
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 June 30, 2017

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, a smaller reporting company or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth 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	☐
		Emerging growth company	☐

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

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

The number of shares outstanding of the registrant's Common Stock, \$0.0001 par value, as of July 28, 2017 was 72,529,963 .

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)

	June 30, 2017	December 31, 2016
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 823,475	\$ 567,923
Marketable securities	301,364	299,910
Accounts receivable, net of allowances of \$4,192 and \$1,521, respectively	269,624	253,119
Inventories	363,803	236,490
Prepaid expenses and other current assets	190,923	168,684
Total current assets	1,949,189	1,526,126
Property and equipment, net	75,840	76,961
Investments	36,136	36,136
Deferred tax assets	81,469	70,960
Other assets	20,306	18,824
TOTAL ASSETS	\$ 2,162,940	\$ 1,729,007
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 80,418	\$ 79,457
Accrued liabilities	84,413	90,951
Deferred revenue	426,750	273,350
Other current liabilities	19,216	15,795
Total current liabilities	610,797	459,553
Income taxes payable	19,970	14,498
Lease financing obligations, non-current	38,672	39,593
Deferred revenue, non-current	127,760	99,585
Other long-term liabilities	7,992	7,958
TOTAL LIABILITIES	805,191	621,187
Commitments and contingencies (Note 5)		
STOCKHOLDERS' EQUITY:		
Preferred stock, \$0.0001 par value—100,000 shares authorized, no shares issued and outstanding as of June 30, 2017 and December 31, 2016	—	—
Common stock, \$0.0001 par value—1,000,000 shares authorized as of June 30, 2017 and December 31, 2016; 72,450 and 70,811 shares issued and outstanding as of June 30, 2017 and December 31, 2016, respectively	7	7
Additional paid-in capital	737,436	674,183
Retained earnings	621,559	435,105
Accumulated other comprehensive loss	(1,253)	(1,475)
TOTAL STOCKHOLDERS' EQUITY	1,357,749	1,107,820
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 2,162,940	\$ 1,729,007

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 June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue:				
Product	\$ 353,904	\$ 235,616	\$ 645,271	\$ 448,091
Service	51,307	33,125	95,415	62,846
Total revenue	405,211	268,741	740,686	510,937
Cost of revenue:				
Product	134,406	88,021	244,242	166,934
Service	11,028	9,269	22,457	17,462
Total cost of revenue	145,434	97,290	266,699	184,396
Total gross profit	259,777	171,451	473,987	326,541
Operating expenses:				
Research and development	81,194	69,020	162,804	131,535
Sales and marketing	38,630	31,744	75,657	59,350
General and administrative	23,319	17,529	45,474	32,763
Total operating expenses	143,143	118,293	283,935	223,648
Income from operations	116,634	53,158	190,052	102,893
Other income (expense), net:				
Interest expense	(623)	(732)	(1,338)	(1,483)
Other income (expense), net	1,119	416	2,144	753
Total other income (expense), net	496	(316)	806	(730)
Income before provision for income taxes	117,130	52,842	190,858	102,163
Provision for income taxes	14,445	13,938	5,212	28,014
Net income	\$ 102,685	\$ 38,904	\$ 185,646	\$ 74,149
Net income attributable to common stockholders:				
Basic	\$ 102,454	\$ 38,617	\$ 185,139	\$ 73,535
Diluted	\$ 102,474	\$ 38,635	\$ 185,182	\$ 73,573
Net income per share attributable to common stockholders:				
Basic	\$ 1.42	\$ 0.57	\$ 2.59	\$ 1.08
Diluted	\$ 1.30	\$ 0.53	\$ 2.37	\$ 1.01
Weighted-average shares used in computing net income per share attributable to common stockholders:				
Basic	71,992	68,275	71,555	68,006
Diluted	78,756	72,817	78,166	72,523

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 June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$ 102,685	\$ 38,904	\$ 185,646	\$ 74,149
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	384	(308)	157	(236)
Net change in unrealized gains (losses) on available-for-sale securities	(7)	255	65	206
Other comprehensive income (loss)	377	(53)	222	(30)
Comprehensive income	<u>\$ 103,062</u>	<u>\$ 38,851</u>	<u>\$ 185,868</u>	<u>\$ 74,119</u>

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)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities		
Net income	\$ 185,646	\$ 74,149
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,033	9,662
Stock-based compensation	34,839	27,592
Deferred income taxes	(8,515)	(6,876)
Amortization of investment premiums	753	385
Changes in operating assets and liabilities:		
Accounts receivable, net	(16,505)	(2,396)
Inventories	(127,313)	(26,001)
Prepaid expenses and other current assets	(22,239)	(2,838)
Other assets	(470)	1,866
Accounts payable	1,299	18,501
Accrued liabilities	(5,981)	(5,196)
Deferred revenue	181,575	33,516
Income taxes payable	5,380	17,853
Other liabilities	3,593	1,779
Net cash provided by operating activities ⁽¹⁾	242,095	141,996
Cash flows from investing activities		
Proceeds from marketable securities	112,053	—
Purchases of marketable securities	(114,195)	(292,938)
Purchases of property and equipment	(9,534)	(12,739)
Investment in privately-held companies	—	(2,500)
Change in restricted cash	(1,254)	—
Net cash used in investing activities	(12,930)	(308,177)
Cash flows from financing activities		
Principal payments of lease financing obligations	(773)	(634)
Proceeds from issuance of common stock under equity plans	28,105	11,205
Minimum tax withholding paid on behalf of employees for net share settlement	(1,356)	(599)
Net cash provided by financing activities ⁽¹⁾	25,976	9,972
Effect of exchange rate changes	411	(59)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	255,552	(156,268)
CASH AND CASH EQUIVALENTS—Beginning of period	567,923	687,326
CASH AND CASH EQUIVALENTS—End of period	\$ 823,475	\$ 531,058
Supplemental disclosures of non-cash investing activities:		
Property and equipment included in accounts payable and accrued liabilities	\$ 672	\$ 1,408

⁽¹⁾ During our first fiscal quarter of 2017, we adopted Accounting Standards Update 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." Refer to Note 1 Recently Adopted Accounting Pronouncements for further details. This adoption resulted in a \$16.0 million increase in net cash provided by operating activities and a corresponding \$16.0 million decrease in net cash provided by financing activities for the six months ended June 30, 2016.

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

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

1. Organization and Summary of Significant Accounting Policies

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

Basis of Presentation and Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) and 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 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 six months ended June 30, 2017, are not necessarily indicative of the results expected for the full fiscal year. The condensed consolidated balance sheet as of December 31, 2016 has been derived from the audited consolidated financial statements at that date but does not include all of the information and notes required by GAAP for complete financial statements. Our unaudited condensed consolidated financial statements (“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.

Our 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, 2016, filed with the SEC on February 17, 2017.

Use of Estimates

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

Recently Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (the “FASB”) amended the existing accounting standard for stock-based compensation, issuing Accounting Standards Update (“ASU”) 2016-09, *Compensation-Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, which impacts 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. We adopted this standard during our first fiscal quarter of 2017. The impact of the adoption was as follows:

- Income tax accounting - The standard eliminates additional paid-in-capital (“APIC”) pools and requires excess tax benefits and tax deficiencies on share-based awards to be recognized in the income statement prospectively as discrete items upon exercise or vesting of such awards. The standard also requires excess tax benefits to be recognized regardless of whether the benefit reduces taxes payable. We adopted the guidance related to the timing of previously unrecognized excess tax benefits on a modified retrospective basis, which resulted in the recognition of a cumulative

effect adjustment of \$1.8 million that increased retained earnings and increased our long-term deferred income tax as of January 1, 2017.

- Earnings per share - Because excess benefits are no longer recognized in APIC, the assumed proceeds from applying the treasury stock method when calculating dilutive shares was amended to exclude the amount of excess tax benefits that would be recognized upon exercise or vesting of such awards. As a result, this reduces the assumed shares to be repurchased under the treasury stock method, thereby increasing the amount of dilutive shares used to compute earnings per share. We adopted the guidance related to the exclusion of excess tax benefits in calculating earnings per share on a prospective basis.
- Forfeitures of stock options and awards - Under the new standard, we can make an accounting policy election to either estimate the number of share-based awards that are expected to vest, or account for forfeitures when they occur. We elected to account for forfeitures when they occur and adopted this change on a modified retrospective basis. As a result, we recorded the cumulative effect of the change as a \$1.0 million decrease to retained earnings as of January 1, 2017.
- Cash flow presentation of excess tax benefits - Prior to the new standard, we were required to present excess tax benefits on share-based awards as a cash inflow from financing activities with a corresponding cash outflow from operating activities. The new standard required that these excess tax benefits be classified with other income tax cash flows as an operating activity. We elected to adopt the guidance related to the presentation of excess tax benefits in our condensed consolidated statements of cash flows on a retrospective basis.

In April 2015, the FASB issued ASU 2015-05, *Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Fees Paid in a Cloud Computing Arrangement*, providing guidance on fees paid in a cloud computing arrangement. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If the arrangement does not include a software license, the customer should account for the arrangement as a service contract. We adopted this standard in our first quarter of fiscal 2017 on a prospective basis, and the adoption did not have a material impact on our consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory: Simplifying the Measurement of Inventory*, which simplifies the measurement of inventory to be measured at the lower of cost or net realizable value. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. We adopted this standard in our first quarter of fiscal 2017 on a prospective basis, and the adoption did not have a material impact on our consolidated financial statements.

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*, and in December 2016, by ASU No. 2016-20- *Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers*), which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The new standard provides principles for recognizing revenue for the transfer of promised goods or services to customers with the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard also requires significantly expanded disclosures about revenue recognition.

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

In May 2016, the FASB issued ASU No. 2016-11, *Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update)* ("ASU 2016-11"), which rescinds various standards codified

as part of Topic 605, Revenue Recognition in relation to the future adoption of Topic 606. These rescissions include changes to topics pertaining to revenue and expense recognition including accounting for shipping and handling fees and costs and accounting for consideration given by a vendor to a customer.

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

Management's assessments of potential impacts of the standards are underway. The standards are expected to impact the amount and timing of revenue recognized and the related disclosures on our consolidated financial statements. We will adopt ASU 2014-09 during the first quarter of 2018 and expect to adopt the guidance under the modified retrospective method which we anticipate will result in a cumulative effect adjustment as of the date of adoption.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments—Recognition and Measurement of Financial Assets and Financial Liabilities*, which enhances the reporting model for financial instruments to provide users of financial statements with more decision-useful information. The guidance will address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The standard is effective for us for our first quarter of fiscal 2018, and 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 June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which requires a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. Credit losses relating to available-for-sale debt securities should be recorded through an allowance for credit losses. This standard is effective for us for our first quarter of 2020. We are currently assessing the impact this guidance may have on our consolidated financial statements.

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.

