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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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)

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 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 number of shares outstanding of the registrant's Common Stock, \$0.0001 par value, as of October 28, 2016 was 70,209,251 .

ARISTA NETWORKS, INC.
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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

ARISTA NETWORKS, INC.
Condensed Consolidated Balance Sheets
(Unaudited in thousands, except par value)

	September 30, 2016	December 31, 2015
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 500,481	\$ 687,326
Marketable securities	299,667	—
Accounts receivable, net of allowances of \$1,540 and \$1,529, respectively	210,243	144,263
Inventories	162,128	92,129
Prepaid expenses and other current assets	151,659	50,610
Total current assets	1,324,178	974,328
Property and equipment, net	78,147	79,706
Investments	36,136	36,636
Deferred tax assets	62,221	48,429
Other assets	18,398	20,791
TOTAL ASSETS	\$ 1,519,080	\$ 1,159,890
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 77,048	\$ 43,966
Accrued liabilities	77,163	60,971
Deferred revenue	191,094	122,049
Other current liabilities	9,777	8,025
Total current liabilities	355,082	235,011
Income taxes payable	11,896	14,060
Lease financing obligations, non-current	40,041	41,210
Deferred revenue, non-current	93,741	74,759
Other long-term liabilities	6,900	6,698
TOTAL LIABILITIES	507,660	371,738
Commitments and contingencies (Note 5)		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.0001 par value—100,000 shares authorized, no shares issued and outstanding as of September 30, 2016 and December 31, 2015	—	—
Common stock, \$0.0001 par value—1,000,000 shares authorized as of September 30, 2016 and December 31, 2015; 70,133 and 68,132 shares issued and outstanding as of September 30, 2016 and December 31, 2015, respectively	7	7
Additional paid-in capital	636,074	537,904
Retained earnings	376,322	250,916
Accumulated other comprehensive loss	(983)	(675)
TOTAL STOCKHOLDERS' EQUITY	1,011,420	788,152
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 1,519,080	\$ 1,159,890

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

ARISTA NETWORKS, INC.
Condensed Consolidated Statements of Income
(Unaudited in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue:				
Product	\$ 254,238	\$ 193,339	\$ 702,329	\$ 527,552
Service	36,023	24,209	98,869	64,593
Total revenue	290,261	217,548	801,198	592,145
Cost of revenue:				
Product	94,777	67,990	261,711	182,443
Service	9,064	7,810	26,526	22,310
Total cost of revenue	103,841	75,800	288,237	204,753
Total gross profit	186,420	141,748	512,961	387,392
Operating expenses:				
Research and development	70,648	58,748	202,183	152,035
Sales and marketing	33,216	26,508	92,566	77,776
General and administrative	19,535	25,195	52,298	57,670
Total operating expenses	123,399	110,451	347,047	287,481
Income from operations	63,021	31,297	165,914	99,911
Other income (expense), net:				
Interest expense	(735)	(753)	(2,218)	(2,406)
Other income (expense), net	639	13	1,392	(38)
Total other income (expense), net	(96)	(740)	(826)	(2,444)
Income before provision for income taxes	62,925	30,557	165,088	97,467
Provision for income taxes	11,668	1,867	39,682	20,289
Net income	\$ 51,257	\$ 28,690	\$ 125,406	\$ 77,178
Net income attributable to common stockholders:				
Basic	\$ 50,962	\$ 28,301	\$ 124,475	\$ 75,864
Diluted	\$ 50,980	\$ 28,329	\$ 124,531	\$ 75,967
Net income per share attributable to common stockholders:				
Basic	\$ 0.74	\$ 0.42	\$ 1.82	\$ 1.16
Diluted	\$ 0.69	\$ 0.39	\$ 1.71	\$ 1.07
Weighted-average shares used in computing net income per share attributable to common stockholders:				
Basic	69,076	66,629	68,365	65,609
Diluted	73,453	71,887	72,811	71,232

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

ARISTA NETWORKS, INC.
Condensed Consolidated Statements of Comprehensive Income
(Unaudited in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	\$ 51,257	\$ 28,690	\$ 125,406	\$ 77,178
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(165)	(249)	(402)	(320)
Net change in unrealized gains (losses) on available-for sale securities	(113)	(39)	94	223
Other comprehensive loss	(278)	(288)	(308)	(97)
Comprehensive income	\$ 50,979	\$ 28,402	\$ 125,098	\$ 77,081

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

ARISTA NETWORKS, INC.
Condensed Consolidated Statements of Cash Flows
(Unaudited in thousands)

	Nine Months Ended September 30,	
	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 125,406	\$ 77,178
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,807	9,724
Stock-based compensation	42,708	32,325
Deferred income taxes	(13,720)	(15,483)
Excess tax benefit on stock-based compensation	(30,043)	(32,381)
Amortization of investment premiums	994	1,332
Changes in operating assets and liabilities:		
Accounts receivable	(65,980)	(63,248)
Inventories	(69,998)	(31,915)
Prepaid expenses and other current assets	(98,050)	(19,352)
Other assets	3,208	(3,092)
Accounts payable	35,510	(145)
Accrued liabilities	15,913	18,102
Deferred revenue	88,027	84,238
Income taxes payable	27,275	24,759
Other liabilities	2,628	1,980
Net cash provided by operating activities	78,685	84,022
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturity of marketable securities	41,917	58,200
Purchases of marketable securities	(342,484)	—
Purchases of property and equipment	(15,787)	(13,974)
Investment in privately-held companies	(2,500)	—
Change in restricted cash	—	(4,039)
Purchases of intangible assets	(697)	(743)
Net cash (used in) provided by investing activities	(319,551)	39,444
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments of lease financing obligations	(960)	(778)
Proceeds from issuance of common stock upon exercising options, net of repurchases	15,556	14,562
Minimum tax withholding paid on behalf of employees for net share settlement	(811)	—
Proceeds from issuance of common stock under employee stock purchase plan	10,326	9,366
Excess tax benefit on stock-based compensation	30,043	32,381
Issuance costs from initial public offering	—	(261)
Net cash provided by financing activities	54,154	55,270
Effect of exchange rate changes	(133)	(267)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(186,845)	178,469
CASH AND CASH EQUIVALENTS—Beginning of period	687,326	240,031
CASH AND CASH EQUIVALENTS—End of period	\$ 500,481	\$ 418,500
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for income taxes, net of refunds	\$ 34,426	\$ 3,806
Cash paid for interest—lease financing obligation	\$ 2,196	\$ 2,257
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING INFORMATION:		
Property and equipment included in accounts payable and accrued liabilities	\$ 1,313	\$ 916

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

ARISTA NETWORKS, INC.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Overview and Basis of Presentation

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 enterprises. Our cloud networking solutions consist of our Extensible Operating System, a set of network applications and our 10/25/40/50/100 Gigabit Ethernet switches. We were incorporated in October 2004 and 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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP" or "GAAP") and following the requirements of the U.S. Securities and Exchange Commission (the "SEC") for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by U.S. GAAP can be condensed or omitted. In management's opinion, the unaudited condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and include all adjustments, which include only normal recurring adjustments, necessary for the fair presentation of our financial information. The results for the three and nine months ended September 30, 2016, are not necessarily indicative of the results expected for the full fiscal year.

The condensed consolidated balance sheet as of December 31, 2015 has been derived from the audited consolidated financial statements at that date but does not include all of the information and notes required by generally accepted accounting principles for complete financial statements.

The accompanying unaudited condensed consolidated financial statements include the accounts of Arista Networks, Inc. and its wholly-owned subsidiaries and are prepared in accordance with GAAP. All significant intercompany accounts and transactions have been eliminated.

The accompanying unaudited condensed consolidated financial statements and related financial information should be read in conjunction with the audited consolidated financial statements and related footnotes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015, filed with the SEC on February 25, 2016.

Use of Estimates

The preparation of the accompanying unaudited condensed consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported and disclosed in the unaudited condensed 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; and the recognition and measurement of contingent liabilities. We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors and adjust those estimates and assumptions when facts and circumstances dictate. As future events and their effects cannot be determined with precision, actual results could differ from these estimates, and those differences could be material to the unaudited condensed consolidated financial statements.

Significant Accounting Policies

There have been no material changes to our significant accounting policies as of and for the nine months ended September 30, 2016, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

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. We plan to adopt the standards our first quarter of fiscal 2018. We are currently reviewing the provisions of the standard and have not yet selected a transition method nor have we determined the effect of the standard on our consolidated financial statements.

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 guidance may be early adopted under early application guidance. If early adoption is elected, all amendments must be adopted in the same period. 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. 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 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

Our assets and liabilities which require fair value measurement consist of cash and cash equivalents, marketable securities, accounts receivable, investments, accounts payable, and accrued liabilities. Cash equivalents, accounts receivable, accounts payable and accrued liabilities are stated at carrying amounts as reported in the condensed 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.

