UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2006

OR

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

For the transition period from ______ to ______

Commission file number 000-25711

EXTREME NETWORKS, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE **[State or other jurisdiction of** **incorporation or organization]**	**77-0430270** **[I.R.S. Employer** **Identification No.]**
3585 Monroe Street	**95051**

Santa Clara, California
[Address of principal executive offices] **[Zip Code]**
Registrant s telephone number, including area code: (408) 579-2800

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

The number of shares of the Registrant s Common Stock, $.001 par value, outstanding at May 31, 2007 was 114,037,984.

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Explanatory Note

In September 2006, our Board of Directors formed a Special Committee (Special Committee) to conduct an independent review of our historical stock option granting and accounting practices. Following the conclusion of the Special Committee s investigation, and with the concurrence of management and the Audit Committee, the Company determined that it should have recognized approximately $223.0 million of pre-tax, non-cash, share-based compensation expense during fiscal years 2000 through 2005 that was not accounted for in the Company s previously issued financial statements. In addition, the Company should have recorded approximately $0.3 million of income tax benefits. Therefore, in our Annual Report on Form 10-K for the year ended July 2, 2006 (the 2006 Form 10-K), we restated financial information for each of the fiscal years ended July 3, 2005, June 27, 2004, June 29, 2003, June 30, 2002, July 1, 2001, and July 2, 2000. None of the information in this Quarterly Report on Form 10-Q is restated, although the filing of this report was delayed pending completion and filing of the 2006 Form 10-K.

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EXTREME NETWORKS, INC.

FORM 10-Q

QUARTERLY PERIOD ENDED DECEMBER 31, 2006

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Part I. Financial Information

Item 1. Financial Statements

EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	December 31, 2006 (Unaudited)	July 2, 2006 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,667	$ 92,598
Short-term investments	112,482	297,726
Accounts receivable, net	30,248	27,681
Inventories, net	23,202	19,303
Prepaid expenses and other current assets, net	11,440	9,420
Total current assets	242,039	446,728
Property and equipment, net	45,020	46,499
Marketable securities	27,010	42,781
Other assets, net	24,207	22,710
TOTAL ASSETS	$ 338,276	$ 558,718
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 16,739	$ 20,138
Accrued compensation and benefits	12,223	11,758
Restructuring liabilities	5,197	5,571
Accrued warranty	6,990	7,027
Deferred revenue	32,635	35,406
Convertible subordinated notes		200,000
Other accrued liabilities	19,492	19,581
Total current liabilities	93,276	299,481
Restructuring liabilities, less current portion	9,626	11,471
Deferred revenue, less current portion	10,851	9,699
Deferred income taxes	654	579
Other long-term liabilities	3,020	1,307
Commitments and contingencies (Note 3)		
Stockholders equity:		
Common stock and capital in excess of par value	932,097	927,835
Treasury stock	(48,303)	(33,700)
Accumulated other comprehensive income (loss)	230	(1,567)
Accumulated deficit	(663,175)	(656,387)
Total stockholders equity	220,849	236,181

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 338,276	$ 558,718

See accompanying notes to the unaudited condensed consolidated financial statements.