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force)* which requires that amounts generally described as restricted cash or restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-

period total amounts shown on the statement of cash flows. This standard is effective for us for our first quarter of fiscal 2018, and may be early adopted. We do not anticipate this standard will have a material impact on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, *Compensation—Stock Compensation (Topic 718) Scope of Modification Accounting* which addresses providing clarity to reduce diversity in practice, cost and complexity in the application of modification accounting when there is a change in terms or conditions of a share-based payment award. The guidance will be applied on a prospective basis to awards modified on or after the adoption date. This standard is effective for us for our first quarter of fiscal 2018, and may be early adopted. We do not anticipate this standard will have a material impact 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):

June 30, 2017				
	Level I	Level II	Level III	Total
Financial Assets:				
Money market funds	\$ 305,786	\$ —	\$ —	\$ 305,786
Money market funds-restricted	5,499	—	—	5,499
Commercial paper	17,962	—	—	17,962
U.S. government notes	98,350	—	—	98,350
Corporate bonds	—	185,052	—	185,052
Total financial assets	<u>\$ 427,597</u>	<u>\$ 185,052</u>	<u>\$ —</u>	<u>\$ 612,649</u>

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

June 30, 2017				
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Commercial paper	\$ 17,901	\$ 61	\$ —	\$ 17,962
U.S. government notes	98,586	—	(236)	98,350
Corporate bonds	185,266	130	(344)	185,052
Total marketable securities	<u>\$ 301,753</u>	<u>\$ 191</u>	<u>\$ (580)</u>	<u>\$ 301,364</u>

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

As of June 30, 2017 and December 31, 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 June 30, 2017.

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 June 30, 2017, 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):

	June 30, 2017
Due in 1 year or less	\$ 185,071
Due in 1 year through 2 years	116,293
Total marketable securities	<u>\$ 301,364</u>

The weighted average remaining duration of our current marketable securities is approximately 0.9 years as of June 30, 2017. 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 unaudited condensed consolidated balance sheets.

Accounts Receivable, net

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

	June 30, 2017	December 31, 2016
Accounts receivable	\$ 273,815	\$ 254,640
Allowance for doubtful accounts	(61)	(204)
Sales return reserve	(4,130)	(1,317)
Accounts receivable, net	<u>\$ 269,624</u>	<u>\$ 253,119</u>

Inventories

Inventories consist of the following (in thousands):

	June 30, 2017	December 31, 2016
Raw materials	\$ 112,558	\$ 99,190
Finished goods	251,245	137,300
Total inventories	<u>\$ 363,803</u>	<u>\$ 236,490</u>

Prepaid Expenses and Other Current Assets

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

	June 30, 2017	December 31, 2016
Inventory deposit	\$ 34,259	\$ 60,315
Prepaid income taxes	22,640	17,383
Other current assets	124,362	79,140
Other prepaid expenses and deposits	9,662	11,846
Total prepaid expenses and other current assets	<u>\$ 190,923</u>	<u>\$ 168,684</u>

Property and Equipment, net

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

	June 30, 2017	December 31, 2016
Equipment and machinery	\$ 45,481	\$ 40,721
Computer hardware and software	20,154	17,420
Furniture and fixtures	2,982	2,879
Leasehold improvements	29,648	29,498
Building	35,154	35,154
Construction-in-process	1,022	421
Property and equipment, gross	134,441	126,093
Less: accumulated depreciation	(58,601)	(49,132)
Property and equipment, net	<u>\$ 75,840</u>	<u>\$ 76,961</u>

Depreciation and amortization expense was \$5.0 million and \$4.8 million , for the three months ended June 30, 2017 and 2016 , respectively, and \$9.8 million and \$9.7 million for the six months ended June 30, 2017 and 2016 , respectively.

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	June 30, 2017	December 31, 2016
Accrued compensation costs	\$ 34,005	\$ 52,854
Accrued warranty costs	8,262	6,744
Accrued manufacturing costs	23,790	14,824
Accrued professional fees	5,767	6,829
Accrued taxes	1,280	1,098
Other	11,309	8,602
Total accrued liabilities	<u>\$ 84,413</u>	<u>\$ 90,951</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 unaudited condensed consolidated balance sheets.

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

	Six Months Ended June 30,	
	2017	2016
Warranty accrual, beginning of period	\$ 6,744	\$ 4,718
Liabilities accrued for warranties issued during the period	3,944	1,141
Warranty costs incurred during the period	(2,426)	(1,018)
Warranty accrual, end of period	<u>\$ 8,262</u>	<u>\$ 4,841</u>

4. Investments

Investments in Privately-held Companies

As of June 30, 2017 and December 31, 2016, we held non-marketable equity investments of approximately \$36.1 million in privately-held companies which are accounted for under the cost method. To date, we have not recognized any impairment losses on our investments.

5. Commitments and Contingencies

Operating Leases

We lease various operating spaces in North America, Europe, Asia and Australia under non-cancelable operating lease arrangements that expire on various dates through 2025. 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 \$2.6 million and \$2.4 million, for the three months ended June 30, 2017 and 2016, respectively, and \$5.0 million and \$4.7 million for the six months ended June 30, 2017 and 2016, respectively. 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, 2016.

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 operating lease commitments under contractual obligation, as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016.

As of June 30, 2017 and December 31, 2016, 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 \$40.4 million and \$41.2 million, respectively. As of June 30, 2017, \$1.7 million and \$38.7 million were recorded as short-term and long-term financing obligations, respectively.

Land lease expense related to our lease financing obligation is classified as rent expense in our unaudited condensed consolidated statements of income, and amounted to \$0.3 million and \$0.6 million for the three and six months ended June 30, 2017, respectively, and \$0.3 million and \$0.6 million for the three and six months ended June 30, 2016, 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 June 30, 2017, we had non-cancelable purchase commitments of \$152.4 million. In addition, we have provided deposits to secure our obligations to purchase inventory. We had \$37.0 million and \$63.1 million in deposits as of June 30, 2017 and December 31, 2016, 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.

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

Trial began on November 28, 2016, and the jury rendered its verdict on December 14, 2016. The jury found that Arista had proven its copyright defense of *scenes a faire* and that Cisco had failed to prove infringement of the ’526 patent, and on that basis judgment was entered in Arista’s favor on all claims on December 19, 2016.

On January 17, 2017, Cisco filed a motion for judgment as a matter of law, challenging the sufficiency of the evidence in support of Arista’s *scenes a faire* defense. Cisco did not file any post-trial motion regarding the ’526 patent, nor did it file a motion for a new trial. We also filed a conditional motion for judgment as a matter of law and/or for a new trial on several grounds, which would be at issue only if the court granted Cisco’s motion. The hearing on both parties’ motions was held on April 27, 2017. On May 10, 2017, the court denied Cisco’s motion and denied our motions as moot.

Cisco filed a notice of appeal on June 6, 2017. The U.S. Court of Appeal for the Federal Circuit has docketed the appeal as Case No. 17-2145. No hearing date in the appeal has been set.

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 August 23, 2016, the Court granted Cisco’s motion to stay the ’23 Case until judgment has been entered on Cisco’s copyright claims in the ’44 Case. On March 2, 2017, the Court lifted the stay and trial is set for August 3, 2018.

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 19 U.S.C. § 1337 (“Section 337”). 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 2, 2016, the Administrative Law Judge (“ALJ”) issued his initial determination finding a violation of Section 337. 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 June 23, 2016, the Commission issued its Final Determination, which found a violation with respect to the ’537, ’592, and ’145 patents, and found no violation with respect to the ’597 and ’164 patents. The Commission also issued a limited exclusion order and a cease and desist order pertaining to network devices, related software and components thereof that infringe one or more of claims 1, 2, 8-11, and 17-19 of the ’537 patent; claims 6, 7, 20, and 21 of the ’592 patent; and claims 5, 7, 45, and 46 of the ’145 patent. On August 22, 2016, the Presidential review period for the 944 investigation expired. The USITC orders will be in effect until the expiration of the ’537, ’592, and ’145 patents.

Both we and Cisco filed petitions for review of the USITC's Final Determination to the U.S. Court of Appeals for the Federal Circuit ("Federal Circuit"). The appeal is fully briefed and oral argument was held on June 6, 2017. The parties await the Federal Circuit's decision.

On August 26, 2016, Cisco filed an enforcement complaint under Section 337 with the USITC. Cisco alleges that we are violating the cease and desist and limited exclusion orders issued in the 944 Investigation by engaging in the "marketing, distribution, offering for sale, selling, advertising, and/or aiding or abetting other entities in the sale and/or distribution of products that Cisco alleges continue to infringe claims 1-2, 8-11, and 17-19 of the '537 patent," despite the design changes we have made to those products. Cisco asks the USITC to (1) enforce the cease and desist order; (2) modify the Commission's limited exclusion order and/or cease and desist order "in any manner that would assist in the prevention of the unfair practices that were originally the basis for issuing such Order or assist in the detection of violations of such Order"; (3) impose the maximum statutory civil penalties for violation of the cease and desist order "including monetary sanctions for each day's violation of the cease and desist order of the greater of \$100,000 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 ALJ Judge Shaw, who presided over the underlying investigation. On October 14, 2016, we responded to the complaint by, among other things, denying the patent infringement allegations and raising affirmative defenses. On November 2, 2016, the ALJ issued an order setting the deadline for the initial determination for June 20, 2017 and the Target Date for September 20, 2017. On April 4 and 5, 2017, the ALJ held the evidentiary hearing in this proceeding. On June 20, 2017, the ALJ issued his initial determination finding that Arista did not violate the June 23, 2016 cease and desist order. The initial determination also recommended a civil penalty of \$307 million if the Commission decided to overturn the finding of no violation. On July 3, 2017, the parties filed petitions for review of certain findings in the initial determination. The deadline for the Commission to decide whether to review the initial determination is August 4, 2017, and the Commission is scheduled to issue a final determination on September 20, 2017.

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

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

On December 9, 2016, the ALJ issued her initial determination finding a violation of Section 337. More specifically, the ALJ found that a violation has occurred in the importation into the United States, the sale for importation, or the sale within the United States after importation, of certain network devices, related software, and components thereof that the ALJ found infringe asserted claims 1, 7, 9, 10, and 15 of the '577 patent; and asserted claims 1, 2, 4, 5, 7, 8, 10, 13, 19, 56, and 64 of the '668 patent. The ALJ did not find a violation of Section 337 with respect to asserted claim 2 of the '577 patent or any asserted claims of the '853, '492, '875, and '211 patents. On December 29, 2016, Arista, Cisco and the Office of Unfair Importation Investigation ("OUII") filed petitions for review of certain findings contained in the initial determination. On March 1, 2017, the Commission issued a notice that it was reviewing the final initial determination in part on certain issues.