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

September 30, 2016				
	Level I	Level II	Level III	Total
Financial Assets:				
Money market funds	\$ 304,926	\$ —	\$ —	\$ 304,926
Money market funds-restricted	4,041	—	—	4,041
Commercial Paper	11,997	—	—	11,997
U.S. government notes	139,499	—	—	139,499
Corporate bonds	—	148,171	—	148,171
Total financial assets	<u>\$ 460,463</u>	<u>\$ 148,171</u>	<u>\$ —</u>	<u>\$ 608,634</u>

December 31, 2015				
	Level I	Level II	Level III	Total
Financial Assets:				
Money market funds	\$ 104,156	\$ —	\$ —	\$ 104,156
Money market funds-restricted	4,041	—	—	4,041
Total financial assets	<u>\$ 108,197</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 108,197</u>

3. Balance Sheet Components

Marketable Securities

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

September 30, 2016				
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Commercial paper	\$ 11,941	\$ 56	\$ —	\$ 11,997
U.S. government notes	139,509	22	(32)	139,499
Corporate bonds	148,123	153	(105)	148,171
Total marketable securities	<u>\$ 299,573</u>	<u>\$ 231</u>	<u>\$ (137)</u>	<u>\$ 299,667</u>

As of September 30, 2016, there have been no other-than-temporary losses on our marketable securities. None of our marketable securities have been in continuous unrealized loss positions for greater than twelve months as of September 30, 2016. We had no marketable securities as of December 31, 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 September 30, 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):

	September 30, 2016
Due in 1 year or less	\$ 171,170
Due in 1 year through 2 years	128,497
Total marketable securities	<u>\$ 299,667</u>

The weighted average remaining duration of our current marketable securities is approximately 0.8 years as of September 30, 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):

	September 30, 2016	December 31, 2015
Accounts receivable	\$ 211,783	\$ 145,792
Allowance for doubtful accounts	(291)	(963)
Sales return reserve	(1,249)	(566)
Accounts receivable, net	<u>\$ 210,243</u>	<u>\$ 144,263</u>

Inventories

Inventories consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Raw materials	\$ 64,610	\$ 29,831
Finished goods	97,518	62,298
Total inventories	<u>\$ 162,128</u>	<u>\$ 92,129</u>

Prepaid Expenses and Other Current Assets

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

	September 30, 2016	December 31, 2015
Inventory deposit	\$ 62,576	\$ —
Prepaid income taxes	22,817	14,150
Other current assets	55,363	29,270
Other prepaid expenses and deposits	10,903	7,190
Total prepaid expenses and other current assets	<u>\$ 151,659</u>	<u>\$ 50,610</u>

Property and Equipment, net

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

	September 30, 2016	December 31, 2015
Equipment and machinery	\$ 38,269	\$ 29,101
Computer hardware and software	16,840	12,630
Furniture and fixtures	2,865	2,380
Leasehold improvements	29,504	24,372
Building	35,154	35,154
Construction-in-process	304	6,408
Property and equipment, gross	122,936	110,045
Less: accumulated depreciation	(44,789)	(30,339)
Property and equipment, net	<u>\$ 78,147</u>	<u>\$ 79,706</u>

Building consists of capitalized construction costs of our leased building in Santa Clara, California. Based on the terms of the lease agreement and due to our involvement in certain aspects of the construction, such as our financial involvement in structural elements of asset construction, making decisions related to tenant improvement costs and purchasing insurance not reimbursable by the buyer-lessor (the "Landlord"), we were deemed the owner of the building (for accounting purposes only) during the construction period. We continue to maintain involvement in the property post construction completion, 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. Due to our continuing involvement in the property post construction and lack of transferability of related risks and rewards of ownership to the Landlord after construction completion, we account for the building as a financing obligation. See "Note 5 - Commitments and Contingencies". Accordingly, as of September 30, 2016 and December 31, 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 Landlord. The building was completed in 2014 .

Depreciation and amortization expense was \$5.1 million and \$3.4 million for the three months ended September 30, 2016 and 2015, respectively, and was \$14.8 million , and \$9.7 million for the nine months ended September 30, 2016 and 2015 , respectively.

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Accrued compensation costs	\$ 41,695	\$ 39,479
Accrued warranty costs	5,597	4,718
Accrued manufacturing costs	14,558	6,397
Accrued professional fees	6,827	4,875
Accrued taxes	1,320	1,347
Other	7,166	4,155
Total accrued liabilities	<u>\$ 77,163</u>	<u>\$ 60,971</u>

Warranty Accrual

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. The accrued warranty liability is recorded in accrued liabilities in the accompanying consolidated balance sheets.

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

	Nine Months Ended September 30,	
	2016	2015
Warranty accrual, beginning of period	\$ 4,718	\$ 3,204
Liabilities accrued for warranties issued during the period	3,717	3,352
Warranty costs incurred during the period	(2,541)	(1,765)
Adjustments related to change in estimate	(297)	—
Warranty accrual, end of period	<u>\$ 5,597</u>	<u>\$ 4,791</u>

4. Investments

Investments in Privately-held Companies

As of September 30, 2016 and December 31, 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 prior quarter ended June 30, 2016 we made an additional investment of \$2.5 million in one of these companies, which was accounted for under the cost method. There were no impairments recognized on our investments for the nine months ended September 30, 2016 .

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 2024. There have been no material changes in our operating lease commitments under contractual obligation, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015 .

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 \$2.3 million , \$2.0 million , \$7.0 million , and \$4.7 million for the three and nine months ended September 30, 2016 and 2015 , 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. The underlying building asset is depreciated over the building's estimated useful life of 30 years . 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. There have been no material changes in our financing obligation commitments under contractual obligation, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015 .

As of September 30, 2016 and December 31, 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 \$41.6 million and \$42.5 million , respectively. As of September 30, 2016 , \$1.5 million and \$40.0 million were recorded as short-term and long-term financing obligations, respectively.

Land lease expense related to our lease financing obligation is classified in rent expense in our unaudited condensed consolidated statements of income, and amounted to \$0.3 million and \$1.0 million for both the three and nine months ended September 30, 2016 and 2015 , respectively.

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 September 30, 2016 , we had non-cancelable purchase commitments of \$226.2 million . In addition, we have provided deposits to secure our obligations to purchase inventory. We had \$64.9 million and \$2.3 million in deposits as of September 30, 2016 and December 31, 2015 , respectively. These deposits are classified in other current and long term assets in our accompanying unaudited condensed 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 lease 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. On May 25, 2016, the Patent and Trademark Appeals Board (“PTAB”) issued an order initiating *inter partes* review of U.S. Patent No. 7,953,886 (“the ’886 patent”). Following that order 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.

Summary judgment cross-motions in the ’44 Case were heard on August 4, 2016, and the Court denied all motions brought by both sides. A final pre-trial conference is set for November 3, 2016 and trial has been set for November 21, 2016.

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 until judgment has been entered on Cisco’s copyright claims in the ’44 Case, which the Court anticipated by December 22, 2016. 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 are currently in effect.

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. Under this schedule, we filed our opening brief on September 23, 2016; Cisco's opening brief is due November 2, 2016; the USITC's brief is due on December 2, 2016; our response/reply brief is due December 19, 2016; and Cisco's reply brief is due January 2, 2017.

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 order 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 numerous affirmative defenses.

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) 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 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 April 19, 2016, the Commission determined not to review this decision. 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, 2016. On September 7, 2016, the Commission determined not to review this decision. The Initial Determination will be subject to review by the Commission, which will then issue a Final Determination and any remedial orders by March 7, 2017. If the Final Determination finds a violation, it will be subject to Presidential review.

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. We filed a notice of appeal with respect to this decision regarding claims 29, 63, 64, 73, and 86 on October 11, 2016, and Cisco requested rehearing of the PTAB’s Final Written Decision on October 28, 2016. 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.

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 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. For example, an adverse litigation ruling could result in a significant damages award against us, could further result in the above described injunctive relief, could result in 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. Any such adverse ruling could materially adversely affect our business, prospects, reputation, results of operation and financial condition.

In particular, 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 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 U.S. Customs and Border Protection (“CBP”) seeking approval to import these redesigned products into the United States, and we are awaiting CBP’s decision. If the USITC finds that we infringe any patent in the 945 Investigation, the USITC is likely to 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. We may not be successful in developing technical design-arounds that do not infringe the patents or that are acceptable to our customers. Our development efforts could be extremely costly and time consuming as well as disruptive to our other development activities and distracting to management. We may not be successful in our efforts to obtain clearance from CBP to import such modified products in a timely manner, or at all. While clearance from CBP will allow us to resume importation of our redesigned products into the United States, the USITC could still determine in the enforcement action that our redesigned products continue to infringe the ‘537, ‘592 or ‘145 patents. Any failure to effectively redesign our products to obtain timely clearance from CBP to import such redesigned products, or to address the USITC’s findings 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.

We have also made certain changes to our manufacturing, importation and shipping workflows to comply with the USITC’s remedial orders. 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.

For example, if the USITC determines that our redesigned products continue to infringe the ‘537, ‘592 or ‘145 patents, 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.”

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. Based on currently available information, management does not believe that liability relating to these other unresolved matters is 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

Total stock-based compensation expense related to options, restricted stock awards, employee stock purchases, restricted stock units and stock purchase rights granted were allocated as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Cost of revenue	\$ 955	\$ 786	\$ 2,616	\$ 2,206
Research and development	8,010	7,037	23,062	18,344
Sales and marketing	3,947	2,864	11,374	8,138
General and administrative	2,204	1,591	5,656	3,637
Total stock-based compensation	\$ 15,116	\$ 12,278	\$ 42,708	\$ 32,325

Stock Option Activities

The following table summarizes the option and RSA (Restricted Stock Award) activity under our equity stock plans and related information:

	Options and RSAs Outstanding			
	Number of Shares Underlying Outstanding Options and RSAs (in thousands)	Weighted- Average Exercise Price per Share	Weighted- Average Remaining Contractual Term (Years) of Stock Options	Aggregate Intrinsic Value of Stock Options Outstanding (in thousands)
Outstanding—December 31, 2015	11,630	\$ 24.49	7.6	\$ 620,802
Options granted	440	56.88		
Options exercised	(1,583)	9.85		
Options canceled	(314)	30.22		
Outstanding—September 30, 2016	10,173	\$ 28.00	7.1	\$ 580,661
Vested and exercisable—September 30, 2016	3,685	\$ 14.38	6.3	\$ 260,514
Vested and expected to vest—September 30, 2016	9,658	\$ 27.39	7.1	\$ 557,170

As of September 30, 2016, the total unrecognized stock-based compensation expense related to unvested stock options, net of expected forfeitures, was \$95.4 million, which is expected to be recognized over a weighted-average period of 3.9 years.