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EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	December 31, 2006	**January 1, 2006**	**December 31, 2006**	**January 1, 2006**
Net revenues:				
Product	$ 71,074	$ 76,998	$ 139,056	$ 158,915
Service	15,779	15,789	31,560	31,794
Total net revenues	86,853	92,787	170,616	190,709
Cost of revenues:				
Product	31,968	33,517	63,767	69,443
Service	8,409	8,488	17,222	17,196
Total cost of revenues	40,377	42,005	80,989	86,639
Gross margin:				
Product	39,106	43,481	75,289	89,472
Service	7,370	7,301	14,338	14,598
Total gross margin	46,476	50,782	89,627	104,070
Operating expenses:				
Sales and marketing	25,829	23,962	51,272	49,878
Research and development	15,602	15,670	31,376	31,933
General and administrative	8,790	6,052	16,395	13,227
Restructuring charge (reversal)	(231)		1,303	
Total operating expenses	49,990	45,684	100,346	95,038
Operating income (loss)	(3,514)	5,098	(10,719)	9,032
Other income, net	2,227	1,427	5,291	2,356
Income (loss) before income taxes	(1,287)	6,525	(5,428)	11,388
Provision for income taxes	573	875	1,359	1,385
Net income (loss)	$ (1,860)	$ 5,650	$ (6,787)	$ 10,003
Net income (loss) per share basic	$ (0.02)	$ 0.05	$ (0.06)	$ 0.08
Net income (loss) per share diluted	$ (0.02)	$ 0.05	$ (0.06)	$ 0.08
Shares used in per share calculation basic	113,644	123,007	114,649	123,013

Shares used in per share calculation diluted	113,644	124,806	114,649	124,762

See accompanying notes to the unaudited condensed consolidated financial statements.

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EXTREME NETWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended December 31, 2006	Six Months Ended January 1, 2006
Cash flows from operating activities:		
Net income (loss)	$ (6,787)	$ 10,003
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,268	6,097
Provision for doubtful accounts	2	716
Provision for excess and obsolete inventory	2,144	155
Deferred income taxes	75	60
Amortization of warrant	2,024	2,667
Loss on disposal of assets	5	
Share-based compensation	3,658	3,444
Restructuring charge	1,303	
Changes in operating assets and liabilities, net:		
Accounts receivable	(2,629)	(2,298)
Inventories	(6,042)	3,854
Prepaid expenses and other assets	(5,481)	4,431
Accounts payable	(3,400)	3,961
Accrued compensation and benefits	465	37
Restructuring liabilities	(3,523)	(3,034)
Lease liability		(471)
Accrued warranty	(36)	(449)
Deferred revenue	(1,619)	(3,120)
Other accrued liabilities	1,893	(2,550)
Net cash provided by (used in) operating activities	(13,680)	23,503
Cash flows from investing activities:		
Capital expenditures	(2,795)	(3,604)
Purchases of investments	(95,059)	(167,590)
Proceeds from sales and maturities of investments and marketable securities	297,603	110,951
Net cash provided by (used) in investing activities	199,749	(60,243)
Cash flows from financing activities:		
Proceeds from issuance of common stock	602	2,715
Repurchase of common stock	(14,602)	(6,809)
Principal payment on convertible debt	(200,000)	
Net cash used in financing activities	(214,000)	(4,094)
Net decrease in cash and cash equivalents	(27,931)	(40,834)
Cash and cash equivalents at beginning of period	92,598	127,470

Cash and cash equivalents at end of period	$ 64,667	$ 86,636

See accompanying notes to the unaudited condensed consolidated financial statements.

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EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements of Extreme Networks, Inc. (referred to as Extreme Networks and as we , us and our) included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet at July 2, 2006 was derived from audited financial statements as of that date but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These interim financial statements and notes should be read in conjunction with our audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended July 2, 2006.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments that, in the opinion of management, are necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition of Extreme Networks at December 31, 2006. The results of operations for the second quarter of fiscal 2007 are not necessarily indicative of the results that may be expected for fiscal 2007 or any future periods.

Revenue Recognition

We derive the majority of our revenue from sales of our modular and stackable networking equipment, with the remaining revenue generated from service fees relating to the service contracts and training on our products. We generally recognize product revenue from our value-added resellers and end-users at the time of shipment, provided that persuasive evidence of an arrangement exists, delivery has occurred, the price of the product is fixed or determinable and collection of the sales proceeds is reasonably assured. Revenue from service obligations under service contracts is deferred and recognized on a straight-line basis over the contractual service period. Service contracts typically range from one to five years. When sales arrangements contain multiple deliverables, such as hardware, service contracts and other services, we determine whether the deliverables represent separate units of accounting and then allocate revenue to each unit of accounting based on their relative fair values. We recognize revenue for each unit of accounting when the revenue recognition criteria for each unit of accounting are met. Shipping costs are included in cost of product revenues.

