause us to lose revenue or market share, increase our service costs, cause us to incur substantial costs in analyzing, correcting or redesigning the products, cause us to lose significant end customers, subject us to liability for damages and divert our resources from other tasks, any one of which could materially adversely affect our business, financial condition, results of operations and prospects.

From time to time, we have had to replace certain components of products that we had shipped and provide remediation in response to the discovery of defects or bugs, including failures in software protocols or defective component batches resulting in reliability issues, in such products, and we may be required to do so in the future. We may also be required to provide full replacements or refunds for such defective products. We cannot assure you that such remediation would not have a material effect on our business, financial condition, results of operations and prospects. Please see “Our business is subject to the risks of warranty claims, product returns, product liability and product defects.”

**Managing the supply of our products and product components is complex. Insufficient supply and inventory may result in lost sales opportunities or delayed revenue, while excess inventory may harm our gross margins.**

Managing the supply of our products and product components is complex, and our inventory management systems and related supply-chain visibility tools may not enable us to forecast accurately and manage effectively the supply of our products and product components. Furthermore, ongoing Cisco litigation before the USITC and any adverse ruling that results from such litigation could cause disruption to our supply-chain or with our suppliers, which may impact our revenues, business and reputation. For example, in the 944 Investigation, the USITC has issued a limited exclusion order barring entry into the United States of our network devices (including our 7000 Series of switches), related software and components thereof that infringe one or more of the claims of the '537, '592, and '145 patents specified above and a Cease and Desist Order restricting our activities with respect to such imported products, which could prevent us from using inventory to satisfy U.S demand and may cause us to write-down such inventory, which could reduce our gross margins.

To the extent that we are required to obtain alternative U.S. sources for these components, we may be unable to obtain a sufficient quantity of these components on commercially reasonable terms or in a timely manner, if at all, sales of our products could be delayed or halted entirely or we may be required to redesign our products. Any of these events could result in lost sales, reduced gross margins or damage to our end-customer relationships, which would materially and adversely impact our business, financial condition, results of operations and prospects.

Insufficient supply and inventory may result in increased lead times for our products, lost sales opportunities or delayed revenue, while excess inventory may harm our gross margins. In order to reduce manufacturing lead times and plan for adequate component supply, from time to time we may issue purchase orders for components and products that are non-cancelable and non-returnable. We establish a liability for non-cancelable, non-returnable purchase commitments with our component inventory suppliers for quantities in excess of our demand forecasts, or for products that are considered obsolete. In addition, we establish a liability and reimburse our contract manufacturer for component inventory purchased on our behalf that has been rendered excess or obsolete due to manufacturing and engineering change orders, or in cases where inventory levels greatly exceed our demand forecasts.

Supply management remains an increased area of focus as we balance the need to maintain sufficient supply levels to ensure competitive lead times against the risk of obsolescence or the end of life of certain products. If we ultimately determine that we have excess supply, we may have to reduce our prices and write down inventory, which in turn could result in lower gross margins. We record a provision when inventory is determined to be in excess of anticipated demand or obsolete to adjust inventory to its estimated realizable value.

Alternatively, insufficient supply levels may lead to shortages that result in delayed revenue or loss of sales opportunities altogether as potential end customers turn to competitors' products that are readily available. Additionally, any increases in the time required to manufacture our products or ship products could result in supply shortfalls. If we are unable to effectively manage our supply and inventory, our business, financial condition, results of operations and prospects could be adversely affected.

**Because some of the key components in our products come from sole limited sources of supply, we are susceptible to supply shortages or supply changes, which could disrupt or delay our scheduled product deliveries to our end customers and may result in the loss of sales and end customers.**

Our products rely on key components, including integrated circuit components and power supplies that our contract manufacturers purchase on our behalf from a limited number of suppliers, including certain sole source providers. We do not have guaranteed supply contracts with any of our component suppliers, and our suppliers could delay shipments or cease manufacturing such products or selling them to us at any time. For example, in the past we have experienced shortages in inventory for dynamic random access memory integrated circuits and delayed releases of the next generation of chipset, which delayed our production and/or the release of our new products. The development of alternate sources for those components is time-consuming, difficult and costly. Additionally, in the 944 Investigation, the USITC has issued a Limited Exclusion Order barring entry into the United States of our network devices (including our 7000 Series of switches), related software and components thereof that infringe one or more of the claims of the '537, '592, and '145 patents specified above and a Cease and Desist Order restricting our activities with respect to such imported products. If we are unable to obtain a sufficient quantity of these components on commercially reasonable terms or in a timely manner, or if we are unable to obtain alternative sources for these components, sales of our products could be delayed or halted entirely or we may be required to redesign our products. Any of these events could result in lost sales, reduced gross margins or damage to our end-customer relationships, which would adversely impact our business, financial condition, results of operations and prospects.

Our reliance on component suppliers also yields the potential for their infringement or misappropriation of third party intellectual property rights with respect to components which may be incorporated into our products. We may not be indemnified by such component suppliers for such infringement or misappropriation claims. Any litigation for which we do not receive indemnification could require us to incur significant legal expenses in defending against such claims or require us to pay substantial royalty payments or settlement amounts that would not be reimbursed by our component suppliers.

Our product development efforts are also dependent upon our continued collaboration with our key merchant silicon vendors such as Broadcom and Intel. As we develop our product roadmap and continue to expand our relationships with these and other merchant silicon vendors, it is critical that we work in tandem with our key merchant silicon vendors to ensure that their silicon includes improved features and that our products take advantage of such improved features. This enables us to focus our research and development resources on our software core competencies and to leverage the investments made by merchant silicon vendors to achieve cost-effective solutions.

If our key merchant silicon vendors do not continue to collaborate in such a fashion, if they do not continue to innovate or if there are delays in the release of their products, our own product launches could be delayed, which could have a material effect on revenue and business, financial condition, results of operations and prospects.

In the event of a shortage or supply interruption from our component suppliers, we may not be able to develop alternate or second sources in a timely manner. Further, long-term supply and maintenance obligations to end customers increase the duration for which specific components are required, which may increase the risk of component shortages or the cost of carrying inventory. In addition, our component suppliers change their selling prices frequently in response to market trends, including industry-wide increases in demand, and because we do not have contracts with these suppliers, we are susceptible to price fluctuations related to raw materials and components. If we are unable to pass component price increases along to our end customers or maintain stable pricing, our gross margins could be adversely affected and our business, financial condition, results of operations and prospects could suffer.

**Because we depend on third-party manufacturers to build our products, we are susceptible to manufacturing delays and pricing fluctuations that could prevent us from shipping end-customer orders on time, if at all, or on a cost-effective basis, which may result in the loss of sales and end customers.**

We depend on third-party contract manufacturers to manufacture our product lines. A significant portion of our cost of revenue consists of payments to these third-party contract manufacturers. Our reliance on these third-party contract manufacturers reduces our control over the manufacturing process, quality assurance, product costs and product supply and timing, which exposes us to risk. To the extent that our products are manufactured at facilities in foreign countries, we may be subject to additional risks associated with complying with local rules and regulations in those jurisdictions. Our reliance on contract manufacturers also yields the potential for their infringement of third party intellectual property rights in the manufacturing of our products or misappropriation of our intellectual property rights in the manufacturing of other customers' products. If we are unable to manage our relationships with our third-party contract manufacturers effectively, or if these third-party manufacturers suffer delays or disruptions or quality control problems in their operations, experience increased manufacturing lead times, capacity constraints or quality control problems in their manufacturing operations or fail to meet our future requirements for timely delivery, our ability to ship products to our end customers would be severely impaired, and our business, financial condition, results of operations and prospects would be seriously harmed.

Our contract manufacturers typically fulfill our supply requirements on the basis of individual orders. We do not have long-term contracts with our third-party manufacturers that guarantee capacity, the continuation of particular pricing terms or the extension of credit limits. Accordingly, they are not obligated to continue to fulfill our supply requirements, which could result in supply shortages, and the prices we are charged for manufacturing services could be increased on short notice. For example, a competitor could place large orders with the third-party manufacturer, thereby utilizing all or substantially all of such third-party manufacturer's capacity and leaving the manufacturer little or no capacity to fulfill our individual orders without price increases or delays, or at all. Our contract with one of our

contract manufacturers permits it to terminate the agreement for convenience, subject to prior notice requirements. We may not be able to develop alternate or second contract manufacturers in a timely manner.

If we add or change contract manufacturers, or change any manufacturing plant locations within a contract manufacturer network, we would add additional complexity and risk to our supply chain management and may increase our working capital requirements. Ensuring a new contract manufacturer or new plant location is qualified to manufacture our products to our standards and industry requirements could take significant effort and be time consuming and expensive. For example, we have added Sanmina as an additional contract manufacturer. Any such addition or change in manufacturers may be extremely costly, time consuming and we may not be able to do so successfully.

In addition, we may be subject to additional significant challenges in ensuring that quality, processes and costs, among other issues, are consistent with our expectations and those of our customers. A new contract manufacturer or manufacturing location may not be able to scale its production of our products at the volumes or quality we require. This could also adversely affect our ability to meet our scheduled product deliveries to our end customers, which could damage our customer relationships and cause the loss of sales to existing or potential end customers, late delivery penalties, delayed revenue or an increase in our costs which could adversely affect our gross margins. This could also result in increased levels of inventory subjecting us to increased excess and obsolete charges that could have a negative impact on our operating results.

We have expanded our contract manufacturing capabilities to include Sanmina as an additional contract manufacturer, which will increase our working capital requirements and the risks noted above apply to this new contract manufacturer. No assurance can be given that this contract manufacturer will continue to successfully qualify and scale production of our products in the volumes or quality that we require. If a USITC Limited Exclusion Order issued in connection with the Cisco litigation bars entry of our products into the United States and we are unable to obtain CPB approval to resume the importation of our redesigned products, we would become reliant upon U.S. manufacturing to continue to supply our products to our U.S. customers. Any failure to meet our scheduled product deliveries to our end customers could damage our customer relationships and cause the loss of sales to existing or potential end customers, late delivery penalties, delayed revenue or an increase in our costs which could adversely affect our gross margins.

Any production interruptions or disruptions for any reason, including those noted above, as well as a natural disaster, epidemic, capacity shortages, adverse results from intellectual property litigation or quality problems, at one of our manufacturing partners would adversely affect sales of our product lines manufactured by that manufacturing partner and adversely affect our business, financial condition, results of operations and prospects.

**If we are unable to attract new large end customers or to sell additional products to our existing end customers, our revenue growth will be adversely affected and our revenue could decrease.**

To increase our revenue, we must add new end customers and large end customers and sell additional products to existing end customers. For example, one of our sales strategies is to target specific projects at our current end customers because they are familiar with the operational and economic benefits of our solutions, thereby reducing the sales cycle into these customers. We believe this opportunity with current end customers to be significant given their existing infrastructure and expected future spend. If we fail to attract new large end customers or fail to reduce the sales cycle and sell additional products to our existing end customers, our business, financial condition, results of operations and prospects will be harmed.

**Reliance on shipments at the end of the quarter could cause our revenue for the applicable period to fall below expected levels.**

We may be subject to supply chain delays, or end-customer buying patterns in which a substantial portion of sales orders and shipments may occur in the second half of each quarter. This places significant pressure on order review and processing, supply chain management, manufacturing, inventory and quality control management, shipping and trade compliance to ensure that we have properly forecasted supply purchasing, manufacturing capacity, inventory and quality compliance and logistics. If there is any significant interruption in these critical functions, it could result in delayed order fulfillment, adversely affect our business, financial condition, results of operations and prospects and result in a decline in the market price of our common stock.

**We base our inventory requirements on our forecasts of future sales. If these forecasts are materially inaccurate, we may procure inventory that we may be unable to use in a timely manner or at all.**

We and our contract manufacturers procure components and build our products based on our forecasts. These forecasts are based on estimates of future demand for our products, which are in turn based on historical trends and analyses from our sales and marketing organizations, adjusted for overall market conditions and other factors. To the extent our forecasts are materially inaccurate or if we otherwise do not need such inventory, we may under- or over-procure inventory, and such inaccuracies in our forecasts could materially adversely affect our business, financial condition and results of operations.

**The sales prices of our products and services may decrease, which may reduce our gross profits and adversely affect our results of operations.**

The sales prices for our products and services may decline for a variety of reasons, including competitive pricing pressures, discounts, a change in our mix of products and services, the introduction of new products and services by us or by our competitors, promotional programs, product and related warranty costs or broader macroeconomic factors. In addition, we have provided, and may

in the future provide, pricing discounts to large end customers, which may result in lower margins for the period in which such sales occur. Our gross margins may also fluctuate as a result of the timing of such sales to large end customers.

We have experienced declines in sales prices for our products. Competition continues to increase in the market segments in which we participate, and we expect competition to further increase in the future, thereby leading to increased pricing pressures. Larger competitors with more diverse product and service offerings may reduce the price of products and services that compete with ours or may bundle them with other products and services. Additionally, although we generally price our products worldwide in U.S. dollars, currency fluctuations in certain countries and regions may adversely affect actual prices that partners and end customers are willing to pay in those countries and regions. Furthermore, we anticipate that the sales prices and gross profits for our products will decrease over product life cycles. Decreased sales prices for any reason may reduce our gross profits and adversely affect our result of operations.

**Seasonality may cause fluctuations in our revenue and results of operations.**

We operate on a December 31st year end and believe that there are significant seasonal factors which may cause sequential product revenue growth to be greater for the second and fourth quarters of our year than our first and third quarters. We believe that this seasonality results from a number of factors, including the procurement, budgeting and deployment cycles of many of our end customers. Our rapid historical growth may have reduced the impact of seasonal or cyclical factors that might have influenced our business to date. As our increasing size causes our growth rate to slow, seasonal or cyclical variations in our operations may become more pronounced over time and may materially affect our business, financial condition, results of operations and prospects.

**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 depends upon our ability to provide cloud networking solutions that address the needs of 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 benefits compared to competing network switching products or if end customers do not recognize the benefits that our solutions provide, then our business, financial condition, results of operations and prospects could be materially adversely affected.

**If we are unable to increase market awareness of our company and our products, our revenue may not continue to grow or may decline.**

We have not yet established broad market awareness of our products and services. Market awareness of our value proposition and products and services will be essential to our continued growth and our success, particularly for the service provider and large enterprise markets. If our marketing efforts are unsuccessful in creating market awareness of our company and our products and services, then our business, financial condition, results of operations and prospects will be adversely affected, and we will not be able to achieve sustained growth.

**The requirements of being a public company may strain our resources, divert management's attention and affect our ability to attract and retain qualified board members.**

As a public company, we are subject to the reporting and corporate governance requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, the listing requirements of the New York Stock Exchange and other applicable securities rules and regulations, including the Sarbanes-Oxley Act of 2002, or the Sarbanes-Oxley Act, and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act. Compliance with these rules and regulations and the attendant responsibilities of management and the board, may make it more difficult to attract and retain executive officers and members of our board of directors, particularly to serve on our Audit Committee and Compensation Committee, has increased our legal and financial compliance costs, made some activities more difficult, time-consuming or costly and increased demand on our systems and resources. Among other things, the Exchange Act requires that we file annual, quarterly and current reports with respect to our business and results of operations and maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. In addition, if our internal control over financial reporting is not effective as defined under Section 404, we could be subject to one or more investigations or enforcement actions by state or federal regulatory agencies, stockholder lawsuits or other adverse actions requiring us to incur defense costs, pay fines, settlements or judgments. As a result, management's attention may be diverted from other business concerns, which could harm our business, financial condition, results of operations and prospects. Although we have already hired additional employees to help comply with these requirements, we may need to further expand our legal and finance departments in the future, which will increase our costs and expenses.

In addition, changing laws, regulations, and standards relating to corporate governance and public disclosure, such as continued rulemaking pursuant to the Dodd-Frank Act and related rules and regulations, are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time consuming. These laws, regulations and standards are subject

to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations, and standards, and this investment may result in increased general and administrative expense and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies, regulatory authorities may initiate legal proceedings against us and our business and prospects may be harmed. As a result of disclosure of information in the filings required of a public company, our business and financial condition will become more visible, which may result in threatened or actual litigation, including by competitors and other third parties. If such claims are successful, our business, financial condition, results of operations and prospects could be harmed, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and harm our business, financial condition, results of operations and prospects.

In addition, as a result of our disclosure obligations as a public company, we will have reduced strategic flexibility and will be under pressure to focus on short-term results, which may adversely affect our ability to achieve long-term profitability. We also believe that being a public company and these new rules and regulations makes it more expensive for us to obtain and maintain director and officer liability insurance, and in the future, we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These factors could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our Audit Committee and Compensation Committee, and qualified executive officers.

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

Assessing our processes, procedures and staffing in order to improve our internal control over financial reporting is an ongoing process. Preparing our financial statements involves a number of complex processes, many of which are done manually and are dependent upon individual data input or review. These processes include, but are not limited to, calculating revenue, inventory costs and the preparation of our statement of cash flows. While we continue to automate our processes and enhance our review controls to reduce the likelihood for errors, we expect that for the foreseeable future many of our processes will remain manually intensive and thus subject to human error.

In the past, we have identified material weaknesses in our internal control over financial reporting and we cannot give assurance that additional material weaknesses will not be identified in the future. The existence of one or more material weaknesses could preclude a conclusion by management that we maintained effective internal control over financial reporting. The existence or disclosure of any such material weakness could adversely affect our stock price.

**If we are unable to hire, retain, train and motivate qualified personnel and senior management, our business, financial condition, results of operations and prospects could suffer.**

Our future success depends, in part, on our ability to continue to attract and retain highly skilled personnel, particularly software engineering and sales personnel. Competition for highly skilled personnel is often intense, especially in the San Francisco Bay Area where we have a substantial presence and need for highly skilled personnel. Many of the companies with which we compete for experienced personnel have greater resources than we have to provide more attractive compensation packages and other amenities. Research and development personnel are aggressively recruited by startup and growth companies, which are especially active in many of the technical areas and geographic regions in which we conduct product development. In addition, in making employment decisions, particularly in the high-technology industry, job candidates often consider the value of the stock-based compensation they are to receive in connection with their employment. Declines in the market price of our stock could adversely affect our ability to attract, motivate or retain key employees. If we are unable to attract or retain qualified personnel, or if there are delays in hiring required personnel, our business, financial condition, results of operations and prospects may be seriously harmed.

Also, to the extent we hire personnel from competitors, we may be subject to allegations that such personnel has been improperly solicited, that such personnel has divulged proprietary or other confidential information or that former employers own certain inventions or other work product. Such claims could result in litigation. Please see "We may become involved in litigation that may materially adversely affect us."

Our future performance also depends on the continued services and continuing contributions of our senior management to execute our business plan and to identify and pursue new opportunities and product innovations. Our employment arrangements with our employees do not require that they continue to work for us for any specified period, and therefore, they could terminate their employment with us at any time. The loss of our key personnel, including Jaysree Ullal, our Chief Executive Officer, Andy Bechtolsheim, our Founder and Chief Development Officer, and Kenneth Duda, our Founder, Chief Technology Officer and SVP Software Engineering or other members of our senior management team, sales and marketing team or engineering team, or any difficulty attracting or retaining other highly qualified personnel in the future, could significantly delay or prevent the achievement of our development and strategic objectives, which could adversely affect our business, financial condition, results of operations and prospects.

**We are subject to a number of risks associated with the expansion of our international sales and operations.**

Our ability to grow our business and our future success will depend to a significant extent on our ability to expand our operations and customer base worldwide. We have a limited history of marketing, selling and supporting our products and services internationally. Operating in a global marketplace, we are subject to risks associated with having an international reach and requirements such as compliance with applicable anti-corruption laws.

One such applicable anti-corruption law is the U.S. Foreign Corrupt Practices Act, or FCPA, which generally prohibits U.S. companies and its employees and intermediaries from making corrupt payments to foreign officials for the purpose of obtaining or keeping business, securing an advantage and directing business to another, and requires companies to maintain accurate books and records and a system of internal accounting controls. Under the FCPA, U.S. companies may be held liable for the corrupt actions taken by directors, officers, employees, agents, or other strategic or local partners or representatives. As such, if we or our intermediaries fail to comply with the requirements of the FCPA or similar legislation, governmental authorities in the U.S. and elsewhere could seek to impose civil and/or criminal fines and penalties which could have a material adverse effect on our business, results of operations and financial conditions. Failure to comply with anti-corruption and anti-bribery laws, such as the FCPA and the United Kingdom Bribery Act of 2010, or the U.K. Bribery Act, and similar laws associated with our activities outside the U.S., could subject us to penalties and other adverse consequences. We intend to increase our international sales and business and, as such, the risk of violating laws such as the FCPA and U.K. Bribery Act increases.

Additionally, as a result of our international reach, we must hire and train experienced personnel to staff and manage our foreign operations. To the extent that we experience difficulties in recruiting, training, managing and retaining an international staff, and specifically staff related to sales management and sales personnel, we may experience difficulties in sales productivity in foreign markets. We also enter into strategic distributor and reseller relationships with companies in certain international markets where we do not have a local presence. If we are not able to maintain successful strategic distributor relationships internationally or to recruit additional companies to enter into strategic distributor relationships, our future success in these international markets could be limited. Business practices in the international markets that we serve may differ from those in the U.S. and may require us in the future to include terms other than our standard terms in end-customer contracts, although to date we generally have not done so. To the extent that we may enter into end-customer contracts in the future that include non-standard terms related to payment, warranties or performance obligations, our results of operations may be adversely affected.

Additionally, our international sales and operations are subject to a number of risks, including the following:

- greater difficulty in enforcing contracts and accounts receivable collection and longer collection periods;
- increased expenses incurred in establishing and maintaining our international operations;
- fluctuations in exchange rates between the U.S. dollar and foreign currencies where we do business;
- greater difficulty and costs in recruiting local experienced personnel;
- wage inflation in certain growing economies;
- general economic and political conditions in these foreign markets;
- economic uncertainty around the world as a result of sovereign debt issues;
- communication and integration problems resulting from cultural and geographic dispersion;
- limitations on our ability to access cash resources in our international operations;
- ability to establish necessary business relationships and to comply with local business requirements;
- risks associated with trade restrictions and foreign legal requirements, including the importation, certification and localization of our products required in foreign countries;
- greater risk of unexpected changes in regulatory practices, tariffs and tax laws and treaties;
- the uncertainty of protection for intellectual property rights in some countries;
- greater risk of a failure of foreign employees to comply with both U.S. and foreign laws, including antitrust regulations, the FCPA and any trade regulations ensuring fair trade practices; and
- heightened risk of unfair or corrupt business practices in certain geographies and of improper or fraudulent sales arrangements that may impact financial results and result in restatements of, or irregularities in, financial statements.

These and other factors could harm our ability to gain future international revenue and, consequently, materially affect our business, financial condition, results of operations and prospects. Expanding our existing international operations and entering into additional international markets will require significant management attention and financial commitments. Our failure to successfully manage our international operations and the associated risks effectively could limit our future growth or materially adversely affect our business, financial condition, results of operations and prospects.

**Our ability to sell our products is highly dependent on the quality of our support and services offerings, and our failure to offer high-quality support and services could have a material adverse effect on our business, financial condition, results of operations and prospects.**

Once our products are deployed within our end customers' networks, our end customers depend on our support organization and our channel partners to resolve any issues relating to our products. High-quality support is critical for the successful marketing and sale of our products. If we or our channel partners do not assist our end customers in deploying our products effectively, do not succeed

in helping our end customers resolve post-deployment issues quickly or do not provide adequate ongoing support, it could adversely affect our ability to sell our products to existing end customers and could harm our reputation with potential end customers. In addition, as we expand our operations internationally, our support organization will face additional challenges, including those associated with delivering support, training and documentation in languages other than English. Our failure or the failure of our channel partners to maintain high-quality support and services could have a material adverse effect on our business, financial condition, results of operations and prospects.

**Adverse economic conditions or reduced information technology and network infrastructure spending may adversely affect our business, financial condition, results of operations and prospects.**

Our business depends on the overall demand for information technology, network connectivity and access to data and applications. Weak domestic or global economic conditions, fear or anticipation of such conditions or a reduction in information technology and network infrastructure spending even if economic conditions improve, could adversely affect our business, financial condition, results of operations and prospects in a number of ways, including longer sales cycles, lower prices for our products and services, higher default rates among our distributors, reduced unit sales and lower or no growth. For example, the ongoing debt concerns in many countries in Europe have caused, and are likely to continue to cause, uncertainty and instability in local economies and in global financial markets, particularly if any future sovereign debt defaults or significant bank failures or defaults occur. Market uncertainty and instability in Europe could intensify or spread further, particularly if ongoing stabilization efforts prove insufficient. Concerns have been raised as to the financial, political and legal ineffectiveness of measures taken to date. Continuing or worsening economic instability in Europe and elsewhere could adversely affect spending for IT, network infrastructure, systems and tools. Continued turmoil in the geopolitical environment in many parts of the world may also affect the overall demand for our products. Although we do not believe that our business, financial condition, results of operations and prospects have been significantly adversely affected by economic and political uncertainty in Europe and other countries, deterioration of such conditions may harm our business, financial condition, results of operations and prospects in the future. A prolonged period of economic uncertainty or a downturn may also significantly affect financing markets, the availability of capital and the terms and conditions of financing arrangements, including the overall cost of financing as well as the financial health or creditworthiness of our end customers. Circumstances may arise in which we need, or desire, to raise additional capital, and such capital may not be available on commercially reasonable terms, or at all.

**We may become involved in litigation that may materially adversely affect us.**

From time to time, we may become involved in various legal proceedings relating to matters incidental to the ordinary course of our business, including patent, copyright, commercial, product liability, employment, class action, whistleblower and other litigation and claims, in addition to governmental and other regulatory investigations and proceedings. Such matters can be time-consuming, divert management's attention and resources, cause us to incur significant expenses or liability and/or require us to change our business practices. Because of the potential risks, expenses and uncertainties of litigation, we may, from time to time, settle disputes, even where we have meritorious claims or defenses, by agreeing to settlement agreements. Because litigation is inherently unpredictable, we cannot assure you that the results of any of these actions will not have a material adverse effect on our business, financial condition, results of operations and prospects.

For more information regarding the litigation in which we are currently involved, see the "Legal Proceedings" subheading in Note 5. Commitments and Contingencies of Notes to Consolidated Financial Statements in Part II, Item 8, of this Annual Report on Form 10-K.

**Assertions by third parties of infringement or other violations by us of their intellectual property rights, or other lawsuits asserted against us, could result in significant costs and substantially harm our business, financial condition, results of operations and prospects.**

Patent and other intellectual property disputes are common in the network infrastructure industry and have resulted in protracted and expensive litigation for many companies. Many companies in the network infrastructure industry, including our competitors and other third parties, as well as non-practicing entities, own large numbers of patents, copyrights, trademarks and trade secrets, which they may use to assert claims of patent infringement, misappropriation or other violations of intellectual property rights against us. From time to time, they have or may in the future also assert such claims against us, our end customers or channel partners whom we typically indemnify against claims that our products infringe, misappropriate or otherwise violate the intellectual property rights of third parties.

As the number of products and competitors in our market increases and overlaps occur, claims of infringement, misappropriation and other violations of intellectual property rights may increase. Any claim of infringement, misappropriation or other violations of intellectual property rights by a third party, even those without merit, could cause us to incur substantial costs defending against the claim, distract our management from our business and require us to cease use of such intellectual property. In addition, some claims for patent infringement may relate to subcomponents that we purchase from third parties. If these third parties are unable or unwilling to indemnify us for these claims, we could be substantially harmed.

The patent portfolios of most of our competitors are larger than ours. This disparity may increase the risk that our competitors may sue us for patent infringement and may limit our ability to counterclaim for patent infringement or settle through patent cross-licenses. In addition, future assertions of patent rights by third parties, and any resulting litigation, may involve patent holding companies

or other adverse patent owners who have no relevant product revenue and against whom our own patents may therefore provide little or no deterrence or protection. We cannot assure you that we are not infringing or otherwise violating any third-party intellectual property rights.

The third-party asserters of intellectual property claims may be unreasonable in their demands, or may simply refuse to settle, which could lead to expensive settlement payments, prolonged periods of litigation and related expenses, additional burdens on employees or other resources, distraction from our business, supply stoppages and lost sales.

An adverse outcome of a dispute (including those lawsuits described under the “Legal Proceedings” subheading in Note 5. Commitments and Contingencies of Notes to Consolidated Financial Statements in Part II, Item 8 of this Annual Report on Form 10-K) may require us to pay substantial damages or penalties including treble damages if we are found to have willfully infringed a third party’s patents; cease making, licensing or using solutions that are alleged to infringe or misappropriate the intellectual property of others; expend additional development resources to attempt to redesign our products or services or otherwise to develop non-infringing technology, which may not be successful; enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or intellectual property rights; and indemnify our partners and other third parties. Any damages, penalties or royalty obligations we may become subject to as a result of an adverse outcome, and any third-party indemnity we may need to provide, could harm our business, financial condition, results of operations and prospects. Royalty or licensing agreements, if required or desirable, may be unavailable on terms acceptable to us, or at all, and may require significant royalty payments and other expenditures. Further, there is little or no information publicly available concerning market or fair values for license fees, which can lead to overpayment of license or settlement fees. In addition, some licenses may be non-exclusive, and therefore our competitors may have access to the same technology licensed to us. Suppliers subject to third-party intellectual property claims also may choose or be forced to discontinue or alter their arrangements with us, with little or no advance notice to us. Any of these events could seriously harm our business, financial condition, results of operations and prospects.

**Our standard sales contracts contain indemnification provisions requiring us to defend our end customers against third-party claims, including against infringement of certain intellectual property rights that could expose us to losses which could seriously harm our business, financial conditions, results of operations and prospects.**

Under the indemnification provisions of our standard sales contracts, we agree to defend our end customers and channel partners against third-party claims asserting infringement of certain intellectual property rights, which may include patents, copyrights, trademarks or trade secrets, and to pay judgments entered on such claims. For example, we are currently involved in ongoing Cisco litigation claims before the USITC. An adverse ruling in such litigation may potentially expose us to claims in the event that claims are brought against our customers based on the ruling and we are required to indemnify such customers.