Restricted Stock Unit (RSU) Activities

A summary of the RSU activity under our stock plans during the reporting period and a summary of information related to RSUs expected to vest are presented below (in thousands, except per share and year amounts):

	Number of Shares	Weighted- Average Grant Date Fair Value Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Unvested balance—December 31, 2015	893	\$ 70.14	1.9	\$ 69,509
RSUs granted	440	63.80		
RSUs vested	(178)	69.66		
RSUs forfeited	(72)	67.06		
Unvested balance—September 30, 2016	1,083	\$ 67.85	1.7	\$ 92,120
Vested and expected to vest—September 30, 2016	1,015	\$ 67.86	1.7	\$ 86,357

As of September 30, 2016, there was \$61.4 million of unrecognized stock-based compensation cost related to unvested RSUs, net of estimated forfeitures. This amount is expected to be recognized over a weighted-average period of 3.3 years.

Employee Stock Purchase Plan Activities

During the nine months ended September 30, 2016, we issued 256,223 shares at a weighted average purchase price of \$40.30 under the 2014 Employee Stock Purchase Plan ("ESPP"). On February 17, 2015, the board authorized an increase to shares available for future issuance under the ESPP. Per the ESPP, the increase is determined based on the lesser of 1% of total shares outstanding as of the first day of each fiscal year, or January 1, 2016, 2,500,000 shares or such amount as determined by our board of directors. The approved increase for 2016 amounted to 681,315 shares. As of September 30, 2016, there remain 1,483,846 shares available for issuance under the ESPP.

As of September 30, 2016, the total unrecognized stock-based compensation expense related to unvested ESPP options, net of expected forfeitures, was \$6.1 million, which is expected to be recognized over a weighted-average period of 1.8 years.

Shares Available for Grant

The following table presents the stock activity and the total number of shares available for grant as of September 30, 2016 (in thousands):

	Number of Shares
Balance—December 31, 2015	10,495
Authorized	2,044
Options granted	(440)
RSUs granted	(440)
Options canceled	314
Options repurchased	5
RSUs forfeited	72
Shares traded for taxes	11
Balance—September 30, 2016	12,061

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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Numerator:				
Basic:				
Net income	\$ 51,257	\$ 28,690	\$ 125,406	\$ 77,178
Less: undistributed earnings allocated to participating securities	(295)	(389)	(931)	(1,314)
Net income available to common stockholders, basic	<u>\$ 50,962</u>	<u>\$ 28,301</u>	<u>\$ 124,475</u>	<u>\$ 75,864</u>
Diluted:				
Net income attributable to common stockholders, basic	\$ 50,962	\$ 28,301	\$ 124,475	\$ 75,864
Add: undistributed earnings allocated to participating securities	18	28	56	103
Net income attributable to common stockholders, diluted	<u>\$ 50,980</u>	<u>\$ 28,329</u>	<u>\$ 124,531</u>	<u>\$ 75,967</u>
Denominator:				
Basic:				
Weighted-average shares used in computing net income per share available to common stockholders, basic	<u>69,076</u>	<u>66,629</u>	<u>68,365</u>	<u>65,609</u>
Diluted:				
Weighted-average shares used in computing net income per share available to common stockholders, basic	69,076	66,629	68,365	65,609
Add weighted-average effect of dilutive securities:				
Stock options and RSUs	4,357	5,163	4,429	5,529
Employee stock purchase plan	20	95	17	94
Weighted-average shares used in computing net income per share available to common stockholders, diluted	<u>73,453</u>	<u>71,887</u>	<u>72,811</u>	<u>71,232</u>
Net income per share attributable to common stockholders:				
Basic	<u>\$ 0.74</u>	<u>\$ 0.42</u>	<u>\$ 1.82</u>	<u>\$ 1.16</u>
Diluted	<u>\$ 0.69</u>	<u>\$ 0.39</u>	<u>\$ 1.71</u>	<u>\$ 1.07</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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Stock options and RSUs to purchase common stock	2,688	2,544	3,215	2,275

8. Income Taxes

Provision for income taxes was approximately \$11.7 million and \$1.9 million for the three months ended September 30, 2016 and 2015, and \$39.7 million and \$20.3 million for the nine months ended September 30, 2016 and 2015, respectively. The change in the provision was a result of an increase in profit before income taxes and the change in effective tax rate based on current geographical distribution of the earnings.

We operate in a number of tax jurisdictions and are subject to taxes in each country or jurisdiction in which we conduct business. As we expand internationally, our marginal tax rate may decrease; however, there can be no certainty that our marginal tax rate will decrease, and we may experience changes in tax rates that are not reflective of actual changes in our business or operations. Earnings from our non-U.S. activities are subject to local country income tax and may be subject to U.S. income tax. Generally, the U.S. tax obligation is reduced by a credit for foreign income taxes paid on these earnings avoiding double taxation.

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 and we do not anticipate a significant impact to our gross unrecognized benefits within the next 12 months related to these years.

Our gross unrecognized tax benefits as of September 30, 2016 were \$20.2 million. If the gross unrecognized tax benefits as of September 30, 2016 were realized in future periods, this could result in a tax benefit of \$11.4 million within our provision of income taxes.

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):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
United States	\$ 233,018	\$ 166,466	\$ 612,852	\$ 437,922
Other Americas	4,081	4,130	8,205	10,294
Europe, Middle East and Africa	37,728	29,457	124,111	94,329
Asia-Pacific	15,434	17,495	56,030	49,600
Total revenue	<u>\$ 290,261</u>	<u>\$ 217,548</u>	<u>\$ 801,198</u>	<u>\$ 592,145</u>

The following table presents our property, plant and equipment, net by geographic region for the periods presented (in thousands):

	September 30, 2016	December 31, 2015
United States	\$ 70,095	\$ 70,719
International	8,052	8,987
Total	<u>\$ 78,147</u>	<u>\$ 79,706</u>

Item 2. 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 Quarterly Report on Form 10-Q, and our Annual Report on Form 10-K filed with the SEC on February 25, 2016. 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 Quarterly Report on Form 10-Q.

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 switches. 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.

We were founded in 2004 to address the limitations of legacy networking products and to create a cloud networking platform that is open and programmable. From 2004 to 2008, our activities were focused on the development of our software, which resulted in the commercial release of our first product, the 7100 Series switches based on our EOS software, in 2008. Since then, we have continued to introduce new products utilizing EOS, including our 7500 Series switch and our 7050 Series switch in 2010, the second generation of our 7500 Series switch, called the 7500E modular switch, in May 2013, our 7300 Series switch in November 2013, and our 7280E in July 2014. In December 2014, we introduced our EOS+ software platform for networking programmability and automation, and in June 2015 we introduced CloudVision, a network-wide approach for workload orchestration and workflow automation. In September 2015, we introduced our Macro Segmentation Services, or MSS, to provide automated insertion of security and other in-line layer 4-7 services within any software driven cloud networking infrastructure. MSS has been endorsed by many of our technology alliance ecosystem partners with whom we are currently partnering with to deliver MSS platform support. In addition, during 2015, we introduced our first 10/25/40/50/100G switches with our 7060, 7260 and 7320 series switches. In January 2016, we unveiled NetDB, the network-wide, state-oriented database that enhances the core system database (SysDB) of Arista EOS. NetDB builds upon the SysDB architecture by adding software infrastructure improvements, including state-sharing and replication mechanisms for centrally storing network state, increased software table capacities up to 1M routes, and the ability to stream state in realtime from EOS devices. This extends the benefits of the state-based system across the entire network. During March 2016, we introduced our 7500R series, building on the 7500E series and providing 100GbE density and large table sizes in a single chassis. At up to 115 Tbps capacity, the 7500R supports up to one million routes, subsuming switching and routing functions into a Universal Spine platform for cloud-scale networks. In June 2016, we introduced our Arista 7280R Universal Leaf Network Platform, a compact form factor capable of a broad set of leaf networking use-cases, including IP storage, routing and digital media. In August 2016, we introduced our next-generation CloudVision and EOS telemetry and analytics capabilities designed for modern cloud networks.

As of September 30, 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 56.4% from 2011 to 2015. As we have grown the functionality of our EOS software, expanded the range of our switching portfolio and increased the size of our sales force, our revenue has continued to grow rapidly. To support our customers and revenue growth, we have expanded our international presence to include 23 foreign subsidiaries as of September 30, 2016, including Australia, Canada, France, Germany, India, Ireland, Japan, South Korea and the United Kingdom. Our revenue for the three and nine months ended September 30, 2016 was \$290.3 million and \$801.2 million, respectively an increase of 33.4% and 35.3% compared to the same periods in 2015, respectively. 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 rapidly 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. As a result, our levels of operating profit as a percentage of revenue could decline in the short to medium term. 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 September 30, 2016, our cumulative end-customer base grew from approximately 1,100 to over 4,100. 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 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 where our EOS software is installed on our products. 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 an additional contract manufacturer in San Jose, California.