We make certain sales to partners in two distribution channels, or tiers. The first tier consists of a limited number of independent distributors that sell primarily to resellers and, on occasion, to end-user customers. We defer recognition of revenue on all sales to these distributors until the distributors sell the product, as evidenced by monthly sales-out reports that the distributors provide to us. We grant these distributors the right to return a portion of unsold inventory to us for the purpose of stock rotation. We also grant these distributors certain price protection rights. The distributor-related deferred revenue and receivables are adjusted at the time of the stock rotation return or price reduction. We also provide distributors with credits for changes in selling prices, and allow them to participate in cooperative marketing programs. Cooperative advertising expenses are recorded as marketing expenses to the extent that an advertising benefit separate from the revenue transaction can be identified and the cash paid does not exceed the fair value of that advertising benefit received. We maintain estimated accruals and allowances for these exposures based upon our historical experience. The second tier of the distribution channel consists of a large number of third-party resellers that sell directly to end-users and are not granted return privileges, except for defective products during the warranty period. We reduce product revenue for certain price protection rights that may occur under contractual arrangements we have with our resellers.

Inventories

Inventories consist of raw materials and finished goods and are stated at the lower of cost, determined on a first-in, first-out basis, or market. Inventories, which are net of an allowance for excess and obsolete inventory (which we determine primarily based on future demand forecasts) of $6.3 million and $5.1 million at December 31, 2006 and July 2, 2006, respectively, consist of (in thousands):

	December 31, 2006	July 2, 2006
Raw materials	$ 611	$ 431

Finished goods	22,591	18,872
Total	$ 23,202	$ 19,303

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Sales to Distributors

We defer recognition of revenue on all sales to distributors until the distributor successfully resells the product, typically to an authorized reseller. Distributors regularly provide us their sales-out reports for this purpose. Until it is sold, inventory held by distributors is included in our reported finished goods inventory and was $3.5 million and $3.2 million at December 31, 2006 and July 2, 2006, respectively. The accounts receivable owed us by distributors, net of the deferred revenue from sales to distributors, is recorded in prepaid expenses and other current assets, as reflected in the following table (in thousands):

	December 31, 2006	July 2, 2006
Accounts receivable, net of allowance for doubtful accounts of $239 ($300 at July 2, 2006)	$ 20,482	$ 17,158
Deferred revenue	(15,868)	(13,325)
Net, included in Prepaid expenses and other current assets	$ 4,614	$ 3,833

Guarantees and Product Warranties

Financial Accounting Standards Board (FASB) Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45) requires that upon issuance of a guarantee, the guarantor must disclose and recognize a liability for the fair value of the obligation it assumes under that guarantee.

We have determined that the requirements of FIN 45 apply to our standard product warranty liability. The following table summarizes the activity related to our product warranty liability during the six months ended December 31, 2006 and January 1, 2006 (in thousands):

	Six Months Ended	
	December 31, 2006	January 1, 2006
Balance beginning of period	$ 7,027	$ 7,471
New warranties issued	4,286	5,582
Warranty expenditures	(4,323)	(6,031)
Balance end of period	$ 6,990	$ 7,022

Our standard hardware warranty period is typically 12 months from the date of shipment to end-users. Upon shipment of products to our customers, we estimate expenses for the cost to repair or replace products that may be returned under warranty and accrue a liability in cost of product revenue for this amount. The determination of our warranty requirements is based on actual historical experience with the product or product family, estimates of repair and replacement costs and any product warranty problems that are identified after shipment. We estimate and adjust these accruals at each balance sheet date in accordance with changes in these factors.