Our exposure under these indemnification provisions is frequently limited to the total amount paid by our end customer under the agreement. However, certain agreements include indemnification provisions that could potentially expose us to losses in excess of the amount received under the agreement. Any of these events, including claims for indemnification, could seriously harm our business, financial condition, results of operations and prospects.

**If we are unable to protect our intellectual property rights, our competitive position could be harmed or we could be required to incur significant expenses to enforce our rights.**

We depend on our ability to protect our proprietary technology. We rely on trade secret, patent, copyright and trademark laws and confidentiality agreements with employees and third parties, all of which offer only limited protection.

The process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. We may choose not to seek patent protection for certain innovations and may choose not to pursue patent protection in certain jurisdictions. Further, we do not know whether any of our pending patent applications will result in the issuance of patents or whether the examination process will require us to narrow our claims. To the extent that additional patents are issued from our patent applications, which is not certain, they may be contested, circumvented or invalidated in the future. Moreover, the rights granted under any issued patents may not provide us with proprietary protection or competitive advantages, and, as with any technology, competitors may be able to develop similar or superior technologies to our own now or in the future. In addition, we rely on confidentiality or license agreements with third parties in connection with their use of our products and technology. There is no guarantee that such parties will abide by the terms of such agreements or that we will be able to adequately enforce our rights, in part because we rely on “shrink-wrap” licenses in some instances.

We have not registered our trademarks in all geographic markets. Failure to secure those registrations could adversely affect our ability to enforce and defend our trademark rights and result in indemnification claims. Further, any claim of infringement by a third party, even those claims without merit, could cause us to incur substantial costs defending against such claim, could divert management attention from our business and could require us to cease use of such intellectual property in certain geographic markets.

Despite our efforts, the steps we have taken to protect our proprietary rights may not be adequate to preclude misappropriation of our proprietary information or infringement of our intellectual property rights, and our ability to police such misappropriation or infringement is uncertain, particularly in countries outside of the United States.

Detecting and protecting against the unauthorized use of our products, technology and proprietary rights is expensive, difficult and, in some cases, impossible. Litigation may be necessary in the future to enforce or defend our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Such litigation could result in substantial costs and diversion of management resources, either of which could harm our business, financial condition, results of operations and prospects, and there is no guarantee that we would be successful. Furthermore, many of our current and potential competitors have the ability to dedicate substantially greater resources to protecting their technology or intellectual property rights than we do. Accordingly, despite our efforts, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property, which could result in a substantial loss of our market share.

**We rely on the availability of licenses to third-party software and other intellectual property.**

Many of our products and services include software or other intellectual property licensed from third parties, and we otherwise use software and other intellectual property licensed from third parties in our business. This exposes us to risks over which we may have little or no control. For example, a licensor may have difficulties keeping up with technological changes or may stop supporting the software or other intellectual property that it licenses to us. Also, it will be necessary in the future to renew licenses, expand the scope of existing licenses or seek new licenses, relating to various aspects of these products and services or otherwise relating to our business, which may result in increased license fees. These licenses may not be available on acceptable terms, if at all. In addition, a third party may assert that we or our end customers are in breach of the terms of a license, which could, among other things, give such third party the right to terminate a license or seek damages from us, or both. The inability to obtain or maintain certain licenses or other rights or to obtain or maintain such licenses or rights on favorable terms, or the need to engage in litigation regarding these matters, could result in delays in releases of products and services and could otherwise disrupt our business, until equivalent technology can be identified, licensed or developed, if at all, and integrated into our products and services or otherwise in the conduct of our business. Moreover, the inclusion in our products and services of software or other intellectual property licensed from third parties on a nonexclusive basis may limit our ability to differentiate our products from those of our competitors. Any of these events could have a material adverse effect on our business, financial condition, results of operations and prospects.

**Our products contain third-party open source software components, and failure to comply with the terms of the underlying open source software licenses could restrict our ability to sell our products.**

Our products contain software modules licensed to us by third-party authors under “open source” licenses. Use and distribution of open source software may entail greater risks than use of third-party commercial software, as open source licensors generally do not provide warranties or other contractual protections regarding infringement claims or the quality of the code. Some open source licenses contain requirements that we make available source code for modifications or derivative works we create based upon the type of open source software that we use. If we combine our software with open source software in a certain manner, we could, under certain open source licenses, be required to release portions of the source code of our software to the public. This would allow our competitors to create similar products with lower development effort and time and ultimately could result in a loss of product sales for us.

Although we monitor our use of open source software to avoid subjecting our products to conditions we do not intend, the terms of many open source licenses have not been interpreted by U.S. courts, and these licenses could be construed in a way that could impose unanticipated conditions or restrictions on our ability to commercialize our products. Moreover, we cannot assure you that our processes for controlling our use of open source software in our products will be effective. If we are held to have breached the terms of an open source software license, we could be required to seek licenses from third parties to continue offering our products on terms that are not economically feasible, to re-engineer our products, to discontinue the sale of our products if re-engineering could not be accomplished on a timely basis or to make generally available, in source code form, our proprietary code, any of which could adversely affect our business, financial condition, results of operations and prospects.

**Sales of our 7000 Series of switches generate most of our product revenue, and if we are unable to continue to grow sales of these products, our business, financial condition, results of operations and prospects will suffer.**

Historically, we have derived substantially all of our product revenue from sales of our 7000 Series of switches, and we expect to continue to do so for the foreseeable future. We have experienced declines in sales prices for our products, including our 10 Gigabit Ethernet modular and fixed switches. A decline in the price of our 7000 Series of switches and related services, or our inability to increase sales of these products, would harm our business, financial condition, results of operations and prospects more seriously than if we derived significant revenue from a larger variety of product lines and services. Our future financial performance will also depend upon successfully developing and selling next-generation versions of our 7000 Series of switches. If we fail to deliver new products, new features, or new releases that end customers want and that allow us to maintain leadership in what will continue to be a competitive market environment, our business, financial condition, results of operations and prospects will be harmed.

**We expect our gross margins to vary over time and to be adversely affected by numerous factors.**

We expect our gross margins to vary over time and to be affected by numerous factors, including:

- changes in end-customer or product mix, including mix of configurations within each product group;
- introduction of new products, including products with price-performance advantages;

- increases in material, labor or other manufacturing-related costs, which could be significant especially during periods of supply constraints, or as a result of changes in our manufacturing process or supply chain;
- our ability to reduce production costs;
- entry into new markets or growth in lower margin markets;
- entry in markets with different pricing and cost structures;
- pricing discounts;
- increases in material costs in the event we are restricted from sourcing components and manufacturing products internationally.
- costs associated with defending intellectual property infringement and other claims and the potential outcomes of such disputes, such as those claims discussed in “Legal Proceedings,” including the Cisco and Optumsoft litigation matters;
- excess inventory and inventory holding charges;
- obsolescence charges;
- changes in shipment volume;
- the timing of revenue recognition and revenue deferrals;
- increased cost, loss of cost savings or dilution of savings due to changes in component pricing or charges incurred due to inventory holding periods if parts ordering does not correctly anticipate product demand or if the financial health of either contract manufacturers or suppliers deteriorates;
- lower than expected benefits from value engineering;
- increased price competition;
- changes in distribution channels;
- increased warranty costs; and
- how well we execute our strategy and operating plans.

**To remain competitive, we must successfully manage product introductions and transitions.**

The success of new product introductions depends on a number of factors including, but not limited to, timely and successful product development, market acceptance, our ability to manage the risks associated with new product production ramp-up issues, the availability of new merchant silicon chips, the effective management of purchase commitments and inventory in line with anticipated product demand, the availability of products in appropriate quantities and costs to meet anticipated demand, and the risk that new products may have quality or other defects or deficiencies in the early stages of introduction. Accordingly, we cannot determine in advance the ultimate effect of new product introductions and transitions on our business and results of operations.

**Our sales cycles can be long and unpredictable, and our sales efforts require considerable time and expense. As a result, our sales and revenue are difficult to predict and may vary substantially from period to period, which may cause our results of operations to fluctuate significantly.**

The timing of our sales and revenue recognition is difficult to predict because of the length and unpredictability of our products’ sales cycles. A sales cycle is the period between initial contact with a prospective end customer and any sale of our products. End-customer orders often involve the purchase of multiple products. These orders are complex and difficult to complete because prospective end customers generally consider a number of factors over an extended period of time before committing to purchase the products and solutions we sell. End customers, especially in the case of our large end customers, often view the purchase of our products as a significant and strategic decision and require considerable time to evaluate, test and qualify our products prior to making a purchase decision and placing an order. The length of time that end customers devote to their evaluation, contract negotiation and budgeting processes varies significantly. Our products’ sales cycles can be lengthy in certain cases, especially with respect to our prospective large end customers. During the sales cycle, we expend significant time and money on sales and marketing activities and make investments in evaluation equipment, all of which lower our operating margins, particularly if no sale occurs. Even if an end customer decides to purchase our products, there are many factors affecting the timing of our recognition of revenue, which makes our revenue difficult to forecast. For example, there may be unexpected delays in an end customer’s internal procurement processes, particularly for some of our larger end customers for which our products represent a very small percentage of their total procurement activity. There are many other factors specific to end customers that contribute to the timing of their purchases and the variability of our revenue recognition, including the strategic importance of a particular project to an end customer, budgetary constraints and changes in their personnel.

Even after an end customer makes a purchase, there may be circumstances or terms relating to the purchase that delay our ability to recognize revenue from that purchase. For example, the sale of our products may be subject to acceptance testing. In addition, the significance and timing of our product enhancements, and the introduction of new products by our competitors, may also affect end customers’ purchases. For all of these reasons, it is difficult to predict whether a sale will be completed, the particular period in which a sale will be completed or the period in which revenue from a sale will be recognized. If our sales cycles lengthen, our revenue could be lower than expected, which would have an adverse effect on our business, financial condition, results of operations and prospects.

**Our business depends on end customers renewing their maintenance and support contracts. Any decline in maintenance renewals could harm our future business, financial condition, results of operations and prospects.**

We typically sell our products with maintenance and support as part of the initial purchase, and a portion of our annual revenue comes from renewals of maintenance and support contracts. Our end customers have no obligation to renew their maintenance and support

contracts after the expiration of the initial period, and they may elect not to renew their maintenance and support contracts, to renew their maintenance and support contracts at lower prices through alternative channel partners or to reduce the product quantity under their maintenance and support contracts, thereby reducing our future revenue from maintenance and support contracts. If our end customers, especially our large end customers, do not renew their maintenance and support contracts or if they renew them on terms that are less favorable to us, our revenue may decline and our business, financial condition, results of operations and prospects will suffer.

**Industry consolidation may lead to increased competition and may harm our business, financial condition, results of operations and prospects.**

Most of our competitors have made acquisitions and/or have entered into or extended partnerships or other strategic relationships to offer more comprehensive product lines, including cloud networking solutions. For example, in the last few years alone Dell acquired Force10 and EMC, IBM acquired Blade Network Technology, Hewlett Packard Enterprises purchased Aruba, Juniper acquired Contrail, Cisco acquired Insieme and Broadcom which currently intends to acquire Brocade.

Moreover, large system vendors are increasingly seeking to deliver top-to-bottom cloud networking solutions to end customers that combine cloud-focused hardware and software solutions to provide an alternative to our products.

We expect this trend to continue as companies attempt to strengthen their market positions in an evolving industry and as companies are acquired or are unable to continue operations. 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. Industry consolidation may result in stronger competitors that are better able to compete with us, including any competitors that seek to become sole source vendors for end customers. This could lead to more variability in our results of operations and could have a material adverse effect on our business, financial condition, results of operations and prospects.

**Our business is subject to the risks of warranty claims, product returns, product liability and product defects.**

Our products are very complex and despite testing prior to their release, they have contained and may contain undetected defects or errors, especially when first introduced or when new versions are released. Product defects or errors could affect the performance of our products and could delay the development or release of new products or new versions of products, adversely affect our reputation and our end customers' willingness to buy products from us and adversely affect market acceptance or perception of our products. Real or perceived errors, failures or bugs in our products could cause us to lose revenue or market share, increase our service costs, cause us to incur substantial costs in redesigning the products, cause us to lose significant end-customers, subject us to liability for damages and divert our resources from other tasks, any one of which could materially and adversely affect our business, results of operations and financial condition.

Additionally, real or perceived errors, failures or bugs in our products could result in claims by end customers for losses that they sustain. If end customers make these types of claims, we may be required, or may choose, for end-customer relations or other reasons, to expend additional resources in order to address the problem. We may also be required to repair or replace such products or provide a refund for the purchase price for such products. Liability provisions in our standard terms and conditions of sale, and those of our resellers and distributors, may not be enforceable under some circumstances or may not fully or effectively protect us from end-customer claims and related liabilities and costs, including indemnification obligations under our agreements with end customers, resellers and distributors. The sale and support of our products also entail the risk of product liability claims. We maintain insurance to protect against certain types of claims associated with the use of our products, but our insurance coverage may not adequately cover any such claims. In addition, even claims that ultimately are unsuccessful could result in expenditures of funds in connection with litigation and divert management's time and other resources.

**In addition to our own direct sales force, we rely on distributors, systems integrators and value-added resellers to sell our products, and our failure to effectively develop, manage or prevent disruptions to our distribution channels and the processes and procedures that support them could cause a reduction in the number of end customers of our products.**

Our future success is highly dependent upon maintaining our relationships with distributors, systems integrators and value-added resellers and establishing additional sales channel relationships. We anticipate that sales of our products to a limited number of channel partners will continue to account for a material portion of our total product revenue for the foreseeable future. We provide our channel partners with specific training and programs to assist them in selling our products, but these steps may not be effective. In addition, our channel partners may be unsuccessful in marketing, selling and supporting our products and services. If we are unable to develop and maintain effective sales incentive programs for our channel partners, we may not be able to incentivize these partners to sell our products to end customers. These partners may have incentives to promote our competitors' products to the detriment of our own or may cease selling our products altogether. One of our channel partners could elect to consolidate or enter into a strategic partnership with one of our competitors, which could reduce or eliminate our future opportunities with that channel partner. Our agreements with our channel partners may generally be terminated for any reason by either party with advance notice. We may be unable to retain these channel partners or secure additional or replacement channel partners. The loss of one or more of our significant channel partners requires extensive training, and any new or expanded relationship with a channel partner may take several months or more to achieve productivity.

Where we rely on the channel partners for sales of our products, we may have little or no contact with the ultimate users of our products that purchase through such channel partners, thereby making it more difficult for us to establish brand awareness, ensure proper

delivery and installation of our products, service ongoing end-customer requirements, estimate end-customer demand and respond to evolving end-customer needs. In addition, our channel partner sales structure could subject us to lawsuits, potential liability and reputational harm if, for example, any of our channel partners misrepresent the functionality of our products or services to end customers, fail to comply with their contractual obligations or violate laws or our corporate policies. If we fail to effectively manage our existing sales channels, or if our channel partners are unsuccessful in fulfilling the orders for our products, if we are unable to enter into arrangements with, and retain a sufficient number of, high-quality channel partners in each of the regions in which we sell products and keep them motivated to sell our products, our ability to sell our products and our business, financial condition, results of operations and prospects will be harmed.

**A portion of our revenue is generated by sales to government entities, which are subject to a number of challenges and risks.**

We anticipate increasing our sales efforts to U.S. and foreign, federal, state and local governmental end customers in the future. Sales to government entities are subject to a number of risks. Selling to government entities can be highly competitive, expensive and time consuming, often requiring significant upfront time and expense without any assurance that these efforts will generate a sale. The substantial majority of our sales to date to government entities have been made indirectly through our channel partners. Government certification requirements for products like ours may change and, in doing so, restrict our ability to sell into the government sector until we have attained revised certifications. Government demand and payment for our products and services may be affected by public sector budgetary cycles and funding authorizations, with funding reductions or delays adversely affecting public sector demand for our products and services. Government entities may have statutory, contractual or other legal rights to terminate contracts with our distributors and resellers for convenience or due to a default, and any such termination may adversely impact our future business, financial condition, results of operations and prospects. Selling to government entities may also require us to comply with various regulations that are not applicable to sales to non-government entities, including regulations that may relate to pricing, classified material and other matters. Complying with such regulations may also require us to put in place controls and procedures to monitor compliance with the applicable regulations that may be costly or not possible. We are not currently certified to perform work under classified contracts with government entities. Failure to comply with any such regulations could adversely affect our business, prospects, results of operations and financial condition. Governments routinely investigate and audit government contractors' administrative processes, and any unfavorable audit could result in the government ceasing to buy our products and services, a reduction of revenue, fines or civil or criminal liability if the audit uncovers improper or illegal activities, any of which could materially adversely affect our business, financial condition, results of operations and prospects. The U.S. government may require certain products that it purchases to be manufactured in the U.S. and other relatively high-cost manufacturing locations, and we may not manufacture all products in locations that meet these requirements. Any of these and other circumstances could have a material adverse effect on our business, financial condition, results of operations and prospects.

**Our products must interoperate with operating systems, software applications and hardware that is developed by others, and if we are unable to devote the necessary resources to ensure that our products interoperate with such software and hardware, we may lose or fail to increase market share and experience a weakening demand for our products.**

Generally, our products comprise only a part of the data center and must interoperate with our end customers' existing infrastructure, specifically their networks, servers, software and operating systems, which may be manufactured by a wide variety of vendors and original equipment manufacturers, or OEMs. Our products must comply with established industry standards in order to interoperate with the servers, storage, software and other networking equipment in the data center such that all systems function efficiently together. We depend on the vendors of servers and systems in a data center to support prevailing industry standards. Often, these vendors are significantly larger and more influential in driving industry standards than we are. Also, some industry standards may not be widely adopted or implemented uniformly, and competing standards may emerge that may be preferred by our end customers.

In addition, when new or updated versions of these software operating systems or applications are introduced, we must sometimes develop updated versions of our software so that our products will interoperate properly. We may not accomplish these development efforts quickly, cost-effectively or at all. These development efforts require capital investment and the devotion of engineering resources. If we fail to maintain compatibility with these systems and applications, our end customers may not be able to adequately utilize our products, and we may lose or fail to increase market share and experience a weakening in demand for our products, among other consequences, which would adversely affect our business, financial condition, results of operations and prospects.

**We are subject to governmental export and import controls that could impair our ability to compete in international markets or subject us to liability if we violate these controls.**

Our products may be subject to various export controls and because we incorporate encryption technology into certain of our products, certain of our products may be exported from various countries only with the required export license or through an export license exception. If we were to fail to comply with the applicable export control laws, customs regulations, economic sanctions or other applicable laws, we could be subject to monetary damages or the imposition of restrictions which could be material to our business, operating results and prospects and could also harm our reputation. Further, there could be criminal penalties for knowing or willful violations, including incarceration for culpable employees and managers. Obtaining the necessary export license or other authorization for a particular sale may be time-consuming and may result in the delay or loss of sales opportunities. Furthermore, certain export control and economic sanctions laws prohibit the shipment of certain products, technology, software and services to embargoed countries and sanctioned governments, entities, and persons. Even though we take precautions to ensure that our channel partners comply with all relevant regulations, any failure by our channel partners to comply with such regulations could have negative consequences, including reputational harm, government investigations and penalties.

As our company grows we also continue developing procedures and controls to comply with export control and other applicable laws. Historically, we have had some instances where we inadvertently have not fully complied with certain export control laws, but we have disclosed them to, and implemented corrective actions with, the appropriate government agencies.

In addition, various countries regulate the import of certain encryption technology, including through import permit and license requirements, and have enacted laws that could limit our ability to distribute our products or could limit our end customers' ability to implement our products in those countries. Any change in export or import regulations, economic sanctions or related legislation, shift in the enforcement or scope of existing regulations or change in the countries, governments, persons or technologies targeted by such regulations could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential end customers with international operations or create delays in the introduction of our products into international markets. Any decreased use of our products or limitation on our ability to export or sell our products could adversely affect our business, financial condition, results of operations and prospects.

**Failure to comply with governmental laws and regulations could harm our business, financial condition, results of operations and prospects.**

Our business is subject to regulation by various federal, state, local and foreign governmental agencies, including agencies responsible for monitoring and enforcing employment and labor laws, workplace safety, product safety, environmental laws, consumer protection laws, anti-bribery laws, import/export controls, federal securities laws and tax laws and regulations. In certain jurisdictions, these regulatory requirements may be more stringent than those in the United States. From time to time, we may receive inquiries from such governmental agencies or we may make voluntary disclosures regarding our compliance with applicable governmental regulations or requirements relating to import/export controls, federal securities laws and tax laws and regulations which could lead to formal investigations. Noncompliance with applicable government regulations or requirements could subject us to sanctions, mandatory product recalls, enforcement actions, disgorgement of profits, fines, damages, civil and criminal penalties or injunctions. If any governmental sanctions are imposed, or if we do not prevail in any possible civil or criminal litigation, our business, financial condition, results of operations and prospects could be materially adversely affected. In addition, responding to any action will likely result in a significant diversion of management's attention and resources and an increase in professional fees. Enforcement actions and sanctions could harm our business, financial condition, results of operations and prospects.

**We may invest in or acquire other businesses which could require significant management attention, disrupt our business, dilute stockholder value and adversely affect our business, financial condition, results of operations and prospects.**

As part of our business strategy, we may make investments in complementary companies, products or technologies which could involve licenses, additional channels of distribution, discount pricing or investments in or acquisitions of other companies. However, we do not have significant experience in making investments in other companies nor have we made any acquisitions to date, and as a result, our ability as an organization to evaluate and/or complete investments or acquire and integrate other companies, products or technologies in a successful manner is unproven. We may not be able to find suitable investment or acquisition candidates, and we may not be able to complete such investments or acquisitions on favorable terms, if at all. If we do complete investments or acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, and any investments or acquisitions we complete could be viewed negatively by our end customers, investors and securities analysts.

In addition, investments and acquisitions may result in unforeseen operating difficulties and expenditures. For example, if we are unsuccessful at integrating any acquisitions or retaining key talent from those acquisitions, or the technologies associated with such acquisitions, into our company, the business, financial condition, results of operations and prospects of the combined company could be adversely affected. Any integration process may require significant time and resources, and we may not be able to manage the process successfully. We may not successfully evaluate or utilize the acquired technology or personnel or accurately forecast the financial effects of an acquisition transaction, including accounting charges. We may have to pay cash, incur debt or issue equity securities to pay for any such investment or acquisition, each of which could adversely affect our financial condition or the market price of our common stock. The sale of equity or issuance of debt to finance any such acquisitions could result in dilution to our stockholders. The incurrence of

indebtedness would result in increased fixed obligations and could also include covenants or other restrictions that would impede our ability to manage our operations. Moreover, if the investment or acquisition becomes impaired, we may be required to take an impairment charge, which could adversely affect our financial condition or the market price of our common stock.

**If we needed to raise additional capital to expand our operations and invest in new products, our failure to do so on favorable terms could reduce our ability to compete and could harm our business, financial condition, results of operations and prospects.**

We expect that our existing cash and cash equivalents, will be sufficient to meet our anticipated cash needs for the foreseeable future. If we did need to raise additional funds to expand our operations and invest in new products, we may not be able to obtain additional debt or equity financing on favorable terms, if at all. If we raise additional equity financing, our stockholders may experience significant dilution of their ownership interests, and the market price of our common stock could decline. Furthermore, if we engage in debt financing, the holders of such debt would have priority over the holders of common stock, and we may be required to accept terms that restrict our ability to incur additional indebtedness or impose other restrictions on our business. We may also be required to take other actions that would otherwise be in the interests of the debt holders, including maintaining specified liquidity or other ratios, any of which could harm our business, financial condition, results of operations and prospects. If we need additional capital and cannot raise it on acceptable terms, if at all, we may not be able to, among other things:

- evolve or enhance our products and services;
- continue to expand our sales and marketing and research and development organizations;
- acquire complementary technologies, products or businesses;
- expand operations, in the U.S. or internationally;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

Our failure to do any of these things could seriously harm our business, financial condition, results of operations and prospects.

**If our estimates or judgments relating to our critical accounting policies are based on assumptions that change or prove to be incorrect, our results of operations could fall below expectations of securities analysts and investors, resulting in a decline in the market price of our common stock.**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, as described in Part II Item 7 of “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” the results of which form the basis for making judgments about the carrying values of assets, liabilities, equity, revenue and expenses that are not readily apparent from other sources. Significant assumptions and estimates used in preparing our consolidated financial statements include those related to revenue recognition, stock-based compensation, contract manufacturing liabilities and income taxes. If our assumptions change or if actual circumstances differ from those in our assumptions, our results of operations may be adversely affected and may fall below the expectations of securities analysts and investors, resulting in a decline in the market price of our common stock.

**We are exposed to the credit risk of our channel partners and some of our end customers, which could result in material losses.**

Most of our sales are on an open credit basis, with standard payment terms of 30 days in the United States and, because of local customs or conditions, longer in some markets outside the U.S. We monitor individual end-customer payment capability in granting such open credit arrangements, seek to limit such open credit to amounts we believe the end customers can pay and maintain reserves we believe are adequate to cover exposure for doubtful accounts. We are unable to recognize revenue from shipments until the collection of those amounts becomes reasonably assured. Any significant delay or default in the collection of significant accounts receivable could result in an increased need for us to obtain working capital from other sources, possibly on worse terms than we could have negotiated if we had established such working capital resources prior to such delays or defaults. Any significant default could adversely affect our results of operations and delay our ability to recognize revenue.

A material portion of our sales is derived through our distributors, systems integrators and value-added resellers. Some of our distributors, systems integrators and value-added resellers may experience financial difficulties, which could adversely affect our collection of accounts receivable. Distributors tend to have more limited financial resources than other systems integrators, value-added resellers and end customers. Distributors represent potential sources of increased credit risk because they may be less likely to have the reserve resources required to meet payment obligations. Our exposure to credit risks of our channel partners may increase if our channel partners and their end customers are adversely affected by global or regional economic conditions. One or more of these channel partners could delay payments or default on credit extended to them, either of which could materially adversely affect our business, financial condition, results of operations and prospects.

**If we or our partners fail to comply with environmental requirements, our business, financial condition, results of operations, prospects and reputation could be adversely affected.**

We and our partners, including our contract manufacturers, are subject to various local, state, federal and international environmental laws and regulations, including laws governing the hazardous material content of our products and laws relating to the collection, recycling and disposal of electrical and electronic equipment. Examples of these laws and regulations include the European Union, or EU, Restrictions on the use of Hazardous Substances Directive, or RoHS Directive, and the EU Waste Electrical and Electronic Equipment Directive, or WEEE Directive, as well as the implementing legislation of the EU member states. Similar laws and regulations have been passed or are pending in China, South Korea, Norway and Japan and may be enacted in other regions, including in the U.S., and we or our partners, including our contract manufacturers, are, or may in the future be, subject to these laws and regulations.

The EU RoHS Directive and the similar laws of other jurisdictions limit the content of certain hazardous materials such as lead, mercury and cadmium in the manufacture of electrical equipment, including our products. Our products currently comply with the RoHS Directive; however, if there are future changes to this directive, we may be required to re-engineer our products to use components compatible with these regulations. This re-engineering and component substitution could result in additional costs to us or disrupt our operations or logistics.

We are also subject to environmental laws and regulations governing the management and disposal of hazardous materials and wastes. Our failure, or the failure of our partners, including our contract manufacturers, to comply with past, present and future environmental laws could result in fines, penalties, third-party claims, reduced sales of our products, substantial product inventory write-offs and reputational damage, any of which could harm our business, financial condition, results of operations and prospects. We also expect that our business will be affected by new environmental laws and regulations on an ongoing basis applicable to us and our partners, including our contract manufacturers. To date, our expenditures for environmental compliance have not had a material effect on our results of operations or cash flows. Although we cannot predict the future effect of such laws or regulations, they will likely result in additional costs or require us to change the content or manufacturing of our products, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

**We are exposed to fluctuations in currency exchange rates, which could adversely affect our business, financial condition, results of operations and prospects.**

Our sales contracts are primarily denominated in U.S. dollars, and therefore substantially all of our revenue is not subject to foreign currency risk. However, a strengthening U.S. dollar could increase the real cost of our products to our end customers outside of the U.S., which could adversely affect our business, financial condition, results of operations and prospects. In addition, a decrease in the value of the U.S. dollar relative to foreign currencies could increase our product and operating costs in foreign locations. Further, an increasing portion of our operating expenses is incurred outside the U.S., is denominated in foreign currencies and is subject to fluctuations due to changes in foreign currency exchange rates. If we are not able to successfully hedge against the risks associated with the currency fluctuations, our business, financial condition, results of operations and prospects could be adversely affected.

**Our business is subject to the risks of earthquakes, fire, power outages, floods and other catastrophic events and to interruption by manmade problems such as terrorism.**

Our corporate headquarters and the operations of our key manufacturing vendors, logistics providers and partners, as well as many of our customers, are located in areas exposed to risks of natural disasters such as earthquakes and tsunamis, including the San Francisco Bay area, Japan and Taiwan. A significant natural disaster, such as an earthquake, tsunami, fire or a flood, or other catastrophic event such as a disease outbreak, could have a material adverse effect on our or their business, which could in turn materially affect our financial condition, results of operations and prospects. For example, in the event our service providers' information technology systems or manufacturing or logistics abilities are hindered by any of the events discussed above, shipments could be delayed, which could result in missed financial targets, such as revenue and shipment targets, for a particular quarter. Further, if a natural disaster occurs in a region from which we derive a significant portion of our revenue, end customers in that region may delay or forego purchases of our products, which may materially and adversely affect our business, financial condition, results of operations and prospects. In addition, acts of terrorism could cause disruptions in our business or the business of our manufacturer, logistics providers, partners or end customers or the economy as a whole. Given our typical concentration of sales at each quarter end, any disruption in the business of our manufacturer, logistics providers, partners or end customers that affects sales at the end of our quarter could have a particularly significant adverse effect on our quarterly results. All of the aforementioned risks may be augmented if our disaster recovery plans and those of our manufacturers, logistics providers or partners prove to be inadequate. To the extent that any of the above results in delays or cancellations of end-customer orders, or delays in the manufacture, deployment or shipment of our products, our business, financial condition, results of operations and prospects would be adversely affected.