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 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 and 7500R 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 a significant portion of our revenue. During the years ended December 31, 2015, 2014, and 2013, our largest end customer accounted for 12.0%, 14.9%, and 21.9% 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.

Basis of Presentation

Revenue

We generate revenue primarily from sales of our switching 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 offer PCS services under renewable, fee-based contracts, which include 24-hour technical support, hardware repair and replacement parts, bug fixes, patches and unspecified upgrades on a when-and-if available basis. 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. Additionally, we expect PCS revenue to increase in absolute dollars as we expand our installed base. Our ability to expand our installed base and increase our revenue is subject to numerous risks and uncertainties. See the section titled “Risk Factors.” We report revenue net of sales taxes.

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. We expect our cost of service revenue to increase as our PCS revenue increases.

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 costs, including costs associated with the introduction of additional contract manufacturing capacity, merchant silicon costs and the mix of products sold. We expect our gross margins to fluctuate over time, depending on the factors described above and others. See the section titled “Risk Factors.”

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, IT, human resources and legal functions. Our professional fees consist primarily of accounting, external legal and IT and other consulting costs. Refer to the discussion under “Legal Proceedings” subheading in Note 5. Commitments and Contingencies of Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q for information related to pending litigation.

Other Income (Expense), Net

Interest Expense

Interest expense consists mostly of interest expense from our lease financing obligation.

Other Income (Expense)

Other income (expense) consists mostly of foreign currency exchange gains and losses and interest income. Our foreign currency exchange gains and losses primarily relate to transactions and asset and liability balances denominated in currencies other than the U.S. dollar. 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. As we expand internationally, our marginal tax rate may decrease; however, there can be no certainty that our marginal tax rate will decrease, and we may experience changes in tax rates that are not reflective of actual changes in our business or operations.

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. We measure deferred income tax assets and liabilities 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.

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 three and nine months ended September 30, 2016 and 2015 from our unaudited condensed consolidated financial statements (in thousands, except for percentages).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenue:				
Product	\$ 254,238	\$ 193,339	\$ 702,329	\$ 527,552
Service	36,023	24,209	98,869	64,593
Total revenue	290,261	217,548	801,198	592,145
Cost of revenue ⁽¹⁾ :				
Product	94,777	67,990	261,711	182,443
Service	9,064	7,810	26,526	22,310
Total cost of revenue	103,841	75,800	288,237	204,753
Gross profit	186,420	141,748	512,961	387,392
Operating expenses ⁽¹⁾ :				
Research and development	70,648	58,748	202,183	152,035
Sales and marketing	33,216	26,508	92,566	77,776
General and administrative	19,535	25,195	52,298	57,670
Total operating expenses	123,399	110,451	347,047	287,481
Income from operations	63,021	31,297	165,914	99,911
Interest expense	(735)	(753)	(2,218)	(2,406)
Other income (expense), net	639	13	1,392	(38)
Total other income (expense), net	(96)	(740)	(826)	(2,444)
Income before provision for income taxes	62,925	30,557	165,088	97,467
Provision for income taxes	11,668	1,867	39,682	20,289
Net income	\$ 51,257	\$ 28,690	\$ 125,406	\$ 77,178

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(as a percentage of revenue)			
Revenue:				
Product	87.6 %	88.9 %	87.7 %	89.1 %
Service	12.4	11.1	12.3	10.9
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Product	32.7	31.2	32.7	30.8
Service	3.1	3.6	3.3	3.8
Total cost of revenue	35.8	34.8	36.0	34.6
Gross margin	64.2	65.2	64.0	65.4
Operating expenses:				
Research and development	24.3	27.0	25.2	25.7
Sales and marketing	11.5	12.2	11.6	13.1
General and administrative	6.7	11.6	6.5	9.8
Total operating expenses	42.5	50.8	43.3	48.6
Income from operations	21.7	14.4	20.7	16.8
Interest expense	(0.2)	(0.3)	(0.3)	(0.4)
Other income (expense), net	0.2	—	0.2	—
Total other income (expense), net	—	(0.3)	(0.1)	(0.4)
Income before provision for income taxes	21.7	14.1	20.6	16.4
Provision for income taxes	4.0	0.9	5.0	3.4
Net income	17.7 %	13.2 %	15.6 %	13.0 %

⁽¹⁾ Includes stock-based compensation expense as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Cost of revenue	\$ 955	\$ 786	\$ 2,616	\$ 2,206
Research and development	8,010	7,037	23,062	18,344
Sales and marketing	3,947	2,864	11,374	8,138
General and administrative	2,204	1,591	5,656	3,637
Total stock-based compensation	\$ 15,116	\$ 12,278	\$ 42,708	\$ 32,325

Three and Nine Months Ended September 30, 2016 Compared to Three and Nine Months Ended September 30, 2015

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Change in		2016	2015	Change in	
	\$	\$	\$	%	\$	\$	\$	%
Revenue								
Product	\$ 254,238	\$ 193,339	\$ 60,899	31.5%	\$ 702,329	\$ 527,552	\$ 174,777	33.1%
Service	36,023	24,209	11,814	48.8	98,869	64,593	34,276	53.1
Total revenue	290,261	217,548	72,713	33.4	801,198	592,145	209,053	35.3
Cost of revenue								
Product	94,777	67,990	26,787	39.4	261,711	182,443	79,268	43.4
Service	9,064	7,810	1,254	16.1	26,526	22,310	4,216	18.9
Total cost of revenue	103,841	75,800	28,041	37.0	288,237	204,753	83,484	40.8
Gross profit	\$ 186,420	\$ 141,748	\$ 44,672	31.5%	\$ 512,961	\$ 387,392	\$ 125,569	32.4%
Gross margin	64.2%	65.2%			64.0%	65.4%		

Revenue by Geography (in thousands, except percentages)

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	% of Total	2015	% of Total	2016	% of Total	2015	% of Total
Americas	\$ 237,099	81.7%	\$ 170,596	78.5%	\$ 621,057	77.5%	\$ 448,216	75.7%
Europe, Middle East and Africa	37,728	13.0	29,457	13.5	124,111	15.5	94,329	15.9
Asia-Pacific	15,434	5.3	17,495	8.0	56,030	7.0	49,600	8.4
Total revenue	\$ 290,261	100.0%	\$ 217,548	100.0%	\$ 801,198	100.0%	\$ 592,145	100.0%

Revenue

Revenue increased 33.4% in the three months ended September 30, 2016 and 35.3% in the nine months ended September 30, 2016, compared to the same periods in 2015. The increase in each 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 switch products and related accessories. The introduction of new products has contributed to our revenue growth, both with existing and new customers. As of September 30, 2016, we have shipped more than 10 million cumulative cloud networking ports worldwide and our overall customer count has exceeded 4,100. Service revenue increased 48.8% in the three months ended September 30, 2016 and 53.1% during the nine months ended September 30, 2016 compared to the same periods in 2015, as a result of continued growth in initial and renewal support contracts as our customer installed base continues 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

Cost of revenue increased \$28.0 million in the three months ended September 30, 2016 and \$83.5 million in the nine months ended September 30, 2016, compared to the same periods in 2015. The increase in cost of revenue was primarily due to an increase in product shipment volumes. In addition, we incurred some increased costs as we added capacity to our manufacturing and operations infrastructure. Gross margin decreased from 65.2% to 64.2% for the three months ended September 30, 2016 compared to the same period in 2015, and from 65.4% to 64.0% for the nine months ended September 30, 2016 compared to the same period in 2015, respectively. The decrease during these periods 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 fourth quarter of 2016 will reflect some further increases in product costs as we continue to invest in new contract manufacturing and supply chain operations.

Operating Expenses (in thousands, except percentages)

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Change in		2016	2015	Change in	
	\$	\$	\$	%	\$	\$	\$	%
Operating expenses:								
Research and development	\$ 70,648	\$ 58,748	\$ 11,900	20.3%	\$ 202,183	\$ 152,035	\$ 50,148	33.0%
Sales and marketing	33,216	26,508	6,708	25.3	92,566	77,776	14,790	19.0
General and administrative	19,535	25,195	(5,660)	(22.5)	52,298	57,670	(5,372)	(9.3)
Total operating expenses	<u>\$ 123,399</u>	<u>\$ 110,451</u>	<u>\$ 12,948</u>	<u>11.7%</u>	<u>\$ 347,047</u>	<u>\$ 287,481</u>	<u>\$ 59,566</u>	<u>20.7%</u>

Research and development

Research and development expenses increased for the three and nine months ended September 30, 2016 compared to the same periods in 2015. The increase in each period was primarily due to an increase in third-party engineering, prototype and consulting costs, which grew \$9.2 million and \$24.2 million in the three months and nine months ended September 30, 2016, respectively as compared to the same periods in 2015. These increases 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. Personnel costs increased by \$3.9 million and \$22.4 million in the three and nine ended September 30, 2016, respectively as compared to the same periods in 2015. These increases reflected additional headcount, increased stock-based compensation charges, and additional bonus expenses under our corporate bonus program. Facilities and IT infrastructure costs increased \$2.4 million in the nine months ended September 30, 2016 compared to the same period in 2015, primarily due to the expansion and support of our research and development activities.

Sales and marketing

Sales and marketing expenses increased for the three and nine months ended September 30, 2016 compared to the same periods in 2015. The increase in each period was primarily due to an increase in personnel costs, which grew \$6.6 million and \$15.3 million in the three and nine months ended September 30, 2016, respectively as compared to the same periods in 2015. These increases reflected additional headcount, additional sales incentive compensation due to higher sales volumes, and additional bonus expenses under our corporate bonus program. The increase in the nine-month period was partially offset by a decrease in product field demonstration costs of \$1.6 million primarily related to significant costs incurred in the previous year due to several product transitions to our next generation products.