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

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Deferred Support Revenue

We offer renewable support arrangements, including extended warranty contracts, to our customers that range generally from one to five years. The change in our deferred support revenue balance in relation to these arrangements was as follows (in thousands):

	Six Months Ended	
	December 31, 2006	**January 1, 2006**
Balance beginning of period	$ 41,722	$ 47,849
New support arrangements	28,920	25,905
Recognition of support revenue	(28,773)	(29,014)
Balance end of period	41,869	44,740
Less current portion	31,018	34,867
Non-current deferred revenue	$ 10,851	$ 9,873

Recently Issued Accounting Standards

Fair Value Measurements

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*. SFAS 157 replaces the different definitions of fair value in the accounting literature with a single definition. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 is effective for fair-value measurements already required or permitted by other standards for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We currently are in the process of determining the impact of adopting the provisions of SFAS 157 on our financial position, results of operations and cash flows.

Fair Value Option for Financial Assets and Liabilities

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115* (FAS 159). FAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The provisions of FAS 159 become effective for fiscal years beginning after November 15, 2007. We believe that the adoption of SFAS 159 will not have a material effect on our financial statements.

Accounting for Electronic Equipment Waste Obligations

In June 2005, the FASB issued FSP No. FAS 143-1, *Accounting for Electronic Equipment Waste Obligations* (FSP 143-1). FSP 143-1 provides guidance in accounting for obligations associated with Directive 2002/96/EC (the Directive) on Waste Electrical and Electronic Equipment adopted by the European Union. FAS 143-1 is required to be applied to the later of the first reporting period ending after June 6, 2005 or the date of the Directive s adoption into law by the applicable EU member countries in which we have significant operations. The Directive distinguishes between new and historical waste. New waste relates to products put on the market after August 13, 2005. FSP 143-1 directs commercial users to apply the provisions of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, and the related FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, for the measurement and recognition of the liability and asset retirement obligation associated with the historical waste management requirements of the Directive. Additionally, FSP 143-1 provides guidance for the accounting by producers for the financing of the obligations of historical waste held by private households.

The adoption of FAS 143-1 in the first quarter of fiscal 2006 did not have a material impact on our consolidated financial position and results of operations. We are continuing to analyze the impact of the Directive, and FSP 143-1, on our consolidated financial position and results of operations as additional EU member countries adopt the Directive.

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Accounting for Income Taxes

In July 2006, the FASB released its final Interpretation on uncertain tax positions, FIN 48, *Accounting for Uncertainty in Income Taxes an interpretation of FAS 109.* This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes* (SFAS 109). This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The guidance will become effective as of the beginning of a company s fiscal year beginning after December 15, 2006. The Company is currently assessing the impact of adopting this standard.

2. Share-Based Compensation

On July 4, 2005, we adopted the fair value recognition provisions of FASB Statement No. 123(R), *Share-Based Payment*, (FAS 123R) using the modified-prospective-transition method.

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

	Three Months Ended		Six Months Ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Cost of product revenue	$ 201	$ 196	$ 398	$ 366
Cost of service revenue	116	92	239	200
Sales and marketing	635	594	1,302	1,376
Research and development	564	442	1,122	967
General and administrative	292	250	597	535
Total share-based compensation expense	1,808	1,574	3,658	3,444
Share-based compensation cost capitalized in inventory	1	1	1	25
Total share-based compensation cost	$ 1,809	$ 1,575	$ 3,659	$ 3,469

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option valuation model with the weighted average assumptions noted in the following table. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected volatility is based on both the implied volatilities from traded options on our stock and historical volatility on our stock.

For options granted after July 3, 2005, and valued in accordance with FAS 123R, we used the straight-line method for expense attribution, and we estimate forfeitures and only recognize expense for those shares expected to vest. Our estimated forfeiture rate in the first half of fiscal 2007, based on our historical forfeiture experience, is approximately 10%.