**Breaches of our cybersecurity systems could degrade our ability to conduct our business operations and deliver products and services to our customers, delay our ability to recognize revenue, compromise the integrity of our software products, result in significant data losses and the theft of our intellectual property, damage our reputation, expose us to liability to third parties and require us to incur significant additional costs to maintain the security of our networks and data.**

We increasingly depend upon our IT systems to conduct virtually all of our business operations, ranging from our internal operations and product development activities to our marketing and sales efforts and communications with our customers and business partners. Computer programmers may attempt to penetrate our network security, or that of our website, and misappropriate our proprietary information or cause interruptions of our service. Because the techniques used by such computer programmers to access or sabotage networks change frequently and may not be recognized until launched against a target, we may be unable to anticipate these techniques. 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 the system. We have also outsourced a number of our business functions to third-parties, including our manufacturers, logistics providers, and cloud service providers, and our business operations also depend, in part, on the success of these third parties' own cybersecurity measures. Similarly, we rely upon distributors, resellers and system integrators to sell our products and our sales operations depend, in part, on the reliability of their cybersecurity measures. Additionally, we depend upon our employees to appropriately handle confidential data and deploy our IT resources in safe and secure fashion that does not expose our network systems to security breaches and the loss of data. Accordingly, if our cybersecurity systems and those of our contractors fail to protect against unauthorized access, sophisticated cyber attacks and the mishandling of data by our employees and contractors, our ability to conduct our business effectively could be damaged in a number of ways, including:

- sensitive data regarding our business, including intellectual property and other proprietary data, could be stolen;
- our electronic communications systems, including email and other methods, could be disrupted, and our ability to conduct our business operations could be seriously damaged until such systems can be restored;
- our ability to process customer orders and electronically deliver products and services could be degraded, and our distribution channels could be disrupted, resulting in delays in revenue recognition;
- defects and security vulnerabilities could be introduced into our software, thereby damaging the reputation and perceived reliability and security of our products and potentially making the data systems of our customers vulnerable to further data loss and cyber incidents; and
- personally identifiable data of our customers, employees and business partners could be compromised.

Should any of the above events occur, we could be subject to significant claims for liability from our customers and regulatory actions from governmental agencies. In addition, our ability to protect our intellectual property rights could be compromised and our reputation and competitive position could be significantly harmed. Also, the regulatory and contractual actions, litigations, investigations, fines, penalties and liabilities relating to data breaches that result in losses of personally identifiable or credit card information of users of our services can be significant in terms of fines and reputational impact and necessitate changes to our business operations that may be disruptive to us. Additionally, we could incur significant costs in order to upgrade our cybersecurity systems and remediate damages. Consequently, our financial performance and results of operations could be adversely affected.

**We believe our long-term value as a company will be greater if we focus primarily on growth instead of profitability.**

Our business strategy is to focus primarily on our long-term growth. As a result, our profitability in any given period may be lower than it would be if our strategy was to maximize short-term profitability. Expenditures on research and development, sales and marketing, infrastructure and other such investments may not ultimately grow our business, prospects or cause long term profitability. For example, in order to support our strong growth, we have accelerated our investment in infrastructure, such as enterprise resource planning software and other technologies to improve the efficiency of our operations. As a result, we expect our levels of operating profit could decline in the short to medium term. If we are ultimately unable to achieve or maintain profitability at the level anticipated by analysts and our stockholders, the market price of our common stock may decline.

**We may not generate positive returns on our research and development investments.**

Developing our products is expensive, and the investment in product development may involve a long payback cycle. For the years ended December 31, 2016, 2015 and 2014, our research and development expenses were \$273.6 million, or approximately 24.2% of our revenue, \$209.4 million, or approximately 25.0% of our revenue, and \$148.9 million, or approximately 25.5% of our revenue, respectively. We expect to continue to invest heavily in software development in order to expand the capabilities of our cloud networking platform, introduce new products and features and build upon our technology leadership. We believe one of our greatest strengths lies in the speed of our product development efforts. By investing in research and development, we believe we will be well positioned to continue our rapid growth and take advantage of our large market opportunity. We expect that our results of operations will be impacted by the timing and size of these investments. These investments may take several years to generate positive returns, if ever.

**We provide access to our software and other selected source code to certain partners, which creates additional risk that our competitors could develop products that are similar to or better than ours.**

Our success and ability to compete depend substantially upon our internally developed technology, which is incorporated in the source code for our products. We seek to protect the source code, design code, documentation and other information relating to our software, under trade secret, patent and copyright laws. However, we have chosen to provide access to selected source code of our software to several of our partners for co-development, as well as for open application programming interfaces, or APIs, formats and protocols. Though we generally control access to our source code and other intellectual property and enter into confidentiality or license agreements with such partners as well as with our employees and consultants, this combination of procedural and contractual safeguards may be insufficient to protect our trade secrets and other rights to our technology. Our protective measures may be inadequate, especially because we may not be able to prevent our partners, employees or consultants from violating any agreements or licenses we may have in place or abusing their access granted to our source code. Improper disclosure or use of our source code could help competitors develop products similar to or better than ours.

**Changes in our provision for income taxes or our effective tax rate, the enactment of new tax laws or changes in the application of existing tax laws of various jurisdictions or adverse outcomes resulting from examination of our income tax returns could adversely affect our results.**

Our provision for income taxes is subject to volatility and could be adversely affected by several factors, many of which are outside of our control, including earnings that are lower than anticipated in countries that have lower tax rates and higher than anticipated in countries that have higher tax rates; our ability to generate and use tax attributes; changes in the valuation of our deferred tax assets and liabilities; expiration of or lapses in the federal research and development ("R&D") tax credit laws; transfer pricing adjustments, including the effect of acquisitions on our inter-company R&D cost sharing arrangement and legal structure; tax effects of nondeductible compensation, including certain stock-based compensation; tax costs related to inter-company realignments; changes in accounting principles; adverse tax consequences, including imposition of withholding or other taxes on payments by subsidiaries or customers; a change in our decision to indefinitely reinvest foreign earnings or changes in tax laws and regulations, including possible U.S. changes to the taxation of earnings of our foreign subsidiaries, the deductibility of expenses attributable to foreign income or the foreign tax credit rules.

Significant judgment is required to evaluate our tax positions and determine our provision for income taxes. The accounting guidance for uncertainty in income taxes applies to all income tax positions, including the potential recovery of previously paid taxes, which if settled unfavorably could adversely affect our provision for income taxes or additional paid-in capital. In addition, tax laws are dynamic and subject to change as new laws are passed and new interpretations of the law are issued or applied. Recent changes to U.S. tax laws, including limitations on the ability of taxpayers to claim and utilize foreign tax credits and the deferral of certain tax deductions until earnings outside of the U.S. are repatriated to the U.S., as well as changes to U.S. tax laws that may be enacted in the future, could impact the tax treatment of our foreign earnings, as well as cash and cash equivalent balances we currently maintain outside of the U.S. Furthermore, due to shifting economic and political conditions, tax policies or rates in various jurisdictions may be subject to significant change.

Further, we are subject to the examination of our income tax returns by the Internal Revenue Service and other tax authorities. Audits by the Internal Revenue Service or other tax authorities are subject to inherent uncertainties and could result in unfavorable outcomes, including potential fines or penalties. As we operate in numerous taxing jurisdictions, the application of tax laws can be subject to diverging and sometimes conflicting interpretations by tax authorities of these jurisdictions. The expense of defending and resolving such an audit may be significant. The amount of time to resolve an audit is also unpredictable and may divert management's attention from our business operations. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. We cannot assure you that fluctuations in our provision for income taxes or our effective tax rate, the enactment of new tax laws or changes in the application or interpretation of existing tax laws or adverse outcomes resulting from examination of our tax returns by tax authorities will not have an adverse effect on our business, financial condition, results of operations and prospects.

**If we do not effectively expand and train our direct sales force, we may be unable to add new end customers or increase sales to our existing end customers, and our business will be adversely affected.**

We depend on our direct sales force to obtain new end customers and increase sales with existing end customers. As such, we have invested and will continue to invest in our sales organization. In recent periods, we have been adding personnel and other resources to our sales function as we focus on growing our business, entering new markets and increasing our market share, and we expect to incur additional expenses in expanding our sales personnel in order to achieve revenue growth. There is significant competition for sales personnel with the skills and technical knowledge that we require. Our ability to achieve significant revenue growth will depend, in large part, on our success in recruiting, training, retaining and integrating sufficient numbers of sales personnel to support our growth, particularly in international markets. New hires require significant training and may take significant time before they achieve full productivity. Our recent hires and planned hires may not become productive as quickly as we expect, and we may be unable to hire, retain or integrate into our corporate culture sufficient numbers of qualified individuals in the markets where we do business or plan to do business. In addition, because we continue to grow rapidly, a large percentage of our sales force is new to our company. If we are unable to hire, integrate and train a sufficient number of effective sales personnel, or the sales personnel we hire are not successful in obtaining new end customers

or increasing sales to our existing end-customer base, our business, financial condition, results of operations and prospects will be adversely affected.

**Regulations related to conflict minerals may cause us to incur additional expenses and could limit the supply and increase the costs of certain metals used in the manufacturing of our products.**

As a public company, we are subject to requirements under the Dodd-Frank that will require us to perform diligence, and disclose and report whether or not our products contain conflict minerals. The implementation of these requirements could adversely affect the sourcing, availability and pricing of the materials used in the manufacture of components used in our products. In addition, we will incur additional costs to comply with these disclosure requirements, including costs related to conducting diligence procedures and, if applicable, potential changes to products, processes or sources of supply as a consequence of such verification activities. We may also face reputational harm if we determine that certain of our products contain minerals not determined to be conflict-free or if we are unable to alter our products, processes or sources of supply to avoid such materials.

**Risks Related to the Securities Markets and Ownership of Our Common Stock**

**The market price of our common stock has been and may continue to be volatile, and the value of your investment could decline.**

The trading price of our common stock has historically been and is likely to continue to be volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. These fluctuations could cause you to lose all or part of your investment in our common stock. Factors that could cause fluctuations in the market price of our common stock include the following:

- actual or anticipated announcements of new products, services or technologies, commercial relationships, acquisitions or other events by us or our competitors;
- forward looking statements related to future revenue, gross margins and earnings per share;
- price and volume fluctuations in the overall stock market from time to time;
- litigation involving us, our industry, or both including events occurring in our litigation with Cisco Systems and Optumsoft;
- manufacturing, supply or distribution shortages or constraints, or challenges with adding or changing our manufacturing process or supply chain;
- significant volatility in the market price and trading volume of technology companies in general and of companies in the IT security industry in particular;
- fluctuations in the trading volume of our shares or the size of our public float;
- sales by our officers, directors or significant stockholders;
- actual or anticipated changes or fluctuations in our results of operations;
- adverse changes to our relationships with any of our channel partners;
- whether our results of operations or our financial outlook for future fiscal periods meet the expectations of securities analysts or investors;
- actual or anticipated changes in the expectations of investors or securities analysts;
- regulatory developments in the U.S., foreign countries or both;
- general economic conditions and trends;
- major catastrophic events;
- sales of large blocks of our common stock; or
- departures of key personnel.

In addition, technology stocks have historically experienced high levels of volatility and, if the market for technology stocks or the stock market in general experiences a loss of investor confidence, the market price of our common stock could decline for reasons unrelated to our business, financial condition, results of operations and prospects. The market price of our common stock might also decline in reaction to events that affect other companies in our industry even if these events do not directly affect us. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been brought against that company. If the market price of our common stock is volatile, we may become the target of securities litigation. Securities litigation could result in substantial costs and divert our management's attention and resources from our business and prospects. This could have a material adverse effect on our business, financial condition, results of operations and prospects.

**Sales of substantial amounts of our common stock in the public markets, or the perception that such sales might occur, could reduce the market price that our common stock might otherwise attain and may dilute your voting power and your ownership interest in us.**

Sales of a substantial number of shares of our common stock in the public market, or the perception that such sales could occur, could adversely affect the market price of our common stock and may make it more difficult for you to sell your common stock at a time and price that you deem appropriate and may dilute your voting power and your ownership interest in us.

Based on approximately 70.8 million shares outstanding as of December 31, 2016, holders of approximately 27.4%, of our common stock have rights, subject to some conditions, to require us to file registration statements covering the sale of their shares or to

include their shares in registration statements that we may file for ourselves or other stockholders. In addition, we have registered the offer and sale of all shares of common stock that we may issue under our equity compensation plans. If holders, by exercising their registration rights, sell large numbers of shares, it could adversely affect the market price of our common stock.

We may also issue shares of common stock or securities convertible into our common stock in connection with a financing, acquisition, our equity incentive plans, or otherwise. Any such issuances would result in dilution to our existing stockholders and could adversely affect the market price of our common stock.

**Insiders have substantial control over us, which could limit your ability to influence the outcome of key transactions, including a change of control.**

Our directors, executive officers and each of our stockholders who own greater than 10% of our outstanding common stock together with their affiliates, in the aggregate, beneficially own approximately 27.8% of the outstanding shares of our common stock, based on shares outstanding as of December 31, 2016. As a result, these stockholders, if acting together, could exercise a significant level of influence over matters requiring approval by our stockholders, including the election of directors and the approval of mergers, acquisitions or other extraordinary transactions. They may also have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interests. This concentration of ownership may also discourage a potential investor from acquiring our common stock due to the limited voting power of such stock or otherwise may have the effect of delaying, preventing or deterring a change of control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and might ultimately affect the market price of our common stock.

**We do not intend to pay dividends for the foreseeable future.**

We have never declared nor paid any dividends on our common stock. We intend to retain any earnings to finance the operation and expansion of our business and prospects, and we do not anticipate paying any cash dividends in the future. As a result, you may only receive a return on your investment in our common stock if the market price of our common stock increases.

**If securities or industry analysts publish inaccurate or unfavorable research reports about our business or prospects, the market price of our common stock and trading volume could decline.**

The trading market for our common stock, to some extent, depends on the research and reports that securities or industry analysts publish about us or our business or prospects. We do not have any control over these analysts. If one or more of the analysts who cover us should downgrade our shares or change their opinion of our shares, the market price of our common stock would likely decline. If one or more of these analysts should cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause the market price of our common stock or trading volume to decline.

**Our charter documents and Delaware law could discourage takeover attempts and lead to management entrenchment.**

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that could delay or prevent a change in control of our company. These provisions could also make it difficult for stockholders to elect directors that are not nominated by the current members of our board of directors or take other corporate actions, including effecting changes in our management. These provisions include:

- a classified board of directors with three-year staggered terms, which could delay the ability of stockholders to change the membership of a majority of our board of directors;
- the ability of our board of directors to issue shares of preferred stock and to determine the price and other terms of those shares, including preferences and voting rights, without stockholder approval, which could be used to significantly dilute the ownership of a hostile acquirer;
- the exclusive right of our board of directors to elect a director to fill a vacancy created by the expansion of our board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;
- a prohibition on stockholder action by written consent, which forces stockholder action to be taken at an annual or special meeting of our stockholders;
- the requirement that a special meeting of stockholders may be called only by the chairman of our board of directors, our president, our secretary or a majority vote of our board of directors, which could delay the ability of our stockholders to force consideration of a proposal or to take action, including the removal of directors;
- the requirement for the affirmative vote of holders of at least 66 2/3% of the voting power of all of the then outstanding shares of the voting stock, voting together as a single class, to amend the provisions of our amended and restated certificate of incorporation relating to the issuance of preferred stock and management of our business or our amended and restated bylaws, which may inhibit the ability of an acquirer to effect such amendments to facilitate an unsolicited takeover attempt;
- the ability of our board of directors, by majority vote, to amend the bylaws, which may allow our board of directors to take additional actions to prevent an unsolicited takeover and inhibit the ability of an acquirer to amend the bylaws to facilitate an unsolicited takeover attempt; and

- advance notice procedures with which stockholders must comply to nominate candidates to our board of directors or to propose matters to be acted upon at a stockholders' meeting, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of us.

In addition, as a Delaware corporation, we are subject to Section 203 of the Delaware General Corporation Law. These provisions may prohibit large stockholders, in particular those owning 15% or more of our outstanding voting stock, from merging or combining with us for a certain period of time.

**The issuance of additional stock in connection with financings, acquisitions, investments, our stock incentive plans or otherwise will dilute all other stockholders.**

Our amended and restated certificate of incorporation authorizes us to issue up to 1,000,000,000 shares of common stock and up to 100,000,000 shares of preferred stock with such rights and preferences as may be determined by our board of directors. Subject to compliance with applicable rules and regulations, we may issue our shares of common stock or securities convertible into our common stock from time to time in connection with a financing, acquisition, investment, our stock incentive plans or otherwise. We may from time to time issue additional shares of common stock at a discount from the then market price of our common stock. Any issuance of stock could result in substantial dilution to our existing stockholders and cause the market price of our common stock to decline.

**Item 1B. Unresolved Staff Comments**

None

**Item 2. Properties**

Our corporate headquarters is located in Santa Clara, California where we currently lease approximately 210,000 square feet of space under a lease agreement that expires in 2023.

We also lease space for operations, sales personnel and research and development in locations throughout the U.S. and various international locations, including Canada, China, India, Ireland, Japan, Korea, Malaysia, Singapore, Taiwan, the United Kingdom, and United Arab Emirates. We believe that our current facilities are adequate to meet our current needs. We intend to expand our facilities or add new facilities as we add employees and enter new geographic markets, and we believe that suitable additional or alternative space will be available as needed to accommodate ongoing operations and any such growth. We expect to incur additional expenses in connection with such new or expanded facilities.

**Item 3. Legal Proceedings**

The information set forth under the “Legal Proceedings” in Note 5 contained in the “Notes to Consolidated Financial Statements” in Item 8 of Part II of this Annual Report on Form 10-K is incorporated herein by reference.

**Item 4. Mine Safety Disclosures**

Not applicable

## PART II

**Item 5. Market for Registrant’s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities****Market Information**

Our common stock is listed on the NYSE under the symbol “ANET”. The following table sets forth for the periods indicated the high and low sales prices of our common stock as reported on the New York Stock Exchange.

	High	Low
<b>Fiscal 2015 Quarters</b>		
First quarter	\$ 74.52	\$ 56.11
Second quarter	\$ 88.56	\$ 63.16
Third quarter	\$ 88.25	\$ 60.10
Fourth quarter	\$ 79.44	\$ 58.77
<b>Fiscal 2016 Quarters</b>		
First quarter	\$ 79.22	\$ 52.51
Second quarter	\$ 75.40	\$ 60.51
Third quarter	\$ 86.35	\$ 62.21
Fourth quarter	\$ 98.90	\$ 78.82

**Holder of Record**

As of February 10, 2017, there were 102 holders of record of our common stock. Because many of our shares of common stock are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these record holders.

**Dividend Policy**

We have never declared or paid any cash dividends on our capital stock. We intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future. Any future determination to declare cash dividends will be made at the discretion of our board of directors, subject to applicable laws, and will depend on a number of factors, including our financial condition, results of operations, capital requirements, contractual restrictions, general business conditions and other factors that our board of directors may deem relevant.

## Stock Performance Graph

The following shall not be deemed “filed” for purposes of Section 18 of the Exchange Act, or incorporated by reference into any of our other filings under the Exchange Act or the Securities Act, except to the extent we specifically incorporate it by reference into such filing.

The following graph compares the cumulative total return of our common stock with the total return for the NYSE Composite Index and the Standard & Poor’s 500 Index (the “S&P 500”) from June 6, 2014 (the date of our initial public offering) through December 31, 2016. The graph assumes that \$100 was invested on June 6, 2014’s closing price in our common stock, the NYSE Composite Index and the S&P 500, and assumes reinvestment of any dividends. The stock price performance on the following graph is not necessarily indicative of future stock price performance.



## Securities Authorized for Issuance Under Equity Compensation Plans

See Item 12 of Part III of this report regarding information about securities authorized for issuance under our equity compensation plans.

## Recent Sales of Unregistered Equity Securities

There were no sales of unregistered securities during fiscal 2016.

## Issuer Repurchases of Equity Securities

Under our equity incentive plans, certain participants may exercise options prior to vesting, subject to a right of a repurchase by us. During the fourth quarter of 2016 there were no repurchases of unvested shares of our common stock made pursuant to our equity incentive plans as a result of us exercising our rights nor pursuant to any publicly announced plan or program.

## Item 6. Selected Consolidated Financial Data

The selected consolidated statements of operations data for fiscal 2016, 2015 and 2014 and the consolidated balance sheet data as of December 31, 2016 and 2015 are derived from our audited financial statements appearing in Part II, Item 8, “Financial Statements and Supplementary Data,” of this Annual Report on Form 10-K. The selected consolidated statements of operations data for fiscal 2013 and 2012 and the consolidated balance sheet data as of December 31, 2014, 2013 and 2012 are derived from audited financial statements not included in this Annual Report on Form 10-K. Our historical results are not necessarily indicative of the results to be expected in the future. The following selected consolidated financial data below should be read in conjunction with Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” our consolidated financial statements, and the accompanying notes appearing in Part II, Item 8, “Financial Statements and Supplementary Data,” of this Annual Report on Form 10-K to fully understand factors that may affect the comparability of the information presented below.

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands, except per share data)				
<b>Selected Consolidated Statements of Operations Data:</b>					
Revenue	\$ 1,129,167	\$ 837,591	\$ 584,106	\$ 361,224	\$ 193,408
Cost of revenue <sup>(1)</sup>	406,051	294,031	192,015	122,686	61,252
Total gross profit	723,116	543,560	392,091	238,538	132,156
Operating expenses <sup>(1)</sup> :					
Research and development	273,581	209,448	148,909	98,587	55,155
Sales and marketing	130,887	109,084	85,338	55,115	28,603
General and administrative	75,239	75,720	32,331	18,688	8,501
Total operating expenses	479,707	394,252	266,578	172,390	92,259
Income from operations	243,409	149,308	125,513	66,148	39,897
Other income (expense), net:					
Interest expense	(3,136)	(3,152)	(6,280)	(7,119)	(7,057)
Other income (expense), net	1,952	(147)	2,275	(754)	135
Total other income (expense), net	(1,184)	(3,299)	(4,005)	(7,873)	(6,922)
Income before provision for income taxes	242,225	146,009	121,508	58,275	32,975
Provision for income taxes	58,036	24,907	34,658	15,815	11,626
Net income	\$ 184,189	\$ 121,102	\$ 86,850	\$ 42,460	\$ 21,349
Net income attributable to common stockholders:					
Basic	\$ 182,965	\$ 119,115	\$ 68,889	\$ 20,777	\$ 9,622
Diluted	\$ 183,039	\$ 119,264	\$ 70,524	\$ 21,780	\$ 9,662
Net income per share attributable to common stockholders:					
Basic	\$ 2.66	\$ 1.81	\$ 1.42	\$ 0.76	\$ 0.39
Diluted	\$ 2.50	\$ 1.67	\$ 1.29	\$ 0.72	\$ 0.39
Weighted-average shares used in computing net income per share attributable to common stockholders:					
Basic	68,771	65,964	48,427	27,320	24,711
Diluted	73,222	71,411	54,590	30,051	24,901

<sup>(1)</sup> Includes stock-based compensation expense as follows:

	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands)				
Cost of revenue	\$ 3,620	\$ 3,048	\$ 1,535	\$ 408	\$ 270
Research and development	31,892	25,515	14,986	5,464	2,590
Sales and marketing	15,666	11,454	7,643	2,985	1,078
General and administrative	7,854	5,286	3,455	1,302	765
Total stock-based compensation	\$ 59,032	\$ 45,303	\$ 27,619	\$ 10,159	\$ 4,703

**Year Ended December 31,**

	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
	<b>(in thousands)</b>				
<b>Consolidated Balance Sheet Data:</b>					
Cash and cash equivalents	\$ 567,923	\$ 687,326	\$ 240,031	\$ 113,664	\$ 88,655
Working capital	1,066,573	739,317	535,106	73,422	130,808
Total assets	1,729,007	1,159,890	811,023	364,520	220,168
Total indebtedness <sup>(1)</sup>	41,210	42,546	43,634	160,213	134,277
Total deferred revenue	372,935	196,808	106,468	58,904	24,777
Total stockholders' equity (deficit)	\$ 1,107,820	\$ 788,152	\$ 555,658	\$ 77,732	\$ 18,910

<sup>(1)</sup> Total indebtedness includes our subordinated convertible promissory notes payable to related parties, subordinated convertible promissory notes payable to third parties, accrued interest payable on the notes and our lease financing obligations.

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

*You should read the following discussion and analysis of our financial condition and results of operations together with the consolidated financial statements and related notes that are included elsewhere in this Annual Report on Form 10-K. This discussion contains forward-looking statements based upon current plans, expectations and beliefs that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, including those set forth under "Risk Factors" and elsewhere in this Annual Report on Form 10-K.*

### Overview

We are a leading supplier of cloud networking solutions that use software innovations to address the needs of large-scale Internet companies, cloud service providers and next-generation data centers for enterprise support. Our cloud networking solutions consist of our Extensible Operating System, or EOS, a set of network applications and our Ethernet switching and routing platforms. Our cloud networking solutions deliver industry-leading performance, scalability, availability, programmability, automation and visibility. At the core of our cloud networking platform is EOS, which was purpose-built to be fully programmable and highly modular. The programmability of EOS has allowed us to create a set of software applications that address the requirements of cloud networking, including workflow automation, network visibility and analytics, and has also allowed us to rapidly integrate with a wide range of third-party applications for virtualization, management, automation, orchestration and network services.

As of December 31, 2016, we have shipped more than 10 million cloud networking ports worldwide. We have experienced rapid revenue growth over the last several years, increasing our revenue at a compound annual growth rate of 51.9% from 2011 to 2016. As we have grown the functionality of our EOS software, expanded the range of our product portfolio and increased the size of our sales force, our revenue has continued to grow rapidly. Our revenue for the year ended December 31, 2016 was \$1.1 billion an increase of 34.8% compared to 2015. We have been profitable and cash flow positive for each year since 2010.

We believe that our cloud networking platform addresses the large and growing cloud networking segment of data center switching, which remains in the early stage of adoption. We expect to continue growing our organization to meet the needs of new and existing customers as they increasingly realize the performance and cost benefits of our cloud networking solutions and as they expand their cloud networks. We intend to continue to invest in our research and development organization to enhance the functionality of our existing cloud networking platform, introduce new products and features and build upon our technology leadership. We believe one of our greatest strengths lies in our rapid development of new features and applications. We intend to continue expanding our sales and marketing teams and programs and carrying out associated marketing activities in key geographies. In order to support our strong growth, we have and may continue to accelerate our investment in infrastructure, such as enterprise resource planning software and other technologies to improve the efficiency of our operations. For a description of factors that may impact our future performance, see the disclosure in the section titled "Factors Affecting Our Performance" below.

### Our Business Model

We derive revenue from sales of products and services. We generate revenue primarily from sales of our switching products which incorporate our EOS software. We generate the majority of our services revenue from post contract support, or PCS, which end customers typically purchase in conjunction with our products.

Since shipping our first products in 2008, our cumulative end-customer base has grown rapidly. Between December 31, 2011 and December 31, 2016, our cumulative end-customer base grew from approximately 1,100 to over 4,200. Our end customers span a range of industries and include large Internet companies, service providers, financial services organizations, government agencies, media and entertainment companies and others.

To continue to grow our revenue, it is important that we both obtain new customers and sell additional products to existing customers. Our development model is focused on the development of new products based on our EOS software and enhancements to EOS. We engineer our products to be agnostic to the underlying merchant silicon architecture. Today, we combine our EOS software with merchant silicon into a family of switching and routing products. This enables us to focus our research and development resources on our software core competencies and to leverage the investments made by merchant silicon vendors to achieve cost-effective solutions. We currently procure certain merchant silicon components from multiple vendors, and we continue to expand our relationships with these and other vendors. We work closely with third party contract manufacturers to manufacture our products. Our contract manufacturers deliver our products to our third party direct fulfillment facilities. We and our fulfillment partners then perform labeling, final configuration, quality assurance testing and shipment to our customers. We have expanded our contract manufacturing capabilities to include Sanmina as an additional contract manufacturer.

We market and sell our products through both our direct sales force and our channel partners, including distributors, value-added resellers, system integrators, original equipment manufacturer, or "OEM" partners and in conjunction with various technology partners. To facilitate channel coordination and increase productivity, we have created a partner program, the Arista Partner Program, to engage partners who provide value-added services and extend our reach into the marketplace. Authorized training partners provide technical training to our channel partners. Our partners commonly receive an order from an end customer prior to placing an order with us, and we confirm the identification of the end customer prior to accepting such orders. Our partners generally do not stock inventory received from us. Our sales organization is supported by systems engineers with deep technical expertise and responsibility for pre-sales technical

support and engineering for our end customers. Each sales team is responsible for a geographic territory, has responsibility for a number of major direct end-customer accounts or has assigned accounts in a specific vertical market.

### **Factors Affecting Our Performance**

We believe that our future success will depend on many factors, including our ability to expand sales to our existing customers as well as to add new end customers. While these areas present significant opportunity, they also present risks that we must manage to ensure successful results. See the section titled “Risk Factors.” Additionally, we face intense competition especially from larger, well-established companies, and we must continue to expand the capabilities of our cloud networking platform to succeed in our market. We are also currently engaged in several lawsuits with Cisco, our largest competitor, whereby they claim that we have infringed their intellectual property rights. We intend to vigorously defend against these Cisco lawsuits as summarized in the Legal Proceedings section below. However, we cannot be certain that any claims by Cisco would be resolved in our favor. If we are unable to address these challenges, our business could be adversely affected.

*Increasing Adoption of Cloud Networks.* Networks are subject to increasing performance requirements due to the growing number of connected devices as well as new enterprise and consumer applications. Computing architectures are evolving to meet the need for constant connectivity and access to data and applications. We believe that cloud networks will continue to replace legacy network technologies. Our business and results of operations will be significantly affected by the speed with which organizations implement cloud networks.