General and administrative

General and administrative expenses decreased for the three and nine months ended September 30, 2016 compared to the same periods in 2015. The decrease in each period was primarily due to a reduction in litigation expenses of \$6.8 million and \$8.5 million in the three and nine months ended September 30, 2016 respectively as compared to the same periods in 2015. These decreases were 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 was partially offset by an increase in personnel costs of \$0.8 million and \$3.2 million in the three and nine months ended September 30, 2016 respectively as compared to the same periods in 2015. These increases reflected additional headcount, increased stock-based compensation charges, and additional bonus expenses under our corporate bonus program.

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

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Change in		2016	2015	Change in	
	\$	\$	\$	%	\$	\$	\$	%
Other income (expense), net:								
Interest expense	\$ (735)	\$ (753)	\$ 18	2.4%	\$ (2,218)	\$ (2,406)	\$ 188	7.8%
Other income (expense), net	639	13	626	4,815.4	1,392	(38)	1,430	3,763.2
Total other income (expense), net	<u>\$ (96)</u>	<u>\$ (740)</u>	<u>\$ 644</u>	87.0%	<u>\$ (826)</u>	<u>\$ (2,444)</u>	<u>\$ 1,618</u>	66.2%

Other income (expense), net

Other income (expense), net improved during the three and nine months ended September 30, 2016 compared to the same periods in 2015 primarily due to a net increase in interest income as we expanded our marketable securities portfolio during the nine months ended September 30, 2016.

Provision for Income Taxes (in thousands, except percentages)

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2016	2015	Change in		2016	2015	Change in	
	\$	\$	\$	%	\$	\$	\$	%
Provision for income taxes	\$ 11,668	\$ 1,867	\$ 9,801	525.0%	\$ 39,682	\$ 20,289	\$ 19,393	95.6%
Effective tax rate	18.5%	6.1%			24.0%	20.8%		

Provision for income taxes

Provision for income taxes and effective tax rate increased in the three and nine months ended September 30, 2016 compared to the same periods in 2015. The increase in the provision for each period was the result of an increase in profit before income taxes and the change in effective tax rate primarily due to the geographical distribution of earnings. In addition, the effective tax rate for the three and nine months ended 2015 and 2016 reflect the release of unrecognized tax benefits due to the statute of limitations expiring in certain domestic tax jurisdictions.

Liquidity and Capital Resources

Our principal sources of liquidity are cash and cash equivalents, marketable securities, and cash generated from operations. As of September 30, 2016, cash and cash equivalents, and marketable securities were \$800.1 million, of which approximately \$74.2 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 September 30, 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 and access to outsourcing our manufacturing, 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

	September 30, 2016	December 31, 2015
	(in thousands)	
Cash and cash equivalents	\$ 500,481	\$ 687,326
	Nine Months Ended September 30,	
	2016	2015
	(in thousands)	
Cash provided by operating activities	\$ 78,685	\$ 84,022
Cash (used in) provided by investing activities	(319,551)	39,444
Cash provided by financing activities	54,154	55,270
Effect of exchange rate changes	(133)	(267)
Net increase (decrease) in cash and cash equivalents	\$ (186,845)	\$ 178,469

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 manufacturers, investment in research and development, and litigation expenses.

During the nine months ended September 30, 2016, cash provided by operating activities was \$78.7 million, primarily from net income of \$125.4 million and net non-cash adjustments to net income of \$14.7 million, partially offset by a net decrease in cash from changes in our operating assets and liabilities of \$61.5 million. The decrease in cash from changes in operating assets and liabilities was primarily due to an increase in accounts receivable of \$66.0 million related to increased shipment volume, and an increase in net inventory of \$70.0 million, and deposits of \$62.6 million related to the expansion of our contract manufacturing and supply chain activities. The cash outflows for inventory-related activity was primarily related to ramping production activities at our new contract manufacturer. These cash outflows were offset by cash inflows from an increase in deferred revenue of \$88.0 million mostly related to new and renewed PCS contracts and product deferrals related to contract acceptance terms and future deliverables, an increase in accounts payable of \$35.5 million primarily due to increased inventory purchases and timing of vendor payments, an increase in cash of \$27.3 million from changes in income taxes payable and an increase in accrued liabilities of \$15.9 million primarily from corporate bonus and compensation related accruals.

During the nine months ended September 30, 2015, cash provided by operating activities was \$84.0 million, primarily from net income of \$77.2 million, and a net increase in cash from changes in our operating assets and liabilities of \$10.7 million, partially offset by net non-cash charges of \$(3.8) million. The net increase in cash from changes in operating assets and liabilities was primarily due to an increase in deferred revenue of \$84.2 million, largely related to short and long-term services contracts and product revenue deferrals related to contract acceptance terms and future deliverables. In addition, we experienced an increase in cash of \$24.8 million from changes in income tax payable, and an increase in our accounts payable and accrued liabilities of \$18.0 million due to the timing of payments. These operating liability increases were partially offset by an increase in our accounts receivable of \$63.9 million resulting from an increase in sales during the period and slower collections in the three months ended September 30, 2015. In addition, inventory increased \$31.9 million during the period due to higher shipment volume and prepaid expenses and current assets increased \$19.4 million in the period.

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 nine months ended September 30, 2016, cash used in investing activities was \$319.6 million, consisting of purchases of available-for-sale securities of \$342.5 million, purchases of property, equipment and other assets of \$16.5 million, and an additional investment in a privately-held company of \$2.5 million.

During the nine months ended September 30, 2015, cash provided by investing activities was \$39.4 million, consisting of proceeds from the maturity of available-for-sale securities of \$58.2 million, offset by purchases of property, equipment and other assets of \$14.0 million and increase in restricted cash of \$4.0 million related to a security deposit required for a facility lease.

Cash Flows from Financing Activities

Our cash flows provided by financing activities primarily consisted of proceeds from the issuance of common stock and the excess tax benefits on stock-based compensation.

During the nine months ended September 30, 2016, cash provided by financing activities was \$54.2 million, consisting primarily of the excess tax benefit associated with equity incentive plans of \$30.0 million, proceeds from the exercise of stock options, net of repurchases of \$15.6 million, and proceeds from the issuance of common stock from our ESPP of \$10.3 million.

During the nine months ended September 30, 2015, cash provided by financing activities was \$55.3 million, consisting primarily of the excess tax benefit associated with equity incentive plans of \$32.4 million, proceeds from the exercise of stock options, net of repurchases of \$14.6 million and the proceeds from the issuance of common stock from our ESPP of \$9.4 million.

Off-Balance Sheet Arrangements

As of September 30, 2016, we did not have any relationships with any unconsolidated entities or financial partnerships, including 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

As of September 30, 2016, our principal commitments consist of obligations under operating leases and purchase commitments. There have been no significant changes to these obligations during the nine months ended September 30, 2016, compared to the contractual obligations disclosed in our "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K, filed with the SEC on February 25, 2016, other than the purchase commitments described in Note 5. Commitments and Contingencies of Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

Critical Accounting Policies and Estimates

Our unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these unaudited condensed consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, expenses, and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Actual results may differ from these estimates. To the extent that there are material differences between these estimates and our actual results, our future financial statements will be affected. We believe the critical accounting policies and estimates discussed in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of our Annual Report on Form 10-K filed with the SEC on February 25, 2016, reflect our more significant judgments and estimates used in the preparation of the condensed consolidated financial statements. There have been no significant changes to our critical accounting policies and estimates as disclosed in our Annual Report on Form 10-K.

Recent Accounting Pronouncements

Refer to “Recent Accounting Pronouncements” in Note 1 of Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

Item 3. 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 September 30, 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 September 30, 2016, we had approximately \$299.7 million invested in available-for-sale marketable securities. The effect of an immediate 10% change in interest rates at September 30, 2016 would not have a material adverse impact on our future operating results and cash flows. As of September 30, 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 September 30, 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 4. 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 pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act (the "SEC"), as amended (the "Exchange Act"). Based on the evaluation of our disclosure controls and procedures as of September 30, 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 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 were 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 Exchange Act that occurred during the quarter ended September 30, 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 error 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth under the “Legal Proceedings” subheading in Note 5. Commitments and Contingencies of Notes to Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by reference.

Item 1A. Risk Factors

You should consider carefully the risks and uncertainties described below, together with all of the other information in this Quarterly Report on Form 10-Q, 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 significantly. To handle the increase in end customers, we expect to continue to grow our headcount significantly over the next 12 months. For example, between December 31, 2011 and September 30, 2016, our cumulative number of end customers grew from approximately 1,100 to over 4,100. As we have grown, we have had to manage an increasingly larger 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 were founded in 2004 and shipped our first products in 2008. 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 Quarterly Report on Form 10-Q. 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 retain and increase sales to existing customer 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 the ITC in 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;
- 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;
- 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;
- 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 Quarterly Report on Form 10-Q.

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 12.0% of our revenue for the year ended December 31, 2015, 14.9% of our revenue for the year ended December 31, 2014 and 21.9% of our revenue for the year ended December 31, 2013.

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 Juniper Networks, Brocade Communications Systems, Hewlett Packard Enterprise and Dell. 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. 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. On May 25, 2016, the Patent and Trademark Appeals Board (“PTAB”) issued an order initiating *inter partes* review of U.S. Patent No. 7,953,886 (“the ’886 patent”). Following that order 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.