On May 4, 2017, the Commission issued its Final Determination, which found a violation with respect to the '577 and '668 patents, and found no violation with respect to the '211, '853, '875 and '492 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, 7, 9, 10, and 15 of the '577 patent and 1, 2, 4, 5, 7, 8, 10, 13, 18, 56, and 64 of the '668 patent. The 60-day Presidential review period for the 945 Investigation has expired. During the 60-day Presidential review period, the USITC Orders permitted Arista to continue importing and selling products covered by the orders so long as Arista paid a 5% bond. Because the United States Trade Representative did not disapprove the USITC's final determination, the limited exclusion order and cease and desist order are now in full effect, and Arista is barred from importing and selling infringing covered products in the United States. On June 30, 2017, Cisco filed a petition for review of the USITC's Final Determination to the Federal Circuit regarding the '853, '492, '875 and '211 patents.

On May 25, 2017 and June 1, 2017, the PTAB issued final written decisions finding all claims of the '577 and '668 patents that Arista was found to have infringed in the 945 Investigation unpatentable. On June 1, 2017 and June 2, 2017, Arista filed emergency petitions to suspend the remedial orders in the 945 Investigation. On June 12, 2017, Cisco filed a brief in response objecting to any suspension of the ITC Orders, while the OUII filed a brief in support of the requested suspension. On July 20, 2017, the Commission issued a notice denying our petition to suspend the remedial orders. On July 21, 2017, we filed a motion to stay the remedial orders in the 945 Investigation pending disposition of the relevant appeals and sought expedited

consideration of our motion. Cisco's opposition to that motion was filed on August 3, 2017. If necessary, we plan to file an emergency motion to stay the remedial orders with the Federal Circuit.

Inter Partes Reviews

We have filed petitions for Inter Partes Review 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. 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. Both parties have appealed the final written decisions on the '211 and '537 patents IPRs.

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

IPRs relating to the '668 (IPR No. 2016-00309), '577 (IPR No. 2016-00303), '853 (IPR No. 2016-0306), and '537 (IPR No. 2016-0308) patents were instituted in June 2016 and hearings were held on March 7, 2017. On May 25, 2017, the PTAB issued final written decisions finding claims 1, 7-10, 12-16, 18-22, 25, and 28-31 of '577 patent unpatentable, and that claim 2 of the '577 patent, claim 63 of the '853 patent, and claims 1, 10, 19, and 21 of the '537 patent had not been shown to be unpatentable. On June 1, 2017, the PTAB issued a final written decision finding claims 1-10, 12-13, 15-28, 30-31, 33-36, 55-64, 66-67, and 69-72 of the '668 patent unpatentable. Arista filed a Notice of Appeal concerning the '577 patent on July 21, 2017. Cisco cross-appealed concerning the '577 patent on July 26, 2017 and filed a Notice of Appeal concerning the '668 patent on August 1, 2017.

* * * * *

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

For example, in the 944 Investigation, the USITC 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 the 945 Investigation, the USITC issued a limited exclusion order barring entry into the United States of our network devices, related software, and components thereof that infringe one or more of the claims of the '577 and '668 patents specified above and a cease and desist order restricting our activities with respect to such imported products.

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

Specifically, in response to the USITC's findings in the 944 Investigation, we have made design changes to our products for sale in the United States to address the features that were found to infringe the '537, '592, and '145 patents. Following the issuance of the final determination in the 944 Investigation, we submitted a Section 177 ruling request to CBP seeking approval to import these redesigned products into the United States. On November 18, 2016, we received a 177 ruling from CBP finding that our redesigned products did not infringe the relevant claims of the '537, '592, and '145 patents, and approving the importation of these redesigned products into the United States. However, on January 13, 2017, at the request of Cisco and without our input, CBP issued a letter to us revoking its prior November 18 ruling. CBP subsequently conducted an *inter partes* proceeding between Arista and Cisco to determine whether our redesigned products infringe and whether to approve them for importation into the

United States. On April 7, 2017, following the *inter partes* proceeding, CBP again ruled that our redesigned products do not infringe the relevant claims of the '537, '592, and '145 patents and again approved those redesigns for importation into the United States.

Similarly, on May 4, 2017, the USITC issued a limited exclusion order and cease and desist order in the 945 Investigation with respect to the '668 and '577 patents. Because the ITC did not suspend its orders despite the PTAB decisions that found every relevant claim of the '668 and '577 patents to be unpatentable, Arista is currently barred from importing and selling infringing covered products in the United States. We have made design changes to our products for sale in the United States to address the features that were found to infringe the '577 and '668 patents. We are making ongoing modifications to our products to also ensure that they continue to meet customer requirements, and we are working with our customers to qualify those modified products for use in our customers' networks. In particular, the '577 patent was directed at a feature that is implemented in the merchant silicon chips that we purchase from third party suppliers. Because we do not design, build or manufacture these merchant silicon chips, we are limited in further modifications that we can make to our products for this patent. We are deploying these additional modifications for a subset of our products, while for others we will remove the feature until the '577 patent expires on June 30, 2018. These redesign and qualification efforts could be extremely costly and time consuming for us and our customers as well as disruptive to our other development activities and distracting to management. We may not be able to complete, and our customers may not be able to qualify these redesigned products in a timely fashion, if at all. This could result in an inability to ship those redesigned products to our customers, a delay or cancellation of purchases by some customers until those further modifications are completed and/or qualified or a rejection or return of our redesigned products, any of which could materially and adversely affect our business, prospects, reputation, results of operations or financial condition. We will also need to obtain the USITC and/or CBP approvals described above to resume importation of our redesigned products into the United States. On July 21, 2017, we submitted a request to CBP under Section 177 of its rules seeking approval to import our redesigned products into the United States. If we are unable to obtain USITC and/or CBP approvals to import our redesigned products or components of those products into the United States, our business, prospects, reputation, results of operations and financial condition could be materially or adversely affected.

If the USITC determines that our redesigned products continue to infringe the patents subject to any USITC limited exclusion order or cease and desist order in an enforcement action for either the 944 Investigation or the 945 Investigation, the USITC may impose the maximum statutory civil penalties for violation of the cease and desist order "including monetary sanctions for each day's violation of the cease and desist order of the greater of \$100,000 or twice the domestic value of the articles entered or sold, whichever is higher," bring a civil action in U.S. district court "requesting collection of such civil penalties and the issuance of a mandatory injunction preventing further violation of Cease and Desist Order," or impose "such other remedies and sanctions as are appropriate and within the Commission's authority." In the 944 Investigation, the ALJ recommended a civil penalty of \$307 million if the Commission were to reverse ALJ's finding of no violation.

An adverse finding in an enforcement action would take effect immediately upon USITC's issuance of the final determination, without any Presidential review period. To address such a finding, we would have to further redesign our products to make them non-infringing, and until we made such changes we would not be able to import or ship our products to customers. We may not be able to do so in a manner that does not continue to infringe the patents or that is acceptable to customers. We may not be able to complete, and our customers may not be able to qualify, such redesigned products in a timely fashion, if at all, following the issuance of an adverse final determination, leading to an inability to ship products to customers. Our redesign efforts could be extremely costly and time consuming as well as disruptive to our other development activities and distracting to management. For example, in the enforcement action for the 944 Investigation, although the ALJ issued his initial determination finding that Arista's redesigned products did not violate the June 23, 2016 cease and desist order, if the Commission overturns that finding in its final determination on September 20, 2017, we will no longer be able to import or ship our products in the U.S. until we make further changes to address those findings, which could materially and adversely affect our business, prospects, reputation, results of operations or financial condition. We would also need to obtain USITC or CBP approval to resume importation of such redesigned products into the United States. In addition, the USITC would not provide a service and support exception for our previously redesigned products, and customers may be required to upgrade to new products to obtain service and support. If we are unable to obtain such approvals or provide such service and support exception, our business, prospects, reputation, results of operations or financial condition could be materially and adversely affected.

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

In connection with these changes, to the extent that we are required to make further modifications to our supply chain to obtain alternative U.S. sources for subcomponents, we may be unable to obtain a sufficient quantity of these components on

commercially reasonable terms or in a timely manner, if at all, which could delay or halt entirely production of our products or require us to make further modifications to our products to incorporate new components that are available in the United States. Any of these events could result in lost sales, reduced gross margins or damage to our end-customer relationships, which would materially and adversely impact our business, financial condition, results of operations and prospects.

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

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.

In the Matter of Certain Semiconductor Devices, Semiconductor Device Packages, and Products Containing Same (U.S. International Trade Commission Investigation No. 337-TA-1010)

On May 23, 2016, Tessera Technologies, Inc., Tessera, Inc., and Invensas Corp. ("Tessera") filed a complaint in the USITC alleging that Broadcom Limited, Broadcom Corporation, Avago Technologies Limited, and Avago Technologies U.S. Inc. ("Broadcom") and certain of Broadcom's customers violated 19 U.S.C. § 1337 ("Section 337"). On June 20, 2016, the USITC instituted Tessera's complaint as Investigation No. 337-TA-1010.

Tessera alleges that certain Broadcom semiconductor devices infringe U.S. Patent No. 6,856,007; U.S. Patent No. 6,849,946; and U.S. Patent No. 6,133,136. Tessera further alleges that Broadcom's downstream customers, Arista Networks, Inc.; ARRIS International plc; ARRIS Group, Inc.; ARRIS Technology, Inc.; ARRIS Enterprises LLC; ARRIS Solutions, Inc.; Pace Ltd.; Pace Americas, LLC; Pace USA; LLC, ASUSStK Computer Inc.; ASUS Computer International; Comcast Cable Communications, LLC; Comcast Cable Communications Management, LLC; Comcast Business Communications, LLC; HTC Corporation; HTC America, Inc.; NETGEAR, Inc.; Technicolor S.A.; Technicolor USA, Inc.; and Technicolor Connected Home USA LLC ("Downstream Respondents") are violating Section 337 by importing, selling after importation, or selling for importation products that incorporate the accused Broadcom semiconductor devices. The accused Company products include certain models of our switching products.

Tessera seeks the following relief: (1) a permanent limited exclusion order excluding from importation into the U.S. all of Broadcom's semiconductor devices and semiconductor device packages, as well as Downstream Respondents' products containing Broadcom's semiconductor devices that infringe one or more of the three patents-in-suit and (2) a permanent cease and desist order prohibiting Broadcom and the Downstream Respondents and related companies from importing, marketing, advertising, demonstrating, warehousing inventory for distribution, offering for sale, selling, qualifying for use in the products of others, distributing, or using the accused Broadcom semiconductor devices and Downstream Respondents' products containing Respondents' semiconductor devices and semiconductor device packages that infringe one or more of the three patents subject to the ITC Investigation.

The evidentiary hearing was held from March 27-31, 2017. On June 30, 2017, the ALJ issued an initial determination that found a violation with respect to the '946 patent and no violation with respect the '136 and '007 patents. The ALJ recommended that the Commission issue limited exclusion and cease and desist orders and recommended a 100% bond for imports during the Presidential review period. Broadcom and the Downstream Respondents are petitioning for Commission review of the initial determination and the target date for the final determination is October 30, 2017.