*Expanding Sales to Existing Customer Base.* We expect that a substantial portion of our future sales will be follow-on sales to existing end customers. As noted above, one of our sales strategies is to target specific projects at our current end customers because they are familiar with the operational and economic benefits of our cloud networking solutions, thereby reducing the sales cycle into these customers. We believe this opportunity with current end customers to be significant given their existing and expected infrastructure spend. We expect our business and results of operations will depend on our ability to sell additional products to our growing base of customers.

*Adding New End Customers.* We believe that the cloud networking market is still in the early stages of adoption. We intend to target new end customers by continuing to invest in our field sales force and extending our relationships with channel, technology and system-level partners. To date, we have primarily targeted end customers with the largest cloud data centers. A typical initial order involves the education of prospective customers about the technical merits and capabilities and potential cost savings of our products as compared to our competitors’ products. Our results of operations will depend on our ability to continue to add new customers. We believe that customer references have been, and will continue to be, an important factor in winning new business with special emphasis on four key verticals: the cloud titans, financial services, service and internet hosting providers and high tech enterprises.

*Selling More Complex and Higher-Performance Configurations .* Our results of operations have been, and we believe will continue to be, affected by our ability to sell more complex and higher-performance configurations of our products. Our ability to sustain our revenue growth will depend, in part, upon our continued sales of these more robust configurations, and quarterly results of operations can be significantly impacted by the mix of products and product configurations sold during the period.

*Leveraging Channel Partners.* We expect to continue to derive a growing portion of our sales through our channel partners as they develop new end customers and expand sales to our existing end customers. We plan to continue to invest in our network of channel partners to enable them to reach new end customers more effectively, increase sales to existing customers and provide services and support effectively. We believe that increasing channel leverage will extend and improve our engagement with a broad set of customers.

*Investing in Research and Development for Growth.* We believe that the market for cloud networking is still in the early stages of adoption and we intend to continue investing for long-term growth. We expect to continue to invest heavily in software development in order to expand the capabilities of our cloud networking platform, introduce new products such as our 7280R platform, 7500R series and 7160 series, new releases and upgrades to our EOS software and new applications building upon our technology leadership. We believe one of our greatest strengths lies in the speed of our product development efforts. By investing in research and development, we believe we will be well positioned to continue our rapid growth and take advantage of our large market opportunity. We expect that our results of operations will be impacted by the timing and size of these product development investments.

*Customer Concentration and Timing of Large Orders .* Historically, large purchases by a relatively limited number of end customers have accounted for significant portion of our revenue. During the years ended December 31, 2016 , 2015 , and 2014 , our largest end customer accounted for 16.4% , 12.0% , and 14.9% of our revenue, respectively. We have also experienced and continue to experience customer concentration on a quarterly basis. In addition, we have experienced increases in the size of our orders, including orders from existing customers, which could result in future increased customer concentration, depending on the timing of the fulfillment of those orders. We have also experienced unpredictability in the timing of large orders, especially with respect to our large end customers, due to the complexity of orders, the time it takes end customers to evaluate, test, qualify and accept our products and factors specific to our end customers. Due to these factors, we expect continued variability in our customer concentration and timing of sales on a quarterly and annual basis. In addition, we have provided, and may in the future provide, pricing discounts to large end customers, which may result in lower margins for the period in which such sales occur. Our gross margins may also fluctuate as a result of the timing of such sales to large end customers.

## **Components of Operating Results**

### ***Revenue***

We generate revenue primarily from sales of our products, which incorporate our EOS software. We also derive a portion of our revenue from sales of post contract support, or PCS, and to a lesser extent professional services. We generate PCS revenue from sales of technical support services contracts that are typically purchased in conjunction with our products and subsequent renewals of those contracts. We expect our revenue may vary from period to period based on, among other things, the timing and size of orders, the delivery and acceptance of products, and the impact of significant transactions with unique terms and conditions that may require deferral of revenue.

### ***Cost of Revenue***

Cost of revenue primarily consists of amounts paid for inventory to our third-party contract manufacturers and merchant silicon vendors, overhead costs in our manufacturing operations department, and other manufacturing-related costs associated with manufacturing our products and managing our inventory. We expect our cost of product revenue to increase as our product revenue increases. Cost of providing PCS and other services consists primarily of personnel costs for our global customer support organization.

### ***Gross Margin***

Gross margin, or gross profit as a percentage of revenue, has been and will continue to be affected by a variety of factors, including sales to large end customers who generally receive lower pricing, the average sales price of our offerings, manufacturing-related costs, including costs associated with the introduction of additional contract manufacturing capacity, merchant silicon costs, supply chain sourcing and the mix of products sold. We expect our gross margins to fluctuate over time, depending on the factors described above and others.

### ***Operating Expenses***

Our operating expenses consist of research and development, sales and marketing and general and administrative expenses. The largest component of our operating expenses is personnel costs. Personnel costs consist of wages, benefits, bonuses and, with respect to sales and marketing expenses, sales commissions. Personnel costs also include stock-based compensation and travel expenses. We expect operating expenses to continue to increase in absolute dollars in the near term as we continue to invest in the growth of our business.

### ***Research and Development Expenses***

Research and development expenses consist primarily of personnel costs, with the remainder being prototype expenses, third-party engineering and contractor support costs, and an allocated portion of facility and IT costs and depreciation. Our research and development efforts are focused on maintaining and developing additional functionality for our existing products and on new product development, including new releases and upgrades to our EOS software and applications. We expense research and development costs as incurred. We expect our research and development expenses to increase in absolute dollars as we continue to invest heavily in software development in order to expand the capabilities of our cloud networking platform, introduce new products and features and build upon our technology leadership.

### ***Sales and Marketing Expenses***

Sales and marketing expenses consist primarily of personnel costs and also include costs related to marketing and promotional activities, with the remainder being an allocated portion of facility and IT costs and depreciation. We expect our sales and marketing expenses to increase in absolute dollars as we expand our sales and marketing efforts worldwide and expand our relationships with current and future channel partners and end customers.

### ***General and Administrative Expenses***

General and administrative expenses consist primarily of personnel costs, legal and professional fees, and an allocated portion of facility and IT costs and depreciation. General and administrative personnel costs include those for our executive, finance, human resources and legal functions. Our professional services costs are primarily due to external legal, accounting, and tax services.

### ***Other Income (Expense), Net***

#### ***Interest Expense***

Interest expense consists primarily of interest expense from our lease financing obligation. In fiscal 2014, interest expense also included interest expense on our subordinated convertible promissory notes, including our related party subordinated convertible promissory notes which were converted during fiscal 2014.

#### ***Other Income (Expense)***

Other income (expense) consists primarily of interest income on marketable securities and foreign currency transaction gains and losses. In addition, during fiscal 2014, other income (expense) consisted of gains on investments, and write-offs of debt discount on

notes payable which were repaid and converted during fiscal 2014. We expect our foreign currency gains and losses to continue to fluctuate in the future due to changes in foreign currency exchange rates.

***Provision for Income Taxes***

We operate in a number of tax jurisdictions and are subject to taxes in each country or jurisdiction in which we conduct business. Earnings from our non-U.S. activities are subject to local country income tax and may be subject to U.S. income tax. Generally, our U.S. tax obligations are reduced by a credit for foreign income taxes paid on these earnings which avoids double taxation. Our tax expense to date consists of federal, state and foreign current and deferred income taxes.

## Results of Operations

The following table summarizes historical results of operations for the periods presented and as a percentage of revenue for those periods. We have derived the data for the years ended December 31, 2016, 2015 and 2014 from our consolidated financial statements included elsewhere in this Form 10-K (in thousands, except for percentage of revenue).

	Year Ended December 31,		
	2016	2015	2014
<b>Consolidated Statements of Operations Data:</b>			
Revenue:			
Product	\$ 991,337	\$ 744,877	\$ 531,543
Service	137,830	92,714	52,563
Total revenue	<u>1,129,167</u>	<u>837,591</u>	<u>584,106</u>
Cost of revenue <sup>(1)</sup> :			
Product	369,768	263,585	174,004
Service	36,283	30,446	18,011
Total cost of revenue	<u>406,051</u>	<u>294,031</u>	<u>192,015</u>
Gross profit	<u>723,116</u>	<u>543,560</u>	<u>392,091</u>
Operating expenses <sup>(1)</sup> :			
Research and development	273,581	209,448	148,909
Sales and marketing	130,887	109,084	85,338
General and administrative	75,239	75,720	32,331
Total operating expenses	<u>479,707</u>	<u>394,252</u>	<u>266,578</u>
Income from operations	<u>243,409</u>	<u>149,308</u>	<u>125,513</u>
Interest expense	(3,136)	(3,152)	(6,280)
Other income (expense), net	1,952	(147)	2,275
Total other income (expense), net	<u>(1,184)</u>	<u>(3,299)</u>	<u>(4,005)</u>
Income before provision for income taxes	242,225	146,009	121,508
Provision for income taxes	58,036	24,907	34,658
Net income	<u>\$ 184,189</u>	<u>\$ 121,102</u>	<u>\$ 86,850</u>

<sup>(1)</sup> Includes stock-based compensation expense as follows:

	Year Ended December 31,		
	2016	2015	2014
<b>Stock-Based Compensation Expense:</b>			
Cost of revenue	\$ 3,620	\$ 3,048	\$ 1,535
Research and development	31,892	25,515	14,986
Sales and marketing	15,666	11,454	7,643
General and administrative	7,854	5,286	3,455
Total stock-based compensation	<u>\$ 59,032</u>	<u>\$ 45,303</u>	<u>\$ 27,619</u>

	Year Ended December 31,		
	2016	2015	2014
	(as a percentage of revenue)		
Revenue:			
Product	87.8 %	88.9 %	91.0 %
Service	12.2	11.1	9.0
Total revenue	100.0	100.0	100.0
Cost of revenue:			
Product	32.8	31.5	29.8
Service	3.2	3.6	3.1
Total cost of revenue	36.0	35.1	32.9
Gross margin	64.0	64.9	67.1
Operating expenses:			
Research and development	24.2	25.0	25.5
Sales and marketing	11.6	13.0	14.6
General and administrative	6.7	9.0	5.5
Total operating expenses	42.5	47.0	45.6
Income from operations	21.6	17.9	21.5
Interest expense	(0.3)	(0.4)	(1.1)
Other income (expense), net	0.2	—	0.4
Total other income (expense), net	(0.1)	(0.4)	(0.7)
Income before provision for income taxes	21.5	17.5	20.8
Provision for income taxes	5.1	3.0	5.9
Net income	16.3 %	14.5 %	14.9 %

**Year Ended December 31, 2016 Compared to Year Ended December 31, 2015**

*Revenue, Cost of Revenue and Gross Profit (in thousands, except percentages)*

	Year Ended December 31,				Change in	
	2016		2015		\$	%
	\$	% of revenue	\$	% of revenue		
Revenue						
Product	\$ 991,337	87.8%	\$ 744,877	88.9%	\$ 246,460	33.1%
Service	137,830	12.2	92,714	11.1	45,116	48.7
Total revenue	1,129,167	100.0	837,591	100.0	291,576	34.8
Cost of revenue						
Product	369,768	32.8	263,585	31.5	106,183	40.3
Service	36,283	3.2	30,446	3.6	5,837	19.2
Total cost of revenue	406,051	36.0	294,031	35.1	112,020	38.1
Gross profit	\$ 723,116	64.0%	\$ 543,560	64.9%	\$ 179,556	33.0%
Gross margin	64.0%		64.9%			

*Revenue by Geography (in thousands, except percentages)*

	Year Ended December 31,			
	2016	% of Total	2015	% of Total
Americas	\$ 874,740	77.5%	\$ 646,919	77.3%
Europe, Middle East and Africa	168,789	14.9	128,400	15.3
Asia-Pacific	85,638	7.6	62,272	7.4
Total revenue	\$ 1,129,167	100.0%	\$ 837,591	100.0%

*Revenue*

Product revenue increased \$246.5 million or 33.1% in the year ended December 31, 2016 compared to 2015. The increase during the period was primarily driven by increased shipments to our existing customers as they continue to grow and expand their businesses, increasing their demand for our products and related accessories. The introduction of new products contributed to our revenue growth, both with existing and new customers. As of December 31, 2016, we have shipped more than 10 million cumulative cloud networking ports worldwide and our overall end-customer base has exceeded 4,200. Service revenue increased 48.7% in the year ended December 31, 2016 as a result of continued growth in initial and renewal support contracts as our customer installed base continued to expand. We also continued to experience pressure in product and service pricing due to competitive market conditions. However, this pricing pressure was more than offset by the increased demand drivers outlined above.

*Cost of Revenue and Gross Margin*

Cost of revenue increased \$112.0 million or 38.1% for the year ended December 31, 2016 compared to the same period in 2015. The increase in cost of revenue was primarily due to an increase in product shipment volumes. In addition, we incurred increased costs as we added capacity to our manufacturing and operations infrastructure. Gross margin decreased from 64.9% to 64.0% for the year ended December 31, 2016 compared to the same period in 2015. The decrease during the period was primarily the result of changes in customer mix as we expanded our business including increased contributions from larger customers who typically receive higher discount levels, and increased costs associated with the expansion of manufacturing and operations capacity. These unfavorable changes were partially offset by improved service margins as we scale our services business. We expect our gross margins in the first quarter of 2017 will reflect some further increases in product costs as we continue to invest in expanded contract manufacturing and supply chain operations.

**Operating Expenses (in thousands, except percentages)**

	Year Ended December 31,				Change in	
	2016		2015		\$	%
	\$	% of revenue	\$	% of revenue		
Operating expenses:						
Research and development	\$ 273,581	24.2%	\$ 209,448	25.0%	\$ 64,133	30.6 %
Sales and marketing	130,887	11.6	109,084	13.0	21,803	20.0
General and administrative	75,239	6.7	75,720	9.0	(481)	(0.6)
Total operating expenses	\$ 479,707	42.5%	\$ 394,252	47.0%	\$ 85,455	21.7 %

*Research and development.*

Research and development expenses increased \$64.1 million , or 30.6% , for the year ended December 31, 2016 compared to the same period in 2015 . The increase was primarily due to an increase in personnel costs of \$31.2 million resulting from an increase in compensation costs, including stock-based compensation and corporate bonus expense, primarily driven by headcount growth. Prototype spend and third-party engineering and consulting costs increased by \$27.3 million, related to additional outsourced development projects, increased internal development activity related to new products and increased costs associated with litigation-related changes in product design. Facilities and IT infrastructure costs increased \$3.1 million primarily due to continued expansion and support of our research and development activities.

*Sales and marketing.*

Sales and marketing expenses increased \$21.8 million , or 20.0% for the year ended December 31, 2016 compared to the same period in 2015 . The increase was primarily due to an increase in personnel costs of \$21.0 million, reflecting increased compensation costs, including sales incentive compensation and corporate bonus expense, primarily driven by headcount growth and higher sales volumes. In addition, sales and customer engineering consulting expenses mostly related to international expansion increased by \$1.3 million, and marketing promotion, trade shows and events increased by \$1.1 million, as compared to the same period in 2015 . The increase was partially offset by a decrease in product field demonstration costs of \$1.7 million primarily related to significant costs incurred in the previous year due to several next generation product transitions.

*General and administrative.*

General and administrative expenses decreased \$(0.5) million , or (0.6)% , for the year ended December 31, 2016 compared to the same period in 2015 . The decrease was primarily due to a reduction in litigation expenses of \$5.6 million during the year ended December 31, 2016 as compared to the same period in 2015 . This decrease was primarily related to the timing of litigation activities associated with the Cisco and OptumSoft legal matters outlined in Note 5 to the Consolidated Financial Statements. This decrease was largely offset by an increase in personnel costs of \$4.9 million in the year ended December 31, 2016 as compared to the same period in 2015 . This reflects increased compensation costs, including increased stock-based compensation and corporate bonus expense, primarily driven by headcount growth.

**Other Income (Expense), Net (in thousands, except percentages)**

	Year Ended December 31,		Change in	
	2016	2015	\$	%
Other income (expense), net:				
Interest expense	\$ (3,136)	\$ (3,152)	\$ 16	(0.5)%
Other income (expense), net	1,952	(147)	2,099	(1,427.9)
Total other income (expense), net	\$ (1,184)	\$ (3,299)	\$ 2,115	(64.1)%

Other income (expense), net improved during the year ended December 31, 2016 compared to 2015 primarily due to a net increase in interest income as we expanded our marketable securities portfolio.

**Provision for Income Taxes (in thousands, except percentages)**

	Year Ended December 31,		Change in	
	2016	2015	\$	%
Provision for income taxes	\$ 58,036	\$ 24,907	\$ 33,129	133.0%
Effective tax rate	24.0%	17.1%		

Provision for income taxes was approximately \$58.0 million and \$24.9 million for the year ended December 31, 2016 and 2015 , respectively. The change in our provision was primarily due to an increase in profit before income taxes. The increase in the provision was also a result of additional state and foreign taxes, non-deductible permanent differences, offset by a shift in the geographic foreign

earnings mix taxed at a lower rate than the U.S. tax rate. For further information regarding income taxes and the impact on our results of operations and financial position, see "Notes to Consolidated Financial Statements - Note 8, Income Taxes."

### Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

#### Revenue, Cost of Revenue and Gross Profit (in thousands, except percentages)

	Year Ended December 31,				Change in	
	2015		2014			
	\$	% of revenue	\$	% of revenue	\$	%
<b>Revenue</b>						
Product	\$ 744,877	88.9%	\$ 531,543	91.0%	\$ 213,334	40.1%
Service	92,714	11.1	52,563	9.0	40,151	76.4
Total revenue	837,591	100.0	584,106	100.0	253,485	43.4
<b>Cost of revenue</b>						
Product	263,585	31.5	174,004	29.8	89,581	51.5
Service	30,446	3.6	18,011	3.1	12,435	69.0
Total cost of revenue	294,031	35.1	192,015	32.9	102,016	53.1
Gross profit	\$ 543,560	64.9%	\$ 392,091	67.1%	\$ 151,469	38.6%
Gross margin	64.9%		67.1%			

#### Revenue by Geography (in thousands, except percentages)

	Year Ended December 31,			
	2015	% of Total	2014	% of Total
Americas	\$ 646,919	77.3%	\$ 465,544	79.7%
Europe, Middle East and Africa	128,400	15.3	74,555	12.8
Asia-Pacific	62,272	7.4	44,007	7.5
Total revenue	\$ 837,591	100.0%	\$ 584,106	100.0%

#### Revenue

Product revenue increased \$213.3 million or 40.1% for the year ended December 31, 2015 compared to 2014. We increased shipments to our existing customers during the year as they continued to grow their businesses and increase their demand for our products and related accessories. In addition, we continued to add new customers as we expanded our market presence and geographic footprint. Service revenue increased 76.4% in the year ended December 31, 2015 with growth in initial and renewal support contracts as our customer installed base continued to expand. We also continued to experience fluctuations in product and service pricing due to competitive market pressures. However, these were more than offset by the increased demand drivers outlined above.

#### Cost of Revenue and Gross Margin

Gross margin decreased from 67.1% to 64.9% for the year ended December 31, 2015 compared to the same period in 2014. This decrease in 2015 was primarily due to increased inventory-related obsolescence charges associated with upcoming product transitions and higher warranty costs, in addition to a greater mix of revenue from larger customers who typically receive higher discounts.

#### Operating Expenses (in thousands, except percentages)

	Year Ended December 31,				Change in	
	2015		2014			
	\$	% of revenue	\$	% of revenue	\$	%
<b>Operating expenses:</b>						
Research and development	\$ 209,448	25.0%	\$ 148,909	25.5%	\$ 60,539	40.7%
Sales and marketing	109,084	13.0	85,338	14.6	23,746	27.8
General and administrative	75,720	9.0	32,331	5.5	43,389	134.2
Total operating expenses	\$ 394,252	47.0%	\$ 266,578	45.6%	\$ 127,674	47.9%

### Research and development

Research and development expenses increased \$60.5 million , or 40.7% , for the year ended December 31, 2015 compared to the same period in 2014 . The increase was primarily due to an increase in personnel costs of \$33.3 million, resulting from headcount growth, which drove an increase in compensation, including stock based compensation, as well as additional bonus expense under our corporate bonus plan. Prototype spend and third-party engineering and consulting costs increased by \$14.2 million, and facilities and IT infrastructure costs increased \$8.6 million due to new product introductions and the continued expansion and support of our research and development activities.

### Sales and marketing

Sales and marketing expenses increased \$23.7 million , or 27.8% , for the year ended December 31, 2015 compared to the same period in 2014 . The increase was primarily due to an increase in personnel costs of \$17.0 million, resulting from increased compensation, including sales commissions, which was driven by headcount growth and higher sales volumes. The increase also related to additional product field demonstration costs of \$6.0 million.

### General and administrative

General and administrative expenses increased \$43.4 million , or 134.2% , for the year ended December 31, 2015 compared to the same period in 2014 . The increase was due to an increase in legal fees of \$39.8 million primarily related to the Cisco and OptumSoft legal matters outlined in Note 5 to the Consolidated Financial Statements. In addition, personnel costs increased by \$4.1 million primarily reflecting additional corporate bonus expense and increased stock-based compensation charges during 2015.

### Other Income (Expense), Net (in thousands, except percentages)

	Year Ended December 31,		Change in	
	2015	2014	\$	%
Other income (expense), net:				
Interest expense	\$ (3,152)	\$ (6,280)	\$ 3,128	(49.8)%
Other income (expense), net	(147)	2,275	(2,422)	(106.5)
Total other income (expense), net	<u>\$ (3,299)</u>	<u>\$ (4,005)</u>	<u>\$ 706</u>	<u>(17.6)%</u>

*Interest expense.* The reduction in interest expense during the year ended December 31, 2015 compared to the same period in 2014 is primarily related to repayment and conversion of our notes payable upon closing of our initial public offering during the second quarter of 2014.

*Other income (expense), net.* The unfavorable change in other income (expense), net during the year ended December 31, 2015 , compared to the same period in 2014 was primarily due to a one-time gain on our notes receivable of \$4.0 million in 2014, partially offset by a \$0.7 million write-off related to the debt discount on notes payable during the second quarter of 2014, and a reduction in transactional exchange rate losses during 2015.

### Provision for Income Taxes (in thousands, except percentages)

	Year Ended December 31,		Change in	
	2015	2014	\$	%
Provision for income taxes	\$ 24,907	\$ 34,658	\$ (9,751)	(28.1)%
Effective tax rate	17.1%	28.5%		

Provision for income taxes was approximately \$24.9 million and \$34.7 million for the year ended December 31, 2015 and 2014 , respectively. The decrease in our provision was the result of foreign mix earnings taxed at a lower rate than the US tax rate, release of reserves due to expiration of the statute of limitations in certain domestic jurisdictions, and reinstatement of the federal R&D credit during 2015. These decreases were partially offset by an increase in the provision due to increased profit before income taxes.

### Liquidity and Capital Resources

Our principal sources of liquidity are cash and cash equivalents, marketable securities, and cash generated from operations. As of December 31, 2016 , cash and cash equivalents were \$567.9 million , of which approximately \$111.7 million was held outside the U.S. in our foreign subsidiaries. We have not repatriated nor do we currently have plans to repatriate these funds, but if we were to repatriate cash held outside of the U.S. for domestic cash operations, we would be required to accrue and pay U.S. income taxes to repatriate these funds less any previously paid foreign income taxes. We consider the undistributed earnings of our foreign subsidiaries as of December 31, 2016 to be indefinitely reinvested, and, accordingly, no U.S. income taxes have been provided thereon.

Our cash and cash equivalents and marketable securities are held for working capital purposes. We plan to continue to invest for long-term growth. We believe that our existing cash and cash equivalents together with cash flow from operations will be sufficient to meet our working capital requirements and our growth strategies for the foreseeable future. Our future capital requirements will depend on many factors, including our growth rate, the timing and extent of our spending to support research and development activities, the

timing and cost of establishing additional sales and marketing capabilities, the introduction of new and enhanced product and service offerings, our costs associated with supply chain activities and manufacturing operations, our costs related to investing in or acquiring complementary or strategic businesses and technologies, the continued market acceptance of our products, and costs incurred related to outstanding litigation claims. If we require or elect to seek additional capital through debt or equity financing in the future, we may not be able to raise capital on terms acceptable to us or at all. If we are required and unable to raise additional capital when desired, our business, operating results and financial condition may be adversely affected.

### Cash Flows

	Year Ended December 31,		
	2016	2015	2014
	(in thousands)		
Cash provided by operating activities	\$ 131,440	\$ 200,533	\$ 131,875
Cash provided by (used in) investing activities	(325,979)	184,170	(249,362)
Cash provided by financing activities	75,600	63,105	243,978
Effect of exchange rate changes	(464)	(513)	(124)
Net increase (decrease) in cash and cash equivalents	<u>\$ (119,403)</u>	<u>\$ 447,295</u>	<u>\$ 126,367</u>

### Cash Flows from Operating Activities

Our primary source of cash from operating activities has been from cash collections from our customers. We expect cash inflows from operating activities to be affected by increased sales and timing of collections. Our primary uses of cash from operating activities have been for personnel costs, inventory purchases from our contract manufacturer, investment in research and development, and litigation expenses.

During the year ended December 31, 2016, cash provided by operating activities was \$131.4 million, primarily from net income of \$184.2 million with non-cash adjustments to net income of \$15.7 million, partially offset by a net decrease in cash from changes in our operating assets and liabilities of \$68.4 million. The decrease in cash from changes in operating assets and liabilities was primarily due to an increase in working capital requirements with accounts receivable up \$108.9 million, inventories up \$144.4 million and inventory deposits (included in prepaid expenses and other assets) up \$63.1 million. These increases reflect substantial growth in the business and the expansion of our manufacturing and supply chain activities at our new contract manufacturer. These working capital increases were partially offset by an increase in deferred revenue of \$176.1 million reflecting ongoing growth in service and support contracts and a significant increase in product deferred revenue related to contract acceptance terms. Other significant changes in operating assets and liabilities largely related to the overall growth of the business including an increase in accounts payable of \$38.7 million, an increase in income taxes payable of \$42.7 million, an increase in accrued liabilities of \$30.6 million offset by further increases in prepaid expenses and current assets of \$54.8 million which was primarily driven by an increase in deferred cost of inventory associated with the increased product revenue deferrals referenced above.

During the year ended December 31, 2015, cash provided by operating activities was \$200.5 million, primarily from net income of \$121.1 million, net non-cash charges of (\$1.2) million, and a net increase in cash from changes in our operating assets and liabilities of \$80.6 million. The net increase in cash from changes in operating assets and liabilities was primarily due to an increase in deferred revenue of \$90.3 million, largely related to short and long-term services contracts and product revenue deferrals related to contracts with acceptance terms. In addition, we experienced an increase in cash of \$32.0 million from income taxes payable and an increase in our accounts payable and accrued liabilities of \$29.4 million due to the timing of payments. These operating liability increases were offset by an increase in our accounts receivable of \$47.3 million resulting from an increase in sales during the period. In addition, inventory increased \$14.1 million during the period due to higher shipment volume, and prepaid expenses and current assets increased \$7.8 million in the period.

During the year ended December 31, 2014, cash provided by operating activities was \$131.9 million primarily from net income of \$86.9 million, net non-cash charges of \$11.0 million, and an increase of \$33.2 million due to changes in our operating assets and liabilities. The increase in cash from operating assets and liabilities was primarily due an increase in deferred revenue of \$47.6 million resulting from the increase in sales, an increase in accrued liabilities of \$18.9 million largely related to our payroll and corporate bonus plan and an increase in accounts payable of \$14.0 million due to the timing of our payments, partially offset by a reduction in cash from an increase in accounts receivable of \$19.0 million from higher products shipments, an increase in inventories of \$13.4 million to meet our customer demand, an increase of \$15.3 million in cash paid for income taxes, and supplier rebates receivable resulting from our increased inventory purchases.

### **Cash Flows from Investing Activities**

Our investing activities have consisted primarily of capital expenditures and net investment purchases of available for sale marketable securities. We expect to continue investing in these activities to support the continued growth of our business.

During the year ended December 31, 2016, cash used in investing activities was \$326.0 million, consisting of purchases of available-for-sale securities of \$439.7 million, purchases of property, equipment and other assets of \$21.4 million, and an additional investment in a privately held company of \$2.5 million. Cash used was offset by cash provided by proceeds from the maturity of available-for-sale securities of \$137.9 million.

During the year ended December 31, 2015, cash provided by investing activities was \$184.2 million, consisting of proceeds from the maturity of available-for-sale securities of \$208.2 million, offset by purchases of property, equipment and other assets of \$19.2 million and increase in restricted cash of \$4.0 million related to a security deposit required for a facility lease.

During the year ended December 31, 2014, cash used in investing activities was \$249.4 million, consisting primarily of purchases of marketable securities of \$210.0 million, purchases of property and equipment of \$13.1 million and other investing activities of \$38.2 million largely due to a \$33.6 million equity investments in privately held companies, partially offset by the proceeds of the repayments of our notes receivable of \$8.0 million and the release of our restricted cash into cash and cash equivalents of \$4.0 million.

### **Cash Flows from Financing Activities**

During the year ended December 31, 2016, cash provided by financing activities was \$75.6 million, consisting primarily of the excess tax benefit associated with equity incentive plans of \$42.9 million, proceeds from the exercise of stock options, net of repurchases, of \$24.9 million, and proceeds from the issuance of common stock from our ESPP of \$10.3 million.

During the year ended December 31, 2015, cash provided by financing activities was \$63.1 million, consisting primarily of the excess tax benefit associated with equity incentive plans of \$37.3 million, proceeds from the exercise of stock options, net of repurchases of \$17.8 million and the proceeds from the issuance of common stock from our ESPP of \$9.4 million.

During the year ended December 31, 2014, cash provided by financing activities was \$244.0 million, consisting primarily of net proceeds raised from our initial public offering of \$239.3 million, proceeds from the exercise of stock options, net of repurchases of \$8.0 million and excess tax benefits from our equity incentive plans amounting to \$17.4 million. These proceeds were partially offset by the repayment of our notes payable of \$20.0 million.