Summary judgment cross-motions in the ’44 Case were heard on August 4, 2016, and the Court denied all motions brought by both sides. A final pre-trial conference is set for November 3, 2016 and trial has been set for November 21, 2016.

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 until judgment has been entered on Cisco’s copyright claims in the ’44 Case, which the Court anticipated by December 22, 2016. 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 are currently in effect.

Both Arista 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. Under this schedule, Arista filed its opening brief on September 23, 2016; Cisco's opening brief is due November 2, 2016; the USITC's brief is due on December 2, 2016; Arista's response/reply brief is due December 19, 2016; and Cisco's reply brief is due January 2, 2017.

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 order 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 numerous affirmative defenses.

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) 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 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 April 19, 2016, the Commission determined not to review this decision. 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, 2016. On September 7, 2016, the Commission determined not to review this decision. The Initial Determination will be subject to review by the Commission, which will then issue a Final Determination and any remedial orders by March 7, 2017. If the Final Determination finds a violation, it will be subject to Presidential review.

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. We filed a notice of appeal with respect to this decision regarding claims 29, 63, 64, 73, and 86 on October 11, 2016, and Cisco requested rehearing of the PTAB's Final Written Decision on October 28, 2016. 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.

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 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. For example, an adverse litigation

ruling could result in a significant damages award against us, could further result in the above described injunctive relief, could result in 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. Any such adverse ruling could materially adversely affect our business, prospects, reputation, results of operation and financial condition.

In particular, 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 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 U.S. Customs and Border Protection ("CBP") seeking approval to import these redesigned products into the United States, and we are awaiting CBP's decision. If the USITC finds that we infringe any patent in the 945 Investigation, the USITC is likely to 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. We may not be successful in developing technical design-arounds that do not infringe the patents or that are acceptable to our customers. Our development efforts could be extremely costly and time consuming as well as disruptive to our other development activities and distracting to management. We may not be successful in our efforts to obtain clearance from CBP to import such modified products in a timely manner, or at all. While clearance from CBP will allow Arista to resume importation of our redesigned products into the United States, the USITC could still determine in the enforcement action that our redesigned products continue to infringe the '537, '592 or '145 patents. Any failure to effectively redesign our products to obtain timely clearance from CBP to import such redesigned products, or to address the USITC's findings 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.

We have also made certain changes to our manufacturing, importation and shipping workflows to comply with the USITC's remedial orders. 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.

For example, if the USITC determines that our redesigned products continue to infringe the '537, '592 or '145 patents, 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."

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 43.4%, 61.7%, and 86.8% in 2015, 2014, and 2013, 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.”

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 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 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.

As a result of end-customer buying patterns and the efforts of our sales force and channel partners to meet or exceed their sales objectives, we have historically received a substantial portion of sales orders and generated a substantial portion of revenue during 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.

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 70000 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.

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 obsolete material charges. In addition, we 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. If we are unable to obtain a sufficient quantity of these components on commercially reasonable terms or in a timely manner, sales of our products could be delayed or halted entirely or we may be required to redesign our products. 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 70000 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 reduce our gross margins. Any of these events could result in lost sales and 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. If we fail to manage our relationships with our third-party manufacturers effectively, or if these third-party manufacturers experience delays, disruptions or quality control problems in their operations, this could severely impair our ability to fulfill orders on time, if at all, or on a cost-effective basis.

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 for any reason, 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 an additional contract manufacturer in San Jose, California. 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 an additional contract manufacturer in the United States, 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 be able to successfully qualify and scale production of our products in the volumes or quality that we require. 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 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 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, including our 10 Gigabit Ethernet modular and fixed switches. 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 31 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 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 and 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. 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.

We are also subject to the independent auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act ("Section 404"), enhanced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. While we were able to determine in our management's report for fiscal 2015 that our internal control over financial reporting is effective, as well as provide an unqualified attestation report from our independent registered public accounting firm to that effect, we will continue to consume management resources and incur significant expenses for Section 404 compliance on an ongoing basis. In the event that our chief executive officer, chief financial officer, or independent registered public accounting firm determines in the future that 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 and causing investor perceptions to be adversely affected and potentially resulting in a decline in the market price of our stock.

In addition, changing laws, regulations, and standards relating to corporate governance and public disclosure, such as continued rulemaking pursuant to the Dodd-Frank Act of 2010 and related rules and regulations regarding the disclosure of conflict minerals that are mandated by the Dodd-Frank Act, 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.

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. We have remediated these previously identified material weaknesses, but we cannot give assurance that additional material weaknesses will not be identified in the future in connection with our compliance with the provisions of Section 404 of the Sarbanes-Oxley Act of 2002. 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 Jayshree 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 Condensed Consolidated Financial Statements in Part I, Item I, of this Quarterly Report on Form 10-Q.

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 Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q) may require us to pay substantial damages 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 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. A decline in the price of these products 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;
- 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, 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;
- 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 acquired 3Com, Brocade acquired Foundry Networks, Juniper acquired Contrail and VMware acquired Nicira.

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 have and may continue to 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 I Item 2 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 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. In 2015, 2014 and 2013, our research and development expenses were \$209.4 million, or approximately 25.0% of our revenue, \$148.9 million, or approximately 25.5% of our revenue, and \$98.6 million, or approximately 27.3% 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.

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 substantially 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 significant 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.

New 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 Wall Street Reform and Consumer Protection Act of 2010, or the Dodd-Frank Act, that will require us to perform diligence, and disclose and report whether or not our products contain conflict minerals. The implementation of these new 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;
- 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;

- manufacturing, supply or distribution shortages or constraints, or challenges with adding or changing our manufacturing process or supply chain;
- 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 70.1 million shares outstanding as of September 30, 2016, holders of approximately 19.4 million shares, or 27.7%, 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.

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 5% of our outstanding common stock together with their affiliates, in the aggregate, beneficially own approximately 29.8% of the outstanding shares of our common stock, based on shares outstanding as of September 30, 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 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

None

Item 6. Exhibits

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

SIGNATURES

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

ARISTA NETWORKS, INC.

Date: November 3, 2016

By: /s/ JAYSHREE ULLAL
Jayshree Ullal
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: November 3, 2016

By: /s/ ITA BRENNAN
Ita Brennan
Chief Financial Officer
(Principal Accounting and Financial Officer)

EXHIBIT INDEX

Exhibit Number	Description	Incorporated by Reference				
		Form	File No.	Exhibit	Filing Date	Filed Herewith
10.1‡	Amended and Restated Manufacturing Services Agreement, dated February 18, 2016, between the Registrant and Sanmina Corporation					✓
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 Quarterly Report on Form 10-Q are not deemed filed with the Securities and Exchange Commission and are not to be incorporated by reference into any filing of 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 Quarterly Report on Form 10-Q, irrespective of any general incorporation language contained in such filing.

‡ 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.

CONFIDENTIAL PORTIONS OF THIS DOCUMENT HAVE BEEN REDACTED AND HAVE BEEN
SEPARATELY FILED WITH THE SECURITIES AND EXCHANGE COMMISSION

Exhibit 10.1

AMENDED AND RESTATED MANUFACTURING SERVICES AGREEMENT

Effective Date: February 18, 2016

This Amended and Restated Manufacturing Services Agreement (the “**Agreement**”) is by and between **Arista Networks, Inc.** for itself and its Affiliates, having a place of business at 5453 Great America Parkway, Santa Clara, CA 95054 (“**Customer**”) and **Sanmina Corporation** for itself and its Affiliates, having a place of business at 2700 North First Street, San Jose, CA 95134 (“**Manufacturer**”). This Agreement amends and restates that certain Amended and Restated Manufacturing Services Agreement between Customer and Manufacturer dated as of the Effective Date (the “**Prior Agreement**”). Customer and Manufacturer are referred to herein as a “Party” and the “Parties.”

1. Under this Agreement, Manufacturer shall serve as the Customer’s strategic partner and, in such capacity, shall procure components, parts, and raw materials (collectively “**Materials**”), and to manufacture, assemble, test, inspect, configure, and ship certain mutually-agreed upon products (including any prototypes and preproduction units of the products (collectively, the “**Products**”) at prices that the Parties have agreed to (the “**Prices**”). The Prices are based on the terms in this Agreement, including the assumptions set forth in Attachment A and the Products and Prices agreed to in the latest quotation issued by Manufacturer attached hereto as Attachment B, which are incorporated by reference. Prices shall be adjusted on a quarterly basis based upon Product volumes as set forth on Attachment B and based on the Product mix from Customer’s forecast. A Party’s “**Affiliate**” shall mean any entity that, directly or through one or more intermediaries, controls, is controlled by or is under common control by such Party, including but not limited to a Party’s subsidiaries.

2. Customer shall issue a forecast in accordance with Attachment A (the “**Forecast**”). Customer authorizes Manufacturer to, and Manufacturer shall, procure the quantity and type of Materials necessary to manufacture the quantities of Products set forth in the Forecast and all Orders (as defined below), including long-lead and minimum order quantities for Materials ordered to Forecast, in accordance with industry standard practices (taking into account Material lead times and manufacturing lead times) (“**Standard Practices**”). Customer shall be financially responsible for (a) all Materials ordered in accordance with such Standard Practices, and (b) all Materials ordered by Manufacturer with Customer’s authorization, whether such order(s) occurred prior to or after the date of this Agreement. Customer is responsible for ordered but unused Materials, partially completed Products, and finished Products (collectively “**Inventory**”) in accordance with Attachment C. Manufacturer and Customer shall set common goals and make joint efforts to set up vendor managed inventory with designated Materials suppliers.