To the extent claims made by Tessera in the USITC Investigation against Arista are based solely on functionality residing in Broadcom's products, Broadcom has agreed to defend Arista at no cost to Arista.

* * * * *

An adverse final determination from the Commission could result in issuance of remedial orders that could prevent Broadcom, Arista, and the other Downstream Respondents from selling infringing products for import into the United States, importing infringing products into the United States, or selling infringing products after importation into the United States. This could include both the infringing semiconductor devices as well as downstream products, including Arista's Ethernet switches, that incorporate those devices. During the 60-day Presidential review period following the final determination, Broadcom, Arista, and the other Downstream Respondents could continue to import and sell infringing products by paying a

bond. The ALJ's recommended bond is 100% of the entered value of the product. Following the end of the Presidential review period, if the U.S. Trade Representative chooses not to disapprove the final determination, the orders would go into full effect.

If the USITC orders go into full effect, to continue importing and selling products found to be infringing, Broadcom and its manufacturers would need to develop redesigned products that do not infringe, and Arista would have to integrate these devices into its own products, or Broadcom and/or the Downstream Respondents would need to obtain a license from Tesser. It may not be possible to do this in a timely fashion, if at all. Because the asserted patents are directed towards technology used in the manufacture of the semiconductor devices not manufactured or designed by Arista, Arista would be dependent on Broadcom and its manufacturers to create such redesigned products.

Before Broadcom, Arista, or the other Downstream Respondents could import redesigned products into the United States, the products would have to be approved by CBP or the USITC. We may not be successful in any efforts to obtain such approvals in a timely manner, or at all. While a favorable ruling from CBP would allow Broadcom, Arista, and the other Downstream Respondents to resume importation of our redesigned products into the United States, the USITC could alternately determine in an enforcement action that such redesigned products continue to infringe the patents that are the subject of the USITC orders.

Any failure to effectively redesign these products and obtain timely clearance from CBP or USITC to import such redesigned products or to obtain a license from Tesser may cause a disruption to our product shipments and materially and adversely affect our business, prospects, reputation, results of operations, and financial condition. However, it is our belief that at this stage of the legal proceedings, the likelihood of a loss is remote.

Other Matters

In the ordinary course of business, we are a party to other claims and legal proceedings including matters relating to commercial, employee relations, business practices and intellectual property. We record a provision for contingent losses when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. As of June 30, 2017, provisions recorded for contingent losses related to other claims and matters have not been significant. Based on currently available information, management does not believe that any additional liabilities relating to other unresolved matters are probable or that the amount of any resulting loss is estimable, and believes these other matters are not likely, individually and in the aggregate, to have a material adverse effect on our financial position, results of operations or cash flows. However, litigation is subject to inherent uncertainties and our view of these matters may change in the future. Were an unfavorable outcome to occur, there exists the possibility of a material adverse impact on our financial position, results of operations or cash flows for the period in which the unfavorable outcome occurs, and potentially in future periods.

6. Equity Award Plan Activities

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 June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Cost of revenue	\$ 1,087	\$ 868	\$ 2,111	\$ 1,661
Research and development	10,342	7,595	19,929	15,052
Sales and marketing	4,080	3,780	7,536	7,427
General and administrative	2,891	1,989	5,263	3,452
Total stock-based compensation	\$ 18,400	\$ 14,232	\$ 34,839	\$ 27,592

Stock Option Activities

On February 6, 2017, the board authorized an increase to shares available for future issuance under the 2014 Equity Incentive Plan (“EIP”). Per the EIP, the increase is determined based on the lesser of 3% of total shares outstanding as of the first day of each fiscal year, 12,500,000 shares, or such amount as determined by our board of directors. The approved increase for 2017 amounted to 2,124,333 shares. As of June 30, 2017, there remain 13.7 million shares available for issuance under the EIP.

The following table summarizes the option activity under our equity stock plans and related information:

	Options Outstanding		Weighted-Average Remaining Contractual Term (Years) of Stock Options	Aggregate Intrinsic Value of Stock Options Outstanding (in thousands)
	Number of Shares Underlying Outstanding Options (in thousands)	Weighted-Average Exercise Price per Share		
Outstanding—December 31, 2016	9,509	\$ 28.79	6.9	\$ 646,394
Options granted	170	96.61		
Options exercised	(1,325)	16.69		
Options canceled	(306)	32.59		
Outstanding—June 30, 2017	8,048	\$ 32.07	6.6	\$ 947,409
Vested and exercisable—June 30, 2017	3,044	\$ 17.89	5.8	\$ 401,454
Vested and expected to vest—June 30, 2017	8,048	\$ 32.07	6.6	\$ 947,409

As of June 30, 2017, the total unrecognized stock-based compensation expense related to unvested stock options was \$82.2 million, which is expected to be recognized over a weighted-average period of 3.7 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, 2016	1,375	\$ 74.23	1.8	\$ 133,081
RSUs granted	392	117.94		
RSUs vested	(226)	73.26		
RSUs forfeited	(44)	72.68		
Unvested balance—June 30, 2017	1,497	\$ 85.87	1.8	\$ 224,290
Vested and expected to vest—June 30, 2017	1,497	\$ 85.87	1.8	\$ 224,290

As of June 30, 2017, there was \$119.5 million of unrecognized stock-based compensation cost related to unvested RSUs. This amount is expected to be recognized over a weighted-average period of 3.4 years.

Equity Incentive Plan Shares Available for Grant

The following table presents EIP stock activity and the total number of shares available for future grant as of June 30, 2017 (in thousands):

	<u>Number of Shares</u>
Balance—December 31, 2016	11,754
Authorized	2,124
Options granted	(170)
RSUs granted	(392)
Options canceled	306
Options repurchased	2
RSUs forfeited	44
Shares traded for taxes	10
Balance—June 30, 2017	<u>13,678</u>

Employee Stock Purchase Plan Activities

During the six months ended June 30, 2017, we issued 99,804 shares at a weighted average purchase price of \$60.03 under the 2014 Employee Stock Purchase Plan ("ESPP"). On February 6, 2017, 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, 2,500,000 shares, or such amount as determined by our board of directors. The approved increase for 2017 amounted to 708,111 shares. As of June 30, 2017, there remain 2,092,153 shares available for issuance under the ESPP.

As of June 30, 2017, the total unrecognized stock-based compensation expense related to unvested ESPP options was \$ 2.6 million, which is expected to be recognized over a weighted-average period of 1.2 years.

7. Net Income Per Share Available to Common Stock

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Numerator:				
Basic:				
Net income	\$ 102,685	\$ 38,904	\$ 185,646	\$ 74,149
Less: undistributed earnings allocated to participating securities	(231)	(287)	(507)	(614)
Net income available to common stockholders, basic	<u>\$ 102,454</u>	<u>\$ 38,617</u>	<u>\$ 185,139</u>	<u>\$ 73,535</u>
Diluted:				
Net income attributable to common stockholders, basic	\$ 102,454	\$ 38,617	\$ 185,139	\$ 73,535
Add: undistributed earnings allocated to participating securities	20	18	43	38
Net income attributable to common stockholders, diluted	<u>\$ 102,474</u>	<u>\$ 38,635</u>	<u>\$ 185,182</u>	<u>\$ 73,573</u>
Denominator:				
Basic:				
Weighted-average shares used in computing net income per share available to common stockholders, basic	<u>71,992</u>	<u>68,275</u>	<u>71,555</u>	<u>68,006</u>
Diluted:				
Weighted-average shares used in computing net income per share available to common stockholders, basic	71,992	68,275	71,555	68,006
Add weighted-average effect of dilutive securities:				
Stock options and RSUs	6,625	4,488	6,474	4,466
Employee stock purchase plan	139	54	137	51
Weighted-average shares used in computing net income per share available to common stockholders, diluted	<u>78,756</u>	<u>72,817</u>	<u>78,166</u>	<u>72,523</u>
Net income per share attributable to common stockholders:				
Basic	<u>\$ 1.42</u>	<u>\$ 0.57</u>	<u>\$ 2.59</u>	<u>\$ 1.08</u>
Diluted	<u>\$ 1.30</u>	<u>\$ 0.53</u>	<u>\$ 2.37</u>	<u>\$ 1.01</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 June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Stock options and RSUs to purchase common stock	18	3,211	103	3,487

8. Income Taxes

We had a provision for income taxes of \$14.4 million and \$5.2 million in the three and six months ended June 30, 2017, respectively as compared to an income tax provision of \$13.9 million and \$28.0 million in the three and six months ended June 30, 2016, respectively. For the three and six months ended June 30, 2017, the change in our income taxes as compared to the same periods in 2016 was primarily due to the recognition of excess tax benefits of \$19.1 million and \$47.9 million as a component of the provision for income taxes resulting from the adoption of ASU 2016-09, offset by an increase in the tax provision driven by higher profits before 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. 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 and the subsequent years remain open for audit. It is difficult to determine when the examinations will ultimately be settled. We believe that we have adequately provided reserves for any reasonably foreseeable adjustment to our tax returns. It is likely that within the next 12 months that either the IRS examination for tax year 2013 and 2014 will be settled or the statute of limitations will run for jurisdictions in which we have unrecognized tax benefits recorded. The settlement or statute lapse would result in a reduction of the unrecognized tax benefit recorded. The reduction may range from no change up to approximately \$3.7 million.

Our gross unrecognized tax benefits as of June 30, 2017 were \$32.2 million. If the gross unrecognized tax benefits as of June 30, 2017 were realized in future periods, this could result in a tax benefit of \$19.1 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 June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
United States	\$ 300,357	\$ 198,958	\$ 562,746	\$ 379,834
Other Americas	3,663	2,359	6,137	4,124
Europe, Middle East and Africa	77,367	42,644	120,101	86,383
Asia-Pacific	23,824	24,780	51,702	40,596
Total revenue	\$ 405,211	\$ 268,741	\$ 740,686	\$ 510,937

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

	June 30, 2017	December 31, 2016
United States	\$ 68,900	\$ 69,352
International	6,940	7,609
Total	\$ 75,840	\$ 76,961

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 unaudited condensed 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 17, 2017. 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 switching and routing platforms. Our cloud networking solutions deliver industry-leading performance, scalability, availability, programmability, automation and visibility. At the core of our cloud networking platform is EOS, which was purpose-built to be fully programmable and highly modular. The programmability of EOS has allowed us to create a set of software applications that address the requirements of cloud networking, including workflow automation, network visibility and analytics, and has also allowed us to rapidly integrate with a wide range of third-party applications for virtualization, management, automation, orchestration and network services.