### **Off-Balance Sheet Arrangements**

As of December 31, 2016, we did not have any relationships with any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

### **Contractual Obligations and Commitments**

Our contractual commitments will have an impact on our future liquidity. Our contractual obligations represent material expected or contractually committed future obligations with terms in excess of one year. We believe that we will be able to fund these obligations through cash generated from operations and from our existing cash balances.

The following summarizes our contractual obligations and commitments as of December 31, 2016 (in thousands):

	Payments Due by Period				
	Total	Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years
Financing lease obligation <sup>(1)</sup>	\$ 43,626	\$ 5,933	\$ 12,406	\$ 13,151	\$ 12,136
Operating lease obligations	50,131	7,867	14,262	12,256	15,746
Non-cancelable purchase obligations	261,868	261,868	—	—	—
Total	\$ 355,625	\$ 275,668	\$ 26,668	\$ 25,407	\$ 27,882

<sup>(1)</sup> Includes interest and land lease

The contractual obligation table above excludes tax liabilities of \$16.1 million related to uncertain tax positions because we are unable to make a reasonably reliable estimate of the timing of settlement, if any, of these future payments.

## Critical Accounting Policies and Estimates

We have prepared our consolidated financial statements in accordance with GAAP and include our accounts and the accounts of our wholly owned subsidiaries. The preparation of these consolidated financial statements requires our management to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities at the date of the financial statements, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the applicable periods. We base our estimates, assumptions and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances. Different assumptions and judgments would change the estimates used in the preparation of our consolidated financial statements, which, in turn, could change the results from those reported. We evaluate our estimates, assumptions and judgments on an ongoing basis. The critical accounting estimates, assumptions and judgments that we believe have the most significant impact on our consolidated financial statements are the following:

### Revenue Recognition

We generate revenue from sales of our products which incorporate our EOS software and accessories such as cables and optics to direct customers and channel partners together with post contract customer support (“PCS”). We typically sell products and PCS in a single transaction. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery or performance has occurred; the sales price is fixed or determinable; and collectability is reasonably assured.

We define each of the four criteria above as follows:

- *Persuasive evidence of an arrangement exists.* Evidence of an arrangement consists of stand-alone purchase orders or purchase orders issued pursuant to the terms and conditions of a master sales agreement. It is our practice to identify an end customer prior to shipment to a reseller or distributor.
- *Delivery or performance has occurred.* We use shipping documents or written evidence of customer acceptance, when applicable, to verify delivery or performance. We recognize product revenue upon transfer of title and risk of loss, which primarily is upon shipment to customers. We generally do not have significant obligations for future performance, rights of return, or pricing credits associated with our product sales. In instances where substantive acceptance provisions are specified in the customer arrangement, revenue and deferred cost of revenue is deferred until all acceptance criteria have been met.
- *The sales price is fixed or determinable.* We assess whether the sales price is fixed or determinable based on payment terms and whether the sales price is subject to refund or adjustment.
- *Collectability is reasonably assured.* We assess probability of collectability on a customer-by-customer basis. Our customers and channel partners are subjected to a credit review process that evaluates their financial condition and ability to pay for products and services.

PCS is offered under renewable, fee-based contracts, which includes technical support, hardware repair and replacement parts beyond standard warranty, bug fixes, patches and unspecified upgrades on a when-and-if-available basis. We initially defer PCS revenue and recognize it ratably over the life of the PCS contract, with the related expenses recognized as incurred. PCS contracts usually have a term of one to three years. We include billed but unearned PCS revenue in deferred revenue.

We report revenue net of sales taxes. We include shipping charges billed to customers in revenue and the related shipping costs are included in cost of goods sold.

### Multiple-Element Arrangements

Most of our arrangements, other than renewals of PCS, are multiple element arrangements with a combination of products and PCS. Products and PCS generally qualify as separate units of accounting. Our hardware deliverables include EOS software, which together deliver the essential functionality of our products. For multiple element arrangements, we allocate revenue to each unit of accounting based on the relative selling price. The relative selling price for each element is based upon the following hierarchy: vendor-specific objective evidence (“VSOE”), if available; third-party evidence (“TPE”), if VSOE is not available; and best estimate of selling price (“BESP”), if neither VSOE nor TPE is available. As we have not been able to establish VSOE or TPE for our products and most of our services, we generally utilize BESP for the purposes of allocating revenue to each unit of accounting.

- *VSOE* —We determine VSOE based on our historical pricing and discounting practices for the specific products and services when sold separately. In determining VSOE, we require that a substantial majority of the stand-alone selling prices fall within a reasonably narrow pricing range.
- *TPE* —When VSOE cannot be established for deliverables in multiple-element arrangements, we apply judgment with respect to whether we can establish a selling price based on TPE. TPE is determined based on competitor prices for interchangeable products or services when sold separately to similarly situated customers. However, as our products contain a significant element of proprietary technology and offer substantially different features and functionality, the comparable pricing of products with similar functionality typically cannot be obtained. Additionally, as we are unable to reliably determine what competitors products’ selling prices are on a stand-alone basis, we are not able to obtain reliable evidence of TPE of selling price.

- *BESP* —When we are unable to establish selling price using VSOE or TPE, we use *BESP* in our allocation of arrangement consideration. The objective of *BESP* is to determine the price at which we would transact a sale if the product or service was sold regularly on a stand-alone basis. *BESP* is based on considering multiple factors including, but not limited to the sales channel (reseller, distributor or end customer), the geographies in which our products and services were sold (domestic or international) and size of the end customer.

We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations, or subject to customer-specific return, acceptance or refund privileges.

We account for multiple agreements with a single partner as 1 arrangement if the contractual terms and/or substance of those agreements indicate that they may be so closely related that they are, in effect, parts of a single arrangement.

We may occasionally accept returns to address customer satisfaction issues even though there is no contractual provision for such returns. We estimate returns for sales to customers based on historical returns rates applied against current-period gross revenues. Specific customer returns and allowances are considered when determining our sales return reserve estimate.

In May 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2014-09, "Revenue from Contracts with Customers," which replaces current revenue recognition guidance. ASU 2014-09 requires revenue to be recognized when a customer obtains control of the promised goods or services. The amount of revenue recognized is limited to the final consideration received in exchange for the goods and services.

Management's assessments of the potential impacts of the standard is underway. The standard is expected to impact the amount and timing of revenue recognized and the related disclosures on our consolidated financial statements.

We will adopt ASU 2014-09 during the first quarter of 2018 and we expect to adopt this new standard using the modified retrospective method that will result in a cumulative effect adjustment as of the date of adoption.

#### ***Inventory Valuation and Contract Manufacturer/Supplier Liabilities***

Inventories primarily consist of finished goods purchased from third party contract manufacturers and are stated at the lower of cost (computed using the first-in, first-out method) or market value. Manufacturing overhead costs and inbound shipping costs are included in the cost of inventory. In addition, we purchase strategic component inventory from certain suppliers under purchase commitments that in some cases are non-cancelable, including integrated circuits, which are held by our contract manufacturers. We record a provision when inventory is determined to be in excess of anticipated demand, or obsolete, to adjust inventory to its estimated realizable value. We also record a liability for non-cancelable, non-returnable purchase commitments with our component inventory suppliers for quantities in excess of our demand forecasts or that are considered obsolete.

Our contract manufacturers procure components and assemble products on our behalf based on our forecasts. We generally incur a liability when the contract manufacturer has converted the component inventory to a finished product. Historically, we have reimbursed our contract manufacturer for component inventory that has been rendered excess or obsolete due to manufacturing and engineering change orders resulting from design changes, or in cases where inventory levels greatly exceed our forecasts.

We use significant judgment in establishing our forecasts of future demand and obsolete material exposures. These estimates depend on our assessment of current and expected orders from our customers, product development plans and current sales levels. If actual market conditions are less favorable than those projected by management, which may be caused by factors within and outside of our control, we may be required to increase our inventory write-downs and liabilities to our contract manufacturers and suppliers, which could have an adverse impact on our gross margins and profitability. We regularly evaluate our exposure for inventory write-downs and adequacy of our contract manufacturer liabilities.

#### ***Warranty***

We offer a one-year warranty on all of our hardware products and a 90-day warranty against defects in the software embedded in the products. We use judgment and estimates when determining warranty costs based on historical costs to replace product returns within the warranty period at the time we recognize revenue. We accrue for potential warranty claims at the time of shipment as a component of cost of revenues based on historical experience and other relevant information. We reserve for specifically identified products if and when we determine we have a systemic product failure. Although we engage in extensive product quality programs, if actual product failure rates or use of materials differ from estimates, additional warranty costs may be incurred, which could reduce our gross margin. The accrued warranty liability is recorded in accrued liabilities in the accompanying consolidated balance sheets.

#### ***Stock-Based Compensation***

Compensation expense related to stock-based transactions, including stock options, restricted stock units ("RSUs"), restricted stock awards ("RSAs"), and stock purchase rights under our employee stock purchase program is measured and recognized in the financial statements based on the estimated fair value of the equity granted. Stock-based compensation expense is generally recognized on a straight-line basis, net of estimated forfeitures, over the requisite service periods of the awards, which typically ranges from two to five years. The assumptions used in our option-pricing model represent management's best estimates. These estimates involve inherent uncertainties and the application of management's judgment. If factors change and different assumptions are used, our stock-based

compensation expense could be materially different in the future. These assumptions and estimates are as follows:

#### *Fair Value*

The fair value of stock options are estimated on the grant date using the Black-Scholes-Merton option-pricing model. This model requires the input of subjective assumptions, including the expected term of the option and the expected volatility of the price of our common stock.

#### *Expected Term*

The expected term represents the period that our equity grants are expected to be outstanding. For option grants that are considered to be “simple,” we used the simplified method to determine the expected term which calculates the expected term as the average of the time-to-vesting and the contractual life of the options. For option grants that are not considered “simple,” the expected term is based on historical option exercise behavior and post-vesting cancellations of options by employees. For ESPP grants, the expected term is based on the length of the each purchase period with an offering period.

#### *Expected Volatility*

Our volatility has historically been derived from the average historical stock volatilities of a peer group of public companies within our industry that we consider to be comparable to our business over a period equivalent to the expected term of the stock-based grants. In late 2016, as sufficient but limited historical information became available, we transitioned our expected volatility model to include a combination of our peer group, and the limited historical and implied volatility of our common stock.

In addition to the assumptions used above, we have through fiscal 2016 applied an estimated forfeiture rate to calculate the stock-based compensation expense for our equity awards. Our forfeiture rate is based on an analysis of our actual forfeitures. We account for forfeitures as they occur and calculate a cumulative adjustment as it relates to equity transactions where prior forfeitures rates have previously and cumulatively been applied.

#### *Income Taxes*

Income tax expense is an estimate of current income taxes payable in the current fiscal year based on reported income before income taxes. Deferred income taxes reflect the effect of temporary differences and carryforwards that we recognize for financial reporting and income tax purposes.

We account for income taxes under the liability approach for deferred income taxes, which requires recognition of deferred income tax assets and liabilities for the expected future tax consequences of events that have been recognized in our consolidated financial statements, but have not been reflected in our taxable income. Estimates and judgments occur in the calculation of certain tax liabilities and in the determination of the recoverability of certain deferred income tax assets, which arise from temporary differences and carryforwards. Deferred income tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. We regularly assess the likelihood that our deferred income tax assets will be realized based on the positive and negative evidence available. We record a valuation allowance to reduce the deferred tax assets to the amount that we are more likely than not to realize.

We believe that we have adequately reserved for our uncertain tax positions, although we can provide no assurance that the final tax outcome of these matters will not be materially different. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made and could have a material impact on our financial condition and results of operations. The provision for income taxes includes the effects of any reserves that we believe are appropriate, as well as the related net interest and penalties.

We regularly review our tax positions and benefits to be realized. We recognize tax liabilities based upon our estimate of whether, and to the extent to which, additional taxes will be due when such estimates are more likely than not to be sustained. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. We recognize interest and penalties related to income tax matters as income tax expense.

#### *Loss Contingencies*

In the ordinary course of business, we are a party to claims and legal proceedings including matters relating to commercial, employee relations, business practices and intellectual property. In assessing loss contingencies, we use significant judgment and assumptions to estimate the likelihood of loss, impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss. We record a provision for contingent losses when it is both probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. We will record a charge equal to the minimum estimated liability for litigation costs or a loss contingency only when both of the following conditions are met: (i) information available prior to issuance of our consolidated financial statements indicates that it is probable that a liability had been incurred at the date of the financial statements and (ii) the range of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted and whether new accruals are required.

**Recent Accounting Pronouncements**

Refer to “Recent Accounting Pronouncements” in Note 1 to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K.

**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk in the ordinary course of our business. Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in foreign currency exchange rates, interest rates and investments in privately held companies.

***Foreign Currency Exchange Risk***

Our results of operations and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. Substantially all of our revenue is denominated in U.S. dollars. Our expenses are generally denominated in the currencies in which our operations are located, which is primarily in the U.S. and to a lesser extent in Europe and Asia. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates and may be adversely affected in the future due to changes in foreign exchange rates. The effect of an immediate 10% adverse change in foreign exchange rates on monetary assets and liabilities at December 31, 2016 would not be material to our financial condition or results of operations. To date, foreign currency transaction gains and losses and exchange rate fluctuations have not been material to our financial statements. While we have not engaged in the hedging of our foreign currency transactions to date, we may in the future hedge selected significant transactions denominated in currencies other than the U.S. dollar.

***Interest Rate Sensitivity***

Our exposure to market risk for changes in interest rates relates primarily to our cash and cash equivalents and available-for-sale marketable securities. Our cash and cash equivalents are held in cash deposits, money market funds with maturities of less than 90 days from the date of purchase. Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of the interest rates in the U.S. However, because of the conservative and short-term nature of the instruments in our portfolio, a sudden change in market interest rates would not be expected to have a material impact on our consolidated financial statements.

As of December 31, 2016, we had approximately \$299.9 million invested in available-for-sale marketable securities. The effect of an immediate 10% change in interest rates at December 31, 2016 would not have a material adverse impact on our future operating results and cash flows. As of December 31, 2016, we did not hold or issue financial instruments for trading purposes.

***Investments in Privately Held Companies***

Our non-marketable equity investments in privately held companies are recorded in investments, non-current in our consolidated balance sheets and are accounted for using the cost method. As of December 31, 2016, the total carrying amount of our investments in privately held companies was \$36.1 million .

Some of the privately held companies in which we invested are in the startup or development stages. These investments are inherently risky because the markets for the technologies or products these companies are developing are typically in the early stages and may never materialize. We could lose our entire investment in these companies. Our evaluation of investments in privately held companies is based on the fundamentals of the businesses invested in, including among other factors, the nature of their technologies and potential for financial return.

**Item 8. Financial Statements and Supplementary Data**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

	Page
<a href="#">Reports of Independent Registered Public Accounting Firm</a>	<a href="#">65</a>
<a href="#">Consolidated Balance Sheets</a>	<a href="#">67</a>
<a href="#">Consolidated Statements of Income</a>	<a href="#">68</a>
<a href="#">Consolidated Statements of Comprehensive Income</a>	<a href="#">69</a>
<a href="#">Consolidated Statements of Stockholders' Equity</a>	<a href="#">70</a>
<a href="#">Consolidated Statements of Cash Flows</a>	<a href="#">71</a>
<a href="#">Notes to the Consolidated Financial Statements</a>	<a href="#">73</a>

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Arista Networks, Inc.

We have audited the accompanying consolidated balance sheets of Arista Networks, Inc. as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2016. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Arista Networks, Inc. at December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Arista Networks, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework), and our report dated February 17, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California  
February 17, 2017

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders  
Arista Networks, Inc.

We have audited Arista Networks, Inc.'s internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). Arista Networks, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. In our opinion, Arista Networks, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on the COSO criteria. We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Arista Networks, Inc. as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive loss, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2016 of Arista Networks, Inc. and our report dated February 17, 2017 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Jose, California  
February 17, 2017

**ARISTA NETWORKS, INC.**  
**Consolidated Balance Sheets**  
(In thousands, except par value)

	December 31,	
	2016	2015
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 567,923	\$ 687,326
Marketable securities	299,910	—
Accounts receivable, net of allowances of \$1,521 and \$1,529, respectively	253,119	144,263
Inventories	236,490	92,129
Prepaid expenses and other current assets	168,684	50,610
Total current assets	1,526,126	974,328
Property and equipment, net	76,961	79,706
Investments	36,136	36,636
Deferred tax assets	70,960	48,429
Other assets	18,824	20,791
<b>TOTAL ASSETS</b>	<b>\$ 1,729,007</b>	<b>\$ 1,159,890</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
CURRENT LIABILITIES:		
Accounts payable	\$ 79,457	\$ 43,966
Accrued liabilities	90,951	60,971
Deferred revenue	273,350	122,049
Other current liabilities	15,795	8,025
Total current liabilities	459,553	235,011
Income taxes payable	14,498	14,060
Lease financing obligations, non-current	39,593	41,210
Deferred revenue, non-current	99,585	74,759
Other long-term liabilities	7,958	6,698
<b>TOTAL LIABILITIES</b>	<b>621,187</b>	<b>371,738</b>
Commitments and contingencies (Note 5)		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.0001 par value—100,000 shares authorized and no shares issued and outstanding as of December 31, 2016 and 2015	—	—
Common stock, \$0.0001 par value—1,000,000 shares authorized as of December 31, 2016 and 2015; 70,811 and 68,132 shares issued and outstanding as of December 31, 2016 and December 31, 2015	7	7
Additional paid-in capital	674,183	537,904
Retained earnings	435,105	250,916
Accumulated other comprehensive loss	(1,475)	(675)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>1,107,820</b>	<b>788,152</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 1,729,007</b>	<b>\$ 1,159,890</b>

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

**ARISTA NETWORKS, INC.**  
**Consolidated Statements of Income**  
(In thousands, except per share amounts)

	Year Ended December 31,		
	2016	2015	2014
<b>Revenue:</b>			
Product	\$ 991,337	\$ 744,877	\$ 531,543
Service	137,830	92,714	52,563
Total revenue	1,129,167	837,591	584,106
<b>Cost of revenue:</b>			
Product	369,768	263,585	174,004
Service	36,283	30,446	18,011
Total cost of revenue	406,051	294,031	192,015
Gross profit	723,116	543,560	392,091
<b>Operating expenses:</b>			
Research and development	273,581	209,448	148,909
Sales and marketing	130,887	109,084	85,338
General and administrative	75,239	75,720	32,331
Total operating expenses	479,707	394,252	266,578
Income from operations	243,409	149,308	125,513
<b>Other income (expense), net:</b>			
Interest expense	(3,136)	(3,152)	(6,280)
Other income (expense), net	1,952	(147)	2,275
Total other income (expense), net	(1,184)	(3,299)	(4,005)
Income before provision for income taxes	242,225	146,009	121,508
Provision for income taxes	58,036	24,907	34,658
Net income	\$ 184,189	\$ 121,102	\$ 86,850
<b>Net income attributable to common stockholders:</b>			
Basic	\$ 182,965	\$ 119,115	\$ 68,889
Diluted	\$ 183,039	\$ 119,264	\$ 70,524
<b>Net income per share attributable to common stockholders:</b>			
Basic	\$ 2.66	\$ 1.81	\$ 1.42
Diluted	\$ 2.50	\$ 1.67	\$ 1.29
<b>Weighted-average shares used in computing net income per share attributable to common stockholders:</b>			
Basic	68,771	65,964	48,427
Diluted	73,222	71,411	54,590

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

**ARISTA NETWORKS, INC.**  
**Consolidated Statements of Comprehensive Income**  
(In thousands)

	Year Ended December 31,		
	2016	2015	2014
Net income	\$ 184,189	\$ 121,102	\$ 86,850
Other comprehensive income (loss), net of tax:			
Foreign currency translation adjustments	(348)	(494)	(217)
Net change in unrealized gains (losses) on available-for-sale securities	(452)	153	(153)
Other comprehensive loss	(800)	(341)	(370)
Comprehensive income	\$ 183,389	\$ 120,761	\$ 86,480

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

**ARISTA NETWORKS, INC.**  
**Consolidated Statements of Stockholders' Equity**  
(In thousands)

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Shares	Amount				
Balance—December 31, 2013	24,000	\$ 5,992	31,927	\$ 3	\$ 28,737	\$ 42,964	\$ 36	\$ 77,732
Net income	—	—	—	—	—	86,850	—	86,850
Other comprehensive income, net of tax	—	—	—	—	—	—	(370)	(370)
Issuance of common stock from initial public offering, net of offering costs	—	—	6,038	1	239,054	—	—	239,055
Conversion of convertible preferred stock into common stock upon initial public offering	(24,000)	(5,992)	24,000	3	5,989	—	—	—
Conversion of notes payable and accrued interest into common stock upon initial public offering	—	—	1,543	—	66,338	—	—	66,338
Conversion of notes payable and accrued interest, related party, into common stock upon initial public offering	—	—	701	—	30,153	—	—	30,153
Tax benefit for equity incentive plans	—	—	—	—	17,358	—	—	17,358
Stock-based compensation	—	—	—	—	27,619	—	—	27,619
Issuance of common stock in connection with employee equity incentive plans	—	—	1,319	—	6,828	—	—	6,828
Vesting of stock options and restricted stock	—	—	—	—	4,095	—	—	4,095
Balance—December 31, 2014	—	—	65,528	7	426,171	129,814	(334)	555,658
Net income	—	—	—	—	—	121,102	—	121,102
Other comprehensive loss, net of tax	—	—	—	—	—	—	(341)	(341)
Tax benefit for equity incentive plans	—	—	—	—	37,003	—	—	37,003
Stock-based compensation	—	—	—	—	45,303	—	—	45,303
Issuance of common stock in connection with employee equity incentive plans	—	—	2,577	—	27,201	—	—	27,201
Vesting of stock options and restricted stock	—	—	27	—	2,226	—	—	2,226
Balance—December 31, 2015	—	—	68,132	7	537,904	250,916	(675)	788,152
Net income	—	—	—	—	—	184,189	—	184,189
Other comprehensive loss, net of tax	—	—	—	—	—	—	(800)	(800)
Tax benefit for equity incentive plans	—	—	—	—	42,084	—	—	42,084
Stock-based compensation	—	—	—	—	59,032	—	—	59,032
Issuance of common stock in connection with employee equity incentive plans	—	—	2,694	—	35,181	—	—	35,181
Minimum tax withholding paid for net share settlement of equity awards	—	—	(15)	—	(1,100)	—	—	(1,100)
Vesting of stock options and restricted stock	—	—	—	—	1,082	—	—	1,082
Balance—December 31, 2016	—	\$ —	70,811	\$ 7	\$ 674,183	\$ 435,105	\$ (1,475)	\$ 1,107,820

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

**ARISTA NETWORKS, INC.**  
**Consolidated Statements of Cash Flows**  
(In thousands)

	Year Ended December 31,		
	2016	2015	2014
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income	\$ 184,189	\$ 121,102	\$ 86,850
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	19,749	13,671	10,021
Stock-based compensation	59,032	45,303	27,619
Deferred income taxes	(21,720)	(24,409)	(6,774)
Excess tax benefit on stock based-compensation	(42,855)	(37,251)	(17,436)
Amortization of investment premiums	1,493	1,471	348
Realized gain on notes receivable	—	—	(4,000)
Amortization of debt discount	—	—	527
Write-off of debt discount on notes payable	—	—	680
Changes in operating assets and liabilities:			
Accounts receivable, net	(108,856)	(47,281)	(18,984)
Inventories	(144,361)	(14,123)	(13,425)
Prepaid expenses and other current assets	(115,074)	(7,827)	(15,257)
Other assets	2,866	(3,087)	(4,261)
Accounts payable	38,678	9,037	14,007
Accrued liabilities	30,629	20,398	18,874
Deferred revenue	176,126	90,340	47,564
Income taxes payable	42,650	32,018	4,377
Other liabilities	8,894	1,171	2,105
Interest payable	—	—	(960)
Net cash provided by operating activities	<u>131,440</u>	<u>200,533</u>	<u>131,875</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Proceeds from marketable securities	137,855	208,200	—
Purchases of marketable securities	(439,711)	—	(210,019)
Purchases of property and equipment	(21,419)	(19,989)	(13,134)
Other investing activities	(2,500)	—	(38,249)
Proceeds from repayment of notes receivable	—	—	8,000
Change in restricted cash	(204)	(4,041)	4,040
Net cash provided by (used in) investing activities	<u>(325,979)</u>	<u>184,170</u>	<u>(249,362)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Principal payments of lease financing obligations	(1,336)	(1,086)	(793)
Proceeds from issuance of common stock upon exercising options, net of repurchases	24,855	17,835	8,020
Minimum tax withholding paid on behalf of employees for net share settlement	(1,100)	—	—
Proceeds from issuance of common stock, employee stock purchase plan	10,326	9,366	—
Excess tax benefit on stock-based compensation	42,855	37,251	17,436
Proceeds from initial public offering, net of issuance cost	—	(261)	239,315
Repayment on notes payable	—	—	(20,000)
Net cash provided by financing activities	<u>75,600</u>	<u>63,105</u>	<u>243,978</u>
Effect of exchange rate changes	(464)	(513)	(124)
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	(119,403)	447,295	126,367
CASH AND CASH EQUIVALENTS—Beginning of year	687,326	240,031	113,664
CASH AND CASH EQUIVALENTS—End of year	<u>\$ 567,923</u>	<u>\$ 687,326</u>	<u>\$ 240,031</u>

**ARISTA NETWORKS, INC.**  
**Consolidated Statements of Cash Flows**  
(In thousands)

Year Ended December 31,

	2016	2015	2014
<b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>			
Cash paid for income taxes, net of refunds	\$ 39,638	\$ 6,591	\$ 44,770
Cash paid for interest— lease financing obligation	\$ 2,916	\$ 2,999	\$ 2,809
Cash paid for interest— notes payable	\$ —	\$ —	\$ 3,639
<b>SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING INFORMATION:</b>			
Property and equipment included in accounts payable and accrued liabilities	\$ 869	\$ 3,957	\$ 1,638
Vesting of early exercised stock options and restricted stock awards	\$ 1,082	\$ 2,226	\$ 4,095
Conversion of notes payable and accrued interest to common stock upon initial public offering	\$ —	\$ —	\$ 66,338
Conversion of notes payable and accrued interest, related party, to common stock upon initial public offering	\$ —	\$ —	\$ 30,153
Conversion of convertible preferred stock to common stock upon initial public offering	\$ —	\$ —	\$ 5,992
Acquisition of building with financing obligation	\$ —	\$ —	\$ 456
Unpaid deferred offering costs	\$ —	\$ —	\$ 261

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

**ARISTA NETWORKS, INC.**  
**Notes to Consolidated Financial Statements**

**1. Organization and Summary of Significant Accounting Policies**

***Organization***

Arista Networks, Inc. (together with our subsidiaries, “we,” “our” or “us”) is a supplier of cloud networking solutions that use software innovations to address the needs of large-scale Internet companies, cloud service providers and next-generation enterprise. Our cloud networking solutions consist of our Extensible Operating System, a set of network applications and our 10/25/40/50/100 Gigabit Ethernet switching and routing platforms. We were incorporated in October 2004 in the State of California under the name Arastra, Inc. In March 2008, we reincorporated in the State of Nevada and in October 2008 changed our name to Arista Networks, Inc. We reincorporated in the state of Delaware in March 2014. Our corporate headquarters are located in Santa Clara, California, and we have wholly-owned subsidiaries throughout the world, including North America, Europe, Asia and Australia.

***Basis of Presentation and Principles of Consolidation***

The accompanying consolidated financial statements include the accounts of Arista Networks, Inc. and its wholly owned subsidiaries and are prepared in accordance with U.S. generally accepted accounting principles (GAAP). All significant intercompany accounts and transactions have been eliminated.

During fiscal 2015 and 2014, certain reclassifications of prior period amounts were made to conform to the current period presentation. There were no reclassifications during fiscal 2016.

***Use of Estimates***

The preparation of the accompanying consolidated financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the consolidated financial statements and accompanying notes. Those estimates and assumptions include, but are not limited to, revenue recognition and deferred revenue; allowance for doubtful accounts and sales return reserve; determination of fair value for stock-based awards; accounting for income taxes, including the valuation allowance on deferred tax assets and reserves for uncertain tax positions; valuation of inventory; valuation of warranty accruals; contract manufacturing liabilities; and recognition and measurement of contingent liabilities. We evaluate our estimates and assumptions based on historical experience and other factors and adjust those estimates and assumptions when facts and circumstances dictate. Actual results could differ materially from those estimates.

### **Concentrations of Business and Credit Risk**

We work closely with third-party contract manufacturing suppliers to manufacture our products. As of December 31, 2016 and December 31, 2015, we had three and two suppliers, respectively, who provided substantially all of our electronic manufacturing services. Our contract manufacturing suppliers deliver our products to our third party direct fulfillment facilities. We and our fulfillment partners then perform labeling, final configuration, quality assurance testing and shipment to our customers. Our products rely on key components, including certain integrated circuit components and power supplies, some of which our contract manufacturers purchase on our behalf from a limited number of suppliers, including certain sole source providers. We do not have guaranteed supply contracts with any of our component suppliers, and our suppliers could delay shipments or cease manufacturing such products or selling them to us at any time. If we are unable to obtain a sufficient quantity of these components on commercially reasonable terms or in a timely manner, or if we are unable to obtain alternative sources for these components, sales of our products could be delayed or halted entirely or we may be required to redesign our products. Quality or performance failures of our products or changes in our contractors' or vendors' financial or business condition could disrupt our ability to supply quality products to our customers. Any of these events could result in lost sales and damage to our end-customer relationships, which would adversely impact our business, financial condition and results of operations.

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash, cash equivalents, marketable securities, restricted cash, and accounts receivable. Our cash, cash equivalents and restricted cash are invested in high quality financial instruments with banks and financial institutions. Such deposits may be in excess of insured limits provided on such deposits.