3. Customer shall issue a purchase order (“**Order**”) for each order for Products. Manufacturer will accept all Orders and provide delivery commitments within [*****] days. Manufacturer may only reject an Order if the stated quantities exceed the flexibility terms provided in Attachment D, the price does not reflect the then current price, or the Order contains terms that deviate from the terms of this Agreement. In the event of quantity increases, rescheduling of shipment dates, and cancelation of an Order, the terms in Attachment D (as updated periodically by the Parties) shall apply.

4. Manufacturer will manufacture the Products in accordance with the specifications set forth in Attachment A and otherwise supplied and/or approved by Customer and accepted by Manufacturer (the “**Specifications**”). Manufacturer will test all Products according to the testing Specifications, and will package and ship the Product in accordance with packaging and shipping Specifications, in each case as the Parties shall agree pursuant to a Statement of Work (“**SOW**”) executed by the Parties. Unless otherwise provided in the SOW, the terms of this Agreement shall control in the event of a conflict between the terms of this Agreement and the SOW.

5. During the warranty period identified in Attachment A (“**Warranty Period**”), Manufacturer warrants that the Product will be free from defects in Manufacturer’s workmanship and meet the Specifications. A Product

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

is free from defects in workmanship (and Customer shall have no warranty claim) if the Product is manufactured in accordance with the most current version of [*****] or any other mutually-agreed upon, written Specifications. Manufacturer makes no warranty with respect to (a) the Materials; (b) the Specifications or the Product design; (c) Product that has been abused, damaged, altered or misused or mishandled; (d) prototypes and pre-production units; or (v) defects resulting from tooling, designs, or instructions produced or supplied by Customer (collectively, the “ **Exclusions** ”). If a breach of the warranty occurs and provided that Manufacturer is notified of such breach within thirty days following the expiration of the Warranty Period, Manufacturer shall, at Manufacturer’s election and expense (and as Customer’s sole and exclusive remedy for breach of any warranty), repair, replace, or issue a credit for Product within [*****] of receipt by Manufacturer of the Product. In addition, Manufacturer will assign to the extent assignable and will manage all manufacturers’ Materials warranties (but Manufacturer does not independently warrant any Materials). **The sole remedy under this warranty shall be the repair, replacement, or refund for defective Product as stated above . This warranty is the sole warranty given by Manufacturer and is in lieu of any other warranties, either express or implied, including but not limited to warranties of title, merchantability, non-infringement, and fitness for a particular purpose, each of which Manufacturer specifically disclaims .** Compliance with “ **ROHS** ” , “ **WEEE** ” , “ **REACH** ” and other environmental legislation worldwide shall be as agreed by the Parties.

6. Customer (or its representatives and others as mutually agreed by the Parties) may during normal business hours and following reasonable notice and subject to reasonable confidentiality requirements, perform confidential audits, test and inspections of Manufacturer’s operations and business records as they pertain to the services provided hereunder. The foregoing audit rights may include audits (a) of practices and procedures; (b) of systems; (c) of general controls and security practices and procedures, (c) of disaster recovery and business continuity procedures; (d) of compliance with the terms of the Agreement; and (e) of compliance with laws relating to the performance under this Agreement, in all cases as shall be relevant to the manufacturing of the Products. Manufacturer shall provide full cooperation to such auditors, inspectors, regulators or other Customer representatives in connection with any such audit. Manufacturer shall make available to Customer any operational audits conducted by any third party for facilities used to manufacture Products.

7. A Party shall not be liable to the other Party if it is unable to perform its obligations for a period not to exceed [*****] for any cause beyond the reasonable control of the Party, including, in the case of Manufacturer, [*****]. Within [*****] of becoming aware of becoming unable to perform its obligations, the effected Party will notify the other party of said circumstance and will work with the other Party to create a suitable recovery plan.

8. The initial term of this Agreement shall be three (3) years from the Effective Date (“ **Initial Term** ”). Following expiration of the Initial Term, this Agreement shall automatically renew for successive one (1) year periods (each, a “ **Renewal Term** ” and, together with the Initial Term, the “ **Term** ”) unless either Party notifies the other in writing of termination at least ninety (90) days prior to the expiration of the Initial Term or the current Renewal Term. Either Party may terminate this Agreement for convenience upon twelve (12) months written notice, or for cause upon written notice to the other Party if the other Party fails to cure a material breach of this Agreement within ninety (90) days of written notice of the breach. Sections 2, 4-14, 19, 20, and 22 shall survive termination of this Agreement. Upon termination of this Agreement for any reason the provisions of Sections 2 and 3 and Exhibit C shall apply with respect to payment and shipment to Customer of all Inventory in existence as of such date.

9. In the event that either Party terminates this Agreement for convenience during the Initial Term such party (the “ **Terminating Party** ”) will be liable for paying to the other party (the “ **Non-Terminating Party** ”), and such Non-Terminating Party may invoice the Terminating Party for, [*****]

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

[****]	[*****]
[*****]	[*****]
[*****]	[*****]
[*****]	[*****]
[*****]	[*****]

In the event that Manufacturer terminates for convenience, in addition to any obligations it may have to pay to Customer [*****].

10. Intentionally Omitted

11. Notwithstanding anything contained herein to the contrary, Customer will be relieved from [*****].

12. Customer is solely responsible for the design of the Products and, [*****], shall obtain all Product-related intellectual property, export, regulatory, and other licenses and certifications required to market, sell, and use the Products. [*****]

[*****]

[*****]

[*****]

[*****]

[*****]

[*****]

[*****]

[*****]

13. WITH THE EXCEPTION OF INDEMNITY OBLIGATIONS UNDER SECTION 12, BREACHES OF SECTION 14 (CONFIDENTIALITY), OR DAMAGES PAYABLE FOR [*****] AS DEFINED IN APPENDIX A, IN NO EVENT SHALL EITHER PARTY BE LIABLE TO THE OTHER PARTY FOR ANY INDIRECT, CONSEQUENTIAL, INCIDENTAL, PUNITIVE, OR SPECIAL DAMAGES, OR ANY DAMAGES WHATSOEVER RESULTING FROM LOSS OF USE, DATA OR PROFITS, EVEN IF SUCH OTHER PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES EXCEPT IN THE CASE OF INTENTIONAL MISCONDUCT OR GROSS NEGLIGENCE. FOR THE PURPOSE OF THIS SECTION, BOTH LOST PROFITS AND DAMAGES RESULTING FROM VALUE ADDED TO THE PRODUCT BY CUSTOMER SHALL BE CONSIDERED CONSEQUENTIAL DAMAGES. IN NO EVENT WILL MANUFACTURER BE LIABLE FOR COSTS OF PROCUREMENT OF SUBSTITUTE PRODUCT BY CUSTOMER. [*****]. THESE LIMITATIONS SHALL APPLY NOTWITHSTANDING ANY FAILURE OF ESSENTIAL PURPOSE OF ANY LIMITED REMEDY. [*****].

14. Each Party owns all background intellectual property rights to any developments made (a) prior to this Agreement, or (b) outside of this Agreement. The Products do not violate the intellectual property rights of a third party. [*****].

15. This Agreement and its Attachments make up the entire agreement between the Parties and supersede prior discussions and agreements relating to the subject matter hereof, including that the Prior Agreement, except for any related written agreements concerning confidentiality. Both Parties expressly reject any pre-printed terms and conditions of any Order, acknowledgment, or any other form or document of either

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

16.

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

Party and any other terms that alter the terms of this Agreement, even if such documents are exchanged and accepted as a matter of convenience. This Agreement may be amended only by a writing executed by authorized representatives of both Parties. Neither Party shall assign, delegate, or transfer (including by sale, merger, operation of law or otherwise) this Agreement without the other Party's prior written consent; however, Customer understands that Manufacturer may engage related legal entities (" **Affiliates** ") to perform all or part of the services contemplated in this Agreement and that Manufacturer may assign, delegate, or otherwise transfer its rights and obligations under this Agreement, in whole or in part, to any of its Affiliates or to a third party financial institution for the purpose of receivables financing (e.g., factoring).

17. At all times during the term of the Agreement, Manufacturer will adopt and comply with the Electronic Industry Citizenship Coalition (" **EICC** ") Code of Conduct as amended from time to time by the EICC available at www.eiccoalition.org/standards/code-of-conduct/ . Manufacturer will support Customer's sustainability and compliance expectations in the following areas: (a) request to complete Self Assessment Questionnaires (SAQ) on EICC-On, (b) information requests on greenhouse gas emissions, energy, water use, (c) information requests on waste management, (d) information requests on labor, health and safety, (e) information requests on process chemicals used during the assembly process.

18. Manufacturer shall comply in all material respects with the applicable laws in connection with the manufacture of Products pursuant to this Agreement.

19. Manufacturer shall maintain the following insurance coverages during the term of this Agreement:

- (a) Workers' Compensation insurance, as prescribed by the law of the state in which Manufacturer's services are performed;
- (b) Employer's Liability insurance with limits of at least \$500,000 per occurrence;
- (c) Commercial Automobile Liability insurance if the use of motor vehicles is required, with limits of at least \$1,000,000 for bodily injury and property damage for each occurrence;
- (d) Commercial General Liability insurance, including blanket contractual liability and broad form property damage, with limits of at least \$1,000,000 combined single limit for personal injury and property damage for each occurrence and naming Customer as an Additional Insured; and
- (e) Commercial General Liability insurance endorsed to include Products Liability and Completed Operations coverage in the amount of \$1,000,000 for each occurrence.
- (f) Manufacturer shall name Customer as an additional insured and Manufacturer shall furnish to Customer upon request certificates or evidence of the foregoing insurance indicating the amount and nature of such coverage and the expiration date of each policy. Each Party agrees that it, its insurer(s) and anyone claiming by, through, under or in its behalf shall have no claim, right of action or right of subrogation against the other Party and the other Party's affiliates, directors, officers, employees and customers based on any loss or liability insured against under the insurance required by this Agreement.