We believe that cloud networks will continue to replace legacy network technologies, and 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. Cloud 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 expect to continue growing our organization to meet the needs of new and existing customers as they increasingly realize the performance and cost benefits of our cloud networking solutions and as they expand their cloud networks. Accordingly, 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 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. 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. As we have grown the functionality of our EOS software, expanded the range of our product portfolio and increased the size of our sales force, our revenue has continued to grow rapidly. We have also been profitable and cash flow positive for each year since 2010.

To continue to grow our revenue, it is important that we both obtain new customers and sell additional products to existing customers. We expect that a substantial portion of our future sales will be follow-on sales to existing customers. We intend to continue expanding our sales force and marketing activities in key geographies, as well as our relationships with channel, technology and system-level partners in order to reach new end customers more effectively, increase sales to existing customers, and provide services and support effectively. 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.

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

Historically, large purchases by a relatively limited number of end customers have accounted for significant portion of our revenue. We have 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.

Furthermore, to comply with the limited exclusion order and cease and desist order in the 945 Investigation as described above in Note 5, entitled Commitments and Contingencies, we have made design changes to our products for sale in the United States to address the features that were found to infringe the '577 and '668 patents. We will continue to improve this with product modifications to meet ongoing customer requirements. As described in Note 5, we will need to complete these further modifications and seek qualification and acceptance by our customers. We will also need to obtain the necessary approvals described in Note 5 in order to resume importation of our redesigned products into the United States. On July 21, 2017, we submitted a Section 177 request to CBP seeking approval to import our redesigned products into the United States.

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 six months ended June 30, 2017 and 2016 from our unaudited condensed consolidated financial statements (in thousands, except for percentages).

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Revenue:				
Product	\$ 353,904	\$ 235,616	\$ 645,271	\$ 448,091
Service	51,307	33,125	95,415	62,846
Total revenue	405,211	268,741	740,686	510,937
Cost of revenue ⁽¹⁾ :				
Product	134,406	88,021	244,242	166,934
Service	11,028	9,269	22,457	17,462
Total cost of revenue	145,434	97,290	266,699	184,396
Gross profit	259,777	171,451	473,987	326,541
Operating expenses ⁽¹⁾ :				
Research and development	81,194	69,020	162,804	131,535
Sales and marketing	38,630	31,744	75,657	59,350
General and administrative	23,319	17,529	45,474	32,763
Total operating expenses	143,143	118,293	283,935	223,648
Income from operations	116,634	53,158	190,052	102,893
Interest expense	(623)	(732)	(1,338)	(1,483)
Other income (expense), net	1,119	416	2,144	753
Total other income (expense), net	496	(316)	806	(730)
Income before provision for income taxes	117,130	52,842	190,858	102,163
Provision for income taxes	14,445	13,938	5,212	28,014
Net income	\$ 102,685	\$ 38,904	\$ 185,646	\$ 74,149

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(as a percentage of revenue)			
Revenue:				
Product	87.3 %	87.7 %	87.1 %	87.7 %
Service	12.7	12.3	12.9	12.3
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Product	33.2	32.8	33.0	32.7
Service	2.7	3.4	3.0	3.4
Total cost of revenue	35.9	36.2	36.0	36.1
Gross margin	64.1	63.8	64.0	63.9
Operating expenses:				
Research and development	20.0	25.7	22.0	25.7
Sales and marketing	9.5	11.8	10.2	11.6
General and administrative	5.8	6.5	6.1	6.4
Total operating expenses	35.3	44.0	38.3	43.7
Income from operations	28.8	19.8	25.7	20.2
Interest expense	(0.2)	(0.3)	(0.2)	(0.3)
Other income (expense), net	0.3	0.2	0.3	0.1
Total other income (expense), net	0.1	(0.1)	0.1	(0.2)
Income before provision for income taxes	28.9	19.7	25.8	20.0
Provision for income taxes	3.6	5.2	0.7	5.5
Net income	25.3 %	14.5 %	25.1 %	14.5 %

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Cost of revenue	\$ 1,087	\$ 868	\$ 2,111	\$ 1,661
Research and development	10,342	7,595	19,929	15,052
Sales and marketing	4,080	3,780	7,536	7,427
General and administrative	2,891	1,989	5,263	3,452
Total stock-based compensation	\$ 18,400	\$ 14,232	\$ 34,839	\$ 27,592

Three and Six Months Ended June 30, 2017 Compared to Three and Six Months Ended June 30, 2016

Revenue, Cost of Revenue and Gross Margin

We generate revenue primarily from sales of our switching products, and a portion of our revenue from sales of PCS. We expect our revenue may vary from period to period based on, among other things, the timing and size of orders, the delivery and acceptance of products, and the impact of significant transactions with unique terms and conditions that may require deferral of revenue.

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

Gross margin, 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, manufacturing-related costs including costs associated with supply chain sourcing activities, 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.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017	2016	Change in		2017	2016	Change in	
	\$	\$	\$	%	\$	\$	\$	%
<i>(in thousands, except percentages)</i>								
Revenue								
Product	\$ 353,904	\$ 235,616	\$ 118,288	50.2%	\$ 645,271	\$ 448,091	\$ 197,180	44.0%
Service	51,307	33,125	18,182	54.9	95,415	62,846	32,569	51.8
Total revenue	405,211	268,741	136,470	50.8	740,686	510,937	229,749	45.0
Cost of revenue								
Product	134,406	88,021	46,385	52.7	244,242	166,934	77,308	46.3
Service	11,028	9,269	1,759	19.0	22,457	17,462	4,995	28.6
Total cost of revenue	145,434	97,290	48,144	49.5	266,699	184,396	82,303	44.6
Gross profit	\$ 259,777	\$ 171,451	\$ 88,326	51.5%	\$ 473,987	\$ 326,541	\$ 147,446	45.2%
Gross margin	64.1%	63.8%			64.0%	63.9%		

Revenue by Geography

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017	% of Total	2016	% of Total	2017	% of Total	2016	% of Total
	<i>(in thousands, except percentages)</i>							
Americas	\$ 304,020	75.0%	\$ 201,317	74.9%	\$ 568,883	76.8%	\$ 383,958	75.1%
Europe, Middle East and Africa	77,367	19.1	42,644	15.9	120,101	16.2	86,383	16.9
Asia-Pacific	23,824	5.9	24,780	9.2	51,702	7.0	40,596	8.0
Total revenue	\$ 405,211	100.0%	\$ 268,741	100.0%	\$ 740,686	100.0%	\$ 510,937	100.0%

Revenue

Product revenue increased 50.2% in the three months ended June 30, 2017 and 44.0% in the six months ended June 30, 2017, compared to the same periods in 2016. The increase 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. In addition, our newer products have continued to gain market acceptance, which has contributed to our revenue growth. Service revenue increased 54.9% in the three months ended June 30, 2017 and 51.8% in the six months ended June 30, 2017, compared to the same periods in 2016, as a result of continued growth in initial and renewal support contracts as our customer installed base continued to expand. We continue to experience pressure on both product and service pricing due to competitive market conditions. However, this pricing pressure was more than offset by the increased demand drivers outlined above.

Cost of Revenue and Gross Margin

Cost of revenue increased \$48.1 million in the three months ended June 30, 2017 and \$82.3 million for the six months ended June 30, 2017, compared to the same periods in 2016. The increase in cost of revenue was primarily due to an increase in product shipment volumes and the corresponding increase in product revenue. Gross margin remained generally consistent, increasing slightly from 63.8% to 64.1% for the three months ended June 30, 2017 and 63.9% to 64.0% for the six months ended June 30, 2017, compared to the same periods in 2016. Gross margin benefited from improved service margins as we scale our services business, but this improvement was partially offset by slightly lower product margins reflecting a somewhat higher mix of shipments to larger end customers who receive lower pricing terms due to volume discounts.

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.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017	2016	Change in		2017	2016	Change in	
	\$	\$	\$	%	\$	\$	\$	%
<i>(in thousands, except percentages)</i>								
Operating expenses:								
Research and development	\$ 81,194	\$ 69,020	\$ 12,174	17.6%	\$ 162,804	\$ 131,535	\$ 31,269	23.8%
Sales and marketing	38,630	31,744	6,886	21.7	75,657	59,350	16,307	27.5
General and administrative	23,319	17,529	5,790	33.0	45,474	32,763	12,711	38.8
Total operating expenses	\$ 143,143	\$ 118,293	\$ 24,850	21.0%	\$ 283,935	\$ 223,648	\$ 60,287	27.0%

Research and development

Research and development expenses consist primarily of personnel costs, prototype expenses, third-party engineering and contractor support costs, and an allocated portion of facility and IT costs. 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 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.

Research and development expenses increased for the three and six months ended June 30, 2017 compared to the same periods in 2016. The increase in each period was primarily due to increased personnel costs of \$6.6 million and \$14.6 million in the three and six months ended June 30, 2017, respectively as compared to the same periods in 2016. These increases were driven by headcount growth, resulting in additional compensation costs including stock-based compensation charges. In addition, prototype, third-party engineering and consulting costs grew \$4.3 million and \$14.7 million in the three and six months ended June 30, 2017, respectively as compared to the same periods in 2016.

Sales and marketing

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

Sales and marketing expenses increased for the three and six months ended June 30, 2017 compared to the same periods in 2016. The increase in each period was driven by personnel costs which increased by \$5.0 million and \$12.0 million in the three and six months ended June 30, 2017, respectively as compared to the same periods in 2016. These increases were primarily due to headcount growth and higher sales volumes, driving increased compensation costs, including commissions. In addition, sales support costs increased by \$2.1 million and \$4.1 million, in the three and six months ended June 30, 2017, respectively as compared to the same periods in 2016, reflecting increased professional services and field demonstration costs.

General and administrative

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

General and administrative expenses increased for the three and six months ended June 30, 2017 compared to the same periods in 2016. The increase in each period was primarily due to an increase in Optumsoft and Cisco litigation related expenses of \$4.4 million and \$8.8 million in the three and six months ended June 30, 2017, respectively as compared to the same periods in 2016. The amounts in each period include bond costs associated with the importation and sale of affected products and components during

the presidential review period of the 945 investigation. In addition, other professional services and overall stock-based compensation charges increased by \$1.3 million and \$2.7 million in the three and six months ended June 30, 2017, respectively as compared to the same periods in 2016.

Other Income (Expense), Net

Other income (expense), net primarily consists of interest income on marketable securities and foreign currency transaction gains and losses, and interest expense from our lease financing obligation.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017	2016	Change in		2017	2016	Change in	
	\$	\$	\$	%	\$	\$	\$	%
<i>(in thousands, except percentages)</i>								
Other income (expense), net:								
Interest expense	\$ (623)	\$ (732)	\$ 109	14.9%	\$ (1,338)	\$ (1,483)	\$ 145	9.8%
Other income (expense), net	1,119	416	703	169.0	2,144	753	1,391	(184.7)
Total other income (expense), net	<u>\$ 496</u>	<u>\$ (316)</u>	<u>\$ 812</u>	<u>257.0%</u>	<u>\$ 806</u>	<u>\$ (730)</u>	<u>\$ 1,536</u>	<u>210.4%</u>

Other income (expense), net

Other income (expense), net improved during the three and six months ended June 30, 2017 compared to the same periods in 2016 primarily due to a net increase in interest income resulting from an increase in our marketable securities portfolio.