Our accounts receivable are unsecured and represent amounts due to us based on contractual obligations of our customers. We mitigate credit risk in respect to accounts receivable by performing ongoing credit evaluations of our customers to assess the probability of accounts receivable collection based on a number of factors, including past transaction experience with the customer, evaluation of their credit history, the credit limits extended and review of the invoicing terms of the arrangement. In situations where a customer may be thinly capitalized and we have limited payment history with it, we will either establish a small credit limit or require it to prepay its purchases. We generally do not require our customers to provide collateral to support accounts receivable. We have recorded an allowance for doubtful accounts for those receivables that we have determined not to be collectible. We mitigate credit risk in respect to the notes receivable by performing ongoing credit evaluations of the borrower to assess the probability of collecting all amounts due to us under the existing contractual terms.

We market and sell our products through both our direct sales force and our channel partners, including distributors, value-added resellers, system integrators and original equipment manufacturer ("OEM") partners and in conjunction with various technology partners. Significant customers are those which represent more than 10% of our total net revenue during the period or net accounts receivable balance at each respective balance sheet date. For each significant customer, revenue as a percentage of total revenue and accounts receivable as a percentage of total accounts receivable are as follows:

	Revenue			Accounts Receivable	
	Year Ended December 31,			December 31,	
	2016	2015	2014	2016	2015
Customer A	16%	12%	15%	36%	30%

### **Comprehensive Income**

Comprehensive income is comprised of net income and other comprehensive income. Unrealized gains and losses on available-for-sale investments and foreign currency translation adjustments are included in our other comprehensive income or loss.

### **Cash and Cash Equivalents**

We consider all highly liquid investments with stated maturity of three months or less at the time of purchase to be cash equivalents. Cash and cash equivalents consist of cash on deposit with various financial institutions and highly liquid investments in money market funds. Interest is accrued as earned. We have restricted cash pledged as collateral representing a security deposit required for a facility lease. As of December 31, 2016 and 2015, we had classified the restricted cash of \$4.2 million and \$4.0 million, respectively, as other assets in our accompanying consolidated balance sheet.

### **Marketable Securities**

We classify all highly liquid investments with stated maturities of greater than three months as marketable securities. We determine the appropriate classification of our investments in marketable securities at the time of purchase and reevaluate such designation at each balance sheet date. We have classified and accounted for our marketable securities as available-for-sale. We may or may not hold securities with stated maturities greater than 12 months until maturity. After consideration of our risk versus reward objectives, as well as our liquidity requirements, we may sell these securities prior to their stated maturities. As we view these securities as available to support current operations, we classify securities with maturities beyond 12 months as current assets under the caption marketable securities in the accompanying consolidated balance sheets. We carry these securities at fair value, and report the unrealized gains and losses, net of taxes, as a component of stockholders' equity, except for unrealized losses determined to be other-than-temporary, which we record as other income (expense), net. We determine any realized gains or losses on the sale of marketable securities on a specific identification method, and we record such gains and losses as a component of interest and other income, net.

### **Accounts Receivable**

Accounts receivable are recorded at the invoiced amount, net of allowances for doubtful accounts, and sales return reserves. We estimate our allowance for doubtful accounts based upon the collectability of the receivables in light of historical trends, adverse situations that may affect our customers' ability to pay and prevailing economic conditions. This evaluation is done in order to identify issues which may impact the collectability of receivables and related estimated required allowance. Revisions to the allowance are recorded as an adjustment to bad debt expense. After appropriate collection efforts are exhausted, specific accounts receivable deemed to be uncollectible are charged against the allowance in the period they are deemed uncollectible. Recoveries of accounts receivable previously written-off are recorded as credits to bad debt expense. We estimate our sales return reserves based on historical return rates applied against current period gross revenues. Specific customer returns and allowances are considered when determining our sales return reserve estimate. Revisions to the reserve are recorded as adjustments to revenue and the sales return reserves.

### **Fair Value Measurements**

Fair value is defined as the exchange price that would be received for an asset or an exit price that would be paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. We apply fair value accounting for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. These assets and liabilities include cash and cash equivalents, marketable securities, accounts receivable, accounts payable, and accrued liabilities. Cash equivalents, accounts receivable, accounts payable and accrued liabilities are stated at carrying amounts as reported in the consolidated financial statements, which approximates fair value due to their short-term nature.

Assets and liabilities recorded at fair value on a recurring basis in the accompanying consolidated balance sheets are categorized based upon the level of judgment associated with the inputs used to measure their fair value. We use a fair value hierarchy to measure fair value, maximizing the use of observable inputs and minimizing the use of unobservable inputs. The three-tiers of the fair value hierarchy are as follows:

*Level I*—Inputs are unadjusted, quoted prices in active markets for identical assets or liabilities at the measurement date;

*Level II*—Inputs are observable, unadjusted quoted prices in active markets for similar assets or liabilities, unadjusted quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the related assets or liabilities; and

*Level III*—Unobservable inputs that are supported by little or no market data for the related assets or liabilities and typically reflect management's estimate of assumptions that market participants would use in pricing the asset or liability.

### **Foreign Currency**

The functional currency of our foreign subsidiaries is either the U.S. dollar or their local currency .

*Transaction re-measurement-* Assets and liabilities denominated in a currency other than the foreign subsidiaries' functional currency are re-measured into the functional currency using exchange rates in effect at the end of the reporting period, with gains and losses recorded in other income (expense), net in the consolidated statements of income. We recognized \$0.7 million , \$0.5 million , and \$0.6 million , in transaction losses for the years ended December 31, 2016 , 2015 and 2014 , respectively.

*Translation-* Assets and liabilities of subsidiaries denominated in foreign functional currencies are translated into U.S. dollars at the closing exchange rate on the balance sheet date and equity related balances are translated at historical exchange rates. Revenues, costs and expenses in foreign functional currencies are translated using average exchange rates that approximate those in effect during the period. Translation adjustments are accumulated as a separate component of accumulated other comprehensive income within stockholders' equity.

### ***Inventory Valuation and Contract Manufacturer/Supplier Liabilities***

Inventories primarily consist of finished goods purchased from third party contract manufacturers and are stated at the lower of cost (computed using the first-in, first-out method) or market value. Manufacturing overhead costs and inbound shipping costs are included in the cost of inventory. In addition, we purchase strategic component inventory from certain suppliers under purchase commitments that in some cases are non-cancelable, including integrated circuits, which are held by our contract manufacturers. We record a provision when inventory is determined to be in excess of anticipated demand, or obsolete, to adjust inventory to its estimated realizable value. We also record a liability for non-cancelable, non-returnable purchase commitments with our component inventory suppliers for quantities in excess of our demand forecasts or that are considered obsolete.

Our contract manufacturers procure components and assemble products on our behalf based on our forecasts. We generally incur a liability when the contract manufacturer has converted the component inventory to a finished product. Historically, we have recorded a liability and have reimbursed our contract manufacturer for component inventory that has been rendered excess or obsolete due to manufacturing and engineering change orders resulting from design changes, or in cases where inventory levels greatly exceed our forecasts.

We use significant judgment in establishing our forecasts of future demand and obsolete material exposures. These estimates depend on our assessment of current and expected orders from our customers, product development plans and current sales levels. If actual market conditions are less favorable than those projected by management, which may be caused by factors within and outside of our control, we may be required to increase our inventory write-downs and liabilities to our contract manufacturers and suppliers, which could have an adverse impact on our gross margins and profitability. We regularly evaluate our exposure for inventory write-downs and adequacy of our contract manufacturer liabilities.

For the years ended December 31, 2016, 2015 and 2014, we recorded inventory write-downs of \$12.1 million, \$9.0 million and \$2.8 million, respectively. In addition, our contract manufacturer and supplier liabilities totaled \$6.3 million and \$3.8 million as of December 31, 2016 and 2015, respectively.

### ***Property and Equipment***

Property and equipment are stated at cost, less accumulated depreciation. Depreciation is calculated using the straight-line method over the estimated useful lives of the related assets, generally from one to five years. Our building is depreciated over 30 years and leasehold improvements are depreciated over the shorter of the estimated useful lives of the improvements or the remaining lease term. The leased building under our build to suit lease is capitalized and included in property and equipment as we were involved in the construction funding and did not meet the "sale-leaseback" criteria.

### ***Investments***

Our investments in privately held companies are accounted for under the cost method and are included in investments, non-current in the accompanying consolidated balance sheets. Our investments under the cost method are recorded at historical cost at the time of investment.

### ***Impairment of Long-Lived Assets and Investments***

The carrying amounts of our long-lived assets, including property and equipment and investments in privately held companies, are periodically reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. Recoverability of these assets is measured by comparison of the carrying amount of each asset to the future undiscounted cash flows the asset is expected to generate over their remaining lives. If the asset is considered to be impaired, the amount of any impairment is measured as the difference between the carrying value and the fair value of the impaired asset. No impairment of any long-lived assets or investments was identified for any of the periods presented.

### ***Loss Contingencies***

In the ordinary course of business, we are a party to claims and legal proceedings including matters relating to commercial, employee relations, business practices and intellectual property. In assessing loss contingencies, we use significant judgment and assumptions to estimate the likelihood of loss, impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss. We record a provision for contingent losses when it is both probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. We will record a charge equal to the minimum estimated liability for litigation costs or a loss contingency only when both of the following conditions are met: (i) information available prior to issuance of our consolidated financial statements indicates that it is probable that a liability had been incurred at the date of the financial statements and (ii) the range of loss can be reasonably estimated. We regularly evaluate current information available to us to determine whether such accruals should be adjusted and whether new accruals are required.

## **Revenue Recognition**

We generate revenue from sales of our products which incorporate our EOS software and accessories such as cables and optics to direct customers and channel partners together with post contract customer support (“PCS”). We typically sell products and PCS in a single transaction. We recognize revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery or performance has occurred; the sales price is fixed or determinable; and collectability is reasonably assured.

We define each of the four criteria above as follows:

- *Persuasive evidence of an arrangement exists.* Evidence of an arrangement consists of stand-alone purchase orders or purchase orders issued pursuant to the terms and conditions of a master sales agreement. It is our practice to identify an end customer prior to shipment to a reseller or distributor.
- *Delivery or performance has occurred.* We use shipping documents or written evidence of customer acceptance, when applicable, to verify delivery or performance. We recognize product revenue upon transfer of title and risk of loss, which primarily is upon shipment to customers. We generally do not have significant obligations for future performance, rights of return or pricing credits associated with our product sales. In instances where substantive acceptance provisions are specified in the customer arrangement, revenue and the related cost of revenue is deferred until all acceptance criteria have been met.
- *The sales price is fixed or determinable.* We assess whether the sales price is fixed or determinable based on payment terms and whether the sales price is subject to refund or adjustment.
- *Collectability is reasonably assured.* We assess probability of collectability on a customer-by-customer basis. Our customers and channel partners are subjected to a credit review process that evaluates their financial condition and ability to pay for products and services.

PCS is offered under renewable, fee-based contracts, which includes technical support, hardware repair and replacement parts beyond standard warranty, bug fixes, patches and unspecified upgrades on a when-and-if-available basis. We initially defer PCS revenue and recognize it ratably over the life of the PCS contract, with the related expenses recognized as incurred. PCS contracts usually have a term of one to three years. We include billed but unearned PCS revenue in deferred revenue.

We report revenue net of sales taxes. We include shipping charges billed to customers in revenue and the related shipping costs are included in cost of goods sold.

### **Multiple-Element Arrangements**

Most of our arrangements, other than renewals of PCS, are multiple element arrangements with a combination of products and PCS. Products and PCS generally qualify as separate units of accounting. Our hardware deliverables include EOS software, which together deliver the essential functionality of our products. For multiple element arrangements, we allocate revenue to each unit of accounting based on the relative selling price. The relative selling price for each element is based upon the following hierarchy: vendor-specific objective evidence (“VSOE”), if available; third-party evidence (“TPE”), if VSOE is not available; and best estimate of selling price (“BESP”), if neither VSOE nor TPE is available. As we have not been able to establish VSOE or TPE for our products and most of our services, we generally utilize BESP for the purposes of allocating revenue to each unit of accounting.

- *VSOE* —We determine VSOE based on our historical pricing and discounting practices for the specific products and services when sold separately. In determining VSOE, we require that a substantial majority of the stand-alone selling prices fall within a reasonably narrow pricing range.
- *TPE* —When VSOE cannot be established for deliverables in multiple-element arrangements, we apply judgment with respect to whether we can establish a selling price based on TPE. TPE is determined based on competitor prices for interchangeable products or services when sold separately to similarly situated customers. However, as our products contain a significant element of proprietary technology and offer substantially different features and functionality, the comparable pricing of products with similar functionality typically cannot be obtained. Additionally, as we are unable to reliably determine what competitors products’ selling prices are on a stand-alone basis, we are not able to obtain reliable evidence of TPE of selling price.
- *BESP* —When we are unable to establish selling price using VSOE or TPE, we use BESP in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service was sold regularly on a stand-alone basis. BESP is based on considering multiple factors including, but not limited to the sales channel (reseller, distributor or end customer), the geographies in which our products and services were sold (domestic or international) and size of the end customer.

We limit the amount of revenue recognition for delivered elements to the amount that is not contingent on the future delivery of products or services, future performance obligations, or subject to customer-specific return, acceptance or refund privileges.

We account for multiple agreements with a single partner as one arrangement if the contractual terms and/or substance of those agreements indicate that they may be so closely related that they are, in effect, parts of a single arrangement.

We may occasionally accept returns to address customer satisfaction issues even though there is no contractual provision for such returns. We estimate returns for sales to customers based on historical returns rates applied against current-period gross revenues. Specific customer returns and allowances are considered when determining our sales return reserve estimate.

#### ***Research and Development Expenses***

Costs related to the research, design and development of our products are charged to research and development expenses as incurred. Software development costs are capitalized beginning when a product's technological feasibility has been established and ending when the product is available for general release to customers. Generally, our products are released soon after technological feasibility has been established. As a result, costs incurred subsequent to achieving technological feasibility have not been significant and accordingly, all software development costs have been expensed as incurred.

#### ***Warranty***

We offer a one-year warranty on all of our hardware products and a 90-day warranty against defects in the software embedded in the products. We use judgment and estimates when determining warranty costs based on historical costs to replace product returns within the warranty period at the time we recognize revenue. We accrue for potential warranty claims at the time of shipment as a component of cost of revenues based on historical experience and other relevant information. We reserve for specifically identified products if and when we determine we have a systemic product failure. Although we engage in extensive product quality programs, if actual product failure rates or use of materials differ from estimates, additional warranty costs may be incurred, which could reduce our gross margin. The accrued warranty liability is recorded in accrued liabilities in the accompanying consolidated balance sheets.

#### ***Post-Employment Benefits***

We have a 401(k) Plan that covers substantially all of our employees in the U.S. For the years ended December 31, 2016, 2015 and 2014, we did not provide a discretionary company match to employee contributions. Effective January 1, 2017, we have elected to match 100% of employees' contributions up to a maximum of 3% of an employee's annual salary. Matching contributions will be immediately vested.

#### ***Segment Reporting***

We develop, market and sell cloud networking solutions, which consist of our Gigabit Ethernet switches and related software. We have one business activity and there are no segment managers who are held accountable for operations or operating results below the Company level. Our chief operating decision maker is our Chief Executive Officer. Our Chief Executive Officer reviews financial information presented on a consolidated basis for purposes of allocating resources and evaluating financial performance. Accordingly, we have determined that we operate as one reportable segment.

#### ***Stock-Based Compensation***

Compensation expense related to stock-based transactions, including stock options, restricted stock units ("RSUs"), restricted stock awards ("RSAs"), and stock purchase rights under our employee stock purchase program is measured and recognized in the financial statements based on the fair value of the equity granted, net of estimated forfeitures, on a straight-line basis over the requisite service periods of the awards, which typically ranges from two to five years. Under ASU 2016-09, *Compensation-Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, beginning the first quarter of fiscal 2017 we have elected to account for forfeitures as they occur and will no longer include an estimate of future forfeitures in the fair value measurement.

Excess tax benefits associated with stock option exercises and other equity awards are recognized in additional paid in capital. The income tax benefits resulting from stock awards that were credited to stockholders' equity were \$42.1 million, \$37.0 million and \$17.4 million, for the years ended December 31, 2016, 2015 and 2014, respectively. With the adoption of ASU 2016-09, effective January 1, 2017 on a prospective basis, excess tax benefits generated from stock option exercises and other equity awards will be recorded as provision of income taxes in the income statement, rather than equity.

## ***Income Taxes***

Income tax expense is an estimate of current income taxes payable in the current fiscal year based on reported income before income taxes. Deferred income taxes reflect the effect of temporary differences and carryforwards that we recognize for financial reporting and income tax purposes.

We account for income taxes under the liability approach for deferred income taxes, which requires recognition of deferred income tax assets and liabilities for the expected future tax consequences of events that have been recognized in our consolidated financial statements, but have not been reflected in our taxable income. Estimates and judgments occur in the calculation of certain tax liabilities and in the determination of the recoverability of certain deferred income tax assets, which arise from temporary differences and carryforwards. Deferred income tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. We regularly assess the likelihood that our deferred income tax assets will be realized based on the positive and negative evidence available. We record a valuation allowance to reduce the deferred tax assets to the amount that we are more likely than not to realize.

We believe that we have adequately reserved for our uncertain tax positions, although we can provide no assurance that the final tax outcome of these matters will not be materially different. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will affect the provision for income taxes in the period in which such determination is made and could have a material impact on our financial condition and results of operations. The provision for income taxes includes the effects of any reserves that we believe are appropriate, as well as the related net interest and penalties.

We regularly review our tax positions and benefits to be realized. We recognize tax liabilities based upon our estimate of whether, and to the extent to which, additional taxes will be due when such estimates are more likely than not to be sustained. An uncertain income tax position will not be recognized if it has less than a 50% likelihood of being sustained. We recognize interest and penalties related to income tax matters as income tax expense.

## ***Net Income per Share of Common Stock***

Basic and diluted net income per share attributable to common stockholders is calculated in conformity with the two-class method required for participating securities. Our shares of common stock subject to repurchase are considered participating securities. In addition, our convertible preferred stock prior to conversion to common shares upon our initial public offering in June 2014, were also considered to be participating securities. Under the two-class method, net income attributable to common stockholders is calculated as net income less earnings attributable to participating securities. In computing diluted net income attributable to common stockholders, undistributed earnings are re-allocated to reflect the potential impact of dilutive securities. Basic net income per common share is computed by dividing the net income attributable to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net income per share attributable to common stockholders is computed by dividing the net income attributable to common stockholders by the weighted-average number of common shares outstanding, including potential dilutive common shares assuming the dilutive effect of outstanding stock options, restricted stock units, and employee stock purchase plan using the treasury stock method. For purposes of this calculation, these amounts are excluded from the calculation of diluted net income per share of common stock if their effect is antidilutive.

## ***Recent Accounting Pronouncements***

In May 2014, the FASB issued ASU No. 2014-09, *Revenue From Contracts With Customers (Topic 606)*, (as amended in June 2016, by ASU No. 2016-12- *Revenue-Narrow-Scope Improvements and Practical Expedients*), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The new standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard also requires significantly expanded disclosures about revenue recognition.

In July 2015, the FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, deferring the effective date of the new revenue standard by one year. In March 2016, the FASB issued ASU No. 2016-08, *Revenue From Contracts With Customers-Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*, and ASU No. 2016-10, *Revenue From Contracts With Customers-Identifying Performance Obligations and Licensing*. ASU No. 2016-08 clarifies the implementation guidance regarding principal versus agent identification and related considerations. Specifically, the guidance provides clarification around performance obligations for goods or services provided by another entity, assisting in determining whether the entity is the provider of the goods or services, the principal, or whether the entity is providing for the arrangement of the goods or services, the agent. ASU No. 2016-10 provides guidance around identifying whether promised goods or services are distinct and separately identifiable, whether promised goods or services are material or immaterial to the contract, and whether shipping and handling is considered an activity to fulfill a promise or an additional promised service. ASU No. 2016-10 also provides guidance around an entity's promise to grant a license providing a customer with either a right to use or a right to access the license, which then determines whether the obligation is satisfied at a point in time or over time, respectively.

In May 2016, the FASB issued ASU No. 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)* ("ASU 2016-11"), which rescinds various standards codified as part of Topic 605, Revenue Recognition in relation to the future adoption of Topic 606. These rescissions include changes to topics pertaining to revenue and expense recognition including accounting for shipping and handling fees and costs and accounting for consideration given by a vendor to a customer.

The above standards are effective for fiscal years (and interim reporting periods within those years) beginning after December 15, 2017. The guidance is effective for us beginning in our first quarter of fiscal 2018. Early adoption would be permitted for all entities but not until the fiscal year beginning after December 15, 2016. The standard permits the use of either the retrospective or cumulative effect transition method. The retrospective method requires a retrospective approach to each prior reporting period presented with the option to elect certain practical expedients as defined within the guidance. The cumulative approach requires a retrospective approach with the cumulative effect of initially applying the guidance recognized at the date of initial application and providing certain additional disclosures as defined per the guidance.

Management's assessments of potential impacts of the standards are underway. The standards are expected to impact the amount and timing of revenue recognized and the related disclosures on our consolidated financial statements.

We will adopt ASU 2014-09 during the first quarter of 2018 and expect to adopt the guidance under the modified retrospective method which we anticipate will result in a cumulative effect adjustment as of the date of adoption.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments—Recognition and Measurement of Financial Assets and Financial Liabilities*, which enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The guidance will address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The standard is effective for us for our first quarter of fiscal 2018. The guidance may be early adopted under early application guidance. We are currently assessing the impact this guidance may have on our consolidated financial statements as well as the transition method that we will use to adopt the guidance.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which addresses the classification and recognition of lease assets and liabilities formerly classified as operating leases under GAAP. The guidance will address certain aspects of recognition and measurement, and quantitative and qualitative aspects of presentation and disclosure. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The standard is effective for us for our first quarter of fiscal 2019. The guidance will be applied to the earliest period presented using a modified retrospective approach. The guidance includes practical expedients that relate to identification, classification, and initial direct costs associated with leases commencing prior to the effective date, and the ability to apply hindsight in evaluating lease options related to extensions, terminations or asset purchases. A practical expedient also exists to treat leases entered into prior effective date under existing GAAP unless the lease has been modified. The guidance may be early adopted. We are currently assessing the impact this guidance may have on our consolidated financial statements as well as the transition method that we will use to adopt the guidance.

In March 2016, the FASB amended the existing accounting standards for stock-based compensation, ASU 2016-09, *Compensation—Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, which impact several aspects of accounting for share-based payment transactions, including the income tax consequences, forfeitures, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The standard is effective for us for our first quarter of fiscal 2017. The manner of application varies by the various provisions of the guidance, with certain provisions applied on a retrospective or modified retrospective approach, while others are applied prospectively.

Based on our assessment of the above standard, guidance related to forfeitures will be adopted under a modified retrospective transition method and a cumulative adjustment to beginning retained earnings will be recorded on the day of adoption. Effective January 1, 2017, we will account for forfeitures as they occur and will calculate a cumulative adjustment as it relates to equity transactions where prior forfeitures rates have previously and cumulatively been applied.

With the adoption of ASU 2016-09, we will prospectively record excess tax benefits generated from stock option exercises and other equity awards as a provision to income tax in the income statement, rather than equity. In addition, we will apply the guidance under a modified retrospective transition method and account for previously unrecognized excess tax benefits through a cumulative-effect adjustment to beginning retained earnings.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Task Force)*, which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice in how certain transactions are presented and classified in the statement of cash flows. The guidance may be adopted early as of the beginning of an annual reporting period. The guidance will be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The standard is effective for us for our first quarter of fiscal 2018. We are currently assessing the impact this guidance may have on our consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*, which addresses recognition of current and deferred income taxes for intra-entity asset transfers when assets are sold to an outside party. Current GAAP prohibits the recognition of current and deferred income taxes until the asset has been sold to an outside party. This prohibition on recognition is considered an exception to the principle of comprehensive recognition of current and deferred income taxes in GAAP. The new guidance requires an entity to recognize the income tax consequences when the transfer occurs eliminating the exception. The guidance will be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The standard is effective for us for our first quarter of fiscal 2018, and may be early adopted under early application guidance. We are currently assessing the impact this guidance may have on our consolidated financial statements.

## 2. Fair Value Measurements

We measure and report our cash equivalents, restricted cash, and available-for-sale marketable securities at fair value. The following table set forth the fair value of our financial assets by level within the fair value hierarchy (in thousands):

	December 31, 2016			
	Level I	Level II	Level III	Total
<b>Financial Assets:</b>				
Money market funds	\$ 305,182	\$ —	\$ —	\$ 305,182
Money market funds-restricted	4,245	—	—	4,245
Commercial Paper	5,962	—	—	5,962
U.S. government notes	110,756	—	—	110,756
Corporate bonds	—	183,192	—	183,192
Total financial assets	\$ 426,145	\$ 183,192	\$ —	\$ 609,337

	December 31, 2015			
	Level I	Level II	Level III	Total
<b>Financial Assets:</b>				
Money market funds	\$ 104,156	\$ —	\$ —	\$ 104,156
U.S. government notes	4,041	—	—	4,041
Total financial assets	\$ 108,197	\$ —	\$ —	\$ 108,197

## 3. Balance Sheet Components

### Marketable Securities

The following table summarizes the unrealized gains and losses and fair value of our available-for-sale marketable securities (in thousands):

	December 31, 2016			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Commercial paper	\$ 5,962	\$ —	\$ —	\$ 5,962
U.S. government notes	110,945	5	(194)	110,756
Corporate bonds	183,455	109	(372)	183,192
Total marketable securities	\$ 300,362	\$ 114	\$ (566)	\$ 299,910

There were no marketable securities as of December 31, 2015. We did not realize any other-than-temporary losses on our marketable securities for the year ended December 31, 2016 and 2015. None of our marketable securities were in continuous unrealized loss positions for greater than twelve months as of December 31, 2016 and 2015.

We invest in marketable securities that have maximum maturities of up to two years and are generally deemed to be low risk based on their credit ratings from the major rating agencies. The longer the duration of these marketable securities, the more susceptible they are to changes in market interest rates and bond yields. As interest rates increase, those marketable securities purchased at a lower yield show a mark-to-market unrealized loss. The unrealized losses are due primarily to changes in credit spreads and interest rates. We expect to realize the full value of these investments upon maturity or sale.

As of December 31, 2016, the contractual maturities of our investments did not exceed 24 months. The fair values of available-for-sale investments, by remaining contractual maturity, are as follows (in thousands):

	December 31, 2016
Due in 1 year or less	\$ 140,879
Due in 1 year through 2 years	159,031
Total marketable securities	\$ 299,910

The weighted average remaining duration of our current marketable securities is approximately 0.9 years as of December 31, 2016. As we view these securities as available to support current operations, we classify securities with maturities beyond 12 months as current assets under the caption marketable securities in the accompanying consolidated balance sheets.

#### Accounts Receivable, net

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

	December 31,	
	2016	2015
Accounts receivable	\$ 254,640	\$ 145,792
Allowance for doubtful accounts	(204)	(963)
Product sales return reserve	(1,317)	(566)
Accounts receivable, net	<u>\$ 253,119</u>	<u>\$ 144,263</u>

#### Allowance for Doubtful Accounts

Activity in the allowance for doubtful accounts consists of the following (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Balance at the beginning of year	\$ 963	\$ 1,063	\$ 810
Charged (credited) to expense	(292)	335	860
Deductions (write-offs)	(467)	(435)	(607)
Balance at the end of year	<u>\$ 204</u>	<u>\$ 963</u>	<u>\$ 1,063</u>

#### Product Sales Return Reserve

Activity in the sales return reserve consists of the following (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Balance at the beginning of year	\$ 566	\$ 2,031	\$ 1,529
Charged against revenue	3,791	2,798	4,063
Deductions	(4,371)	(2,283)	(2,943)
Change in estimate	1,331	(1,980)	(618)
Balance at the end of year	<u>\$ 1,317</u>	<u>\$ 566</u>	<u>\$ 2,031</u>

#### Inventories

Inventories consist of the following (in thousands):

	December 31,	
	2016	2015
Raw materials	\$ 99,190	\$ 29,831
Finished goods	137,300	62,298
Total inventories	<u>\$ 236,490</u>	<u>\$ 92,129</u>

### Prepaid Expenses and Other Current Assets

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

	December 31,	
	2016	2015
Inventory deposit	\$ 60,315	\$ —
Prepaid income taxes	17,383	14,150
Other current assets	79,140	29,270
Other prepaid expenses and deposits	11,846	7,190
Total prepaid expenses and other current assets	\$ 168,684	\$ 50,610

### Property and Equipment, net

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

	December 31,	
	2016	2015
Equipment and machinery	\$ 40,721	\$ 29,101
Computer hardware and software	17,420	12,630
Furniture and fixtures	2,879	2,380
Leasehold improvements	29,498	24,372
Building	35,154	35,154
Construction-in-process	421	6,408
Property and equipment, gross	126,093	110,045
Less: accumulated depreciation	(49,132)	(30,339)
Property and equipment, net	\$ 76,961	\$ 79,706

Depreciation expense was \$19.4 million , \$13.4 million and \$10.0 million for the years ended December 31, 2016 , 2015 and 2014 , respectively.

### Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	December 31,	
	2016	2015
Accrued payroll related costs	\$ 52,854	\$ 39,479
Accrued warranty costs	6,744	4,718
Accrued manufacturing costs	14,824	6,397
Accrued professional fees	6,829	4,875
Accrued taxes	1,098	1,347
Other	8,602	4,155
Total accrued liabilities	\$ 90,951	\$ 60,971

### Warranty Accrual

The following table summarizes the activity related to our accrued liability for estimated future warranty costs (in thousands):

	Year Ended December 31,	
	2016	2015
Warranty accrual, beginning of year	\$ 4,718	\$ 3,204
Liabilities accrued for warranties issued during the year	\$ 5,421	3,973
Warranty costs incurred during the year	(3,395)	(2,459)
Warranty accrual, end of year	\$ 6,744	\$ 4,718

There were no significant specific product warranty reserves recorded for the years ended December 31, 2016 or 2015 .