20. The laws of the state of Delaware govern this Agreement and all disputes related to this Agreement or the Products. The Parties shall submit any dispute, claim or controversy arising from or related in any way to this Agreement or the interpretation, application, breach, termination, or validity of this Agreement for resolution by binding arbitration in accordance with the Comprehensive Arbitration Rules & Procedures of JAMS. The arbitration is to be held in Santa Clara County, California and be conducted in English by one arbitrator. The arbitrator shall be a retired judge selected from the panel of available arbitrators. Judgment on any award in arbitration may be entered in any court of competent jurisdiction. Notwithstanding the foregoing sentence, should any Party to this Agreement hereafter institute any legal action or administrative proceeding against the other by any method other than set forth in this Section 19, the prevailing Party shall be entitled to recover from the other Party all damages, costs, expenses, and attorneys' fees incurred as a result of such action. Notwithstanding the above, each Party has the right to file exclusively in the Santa Clara, California state court or the federal courts in and for the Northern District of California an application for temporary or preliminary injunctive relief, writ of attachment, writ of possession, temporary protective order, or appointment of a receiver on the grounds that the arbitration award to which the applicant may be entitled may be rendered ineffectual in the absence of such relief.

In the event of any dispute between the Parties, the Parties hereby knowingly and voluntarily agree that any and all matters shall be decided by a judge or arbitrator without a jury to the fullest extent permissible under applicable law.

21. Notices . Wherever one Party is required or permitted or required to give written notice to the other under this Agreement, such notice will be given by hand, by certified U.S. mail, return receipt requested, by overnight courier, or by fax and addressed as follows:

If to Customer:

Arista Networks, Inc.
5453 Great America Parkway
Santa Clara, CA 95054
Attention: Chief Executive Officer
Phone: [*****]
Fax: [*****]

with a copy to:

Arista Networks, Inc.
5453 Great America Parkway
Santa Clara, CA 95054
Attention: Legal Department
Phone: [*****]
Fax: [*****]

If to Manufacturer:

Sanmina Corporation
2700 North First Street
San Jose, California 95134
Att'n: EVP, Sales
Phone: [*****]
Fax: [*****]

with a copy to:

Sanmina Corporation
2700 North First Street
San Jose, California 95134
Att'n: Legal Department
Phone: [*****]
Fax: [*****]

All such notices shall be effective upon receipt. Either Party may designate a different notice address from time to time upon giving ten (10) days prior written notice thereof to the other Party.

22. The parties acknowledge that from time to time Customer enters into agreements with its customers that require its contract manufacturers to agree to certain additional covenants and obligations with respect to its manufacture and sale of Products. Accordingly, the Parties agree to negotiate in good faith to amend this Agreement to accommodate such contractual obligations to such customers. Without limiting the generality of the foregoing, such additional obligations may include provisions relating to compliance with environmental, export and other laws, audit rights, security, disaster recovery and business continuity

23. The Parties shall keep the the terms and conditions contained in this Agreement or any materials disclosed during the course of this Agreement confidential (" **Confidential Information** "). However, either Party may disclose Confidential Information: (a) as required by law or (b) as necessary to perform its obligations under this Agreement. The Parties may not disclose Confidential Information without the other Party's prior written authorization, which may be granted or denied in either Party's sole discretion. Notwithstanding the provisions of Section 22, the Parties agree that the covenants, restrictions and agreements contained in any confidentiality agreement executed by the Parties prior to the Effective Date shall survive the execution of this Contract and shall not be superseded hereby.

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

IN WITNESS WHEREOF, the Parties hereto have caused this Agreement to be executed as of the Effective Date, by their officers, duly authorized.

Sanmina Corporation

By /s/ Marco Gonzalez

Name: Marco Gonzalez

Title: EVP & COO Americas BMS

Date: 10/24/2016

Arista Networks, Inc.

By /s/ Anshul Sadana

Name Anshul Sadana

Title: Chief Customer Officer

Date: 10/26/2016

CONFIDENTIALTREATMENT REQUESTED

CONFIDENTIAL PORTIONS OF THIS DOCUMENT HAVE BEEN REDACTED AND HAVE BEEN
SEPARATELY FILED WITH THE SECURITIES AND EXCHANGE COMMISSION

Attachment A
Additional Assumptions , Products and Prices

1. [****]
2. Manufacturer will acknowledge receipt of Customer's Orders within five (5) business days. Such PO acknowledgement will include the Product shipment date.
3. [*****]. Warranty related defects will be returned using a Return Materials Authorization ("RMA"). Manufacturer will issue an RMA within [*****] of receipt of an RMA request. Upon receipt, Manufacturer and Customer will determine whether the defects were covered by the warranty contained in the Agreement. The shipping costs for RMA returns to Manufacturer and the return of the repaired Product to Customer shall be paid by Customer.
4. [****]
5. [****]
6. [****]
7. Unless otherwise agreed between the Parties all shipments shall be made [*****], and title and risk of loss pass to Customer upon delivery.
8. The Prices shall be negotiated on a [*****] and shall reflect a standard markup in addition to the cost of materials necessary to manufacture Products as set forth below.

Manufacturer Value Add (" **MVA** ") is defined as price charged to Customer minus the component cost divided by the price charged to the Customer. MVA shall be calculated on the basis of component costs for existing products as of [*****].

[*****]

[*****]	[*****]
[*****]	[*****]
	[*****]

[*****]

9. [*****]

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

[****]	[****]
[****]	[****]
[****]	[****]
[****]	[****]
[****]	[****]
[****]	[****]
[****]	[****]

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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Attachment B
[*****]

[*****] _

[*****]			
[*****]	[*****]		
	[*****]		
	[*****]		
[*****]	[*****]		
	[*****]		
[*****]	[*****]		[*****]
	[*****]		
	[*****]	[*****]	

	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]		[*****]
[*****]		[*****]

[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]

[*****]						
[*****]	[*****]					
[*****]	[*****]		[*****]	[*****]	[*****]	[*****]
[*****]	[*****]	[*****]	[*****]	[*****]	[*****]	

[*****]	[*****]	
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]
[*****]	[*****]	[*****]

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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Attachment C

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[***]**

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

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Attachment D
Order Flexibility Terms

(i) For any accepted Order or Forecast, Customer may request an increase in the quantity of Products ordered or forecast. Manufacturer shall use reasonable commercial efforts to meet any allowed Product quantity increases, which are subject to Materials and capacity availability. If Manufacturer agrees to such increase in the quantity, and if there are extra costs to meet such increase, Manufacturer will get approval from Customer for the extra cost and Customer shall be liable for such extra costs.

(ii) For any accepted Order, Customer may request a push-out (“ **Reschedule** ”) of the expected delivery date. Customer may Reschedule all or part of a scheduled delivery (per Order or Forecast) [****] in accordance with the table below. No reschedules will be allowed after Manufacturer has begun manufacturing (WIP). Additional requests for Reschedules, require Manufacturer’s approval, which, in its sole discretion, may or may not be granted. If Manufacturer agrees to accept a Reschedule of any length of time, and if there are extra costs to meet such Reschedule, then Customer shall be liable for such extra costs. Any part of an Order quantity that is Rescheduled may not be subsequently rescheduled. Any Reschedule not consented to by Manufacturer or that otherwise does not satisfy the requirements of this subsection (ii) shall be treated as a cancellation, for which Customer shall be liable for the full Order value of the Products stated therein.

(iii) Customer should have a right to change the Product mix of the build as long as the build has not started (Work order or kit has not scheduled to pull). Any excess or obsolete Material that impacted due to this change will be handled via the Excess&Obsolete process according to Attachment C. [****] .

(iv) Any delays in the normal production or interruption in the workflow process caused by Customer’s changes to the Specifications or failure to provide sufficient quantities or a reasonable quality level of Customer Controlled Materials where applicable to sustain the production schedule, shall be considered a Reschedule of any affected Orders for purposes of this Section for the period of such delay.

[****]

[*****] Certain portions denoted with an asterisk have been omitted and filed separately with the Securities and Exchange Commission. Confidential treatment has been requested with respect to the omitted portions.

**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 quarterly report on Form 10-Q of Arista Networks, Inc. for the quarter ended September 30, 2016 ;
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: November 3, 2016

/s/ JAYSHREE ULLAL

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 quarterly report on Form 10-Q of Arista Networks, Inc. for the quarter ended September 30, 2016 ;
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: November 3, 2016

/s/ ITA BRENNAN

Ita Brennan

Chief Financial Officer

(Principal Accounting and Financial Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER
PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

I, Jayshree Ullal, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Arista Networks, Inc. on Form 10-Q for the quarter ended September 30, 2016 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Arista Networks, Inc.

Date: November 3, 2016

By:	<u>/s/ JAYSHREE ULLAL</u>
Name:	Jayshree Ullal
Title:	President, Chief Executive Officer and Director (Principal Executive Officer)

I, Ita Brennan , certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Arista Networks, Inc. on Form 10-Q for the quarter ended September 30, 2016 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Arista Networks, Inc.

Date: November 3, 2016

By:	<u>/s/ ITA BRENNAN</u>
Name:	Ita Brennan
Title:	Chief Financial Officer (Principal Accounting and Financial Officer)