Provision (Benefit) 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.

	Three Months Ended June 30,				Six Months Ended June 30,			
	2017	2016	Change in		2017	2016	Change in	
	\$	\$	\$	%	\$	\$	\$	%
<i>(in thousands, except percentages)</i>								
Provision (benefit) for income taxes	\$ 14,445	\$ 13,938	\$ 507	3.6%	\$ 5,212	\$ 28,014	\$ (22,802)	(81.4)%
Effective tax rate	12.3%	26.4%			2.7%	27.4%		

The effective tax rate for the three and six months ended June 30, 2017 was significantly lower than the U.S federal statutory rate primarily due to the recognition of excess tax benefits resulting from the adoption of ASU 2016-09, and earnings taxed at lower rates in foreign jurisdictions. The decrease in the effective tax rate in the three and six months ended June 30, 2017, as compared to the same periods in 2016, was primarily due to the recognition of excess tax benefits as a component of the provision for income taxes attributable to the adoption of ASU 2016-09. Prior to the adoption, these benefits were recorded as a component of shareholders' equity. Our future effective tax rate may fluctuate based upon our stock price and the amount of stock options exercised and equity awards vested in the quarter.

Liquidity and Capital Resources

Our principal sources of liquidity are cash and cash equivalents, marketable securities, and cash generated from operations. As of June 30, 2017, cash and cash equivalents, and marketable securities were \$1.1 billion, of which approximately \$125.1 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 June 30, 2017 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 flows 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

	Six Months Ended June 30,	
	2017	2016
	(in thousands)	
Cash provided by operating activities	\$ 242,095	\$ 141,996
Cash used in by investing activities	(12,930)	(308,177)
Cash provided by financing activities	25,976	9,972
Effect of exchange rate changes	411	(59)
Net increase (decrease) in cash and cash equivalents	\$ 255,552	\$ (156,268)

Cash Flows from Operating Activities

During the six months ended June 30, 2017, cash provided by operating activities was \$242.1 million, resulting from net income of \$185.6 million non-cash adjustments to net income of \$37.1 million, and a net increase in cash from changes in our operating assets and liabilities of \$19.3 million. Our operating cash benefited from increased deferred revenue of \$181.6 million resulting from growth in product deferred revenue related to contract acceptance terms and ongoing growth in PCS contracts. These increases were partially offset by growth in inventory of \$127.3 million, supporting overall growth in the business and the expansion of our manufacturing and supply chain activities. In addition, accounts receivable increased by \$16.5 million related to timing of billing and cash collections, and prepaid expenses and current assets increased by \$22.2 million primarily due to higher deferred cost of inventory associated with the increased product revenue deferrals referenced above, partially offset by a reduction in inventory deposits.

During the six months ended June 30, 2016, cash provided by operating activities was \$142.0 million, primarily from net income of \$74.1 million, net non-cash adjustments to net income of \$30.8 million, and a net increase in cash from changes in our operating assets and liabilities of \$37.1 million. The increase in cash from changes in operating assets and liabilities was primarily due to an increase in deferred revenue of \$33.5 million mostly related to new and renewed PCS contracts, an increase in accounts payable of \$18.5 million primarily due to timing of vendor payments, and an increase in cash of \$17.9 million from changes in income taxes payable. Cash outflows from changes in operating assets and liabilities primarily consisted of net inventory purchases of \$26.0 million as we continue to build our inventory balances.

Cash Flows from Investing Activities

During the six months ended June 30, 2017, cash used in investing activities was \$12.9 million, consisting of purchases of available-for-sale securities of \$114.2 million, offset by proceeds of \$112.1 million and purchases of property, equipment and other assets of \$9.5 million.

During the six months ended June 30, 2016, cash used in investing activities was \$308.2 million, consisting of purchases of available-for-sale securities of \$292.9 million, purchases of property, equipment and other assets of \$12.7 million, and an additional investment in a privately-held company of \$2.5 million.

Cash Flows from Financing Activities

During the six months ended June 30, 2017, cash provided by financing activities was \$26.0 million, consisting primarily of proceeds from the issuance of common stock under employee equity incentive plans of \$28.1 million.

During the six months ended June 30, 2016, cash provided by financing activities was \$10.0 million, consisting primarily of proceeds from equity incentive plans of \$11.2 million, offset by minimum tax withheld for employees and payments for lease financing obligations of \$1.2 million.

Off-Balance Sheet Arrangements

As of June 30, 2017, we did not have any relationships with any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

Contractual Obligations and Commitments

As of June 30, 2017, our principal commitments consist of obligations under operating leases and purchase commitments. There have been no significant changes to these obligations during the six months ended June 30, 2017, 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 17, 2017, 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 management's discussion and analysis of financial condition and results of operations is based on our unaudited condensed consolidated financial statements, which have been prepared in accordance with GAAP. 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 17, 2017, 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 June 30, 2017 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, 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 June 30, 2017, we had approximately \$301.4 million invested in available-for-sale marketable securities. The effect of an immediate 10% change in interest rates at June 30, 2017 would not have a material adverse impact on our future operating results and cash flows. As of June 30, 2017, 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 June 30, 2017, 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 June 30, 2017, 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, as amended, that occurred during the quarter ended June 30, 2017 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 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, and we expect both to continue to grow over the next year. For example, between December 31, 2011 and December 31, 2016, our headcount grew from approximately 250 employees to approximately 1,500 employees, and our cumulative number of end customers grew from approximately 1,100 to over 4,200. As we have grown, we have had to manage an increasingly large and more complex array of internal systems and processes to scale with all aspects of our business, including our hardware and software development, contract manufacturing and purchasing, logistics and fulfillment and maintenance and support. Our success will depend in part upon our ability to manage our growth effectively. To do so, we must continue to increase the productivity of our existing employees and continue to hire, train and manage new employees as needed. To manage domestic and international growth of our operations and personnel, we will need to continue to improve our operational, financial and management controls and our reporting processes and procedures and implement more extensive and integrated financial and business information systems. We may not be able to successfully implement these or other improvements to our systems and processes in an efficient or timely manner, and we may discover deficiencies in their capabilities or effectiveness. We may experience difficulties in managing improvements to our systems and processes or in connection with third-party technology. In addition, our systems and processes may not prevent or detect all errors, omissions or fraud. Our failure to improve our systems and processes, or their failure to operate effectively and in the intended manner, may result in disruption of our current operations and end-customer relationships, our inability to manage the growth of our business and our inability to accurately forecast our revenue, expenses and earnings and prevent certain losses.

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

We shipped our first products in 2008 and the majority of our revenue growth has occurred since the beginning of 2010. Our limited operating history makes it difficult to evaluate our current business and our future prospects, including our ability to plan for and model future growth. We have encountered and will continue to encounter risks and difficulties frequently experienced by rapidly growing companies in constantly evolving industries, including the risks described elsewhere in this 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 increase sales to existing customers and attract new end customers, including large end customers;
- the budgeting cycles and purchasing practices of end customers, including large end customers who may receive lower pricing terms due to volume discounts;
- the buying patterns of our large end customers in which large bulk purchases may or may not occur in certain quarters;
- the cost and potential outcomes of existing and future litigation, including Cisco and Optumsoft litigation matters;
- our ability to comply with any remedial orders issued in connection with the Cisco litigation including our ability to develop, market and sell redesigned products that are not covered by such remedial orders;
- the rate of expansion and productivity of our sales force;
- changes in our pricing policies, whether initiated by us or as a result of competition;
- our inability to fulfill our end customers' orders due to supply chain delays, access to key commodities or technologies or events that impact our manufacturers or their suppliers;
- the amount and timing of operating costs and capital expenditures related to the operation and expansion of our business;
- changes in end-customer, distributor or reseller requirements or market needs;
- deferral or cancellation of orders from end customers, including in anticipation of new products or product enhancements announced by us or our competitors, or warranty returns;
- the inclusion of any acceptance provisions in our customer contracts or any delays in acceptance of those products;
- changes in the growth rate of the networking market;
- the actual or rumored timing and success of new product and service introductions by us or our competitors or any other change in the competitive landscape of our industry, including consolidation among our competitors or end customers;
- our ability to successfully expand our business domestically and internationally;
- our ability to increase the size of our distribution channel;
- decisions by potential end customers to purchase cloud networking solutions from larger, more established vendors, white box vendors or their primary network equipment vendors;
- price competition;
- insolvency or credit difficulties confronting our end customers, which could adversely affect their ability to purchase or pay for our products and services, or confronting our key suppliers, including our sole source suppliers, which could disrupt our supply chain;
- any disruption in our sales channel or termination of our relationship with important channel partners;
- seasonality or cyclical fluctuations in our markets;
- future accounting pronouncements or changes in our accounting policies;
- stock-based compensation expense;
- our overall effective tax rate, including impacts caused by any reorganization in our corporate structure, any changes in our valuation allowance for domestic deferred tax assets and any new legislation or regulatory developments;
- increases or decreases in our expenses caused by fluctuations in foreign currency exchange rates, as an increasing portion of our expenses are incurred and paid in currencies other than the U.S. dollar;
- general economic conditions, both domestically and in foreign markets; and
- other risk factors described in this 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 16% of our revenue for the year ended December 31, 2016, 12% of our revenue for the year ended December 31, 2015 and 15% of our revenue for the year ended December 31, 2014.

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

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

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

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

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

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

We also expect increased competition if our market continues to expand. Conditions in our market could change rapidly and significantly as a result of technological advancements or other factors. Current or potential competitors may be acquired by third parties that have greater resources available than we do. Our current or potential competitors might take advantage of the greater resources of the larger organization resulting from these acquisitions to compete more vigorously or broadly with us. In addition, continued industry

consolidation might adversely affect end customers' perceptions of the viability of smaller and even medium-sized networking companies and, consequently, end customers' willingness to purchase from those companies. Further, certain large end customers may develop network switches and cloud service solutions for internal use and/or to broaden their portfolio of products, which could allow these end customers to become new competitors in the market.

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

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

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

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

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

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

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

Trial began on November 28, 2016, and the jury rendered its verdict on December 14, 2016. The jury found that Arista had proven its copyright defense of *scenes a faire* and that Cisco had failed to prove infringement of the ’526 patent, and on that basis judgment was entered in Arista’s favor on all claims on December 19, 2016.