#### 4. Investments

##### Investments in Privately Held Companies

As of December 31, 2016 and 2015, we held non-marketable equity investments of approximately \$36.1 million and \$33.6 million, respectively, in privately held companies which are accounted for under the cost method. During the year ended 2016 we made an additional investment of \$2.5 million in one of these companies. To date, we have not recognized any impairment losses on our investments.

#### 5. Commitments and Contingencies

##### Operating Leases

We lease various operating spaces in North America, Europe, Asia and Australia under non-cancelable operating lease arrangements that expire on various dates through 2025. These arrangements require us to pay certain operating expenses, such as taxes, repairs, and insurance and contain renewal and escalation clauses. We recognize rent expense under these arrangements on a straight-line basis over the term of the lease.

As of December 31, 2016, the aggregate future minimum payments under non-cancelable operating leases consist of the following (in thousands):

##### Years Ending December 31,

2017	\$	7,867
2018		7,373
2019		6,889
2020		6,552
2021		5,704
Thereafter		15,746
Total minimum future lease payments	\$	<u>50,131</u>

We recognize rent expense under these arrangements on a straight-line basis over the term of the lease. Rent expense for all operating leases amounted to \$8.1 million, \$5.4 million and \$2.1 million for the years ended December 31, 2016, 2015 and 2014, respectively.

##### Financing Obligation—Build-to-Suit Lease

In August 2012, we executed a lease for a building then under construction in Santa Clara, California to serve as our headquarters. The lease term is 120 months and commenced in August 2013. Based on the terms of the lease agreement and due to our involvement in certain aspects of the construction, we were deemed the owner of the building (for accounting purposes only) during the construction period. Upon completion of construction in 2013, we concluded that we had forms of continued economic involvement in the facility, and therefore did not meet with the provisions for sale-leaseback accounting. We continue to maintain involvement in the property post construction and lack transferability of the risks and rewards of ownership, due to our required maintenance of a \$4.0 million letter of credit, in addition to our ability and option to sublease our portion of the leased building for fees substantially higher than our base rate. Therefore, the lease is accounted for as a financing obligation and lease payments will be attributed to (1) a reduction of the principal financing obligation; (2) imputed interest expense; and (3) land lease expense, representing an imputed cost to lease the underlying land of the building. At the conclusion of the initial lease term, we will de-recognize both the net book values of the asset and the remaining financing obligation.

As of December 31, 2016 and 2015, we have recorded assets of \$53.4 million, representing the total costs of the building and improvements incurred, including the costs paid by the lessor (the legal owner of the building) and additional improvement costs paid by us, and a corresponding financing obligation of \$41.2 million and \$42.5 million, respectively. As of December 31, 2016, \$1.6 million and \$39.6 million were recorded as short-term and long-term financing obligations, respectively.

Land lease expense under our lease financing obligation amounted to \$1.3 million, \$1.3 million and \$1.2 million for the years ended December 31, 2016, 2015 and 2014 respectively.

As of December 31, 2016, the future minimum payments due under the lease financing obligation were as follows (in thousands):

**Years Ending December 31,**

2017	\$	5,933
2018		6,113
2019		6,293
2020		6,477
2021		6,674
Thereafter		12,136
<b>Total payments</b>		<b>43,626</b>
Less: interest and land lease expense		(26,045)
<b>Total payments under facility financing obligations</b>		<b>17,581</b>
Property reverting to landlord		23,630
<b>Present value of obligation</b>		<b>41,211</b>
Less current portion		(1,618)
<b>Long-term portion of obligation</b>	<b>\$</b>	<b>39,593</b>

**Purchase Commitments**

We outsource most of our manufacturing and supply chain management operations to third-party contract manufacturers, who procure components and assemble products on our behalf based on our forecasts in order to reduce manufacturing lead times and ensure adequate component supply. We issue purchase orders to our contract manufacturers for finished product and a significant portion of these orders consist of firm non-cancelable commitments. In addition, we purchase strategic component inventory from certain suppliers under purchase commitments that in some cases are non-cancelable, including integrated circuits, which are consigned to our contract manufacturers. As of December 31, 2016, we had non-cancelable purchase commitments of \$261.9 million. In addition, we have provided deposits to secure our obligations to purchase inventory. We had \$63.1 million and \$2.3 million in deposits as of December 31, 2016 and December 31, 2015, respectively. These deposits are classified in other current and long term assets in our accompanying audited consolidated balance sheets.

**Guarantees**

We have entered into agreements with some of our direct customers and channel partners that contain indemnification provisions relating to potential situations where claims could be alleged that our products infringe the intellectual property rights of a third party. We have at our option and expense the ability to repair any infringement, replace product with a non-infringing equivalent-in-function product or refund our customers all or a portion of the value of the product. Other guarantees or indemnification agreements include guarantees of product and service performance and standby letters of credit for leased facilities and corporate credit cards. We have not recorded a liability related to these indemnification and guarantee provisions and our guarantee and indemnification arrangements have not had any significant impact on our consolidated financial statements to date.

**Legal Proceedings**

***OptumSoft, Inc. Matters***

On April 4, 2014, OptumSoft filed a lawsuit against us in the Superior Court of California, Santa Clara County titled *OptumSoft, Inc. v. Arista Networks, Inc.*, in which it asserts (i) ownership of certain components of our EOS network operating system pursuant to the terms of a 2004 agreement between the companies; and (ii) breaches of certain confidentiality and use restrictions in that agreement. Under the terms of the 2004 agreement, OptumSoft provided us with a non-exclusive, irrevocable, royalty-free license to software delivered by OptumSoft comprising a software tool used to develop certain components of EOS and a runtime library that is incorporated into EOS. The 2004 agreement places certain restrictions on our use and disclosure of the OptumSoft software and gives OptumSoft ownership of improvements, modifications and corrections to, and derivative works of, the OptumSoft software that we develop.

In its lawsuit, OptumSoft has asked the Court to order us to (i) give OptumSoft access to our software for evaluation by OptumSoft; (ii) cease all conduct constituting the alleged confidentiality and use restriction breaches; (iii) secure the return or deletion of OptumSoft's alleged intellectual property provided to third parties, including our customers; (iv) assign ownership to OptumSoft of OptumSoft's alleged intellectual property currently owned by us; and (v) pay OptumSoft's alleged damages, attorney's fees, and costs of the lawsuit. David Cheriton, one of our founders and a former member of our board of directors, who resigned from our board of directors on March 1, 2014 and has no continuing role with us, is a founder and, we believe, the largest stockholder and director of OptumSoft. The 2010 David R. Cheriton Irrevocable Trust dtd July 28, 2010, a trust for the benefit of the minor children of Mr. Cheriton, is one of our largest stockholders.

On April 14, 2014, we filed a cross-complaint against OptumSoft, in which we assert our ownership of the software components at issue and our interpretation of the 2004 agreement. Among other things, we assert that the language of the 2004 agreement and the parties' long course of conduct support our ownership of the disputed software components. We ask the Court to declare our ownership of those software components, all similarly-situated software components developed in the future and all related intellectual property. We also assert that, even if we are found not to own certain components, such components are licensed to us under the terms of the 2004 agreement. However, there can be no assurance that our assertions will ultimately prevail in litigation. On the same day, we also filed an answer to OptumSoft's claims, as well as affirmative defenses based in part on OptumSoft's failure to maintain the confidentiality of its claimed trade secrets, its authorization of the disclosures it asserts and its delay in claiming ownership of the software components at issue. We have also taken additional steps to respond to OptumSoft's allegations that we improperly used and/or disclosed OptumSoft confidential information. While we believe we have meritorious defenses to these allegations, we believe we have (i) revised our software to remove the elements we understand to be the subject of the claims relating to improper use and disclosure of OptumSoft confidential information and made the revised software available to our customers and (ii) removed information from our website that OptumSoft asserted disclosed OptumSoft confidential information.

The parties tried Phase I of the case, relating to contract interpretation and application of the contract to certain claimed source code, in September 2015. On December 16, 2015, the Court issued a Proposed Statement of Decision Following Phase I Trial, and on January 8, 2016, OptumSoft filed objections to that Proposed Statement of Decision. On March 23, 2016, the Court issued a Final Statement of Decision Following Phase I Trial, in which it agreed with and adopted our interpretation of the 2004 agreement and held that we, and not OptumSoft, own all the software at issue in Phase I. The remaining issues that were not addressed in the Phase I trial are set to be tried in Phase II including the application of the Court's interpretation of the 2004 agreement as set forth in the Final Statement of Decision Following Phase I Trial to any other source code that OptumSoft claims to own following a review. Phase II was previously scheduled to be tried in April 2016; however, that trial date has been vacated and a new trial date has not yet been set.

We intend to vigorously defend against any claims brought against us by OptumSoft. However, we cannot be certain that, if litigated, any claims by OptumSoft would be resolved in our favor. For example, if it were determined that OptumSoft owned components of our EOS network operating system, we would be required to transfer ownership of those components and any related intellectual property to OptumSoft. If OptumSoft were the owner of those components, it could make them available to our competitors, such as through a sale or license. An adverse litigation ruling could result in a significant damages award against us and injunctive relief. In addition, OptumSoft could assert additional or different claims against us, including claims that our license from OptumSoft is invalid.

With respect to the legal proceedings described above, it is our belief that while a loss is not probable, it may be reasonably possible. Further, at this stage in the litigation, any possible loss or range of loss cannot be estimated. However, the outcome of litigation is inherently uncertain. Therefore, if one or more of these legal matters were resolved against us in a reporting period for a material amount, our consolidated financial statements for that reporting period could be materially adversely affected.

#### ***Cisco Systems, Inc. ("Cisco") Matters***

We are currently involved in several litigation matters with Cisco Systems, Inc. These matters are summarized below.

##### *Cisco Systems, Inc. v. Arista Networks, Inc. (Case No. 4:14-cv-05343) (''43 Case'')*

On December 5, 2014, Cisco filed a complaint against us in the District Court for the Northern District of California alleging that we infringe U.S. Patent Nos. 6,377,577; 6,741,592; 7,023,853; 7,061,875; 7,162,537; 7,200,145; 7,224,668; 7,290,164; 7,340,597; 7,460,492; 8,051,211; and 8,356,296 (respectively, "the '577 patent," "the '592 patent," "the '853 patent," "the 875 patent," "the '537 patent," "the '145 patent," "the '668 patent," "the '164 patent," "the '597 patent," "the '492 patent," "the '211 patent," and "the '296 patent"). Cisco seeks, as relief for our alleged infringement in the '43 Case, lost profits and/or reasonable royalty damages in an unspecified amount, including treble damages, attorney's fees, and associated costs. Cisco also seeks injunctive relief in the '43 Case. On February 10, 2015, the Court granted our unopposed motion to stay the '43 Case until the proceedings before the United States International Trade Commission ("USITC") pertaining to the same patents (as discussed below) became final. Trial has not been scheduled in the '43 Case.

Cisco Systems, Inc. v. Arista Networks, Inc. (Case No. 5:14-cv-05344) (“’44 Case”)

On December 5, 2014, Cisco filed a complaint against us in the District Court for the Northern District of California alleging that we infringe numerous copyrights pertaining to Cisco’s “Command Line Interface” or “CLI” and U.S. Patent Nos. 7,047,526 and 7,953,886 (respectively, “the ’526 patent” and “the ’886 patent”). As relief for our alleged patent infringement in the ’44 Case, Cisco seeks lost profits and/or reasonable royalty damages in an unspecified amount including treble damages, attorney’s fees, and associated costs as well as injunctive relief. As relief for our alleged copyright infringement, Cisco seeks monetary damages for alleged lost profits, profits from our alleged infringement, statutory damages, attorney’s fees, and associated costs.

On February 13, 2015, we answered the complaint in the ’44 Case, denying the patent and copyright infringement allegations and raising numerous affirmative defenses. On March 6, 2015, Cisco filed an amended complaint against us in the ’44 Case. In response, we moved to dismiss Cisco’s allegations of willful patent infringement and pre-suit indirect patent infringement. The Court granted the motion with leave to amend on July 2, 2015. On July 23, 2015, Cisco filed an amended complaint.

As described below, on May 25, 2016, our petition for Inter Partes Review (“IPR”) of the ’886 patent was instituted by the United States Patent Trial and Appeal Board (“PTAB”). Cisco subsequently agreed to dismiss its claims as to the ’886 patent with prejudice.

Summary judgment cross-motions in the ’44 Case were heard on August 4, 2016, and the Court denied all motions brought by both sides. Trial began on November 28, 2016, and the jury rendered its verdict on December 14, 2016. The jury found that Arista had proven its copyright defense of *scenes a faire* and that Cisco had failed to prove infringement of the ’526 patent, and on that basis judgment was entered in Arista’s favor on all claims on December 19, 2016.

On January 17, 2017, Cisco filed a motion for judgment as a matter of law, challenging the sufficiency of the evidence in support of Arista’s *scenes a faire* defense. Cisco did not file any post-trial motion regarding the ’526 patent, nor did it file a motion for a new trial. We also filed a motion for judgment as a matter of law on several issues. The hearing on both parties’ motions is currently set for April 27, 2017.

Arista Networks, Inc. v. Cisco Systems, Inc. (Case No. 5:16-cv-00923) (“’23 Case”)

On February 24, 2016, we filed a complaint against Cisco in the District Court for the Northern District of California alleging antitrust violations and unfair competition. On April 13, 2016, Cisco filed a motion to stay the ’23 Case, or in the alternative, to dismiss the complaint. On August 23, 2016, the Court granted Cisco’s motion to stay the ’23 Case until judgment has been entered on Cisco’s copyright claims in the ’44 Case, which the Court anticipated by December 22, 2016. Following the jury’s verdict in Arista’s favor in the ’44 Case, the parties filed a stipulation continuing the Case Management Conference until March 2, 2017. Trial in the ’23 Case is set for August 3, 2018, and is not affected by the Court’s granting of the interim stay.

Certain Network Devices, Related Software, and Components Thereof (Inv. No. 337-TA-944) (“944 Investigation”)

On December 19, 2014, Cisco filed a complaint against us in the USITC alleging that we have violated Section 337 of the Tariff Act of 1930, as amended. The USITC instituted Cisco’s complaint as Investigation No. 337-TA-944. Cisco initially alleged that certain of our switching products infringe the ’592, ’537, ’145, ’164, ’597, and ’296 patents. Cisco subsequently dropped the ’296 patent from the 944 Investigation. Cisco sought, among other things, a limited exclusion order barring entry into the United States of accused switch products (including our 7000 Series of switches) and components and software therein and a cease and desist order against us restricting our activities with respect to our imported accused switch products and components and software therein. On February 11, 2015, we responded to the complaint in the 944 Investigation by, among other things, denying the patent infringement allegations and raising numerous affirmative defenses.

The Administrative Law Judge (“ALJ”) assigned to the 944 Investigation issued a procedural schedule calling for, among other events: an evidentiary hearing on September 9-11 and 15-17, 2015; issuance of an initial determination regarding our alleged violations on January 27, 2016; and a Target Date for completion of the investigation on May 27, 2016. On January 27, 2016, the ALJ issued a revised procedural schedule extending the date for issuance of an initial determination to February 2, 2016 and extending the Target Date to June 2, 2016.

On February 2, 2016, the ALJ issued his initial determination finding a violation of section 337 of the Tariff Act. More specifically, the ALJ found that a violation has occurred in the importation into the United States, the sale for importation, or the sale within the United States after importation, of certain network devices, related software, and components thereof that the ALJ found infringe asserted claims 1, 2, 8-11, and 17-19 of the ’537 patent; asserted claims 6, 7, 20, and 21 of the ’592 patent; and asserted claims 5, 7, 45, and 46 of the ’145 patent. The ALJ did not find a violation of section 337 with respect to any asserted claims of the ’597 and ’164 patents. On April 11, 2016, the Commission decided to review certain findings contained in the initial determination. On June 23, 2016, the Commission issued its Final Determination, which found a violation with respect to the ’537, ’592, and ’145 patents, and found no violation with respect to the ’597 and ’164 patents. The Commission also issued a limited exclusion order and a cease and desist order pertaining to network devices, related software and components thereof that

infringe one or more of claims 1, 2, 8-11, and 17-19 of the '537 patent; claims 6, 7, 20, and 21 of the '592 patent; and claims 5, 7, 45, and 46 of the '145 patent. On August 22, 2016, the Presidential review period for the 944 investigation expired. The USITC orders will be in effect until the expiration of the '537, '592, and '145 patents.

Both we and Cisco filed petitions for review of the USITC's Final Determination to the U.S. Court of Appeals for the Federal Circuit ("Federal Circuit"). On August 26, 2016, the Federal Circuit consolidated the appeals, and on September 23, 2016, it issued an order setting an expedited briefing schedule. The appeal is fully briefed and oral argument has not been scheduled.

On August 26, 2016, Cisco filed an enforcement complaint under Section 337 of the Tariff Act of 1930, as amended, with the USITC. Cisco alleges that we are violating the cease and desist and limited exclusion orders issued in the 944 Investigation by engaging in the "marketing, distribution, offering for sale, selling, advertising, and/or aiding or abetting other entities in the sale and/or distribution of products that Cisco alleges continue to infringe claims 1-2, 8-11, and 17-19 of the '537 patent," despite the design changes we have made to those products. Cisco asks the USITC to (1) enforce the cease and desist order; (2) modify the Commission's limited exclusion order and/or cease and desist order "in any manner that would assist in the prevention of the unfair practices that were originally the basis for issuing such Order or assist in the detection of violations of such Order"; (3) impose the maximum statutory civil penalties for violation of the cease and desist order "including monetary sanctions for each day's violation of the cease and desist order of the greater of \$100,000.00 or twice the domestic value of the articles entered or sold, whichever is higher"; (4) bring a civil action in U.S. district court "requesting collection of such civil penalties and the issuance of a mandatory injunction preventing further violation of Cease and Desist Order"; and (5) impose "such other remedies and sanctions as are appropriate and within the Commission's authority." On September 28, 2016, the Commission instituted the enforcement proceeding. The proceeding has been assigned to Administrative Law Judge Shaw, who presided over the underlying investigation. On October 14, 2016, we responded to the complaint by, among other things, denying the patent infringement allegations and raising affirmative defenses. On November 2, 2016, the ALJ issued an order setting the deadline for the initial determination for June 20, 2017 and the Target Date for September 20, 2017. On November 3, 2016, the ALJ issued a scheduling order setting the evidentiary hearing in this proceeding for April 5, 2017.

*Certain Network Devices, Related Software, and Components Thereof (Inv. No. 337-TA-945) ("945 Investigation")*

On December 19, 2014, Cisco filed a complaint against us in the USITC alleging that we violated Section 337 of the Tariff Act of 1930, as amended. The USITC instituted Cisco's complaint as Investigation No. 337-TA-945. Cisco alleges that certain of our switching products infringe the '577, '853, '875, '668, '492, and '211 patents. Cisco seeks, among other things, a limited exclusion order barring entry into the United States of accused switch products (including our 7000 Series of switches) related software, and components thereof and a cease and desist order against us restricting our activities with respect to our imported accused switch products, related software, and components thereof. On February 11, 2015, we responded to the notice of investigation and complaint in the 945 Investigation by, among other things, denying the patent infringement allegations and raising numerous affirmative defenses.

The ALJ issued a procedural schedule calling for, among other events: an evidentiary hearing on November 9-20, 2015; issuance of an initial determination regarding our alleged violations on April 26, 2016; and a Target Date for completion on August 26, 2016. On March 29, 2016, the ALJ issued a revised procedural schedule extending the deadline for issuance of an initial determination to August 26, 2016, and extending the Target Date to December 26, 2016. On August 24, 2016, the ALJ issued a revised procedural schedule extending the deadline for issuance of an initial determination to November 7, 2016, and extending the Target Date to March 7, 2017. On November 4, 2016, the ALJ issued a revised procedural schedule extending the deadline for issuance of an initial determination to December 7, 2016, and extending the Target Date to April 7, 2017. On December 7, 2016, the ALJ issued a revised procedural schedule extending the deadline for issuance of an initial determination to December 9, 2016, and extending the Target Date to April 9, 2017.

On December 9, 2016, the ALJ issued her initial determination finding a violation of section 337 of the Tariff Act. More specifically, the ALJ found that a violation has occurred in the importation into the United States, the sale for importation, or the sale within the United States after importation, of certain network devices, related software, and components thereof that the ALJ found infringe asserted claims 1, 7, 9, 10, and 15 of the '577 patent; and asserted claims 1, 2, 4, 5, 7, 8, 10, 13, 19, 56, and 64 of the '668 patent. The ALJ did not find a violation of section 337 with respect to asserted claim 2 of the '577 patent or any asserted claims of the '853, '492, '875, and '211 patents. On December 29, 2016, Arista, Cisco and the OUII filed petitions for review of certain findings contained in the initial determination. On January 3, 2017, the Commission extended the Target Date to April 17, 2017, and set the deadline for determining whether to review the final initial determination to February 15, 2017. On January 27, 2017, the Commission further extended the Target Date to May 1, 2017, and set the deadline for determining whether to review the final initial determination to March 1, 2017. If the Commission finds a violation in its Final Determination, that finding will be subject to a 60-day Presidential review period.

### Inter Partes Reviews

We have filed petitions for Inter Partes Review (“IPR”) of the ’597, ’211, ’668, ’853, ’537, ’577, ’886, and ’526 patents. IPRs relating to the ’597 (IPR No. 2015-00978) and ’211 (IPR No. 2015-00975) patents were instituted in October 2015 and hearings on these IPRs were completed in July 2016. On September 28, 2016, the PTAB issued a final written decision finding claims 1, 14, 39-42, 71, 72, 84, and 85 of the ’597 patent unpatentable. The PTAB also found that claims 29, 63, 64, 73, and 86 of the ’597 patent had not been shown to be unpatentable. Cisco requested rehearing of the PTAB’s Final Written Decision on October 28, 2016, which the PTAB denied on January 13, 2017. On January 23, 2017, we filed a notice of appeal with respect to this decision regarding claims 29, 63, 64, 73, and 86 of the ’597 patent. On October 5, 2016, the PTAB issued a final written decision finding claims 1 and 12 of the ’211 patent unpatentable. The PTAB also found that claims 2, 6-9, 13, 17-20 of the ’211 patent had not been shown to be unpatentable. On December 5, 2016, we filed a notice of appeal with respect to this decision regarding claims 2, 6-9, 13, 17-20, which was docketed as Appeal No. 17-1313. Cisco filed a notice of cross-appeal with respect to claims 1 and 12 on December 19, 2016, which was docketed as Appeal No. 17-1380. The Court of Appeals for the Federal Circuit consolidated these appeals on December 20, 2016. The briefing is set to be completed in July 2017.

The IPR relating to the ’886 patent was instituted on May 25, 2016. Following that decision, Cisco agreed to dismiss its claims as to the ’886 patent with prejudice, and we dismissed our counterclaims as to the ’886 patent without prejudice.

IPRs relating to the ’668 (IPR No. 2016-00309), ’577 (IPR No. 2016-00303), ’853 (IPR No. 2016-0306), and ’537 (IPR No. 2016-0308) patents were instituted in June 2016 and are set for hearing in March 2017. Final Written Decisions on these IPRs will be issued by June 2017.

\* \* \* \* \*

We intend to vigorously defend against each of the Cisco’s lawsuits, as summarized in the preceding paragraphs. However, we cannot be certain that any claims by Cisco would be resolved in our favor regardless of the merit of the claims. Any adverse litigation ruling could result in the above described injunctive relief, could require a significant damages award against us or a requirement that we make substantial royalty payments to Cisco, and/or could require that we modify our products to the extent that we are found to infringe any valid claims asserted against us by Cisco.

For example, in the 944 Investigation, the USITC has issued a limited exclusion order barring entry into the United States of our network devices (including our 7000 Series of switches), related software, and components thereof that infringe one or more of the claims of the ’537, ’592, and ’145 patents specified above and a cease and desist order restricting our activities with respect to such imported products. In addition, in the 945 Investigation, the ALJ has issued her initial determination finding a violation of section 337 of the Tariff Act with respect to the ’668 and ’577 patents, which is now subject to review by the Commission.

To comply with these orders, we have sought to develop technical design-arounds that no longer infringe the patents that are the subject of the orders. In any efforts to develop technical design-arounds for our products, we may be unable to do so in a manner that does not continue to infringe the patents or that is acceptable to our customers. These development efforts could be extremely costly and time consuming as well as disruptive to our other development activities and distracting to management. Moreover, in the 944 Investigation and 945 Investigation, such design-arounds would require us to obtain approval of either the USITC or U.S. Customs and Border Protection (“CBP”) to resume the importation of the redesigned products into the United States. We may not be successful in our efforts to obtain such approvals to import such modified products in a timely manner, or at all. While a favorable ruling from the CBP would allow us to resume importation of our redesigned products into the United States, the USITC could still determine in an enforcement action that our redesigned products continue to infringe the patents that are the subject of any USITC orders. Any failure to effectively redesign our products, to obtain timely clearance from USITC or CBP to import such redesigned products, or to address the USITC findings in a manner that complies with the USITC orders, may cause a disruption to our product shipments and materially and adversely affect our business, prospects, reputation, results of operations, and financial condition.

Specifically, in response to the USITC’s findings in the 944 Investigation, we have made design changes to our products for sale in the United States to address the features that were found to infringe the ’537, ’592, ’145 patents. Following the issuance of the final determination in the 944 Investigation, we submitted a Section 177 ruling request to CBP seeking approval to import these redesigned products into the United States. On November 18, 2016, we received a 177 ruling from CBP finding that our redesigned products did not infringe the ’537, ’592, and ’145 patents, and approving the importation of these redesigned products into the United States. However, on January 13, 2017, at the request of Cisco Systems and without our input, CBP issued a letter to us revoking its prior November 18 ruling. Due to this revocation, we can no longer import its products into the United States. CBP has informed us that it currently takes no position on whether our redesigned products infringe and will conduct an inter partes proceeding between Arista and Cisco to determine whether our redesigned products infringe and whether to approve them for importation into the United States. We do not yet know when CBP will complete the process and provide that ruling. The CBP may not rule in a timely fashion, and we may not receive a favorable ruling at the end of the process.

Similarly, if the USITC finds in a Final Determination that we infringe any patent in the 945 Investigation, the USITC will likely issue remedial orders in that investigation as well. If such orders are not disapproved by the United States Trade Representative, we would need to further modify our products to take our products outside the scope of any patents we are found to have infringed in the 945 Investigation and obtain the USITC and/or CBP approvals described above in order to resume importation of our redesigned products into the United States.

If the USITC determines that our redesigned products continue to infringe the patents subject to any USITC limited exclusion order or cease and desist order in an enforcement action for either the 944 Investigation or the 945 Investigation, the USITC may impose the maximum statutory civil penalties for violation of the cease and desist order “including monetary sanctions for each day’s violation of the cease and desist order of the greater of \$100,000.00 or twice the domestic value of the articles entered or sold, whichever is higher,” bring a civil action in U.S. district court “requesting collection of such civil penalties and the issuance of a mandatory injunction preventing further violation of Cease and Desist Order” or impose “such other remedies and sanctions as are appropriate and within the Commission’s authority.”

In order to comply with the USITC’s remedial orders, we have also made certain changes to our manufacturing, importation and shipping workflows. These changes have included shifting manufacturing and integration of our products to be sold in the United States to U.S. facilities. Such changes may be extremely costly, time consuming, and we may not be able to implement such changes successfully. Any failure to successfully change our manufacturing and importation processes or shipping workflows in a manner that is compliant with the limited exclusion order and cease and desist order may cause a disruption in our product shipments and materially and adversely affect our business, prospects, reputation, results of operations, and financial condition.

In connection with these changes, to the extent that we are required to make further modifications to our supply chain to obtain alternative U.S. sources for subcomponents, we may be unable to obtain a sufficient quantity of these components on commercially reasonable terms or in a timely manner, if at all, which could delay or halt entirely production of our products or require us to make further modifications to our products to incorporate new components that are available in the United States. Any of these events could result in lost sales, reduced gross margins or damage to our end-customer relationships, which would materially and adversely impact our business, financial condition, results of operations and prospects.

Additionally, the existence of Cisco’s lawsuits against us could cause concern among our customers and partners and could adversely affect our business and results of operations. Whether or not we prevail in the lawsuit, we expect that the litigation will be expensive, time-consuming and a distraction to management in operating our business.

With respect to the various legal proceedings described above, it is our belief that while a loss is not probable, it may be reasonably possible. Further, at this stage in the litigation, any possible loss or range of loss cannot be estimated. However, the outcome of litigation is inherently uncertain. Therefore, if one or more of these legal matters were resolved against us in a reporting period for a material amount, our consolidated financial statements for that reporting period could be materially adversely affected.

#### ***Other Matters***

In the ordinary course of business, we are a party to other claims and legal proceedings including matters relating to commercial, employee relations, business practices and intellectual property. We record a provision for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. As of December 31, 2016, provisions recorded for contingent losses related to other claims and matters have not been significant. Based on currently available information, management does not believe that any additional liabilities relating to other unresolved matters are probable or that the amount of any resulting loss is estimable, and believes these other matters are not likely, individually and in the aggregate, to have a material adverse effect on our financial position, results of operations or cash flows. However, litigation is subject to inherent uncertainties and our view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on our financial position, results of operations or cash flows for the period in which the unfavorable outcome occurs, and potentially in future periods.

## 6. Equity Award Plan Activities

### 2014 Equity Incentive Plan

In April 2014, the board of directors and stockholders approved the 2014 Equity Incentive Plan (the “2014 Plan”), effective on the first day that our common stock was publicly traded. Our board of directors has terminated the 2004 and 2011 equity plans as to future grants. However, these plans will continue to govern the terms and conditions of the outstanding options previously granted thereunder.