On January 17, 2017, Cisco filed a motion for judgment as a matter of law, challenging the sufficiency of the evidence in support of Arista’s *scenes a faire* defense. Cisco did not file any post-trial motion regarding the ’526 patent, nor did it file a motion for a new trial. We also filed a conditional motion for judgment as a matter of law and/or for a new trial on several grounds, which would be at issue only if the court granted Cisco’s motion. The hearing on both parties’ motions was held on April 27, 2017. On May 10, 2017, the court denied Cisco’s motion and denied our motions as moot.

Cisco filed a notice of appeal on June 6, 2017. The U.S. Court of Appeal for the Federal Circuit has docketed the appeal as Case No. 17-2145. No hearing date in the appeal has been set.

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 August 23, 2016, the Court granted Cisco’s motion to stay the ’23 Case until judgment has been entered on Cisco’s copyright claims in the ’44 Case. On March 2, 2017, the Court lifted the stay and trial is set for August 3, 2018.

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 19 U.S.C. § 1337 (“Section 337”). 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 2, 2016, the Administrative Law Judge (“ALJ”) issued his initial determination finding a violation of Section 337. 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 June 23, 2016, the Commission issued its Final Determination, which found a violation with respect to the '537, '592, and '145 patents, and found no violation with respect to the '597 and '164 patents. The Commission also issued a limited exclusion order and a cease and desist order pertaining to network devices, related software and components thereof that infringe one or more of claims 1, 2, 8-11, and 17-19 of the '537 patent; claims 6, 7, 20, and 21 of the '592 patent; and claims 5, 7, 45, and 46 of the '145 patent. On August 22, 2016, the Presidential review period for the 944 investigation expired. The USITC orders will be in effect until the expiration of the '537, '592, and '145 patents.

Both we and Cisco filed petitions for review of the USITC's Final Determination to the U.S. Court of Appeals for the Federal Circuit ("Federal Circuit"). The appeal is fully briefed and oral argument was held on June 6, 2017. The parties await the Federal Circuit's decision.

On August 26, 2016, Cisco filed an enforcement complaint under Section 337 with the USITC. Cisco alleges that we are violating the cease and desist and limited exclusion orders issued in the 944 Investigation by engaging in the "marketing, distribution, offering for sale, selling, advertising, and/or aiding or abetting other entities in the sale and/or distribution of products that Cisco alleges continue to infringe claims 1-2, 8-11, and 17-19 of the '537 patent," despite the design changes we have made to those products. Cisco asks the USITC to (1) enforce the cease and desist order; (2) modify the Commission's limited exclusion order and/or cease and desist order "in any manner that would assist in the prevention of the unfair practices that were originally the basis for issuing such Order or assist in the detection of violations of such Order"; (3) impose the maximum statutory civil penalties for violation of the cease and desist order "including monetary sanctions for each day's violation of the cease and desist order of the greater of \$100,000 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 ALJ Judge Shaw, who presided over the underlying investigation. On October 14, 2016, we responded to the complaint by, among other things, denying the patent infringement allegations and raising affirmative defenses. On November 2, 2016, the ALJ issued an order setting the deadline for the initial determination for June 20, 2017 and the Target Date for September 20, 2017. On April 4 and 5, 2017, the ALJ held the evidentiary hearing in this proceeding. On June 20, 2017, the ALJ issued his initial determination finding that Arista did not violate the June 23, 2016 cease and desist order. The initial determination also recommended a civil penalty of \$307 million if the Commission decided to overturn the finding of no violation. On July 3, 2017, the parties filed petitions for review of certain findings in the initial determination. The deadline for the Commission to decide whether to review the initial determination is August 4, 2017, and the Commission is scheduled to issue a final determination on September 20, 2017.

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

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

On December 9, 2016, the ALJ issued her initial determination finding a violation of Section 337. More specifically, the ALJ found that a violation has occurred in the importation into the United States, the sale for importation, or the sale within the United States after importation, of certain network devices, related software, and components thereof that the ALJ found infringe asserted claims 1, 7, 9, 10, and 15 of the '577 patent; and asserted claims 1, 2, 4, 5, 7, 8, 10, 13, 19, 56, and 64 of the '668 patent. The ALJ did not find a violation of Section 337 with respect to asserted claim 2 of the '577 patent or any asserted claims of the '853, '492, '875, and '211 patents. On December 29, 2016, Arista, Cisco and the Office of Unfair Importation Investigation ("OUII") filed petitions for review of certain findings contained in the initial determination. On March 1, 2017, the Commission issued a notice that it was reviewing the final initial determination in part on certain issues.

On May 4, 2017, the Commission issued its Final Determination, which found a violation with respect to the '577 and '668 patents, and found no violation with respect to the '211, '853, '875 and '492 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, 7, 9, 10, and 15 of the '577 patent and 1, 2, 4, 5, 7, 8, 10, 13, 18, 56, and 64 of the '668 patent. The 60-day Presidential review period for the 945 Investigation has expired. During the 60-day Presidential review period, the USITC Orders permitted Arista to continue importing and selling products covered by the orders so long as Arista paid a 5% bond. Because the United States Trade Representative did not disapprove the USITC's final determination, the limited exclusion order and cease and desist order are now in full effect, and Arista is barred from importing and selling infringing covered products in the United States. On June 30, 2017, Cisco filed a petition for review of the USITC's Final Determination to the Federal Circuit regarding the '853, '492, '875 and '211 patents.

On May 25, 2017 and June 1, 2017, the PTAB issued final written decisions finding all claims of the '577 and '668 patents that Arista was found to have infringed in the 945 Investigation unpatentable. On June 1, 2017 and June 2, 2017, Arista filed emergency petitions to suspend the remedial orders in the 945 Investigation. On June 12, 2017, Cisco filed a brief in response objecting to any suspension of the ITC Orders, while the OUII filed a brief in support of the requested suspension. On July 20, 2017,

the Commission issued a notice denying our petition to suspend the remedial orders. On July 21, 2017, we filed a motion to stay the remedial orders in the 945 Investigation pending disposition of the relevant appeals and sought expedited consideration of our motion. Cisco's opposition to that motion was filed on August 3, 2017. If necessary, we plan to file an emergency motion to stay the remedial orders with the Federal Circuit.

Inter Partes Reviews

We have filed petitions for Inter Partes Review 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. 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. Both parties have appealed the final written decisions on the '211 and '537 patents IPRs.

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

IPRs relating to the '668 (IPR No. 2016-00309), '577 (IPR No. 2016-00303), '853 (IPR No. 2016-0306), and '537 (IPR No. 2016-0308) patents were instituted in June 2016 and hearings were held on March 7, 2017. On May 25, 2017, the PTAB issued final written decisions finding claims 1, 7-10, 12-16, 18-22, 25, and 28-31 of '577 patent unpatentable, and that claim 2 of the '577 patent, claim 63 of the '853 patent, and claims 1, 10, 19, and 21 of the '537 patent had not been shown to be unpatentable. On June 1, 2017, the PTAB issued a final written decision finding claims 1-10, 12-13, 15-28, 30-31, 33-36, 55-64, 66-67, and 69-72 of the '668 patent unpatentable. Arista filed a Notice of Appeal concerning the '577 patent on July 21, 2017. Cisco cross-appealed concerning the '577 patent on July 26, 2017 and filed a Notice of Appeal concerning the '668 patent on August 1, 2017.

* * * * *

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

For example, in the 944 Investigation, the USITC 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 the 945 Investigation, the USITC issued a limited exclusion order barring entry into the United States of our network devices, related software, and components thereof that infringe one or more of the claims of the '577 and '668 patents specified above and a cease and desist order restricting our activities with respect to such imported products.

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

Specifically, in response to the USITC's findings in the 944 Investigation, we have made design changes to our products for sale in the United States to address the features that were found to infringe the '537, '592, and '145 patents. Following the issuance of the final determination in the 944 Investigation, we submitted a Section 177 ruling request to CBP seeking approval to import these redesigned products into the United States. On November 18, 2016, we received a 177 ruling from CBP finding that our redesigned products did not infringe the relevant claims of the '537, '592, and '145 patents, and approving the importation of these redesigned products into the United States. However, on January 13, 2017, at the request of Cisco and without our input, CBP issued a letter to us revoking its prior November 18 ruling. CBP subsequently conducted an *inter partes* proceeding between Arista and Cisco to determine whether our redesigned products infringe and whether to approve them for importation into the United States. On April 7, 2017, following

the *inter partes* proceeding, CBP again ruled that our redesigned products do not infringe the relevant claims of the '537, '592, and '145 patents and again approved those redesigns for importation into the United States.

Similarly, on May 4, 2017, the USITC issued a limited exclusion order and cease and desist order in the 945 Investigation with respect to the '668 and '577 patents. Because the ITC did not suspend its orders despite the PTAB decisions that found every relevant claim of the '668 and '577 patents to be unpatentable, Arista is currently barred from importing and selling infringing covered products in the United States. We have made design changes to our products for sale in the United States to address the features that were found to infringe the '577 and '668 patents. We are making ongoing modifications to our products to also ensure that they continue to meet customer requirements, and we are working with our customers to qualify those modified products for use in our customers' networks. In particular, the '577 patent was directed at a feature that is implemented in the merchant silicon chips that we purchase from third party suppliers. Because we do not design, build or manufacture these merchant silicon chips, we are limited in further modifications that we can make to our products for this patent. We are deploying these additional modifications for a subset of our products, while for others we will remove the feature until the '577 patent expires on June 30, 2018. These redesign and qualification efforts could be extremely costly and time consuming for us and our customers as well as disruptive to our other development activities and distracting to management. We may not be able to complete, and our customers may not be able to qualify these redesigned products in a timely fashion, if at all. This could result in an inability to ship those redesigned products to our customers, a delay or cancellation of purchases by some customers until those further modifications are completed and/or qualified or a rejection or return of our redesigned products, any of which could materially and adversely affect our business, prospects, reputation, results of operations or financial condition. We will also need to obtain the USITC and/or CBP approvals described above to resume importation of our redesigned products into the United States. On July 21, 2017, we submitted a request to CBP under Section 177 of its rules seeking approval to import our redesigned products into the United States. If we are unable to obtain USITC and/or CBP approvals to import our redesigned products or components of those products into the United States, our business, prospects, reputation, results of operations and financial condition could be materially or adversely affected.

If the USITC determines that our redesigned products continue to infringe the patents subject to any USITC limited exclusion order or cease and desist order in an enforcement action for either the 944 Investigation or the 945 Investigation, the USITC may impose the maximum statutory civil penalties for violation of the cease and desist order "including monetary sanctions for each day's violation of the cease and desist order of the greater of \$100,000 or twice the domestic value of the articles entered or sold, whichever is higher," bring a civil action in U.S. district court "requesting collection of such civil penalties and the issuance of a mandatory injunction preventing further violation of Cease and Desist Order," or impose "such other remedies and sanctions as are appropriate and within the Commission's authority." In the 944 Investigation, the ALJ recommended a civil penalty of \$307 million if the Commission were to reverse ALJ's finding of no violation.

An adverse finding in an enforcement action would take effect immediately upon USITC's issuance of the final determination, without any Presidential review period. To address such a finding, we would have to further redesign our products to make them non-infringing, and until we made such changes we would not be able to import or ship our products to customers. We may not be able to do so in a manner that does not continue to infringe the patents or that is acceptable to customers. We may not be able to complete, and our customers may not be able to qualify, such redesigned products in a timely fashion, if at all, following the issuance of an adverse final determination, leading to an inability to ship products to customers. Our redesign efforts could be extremely costly and time consuming as well as disruptive to our other development activities and distracting to management. For example, in the enforcement action for the 944 Investigation, although the ALJ issued his initial determination finding that Arista's redesigned products did not violate the June 23, 2016 cease and desist order, if the Commission overturns that finding in its final determination on September 20, 2017, we will no longer be able to import or ship our products in the U.S. until we make further changes to address those findings, which could materially and adversely affect our business, prospects, reputation, results of operations or financial condition. We would also need to obtain USITC or CBP approval to resume importation of such redesigned products into the United States. In addition, the USITC would not provide a service and support exception for our previously redesigned products, and customers may be required to upgrade to new products to obtain service and support. If we are unable to obtain such approvals or provide such service and support exception, our business, prospects, reputation, results of operations or financial condition could be materially and adversely affected.

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

In connection with these changes, to the extent that we are required to make further modifications to our supply chain to obtain alternative U.S. sources for subcomponents, we may be unable to obtain a sufficient quantity of these components on commercially reasonable terms or in a timely manner, if at all, which could delay or halt entirely production of our products or require us to make further modifications to our products to incorporate new components that are available in the United States. Any of these events could

result in lost sales, reduced gross margins or damage to our end-customer relationships, which would materially and adversely impact our business, financial condition, results of operations and prospects.

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

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

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

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

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

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

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

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

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

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

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

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

Managing the supply of our products and product components is complex, and our inventory management systems and related supply-chain visibility tools may not enable us to forecast accurately and manage effectively the supply of our products and product components. Furthermore, ongoing Cisco litigation before the USITC and any adverse ruling that results from such litigation could cause disruption to our supply-chain or with our suppliers, which may impact our revenues, business and reputation. For example, in the 944 Investigation, the USITC has issued a limited exclusion order barring entry into the United States of our network devices (including our 7000 Series of switches), related software and components thereof that infringe one or more of the claims of the '537, '592, and '145 patents specified above and a Cease and Desist Order restricting our activities with respect to such imported products. Similarly, in the 945 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 '577 and '668 patents specified above and a Cease and Desist Order restricting our activities with respect to such imported products. Each of these remedial orders could prevent us from using inventory to satisfy U.S demand and may cause us to write-down such inventory, which could reduce our gross margins.

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

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

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

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

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

Our products rely on key components, including integrated circuit components and power supplies that our contract manufacturers purchase on our behalf from a limited number of suppliers, including certain sole source providers. We do not have guaranteed supply contracts with any of our component suppliers, and our suppliers could delay shipments or cease manufacturing such products or selling them to us at any time. For example, in the past we have experienced shortages in inventory for dynamic random access memory integrated circuits and delayed releases of the next generation of chipset, which delayed our production and/or the release of our new products. The development of alternate sources for those components is time-consuming, difficult and costly. Additionally, in the 944 Investigation, the USITC has issued a Limited Exclusion Order barring entry into the United States of our network devices (including our 7000 Series of switches), related software and components thereof that infringe one or more of the claims of the '537, '592, and '145 patents specified above and a Cease and Desist Order restricting our activities with respect to such imported products. The USITC has also issued a Limited Exclusion Order in the 945 Investigation 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 '577 and '668 patents specified above and a Cease and Desist Order restricting our activities with respect to such imported products. If we are unable to obtain a sufficient quantity of these components on commercially reasonable terms or in a timely manner, or if we are unable to obtain alternative sources for these components, sales of our products could be delayed or halted entirely or we may be required to redesign our products. Any of these events could result in lost sales, reduced gross margins or damage to our end-customer relationships, which would adversely impact our business, financial condition, results of operations and prospects.

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

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

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

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

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

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

Our contract manufacturers typically fulfill our supply requirements on the basis of individual orders. We do not have long-term contracts with our third-party manufacturers that guarantee capacity, the continuation of particular pricing terms or the extension of credit limits. Accordingly, they are not obligated to continue to fulfill our supply requirements, which could result in supply shortages, and the

prices we are charged for manufacturing services could be increased on short notice. For example, a competitor could place large orders with the third-party manufacturer, thereby utilizing all or substantially all of such third-party manufacturer's capacity and leaving the manufacturer little or no capacity to fulfill our individual orders without price increases or delays, or at all. Our contract with one of our contract manufacturers permits it to terminate the agreement for convenience, subject to prior notice requirements. We may not be able to develop alternate or second contract manufacturers in a timely manner.

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

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

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

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

If we 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.”

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

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

Reliance on or delays in shipments could cause our revenue for the applicable period to fall below expected levels.

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

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

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

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

The sales prices for our products and services may decline for a variety of reasons, including competitive pricing pressures, discounts, a change in our mix of products and services, the introduction of new products and services by us or by our competitors, promotional programs, product and related warranty costs or broader macroeconomic factors. In addition, we have provided, and may in the future provide, pricing discounts to large end customers, which may result in lower margins for the period in which such sales occur. Our gross margins may also fluctuate as a result of the timing of such sales to large end customers.

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

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

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

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

The cloud networking market is still in its early stages. The market demand for cloud networking solutions has increased in recent years as end customers have deployed larger networks and have increased the use of virtualization and cloud computing. Our success depends upon our ability to provide cloud networking solutions that address the needs of end customers more effectively and economically than those of other competitors or existing technologies.

If the cloud networking solutions market does not develop in the way we anticipate, if our solutions do not offer benefits compared to competing network switching products or if end customers do not recognize the benefits that our solutions provide, then our business, financial condition, results of operations and prospects could be materially adversely affected.

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

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

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

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

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

the time and resources necessary to resolve them, could divert the resources of our management and harm our business, financial condition, results of operations and prospects.

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

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

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

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

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

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

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

Our future performance also depends on the continued services and continuing contributions of our senior management to execute our business plan and to identify and pursue new opportunities and product innovations. Our employment arrangements with our employees do not require that they continue to work for us for any specified period, and therefore, they could terminate their employment with us at any time. The loss of our key personnel, including 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 1 of this Quarterly Report on Form 10-Q incorporated herein by reference.

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 or penalties including treble damages if we are found to have willfully infringed a third party's patents; cease making, licensing, using or importing into the U.S. solutions that are alleged to infringe or misappropriate

the intellectual property of others; expend additional development resources to attempt to redesign our products or services or otherwise to develop non-infringing technology, which may not be successful; enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies or intellectual property rights; and indemnify our partners and other third parties. Any damages, penalties or royalty obligations we may become subject to as a result of an adverse outcome, and any third-party indemnity we may need to provide, could harm our business, financial condition, results of operations and prospects. Royalty or licensing agreements, if required or desirable, may be unavailable on terms acceptable to us, or at all, and may require significant royalty payments and other expenditures. Further, there is little or no information publicly available concerning market or fair values for license fees, which can lead to overpayment of license or settlement fees. In addition, some licenses may be non-exclusive, and therefore our competitors may have access to the same technology licensed to us. Suppliers subject to third-party intellectual property claims also may choose or be forced to discontinue or alter their arrangements with us, with little or no advance notice to us. Any of these events could seriously harm our business, financial condition, results of operations and prospects.

In the event that we are found to infringe any third party intellectual property, we could be enjoined, or subject to other remedial orders that would prohibit us, from making, licensing, using or importing into the U.S. such solutions. In order to resume such activities with respect to any affected solutions, we (or our component suppliers) would be required to develop technical design-arounds to this third party intellectual property that no longer infringe the third party intellectual property. In any efforts to develop technical design-arounds for these solutions, we (or our component suppliers) may be unable to do so in a manner that does not continue to infringe the third party intellectual property or that is acceptable to our customers. These redesign efforts could be extremely costly and time consuming as well as disruptive to our other development activities and distracting to management. Moreover, such design-arounds could require us to obtain approvals from the court or administrative body to resume the activities with respect to these affected solutions. We may not be successful in our efforts to obtain such approvals in a timely manner, or at all. Any failure to effectively redesign our solutions or to obtain timely clearance from the court or administrative body may cause a disruption to our product shipments and materially and adversely affect our business, prospects, reputation, results of operations, and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

If we needed to raise additional capital to expand our operations, invest in new products or for other corporate purposes, 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, invest in new products or for other corporate purposes, 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 condensed 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 condensed 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, financial information and other proprietary data, could be stolen;
- our electronic communications systems, including email and other methods, could be disrupted, and our ability to conduct our business operations could be seriously damaged until such systems can be restored;
- our ability to process customer orders and electronically deliver products and services could be degraded, and our distribution channels could be disrupted, resulting in delays in revenue recognition;
- defects and security vulnerabilities could be introduced into our software, thereby damaging the reputation and perceived reliability and security of our products and potentially making the data systems of our customers vulnerable to further data loss and cyber incidents; and
- personally identifiable data of our customers, employees and business partners could be compromised.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

As a public company, we are subject to requirements under the Dodd-Frank Act that require us to perform diligence, and disclose and report whether or not our products contain conflict minerals. The implementation of these requirements could adversely affect the sourcing, availability and pricing of the materials used in the manufacture of components used in our products. In addition, we have incurred and will continue to 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 market price of our common stock has historically been and is likely to continue to be volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. These fluctuations could cause you to lose all or part of your investment in our common stock. Factors that could cause fluctuations in the market price of our common stock include the following:

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

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

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

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

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

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

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

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

Our directors, executive officers and each of our stockholders who own greater than 10% of our outstanding common stock together with their affiliates, in the aggregate, beneficially own approximately 28% of the outstanding shares of our common stock, based on shares outstanding as of December 31, 2016. As a result, these stockholders, if acting together, could exercise a significant level of influence over matters requiring approval by our stockholders, including the election of directors and the approval of mergers, acquisitions or other extraordinary transactions. They may also have interests that differ from yours and may vote in a way with which you disagree and which may be adverse to your interests. This concentration of ownership may also discourage a potential investor from acquiring our common stock due to the limited voting power of such stock or otherwise may have the effect of delaying, preventing or deterring a change of control of our company, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company and might ultimately affect the market price of our common stock.

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

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

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

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

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

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

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

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

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

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

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

Item 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: August 4, 2017

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

Date: August 4, 2017

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
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.

**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 June 30, 2017 ;
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: August 4, 2017

/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 June 30, 2017 ;
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: August 4, 2017

/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 June 30, 2017 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: August 4, 2017

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 June 30, 2017 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: August 4, 2017

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