Awards granted under the 2014 Plan could be in the form of Incentive Stock Options (“ISOs”), Nonstatutory Stock Options (“NSOs”), Restricted Stock Awards (“RSAs”), Stock Appreciation Rights (“SARs”) or Restricted Stock Units (“RSUs”). The number of shares available for grant and issuance under the 2014 Plan increases automatically on January 1 of each year commencing with 2016 by the number of shares equal to 3% of our shares outstanding on the immediately preceding December 31, but not to exceed 12,500,000 shares, unless the board of directors, in its discretion, determines to make a smaller increase. As of December 31, 2016, there remained approximately 11.8 million shares available for issuance under the 2014 Plan.

On February 6, 2017, our board of directors authorized an increase to the shares available for issuance under the plan of 3% of the total shares outstanding on December 31, 2016 effective January 1, 2017. The increase amounted to 2,124,333 shares.

### 2014 Employee Stock Purchase Plan

In April 2014, the board of directors and stockholders approved the 2014 Employee Stock Purchase Plan (the “ESPP”). The ESPP became effective on the first day that our common stock was publicly traded. The number of shares reserved for issuance under the ESPP increases automatically on January 1 of each year by the number of shares equal to 1% of our shares outstanding immediately preceding December 31, but not to exceed 2,500,000 shares, unless the board of directors, in its discretion, determines to make a smaller increase.

Under our 2014 ESPP eligible employees are permitted to acquire shares of our common stock at 85% of the lower of the fair market value of our common stock on the first trading day of each offering period or on the exercise date. Each offering period will be approximately two years starting on the first trading date after February 15 and August 15 of each year. Participants may purchase shares of common stock through payroll deductions up to 10% of their eligible compensation, subject to Internal Revenue Service mandated purchase limits. As of December 31, 2016, there remained 1,483,846 shares available for issuance under the ESPP.

On February 6, 2017, our board of directors authorized an increase to shares available for issuance under the plan of 1% of the total shares outstanding on December 31, 2016 effective January 1, 2017. The increase amounted to 708,111 shares.

### Stock Option Activities

The following table summarizes the option activity under our stock plans and related information (in thousands, except years and per share amounts):

	Options Outstanding		Weighted-Average Remaining Contractual Term (Years) of Stock Options	Aggregate Intrinsic Value of Stock Options Outstanding
	Number of Shares Underlying Outstanding Options	Weighted-Average Exercise Price per Share		
Balance—December 31, 2015	11,630	\$ 24.49	7.6	\$ 620,802
Authorized				
Options granted	441	56.95		
Options exercised	(2,200)	11.32		
Options canceled	(362)	31.22		
Balance—December 31, 2016	9,509	\$ 28.79	6.9	\$ 646,394
Vested and exercisable—December 31, 2016	3,642	\$ 15.29	6.1	\$ 296,738
Vested and expected to vest—December 31, 2016	9,050	\$ 28.23	6.9	\$ 620,296

The weighted-average grant-date fair value of options granted during the year ended December 31, 2016 and 2015 was \$23.66 and \$29.20 per share, respectively. The aggregate intrinsic value of options exercised during the year ended December 31, 2016 was \$147.6 million.

### **Restricted Stock Unit (RSU) Activities**

A summary of the activity under our 2014 Plan and changes during the reporting period and a summary of information related to RSUs are presented below (in thousands, except years and per share amounts):

	<b>Number of Shares</b>	<b>Weighted-Average Grant Date Fair Value Per Share</b>	<b>Weighted-Average Remaining Contractual Term (in years)</b>	<b>Aggregate Intrinsic Value</b>
Unvested balance—December 31, 2015	893	\$ 70.14	1.9	\$ 69,509
RSUs granted	816	76.54		
RSUs vested	(244)	69.32		
RSUs forfeited/canceled	(90)	67.97		
Unvested balance—December 31, 2016	<u>1,375</u>	\$ 74.23	1.8	\$ 133,081
RSUs vested and expected to vest—December 31, 2016	<u>1,288</u>	\$ 74.14	1.7	\$ 124,683

### **Employee Stock Purchase Plan Activities**

During the year ended December 31, 2016, we issued 256,223 shares at an average purchase price of \$40.30 under our ESPP. Shares available for future issuance under our ESPP, subsequent to the increase authorized by our board of directors, are approximately 2.2 million.

### **Shares Available for Grant**

The following table presents the stock activity and the total number of shares available for grant as of December 31, 2016 (in thousands):

	<b>Number of Shares</b>
Balance—December 31, 2015	10,495
Authorized	2,044
Options granted	(441)
RSUs granted	(816)
Options canceled	362
Options repurchased	5
RSUs forfeited	90
Shares traded for taxes	15
Balance—December 31, 2016	<u>11,754</u>

### **Early Exercise of Stock Options**

We have historically allowed our employees and directors to exercise options prior to vesting. Upon an "early exercise" of these options, the unvested shares acquired through the exercise become options subject to our repurchase right that lapse in accordance with the original option vesting schedule. Upon termination of employment prior to our repurchase rights lapsing in full, we have a right to repurchase the unvested shares at the original purchase price. The proceeds received from the early exercise of stock options and are initially recorded in other liabilities and are reclassified to common stock and paid-in capital as our repurchase right lapse. For the year ended December 31, 2016, we repurchased 5,364 shares of common stock at the original exercise price due to the termination of the holders of the unvested shares. As of December 31, 2016, early exercised shares subject to repurchase were 0.3 million, with an aggregate value of \$1.3 million.

### **Stock-Based Compensation Expense**

Total stock-based compensation expense related to options, RSAs, ESPP and RSUs granted were charged to the department to which the associated employee reported as follow (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Cost of revenue	\$ 3,620	\$ 3,048	\$ 1,535
Research and development	31,892	25,515	14,986
Sales and marketing	15,666	11,454	7,643
General and administrative	7,854	5,286	3,455
Total stock-based compensation	\$ 59,032	\$ 45,303	\$ 27,619

### **Determination of Fair Value**

We record stock-based compensation awards based on fair value as of the grant date. For option awards and ESPP offerings we use the Black-Scholes-Merton option-pricing model to determine fair value. We recognize such costs as compensation expense generally on a straight-line basis over the requisite service period of the award.

### **Stock Options**

For the years ended December 31, 2016 , 2015 and 2014 the fair value of each stock option granted under our plans was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions and fair value per share:

	Year Ended December 31,		
	2016	2015	2014
Expected term (in years)	6.7	6.2	7.6
Risk-free interest rate	1.5%	1.6%	2.2%
Expected volatility	38.9%	42.9%	47.7%
Dividend rate	—%	—%	—%

As of December 31, 2016 , the total unrecognized stock-based compensation expense for unvested stock options, net of expected forfeitures, was \$87.4 million , which is expected to be recognized over a weighted-average period of 3.7 years. The total fair value of options vested for the year ended December 31, 2016 was \$28.6 million .

As of December 31, 2016 , there was \$87.6 million of unrecognized stock-based compensation expense related to unvested RSUs, net of estimated forfeitures. This amount is expected to be recognized over a weighted-average period of 3.4 years.

### **ESPP**

The following table summarizes the assumptions relating to our ESPP:

	Year Ended December 31,		
	2016	2015	2014
Expected term (in years)	1.2	1.4	1.4
Risk-free interest rate	0.6%	0.3%	0.3%
Expected volatility	31.8%	34.8%	36.3%
Dividend rate	—%	—	—

As of December 31, 2016 , the total unrecognized stock-based compensation expense related to unvested ESPP options, net of expected forfeitures, was \$4.2 million , which is expected to be recognized over a weighted-average period of 1.5 years.

## 7. Net Income Per Share Available to Common Stock

The following table sets forth the computation of our basic and diluted net income per share available to common stock (in thousands, except per share amounts):

	Year Ended December 31,		
	2016	2015	2014
<b>Numerator:</b>			
<b>Basic:</b>			
Net income	\$ 184,189	\$ 121,102	\$ 86,850
Less: undistributed earnings allocated to participating securities	(1,224)	(1,987)	(17,961)
Net income available to common stockholders, basic	<u>\$ 182,965</u>	<u>\$ 119,115</u>	<u>\$ 68,889</u>
<b>Diluted:</b>			
Net income attributable to common stockholders, basic	\$ 182,965	\$ 119,115	\$ 68,889
Add: undistributed earnings allocated to participating securities	74	149	1,635
Net income attributable to common stockholders, diluted	<u>\$ 183,039</u>	<u>\$ 119,264</u>	<u>\$ 70,524</u>
<b>Denominator:</b>			
<b>Basic:</b>			
Weighted-average shares used in computing net income per share available to common stockholders, basic	<u>68,771</u>	<u>65,964</u>	<u>48,427</u>
<b>Diluted:</b>			
Weighted-average shares used in computing net income per share available to common stockholders, basic	68,771	65,964	48,427
<b>Add weighted-average effect of dilutive securities:</b>			
Stock options, RSUs and RSAs	4,408	5,363	6,059
Employee stock purchase plan	43	84	104
Stock purchase rights	—	—	—
Weighted-average shares used in computing net income per share available to common stockholders, diluted	<u>73,222</u>	<u>71,411</u>	<u>54,590</u>
<b>Net income per share attributable to common stockholders:</b>			
Basic	<u>\$ 2.66</u>	<u>\$ 1.81</u>	<u>\$ 1.42</u>
Diluted	<u>\$ 2.50</u>	<u>\$ 1.67</u>	<u>\$ 1.29</u>

The following outstanding shares of common stock equivalents were excluded from the computation of diluted net income per share available to common stockholders for the periods presented because including them would have been anti-dilutive (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Stock options and RSUs to purchase common stock	2,594	2,427	1,263

## 8. Income Taxes

The geographical breakdown of income before provision for income taxes is as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Domestic	\$ 196,202	\$ 129,240	\$ 120,838
Foreign	46,023	16,769	670
Income before provision for income taxes	\$ 242,225	\$ 146,009	\$ 121,508

The components of the provision for income taxes are as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Current provision for income taxes:			
Federal	\$ 67,253	\$ 43,706	\$ 34,314
State	10,529	5,500	4,493
Foreign	2,016	1,588	3,306
Total current	79,798	50,794	42,113
Deferred tax benefit:			
Federal	(18,579)	(23,896)	(7,105)
State	(3,564)	(2,300)	230
Foreign	381	309	(580)
Total deferred	(21,762)	(25,887)	(7,455)
Total provision for income taxes	\$ 58,036	\$ 24,907	\$ 34,658

The reconciliation of the statutory federal income tax and our effective income tax is as follows:

	Year Ended December 31,		
	2016	2015	2014
U.S. federal statutory income tax	35.00 %	35.00 %	35.00 %
State tax, net of federal benefit	(0.03)	(1.35)	1.19
Foreign tax differential	(3.24)	(2.16)	0.68
Tax credits	(4.24)	(6.72)	(5.26)
Change in valuation allowance	1.71	2.84	1.92
Permanent items	(1.02)	(1.32)	(0.86)
Uncertain tax positions and associated interest	(1.46)	(3.95)	0.37
Stock-based compensation	(2.81)	(5.29)	(4.01)
Other, net	0.05	0.01	(0.51)
Total provision for income taxes	23.96 %	17.06 %	28.52 %

We have operations and a taxable presence in numerous jurisdictions outside the U.S. All of these countries except one jurisdiction have a lower tax rate than the U.S. The significant jurisdictions in which we have a presence include Cayman Islands, Ireland, and the United Kingdom.

The tax effects of temporary differences that give rise to significant portions of deferred tax assets (liabilities) are as follows (in thousands):

	December 31,	
	2016	2015
Deferred tax assets:		
Property and equipment	\$ 473	\$ 241
Stock-based compensation	23,071	15,859
Reserves and accruals not currently deductible	49,436	33,686
Net operating losses	1,140	221
Tax credits	15,015	12,465
State taxes	—	9
Other	194	380
Gross deferred tax assets	89,329	62,861
Valuation allowance	(16,894)	(12,655)
Total deferred tax assets	72,435	50,206
Deferred tax liabilities:		
Property and equipment	(198)	(1,517)
Accrued liabilities	(2,555)	(728)
Other	(3)	(1)
Total deferred tax liabilities	(2,756)	(2,246)
Net deferred tax assets	\$ 69,679	\$ 47,960

The following table presents the breakdown between non-current deferred tax assets and liabilities (in thousands):

	December 31,	
	2016	2015
Deferred tax assets, non-current	70,960	48,429
Deferred tax liabilities, non-current	(1,281)	(469)
Total net deferred tax assets	\$ 69,679	\$47,960

Recognition of deferred tax assets is appropriate when realization of these assets is more likely than not. We believe that all of the deferred tax assets were realizable with the exception of California and Canada deferred tax assets. Therefore, a valuation allowance of \$16.9 million and \$12.7 million was recorded as of December 31, 2016 and 2015, respectively, against the California and Canadian deferred tax assets as it was not more likely than not that these assets will be recognized. The net valuation allowance increased by \$4.2 million and \$3.7 million as of December 31, 2016 and 2015, respectively.

As of December 31, 2016, we had no net operating loss carryforwards for federal and state income tax purposes. For foreign jurisdictions, we had combined foreign net operating loss carryforwards of \$17.2 million which do not expire.

As of December 31, 2016, we had no U.S. federal credit carryforwards and state credit carryforwards of \$39.2 million, which can be carried over indefinitely. For foreign jurisdictions, we had \$1.1 million of Canadian scientific research and experimental development tax credit carry-forwards, which begin to expire in 2034.

Utilization of the net operating losses and tax credit carryforwards may be subject to limitations due to ownership changes limitations provided in the Internal Revenue code and similar state or foreign provisions. In all years up to December 31, 2016, such limitations had no impact to our deferred tax assets.

Our policy with respect to our undistributed foreign subsidiaries earnings is to consider those earnings to be indefinitely reinvested and, accordingly, no related provision for U.S. federal and state income taxes has been provided. Upon distribution of those earnings' in the form of dividends or otherwise, we may be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes in the various countries. As of December 31, 2016, 2015 and 2014, the undistributed earnings approximated \$36.4 million, \$16.4 million and \$4.9 million, respectively. The determination of the future tax consequences of the remittance of these earnings is not practicable.

## Uncertain Tax Positions

We recognize uncertain tax positions only to the extent that management believes that it is more likely than not the position will be sustained. The reconciliation of the beginning and ending amount of gross unrecognized tax benefits as of December 31, 2016, 2015 and 2014 was as follows (in thousands):

	Year Ended December 31,		
	2016	2015	2014
Gross unrecognized tax benefits—beginning balance	\$ 22,239	\$ 21,322	\$ 16,973
Increases related to tax positions taken in a prior year	46	346	425
Increases related to tax positions taken during current year	11,359	7,385	4,355
Decreases related to tax positions taken in a prior year	(426)	(228)	(431)
Decreases related to settlements with taxing authorities	(432)	—	—
Decreases related to lapse of statute of limitations	(5,871)	(6,586)	—
Gross unrecognized tax benefits—ending balance	\$ 26,915	\$ 22,239	\$ 21,322

As of December 31, 2016, 2015 and 2014 the total amount of gross unrecognized tax benefits was \$26.9 million, \$22.2 million and \$21.3 million of which \$13.9 million, \$13.0 million and \$15.8 million would affect our effective tax rate if recognized, respectively.

Our policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. We have recorded a net benefit for interest and penalties of \$0.5 million and net expense of \$0.4 million in the years ended December 31, 2016 and 2015, respectively. As of December 31, 2016 and 2015, we recognized a liability for interest and penalties of \$0.6 million and \$1.1 million, respectively.

We have been selected for examination by the Internal Revenue Service ("IRS") for our 2013 and 2014 tax years. It is difficult to determine when the examinations will be settled or their final outcomes in the foreseeable future. We believe that we have adequately provided reserves for any reasonably foreseeable adjustment to our tax returns.

The statute of limitations for Federal remains open for 2013 and forward. Because of the net operating loss and tax credit carryforwards, all tax years remain open to state tax examination. The majority of our foreign tax returns are open to audit under the statute of limitations of the respective foreign countries, in which the subsidiaries are located. It is possible that the amount of existing unrecognized tax benefits may decrease within the next 12 months as a result of statute of limitation lapses in some of the jurisdictions, however, an estimate of the range cannot be made.

## 9. Segment Information

We have determined that we operate as one reportable segment. The following table represents revenue based on the customer's location, as determined by the customer's shipping address (in thousands):

	Year Ended December 31,		
	2016	2015	2014
United States	\$ 862,352	\$ 634,413	\$ 456,691
Other Americas	12,388	12,506	8,853
Europe, Middle East and Africa	168,789	128,400	74,555
Asia Pacific	85,638	62,272	44,007
Total revenue	\$ 1,129,167	\$ 837,591	\$ 584,106

Long lived assets, excluding intercompany receivables, investments in subsidiaries, privately held equity investments and deferred tax assets, net by location are summarized as follows (in thousands):

	December 31,	
	2016	2015
United States	\$ 69,352	\$ 70,719
International	7,609	8,987
Total	\$ 76,961	\$ 79,706

## 10. Related Party Transactions and Balances

Certain members of our board of directors serve on the boards of our customers and one of our vendors. During the years ended December 31, 2016 , 2015 and 2014 , we recognized revenue of \$76.1 million , \$39.4 million and \$29.6 million , respectively, from sales transactions with these related party customers. Amounts due from these related party customers were \$8.7 million and \$9.8 million as of December 31, 2016 and 2015 , respectively. The amount incurred related to transactions with a related party vendor was \$2.1 million and \$2.7 million during the year ended December 31, 2016 and 2015 . There were no transactions with this related party vendor during the year ended December 31, 2014 .

## 11. Selected Quarterly Financial Information (Unaudited)

The following tables set forth selected unaudited quarterly consolidated statements of income data for each of the quarters in the years ended December 31, 2016 and 2015 :

	Three Months Ended							
	Dec. 31, 2016	Sep. 30, 2016	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sep. 30, 2015	Jun. 30, 2015	Mar. 31, 2015
	(in thousands)							
Revenue:								
Product	\$ 289,008	\$ 254,238	\$ 235,616	\$ 212,475	\$ 217,325	\$ 193,339	\$ 174,072	\$ 160,141
Service	38,961	36,023	33,125	29,721	28,121	24,209	21,480	18,904
Total revenue	327,969	290,261	268,741	242,196	245,446	217,548	195,552	179,045
Cost of revenue:								
Product	108,057	94,777	88,021	78,913	81,142	67,990	60,014	54,439
Service	9,757	9,064	9,269	8,193	8,136	7,810	7,648	6,852
Total cost of revenue	117,814	103,841	97,290	87,106	89,278	75,800	67,662	61,291
Gross profit	210,155	186,420	171,451	155,090	156,168	141,748	127,890	117,754
Operating expenses:								
Research and development	71,398	70,648	69,020	62,515	57,413	58,748	49,947	43,340
Sales and marketing	38,321	33,216	31,744	27,606	31,308	26,508	26,681	24,587
General and administrative	22,941	19,535	17,529	15,234	18,050	25,195	18,403	14,072
Total operating expenses	132,660	123,399	118,293	105,355	106,771	110,451	95,031	81,999
Income from operations	77,495	63,021	53,158	49,735	49,397	31,297	32,859	35,755
Other income (expense), net:								
Interest expense	(918)	(735)	(732)	(751)	(746)	(753)	(832)	(821)
Other income (expense), net	560	639	416	337	(109)	13	417	(468)
Total other income (expense), net	(358)	(96)	(316)	(414)	(855)	(740)	(415)	(1,289)
Income before provision for income taxes	77,137	62,925	52,842	49,321	48,542	30,557	32,444	34,466
Provision for income taxes	18,354	11,668	13,938	14,076	4,618	1,867	8,448	9,974
Net income	\$ 58,783	\$ 51,257	\$ 38,904	\$ 35,245	\$ 43,924	\$ 28,690	\$ 23,996	\$ 24,492
Net income per share attributable to common stockholders:								
Basic	\$ 0.84	\$ 0.74	\$ 0.57	\$ 0.52	\$ 0.65	\$ 0.42	\$ 0.36	\$ 0.37
Diluted	\$ 0.79	\$ 0.69	\$ 0.53	\$ 0.48	\$ 0.60	\$ 0.39	\$ 0.33	\$ 0.34

### Item 9. Change in and Disagreements With Accountants on Accounting and Financial Disclosure

None

### Item 9A. Controls and Procedures

#### Evaluation of Disclosure Controls and Procedures

Management, with the participation of our Chief Executive Officer ("CEO") and our Chief Financial Officer ("CFO"), evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2016. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Based on the evaluation of our disclosure controls and procedures as of December 31, 2016, our CEO and CFO concluded that, as of such date, our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable

assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission (SEC) rules and forms, and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosure.

### ***Changes in Internal Control over Financial Reporting***

There have been no changes in our internal control over financial reporting identified in connection with the evaluation required by Rule 13a-15(d) and 15d-15(d) of the Securities and Exchange Act of 1934, as amended, that occurred during the year ended December 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### ***Inherent Limitations of Internal Controls***

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal controls over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple error or mistake. Additionally, controls can 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 also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

### ***Management's Report on Internal Control Over Financial Reporting***

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is a process designed under the supervision of our principal executive and principal financial officers to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2016, based on the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control - Integrated Framework (2013 framework). Based on that assessment, management concluded that, as of December 31, 2016, our internal control over financial reporting was effective.

The effectiveness of our internal control over financial reporting as of December 31, 2016, has been audited by Ernst & Young LLP, the independent registered public accounting firm that audits our Consolidated Financial Statements, as stated in their report preceding this report, which expresses an unqualified opinion on the effectiveness of our internal control over financial reporting as of December 31, 2016.

**Item 9B. Other Information**

None

**PART III****Item 10. Directors, Executive Officers, and Corporate Governance**

Information required by this Item is incorporated herein by reference to our definitive proxy statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**Item 11. Executive Compensation**

Information required by this Item is incorporated herein by reference to our definitive proxy statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information required by this Item is incorporated herein by reference to our definitive proxy statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**Item 13. Certain Relationships and Related Transactions and Director Independence**

Information required by this Item is incorporated herein by reference to our definitive proxy statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**Item 14. Principal Accountant Fees and Services**

Information required by this Item is incorporated herein by reference to our definitive proxy statement with respect to our 2017 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**PART IV****Item 15. Exhibits and Financial Statement Schedules**

Documents filed as part of this Annual Report on Form 10-K are as follows:

1. Consolidated Financial Statements

Our Consolidated Financial Statements are listed in the “Index to Consolidated Financial Statements” under Part II, Item 8 of this Annual Report on Form 10-K.

2. Financial Statement Schedules

Financial statement schedules have been omitted because they are not required, not applicable, not present in amounts sufficient to require submission of the schedule, or the required information is shown in the Consolidated Financial Statements or Notes thereto.

3. Exhibits

The documents listed in the Exhibit Index of this Annual Report on Form 10-K are incorporated by reference or are filed with this Annual Report on Form 10-K, in each case as indicated therein (numbered in accordance with Item 601 of Regulation S-K).

**Item 6. Exhibits**

See the Exhibit Index following the signature page to this Annual Report on Form 10-K for a list of exhibits filed or furnished with this report, which Exhibit Index is incorporated herein by reference.



## EXHIBIT INDEX

Exhibit Number	Description	Incorporated by Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	001-36468	3.1	8/8/2014	
3.2	Bylaws of the Registrant.	10-Q	001-36468	3.2	8/8/2014	
4.1	Form of the Registrant's common stock certificate.	S-1/A	333-194899	4.1	4/21/2014	
4.2	Investors' Rights Agreement, dated October 16, 2004, between Registrant and certain holders of Registrant's capital stock named therein.	S-1	333-194899	4.2	3/31/2014	
4.3	Investors' Rights Agreement, dated January 4, 2011, between Registrant and certain holders of Registrant's capital stock named therein.	S-1	333-194899	4.3	3/31/2014	
10.1	Form of Indemnification Agreement between the Registrant and each of its directors and executive officers.	S-1/A	333-194899	10.1	5/2/2014	
10.2 †	2004 Equity Incentive Plan.	S-1	333-194899	10.2	3/31/2014	
10.3 †	2011 Equity Incentive Plan.	S-1	333-194899	10.3	3/31/2014	
10.4 †	2014 Equity Incentive Plan.	S-1/A	333-194899	10.4	5/2/2014	
10.5 †	2014 Employee Stock Purchase Plan.	10-K	001-36468	10.5	3/11/2015	
10.6 †	Offer Letter, dated October 17, 2004, by and between the Registrant and Kenneth Duda.	S-1	333-194899	10.6	3/31/2014	
10.7 †	Offer Letter, dated June 8, 2007, by and between the Registrant and Anshul Sadana.	S-1	333-194899	10.7	3/31/2014	
10.8 †	Offer Letter, dated August 1, 2008, by and between the Registrant and Jayshree Ullal.	S-1	333-194899	10.8	3/31/2014	
10.9 †	Offer Letter, dated March 27, 2013, by and between the Registrant and Charles Giancarlo.	S-1	333-194899	10.9	3/31/2014	
10.10 †	Offer Letter, dated June 3, 2013, by and between the Registrant and Ann Mather.	S-1	333-194899	10.10	3/31/2014	
10.11 †	Offer Letter, dated October 3, 2013, by and between the Registrant and Marc Stoll.	S-1	333-194899	10.13	3/31/2014	
10.12	Lease between Arista Networks, Inc. and The Irvine Company LLC, dated August 10, 2012, as amended on February 28, 2013.	S-1	333-194899	10.15	3/31/2014	
10.13	Second Amendment to Lease, by and between Arista Networks, Inc. and The Irvine Company LLC, dated July 30, 2014.	10-Q	001-36468	10.1	8/8/2014	
10.14	License Agreement, dated November 30, 2004, by and between the Registrant and Optumsoft, Inc.	S-1	333-194899	10.16	3/31/2014	
10.15 ‡	Manufacturing Services Letter Agreement, dated February 5, 2007, between the Registrant and Jabil Circuit, Inc.	S-1	333-194899	10.17	3/31/2014	
10.16 †	Employee Incentive Plan.	S-1/A	333-194899	10.21	4/21/2014	
10.17 †	Offer Letter, dated May 18, 2015, by and between the Registrant and Ita Brennan.	8-K	001-36468	10.1	5/14/2015	
10.18 †	Severance Agreement, effective May 18, 2015, by and between the Registrant and Ita Brennan.	8-K	001-36468	10.2	5/14/2015	
10.19 †	Offer letter, dated November 2, 2012, be and between the Registrant and Mark Smith	10-Q	001-36468	10.1	5/5/2016	
10.20 †	Severance Agreement, dated December 3, 2012, by and between the Registrant and Mark Smith	10-Q	001-36468	10.2	5/5/2016	
10.21 †	2015 Global Sales Incentive Plan	10-Q	001-36468	10.3	5/5/2016	

10.22‡	Amended and Restated Manufacturing Services Agreement, dated February 18, 2016, between the Registrant and Sanmina Corporation	10-Q	001-36468	10.1	11/3/2016	
21.1	List of Subsidiaries of the Registrant.					✓
23.1	Consent of Independent Registered Public Accounting Firm.					✓
31.1	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.					✓
31.2	Certification of the Chief Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.					✓
32.1*	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002.					✓
101.INS	XBRL Instance Document.					
101.SCH	XBRL Taxonomy Extension Schema Document.					
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.					
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.					
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.					
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.					

\* The certifications attached as Exhibit 32.1 that accompany this Annual Report on Form 10-K are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of Arista Networks, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Annual Report on Form 10-K, irrespective of any general incorporation language contained in such filing.

† Indicates a management contract or compensatory plan or arrangement.

‡ Confidential treatment has been requested for portions of this exhibit. These portions have been omitted and have been filed separately with the Securities and Exchange Commission.

## SUBSIDIARIES OF ARISTA NETWORKS, INC.

<b><u>Name of Subsidiary</u></b>	<b><u>Jurisdiction of Incorporation</u></b>
Arista Networks Australia Pty Ltd.	Australia
Arista Networks Austria GmbH	Austria
Arista Networks Canada Ltd.	Canada
Arista Networks ULC	Canada
Arista Technology Limited	Cayman Islands
Arista Networks (Shanghai) Co. Ltd.	China
Arista Networks Cyprus Ltd.	Cyprus
Arista Networks EURL	France
Arista Networks GmbH	Germany
Arista Networks Hong Kong Ltd.	Hong Kong
Arista Networks India Pvt. Ltd.	India
Arista Networks Limited	Ireland
Arista Networks International Limited	Ireland
Arista Networks Israel Ltd.	Israel
Arista Networks Japan Ltd. GK	Japan
Arista Networks Korea, LLC	Korea
Arista Networks Malaysia, Sdn. Bhd.	Malaysia
Arista Networks Mexico S. de R.L. de C.V.	Mexico
Arista Networks Middle East DMCC	United Arab Emirates
Arista Networks B.V.	Netherlands
Arista Networks Singapore Pvt. Ltd.	Singapore
Arista Networks Sweden AB	Sweden
Arista Networks Taiwan Limited	Taiwan
Arista Networks UK Ltd.	United Kingdom

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We consent to the incorporation by reference in the Registration Statements (Form S-8 Nos. 333-196550, 333-202919 and 333-209723) pertaining to the 2004 Equity Incentive Plan, the 2011 Equity Incentive Plan, the 2014 Equity Incentive Plan and the 2014 Employee Stock Purchase Plan of Arista Networks, Inc. of our reports dated February 17, 2017, with respect to the consolidated financial statements of Arista Networks, Inc. and the effectiveness of internal control over financial reporting of Arista Networks, Inc. included in this Annual Report (Form 10-K) for the year ended December 31, 2016, filed with the Securities and Exchange Commission.

/s/ Ernst & Young LLP

San Jose, California  
February 17, 2017

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Jayshree Ullal, certify that:

1. I have reviewed this Annual Report on Form 10-K of Arista Networks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 17, 2017

/s/ JAYSHREE ULLAL

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**Jayshree Ullal**  
**President, Chief Executive Officer and Director**  
**(Principal Executive Officer)**

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER  
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Ita Brennan, certify that:

1. I have reviewed this Annual Report on Form 10-K of Arista Networks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 17, 2017

/s/ ITA BRENNAN

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Ita Brennan  
Chief Financial Officer  
(Principal Accounting and Financial Officer)