	Stock Option Plans				Employee Stock Purchase Plan			
	Three months ended		Six months ended		Three months ended		Six months ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Expected life	2.5 yrs	2.2 yrs	2.5 yrs	2.5 yrs	N/A	0.7 yrs	0.9 yrs	0.7 yrs
Risk-free interest rate	4.69%	4.45%	4.88%	4.10%	N/A	4.27%	5.03%	4.05%
Volatility	47%	58%	50%	61%	N/A	43%	37%	44%
	0.0%	0.0%	0.0%	0.0%	N/A	0.0%	0.0%	0.0%

Expected
dividend yield
The Black-Scholes-Merton option valuation model requires the input of highly subjective assumptions, including the expected life of the share-based award and stock price volatility. The assumptions listed above represent management s best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, our share-based compensation cost could have been materially different from that recorded. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the share-based compensation expense could be materially different.

The weighted-average grant-date per share fair value of options granted in the second quarter of fiscal 2007 and fiscal 2006 were $1.31 and $1.69, respectively. The weighted-average estimated per share fair value of shares granted under our 1999 Employee Stock Purchase Plan (ESPP) in the second quarter of fiscal 2006 was $1.41. No shares were granted under the ESPP in the second quarter of fiscal 2007.

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The Company has temporarily suspended purchases under the ESPP as a result of our delinquent status for filing our 2006 Form 10-K and subsequent Quarterly Report on Form 10-Q. Since the cancellation of the ESPP purchases was not accompanied by a concurrent grant or a replacement award, cancellations were accounted for as a repurchase for no consideration. Accordingly, any previously unrecognized compensation cost related to a cancelled purchase is recognized as compensation cost in the current period. In the second quarter of fiscal 2007, we recognized $0.4 million of compensation cost related to cancelled ESPP purchases.

3. Commitments, Contingencies and Leases

Stock Repurchase Program

On October 20, 2005, our Board of Directors authorized the repurchase of up to $50 million of our common stock. This authorization originally was to expire in October 2007, but on October 25, 2006, the Board of Directors terminated the share repurchase plan. In the quarter ended December 1, 2006, we repurchased approximately 0.9 million shares for approximately $3.4 million, primarily through open market purchases, bringing the cumulative total to 11.1 million repurchased shares for approximately $48.3 million.

Line of Credit

We have a revolving line of credit for $10.0 million with a major lending institution. Borrowings under this line of credit bear interest at the bank s prime rate. As of December 31, 2006, there were no outstanding borrowings under this line of credit. The line of credit contains a provision for the issuance of letters of credit not to exceed the unused balance of the line. As of December 31, 2006, we had letters of credit totaling $0.8 million. These letters of credit were primarily issued to satisfy requirements of certain of our customers for performance bonds. The line of credit requires us to maintain specified financial covenants related to tangible net worth and liquidity with which we were not in compliance as of December 31, 2006. Subsequently, the Company has received a waiver from the bank on the non-compliant covenant. The line of credit originally expired on January 25, 2007, and was subsequently renewed with a new expiration date of January 24, 2008.

Purchase Commitments

We currently have arrangements with one contract manufacturer and other suppliers for the manufacture of our products. Our arrangements allow them to procure long lead-time component inventory on our behalf based upon a rolling production forecast provided by us. We are obligated to the purchase of long lead-time component inventory that our contract manufacturer procures in accordance with the forecast, unless we give notice of order cancellation outside of applicable component lead-times. As of December 31, 2006, we had non-cancelable commitments to purchase approximately $22.6 million of such inventory during the third quarter of fiscal 2007.

Legal Proceedings

Government Inquiries Relating to Historical Stock Option Practices

On June 27, 2006, the Company received an informal inquiry letter from the Staff of the SEC Enforcement Division requesting that the Company voluntarily provide documents related to its policies, practices and procedures for granting stock options for the period since its initial public offering on April 9, 1999 (IPO). The Company responded to the request and is cooperating fully with the SEC inquiry.

Late SEC Filing and Nasdaq Delisting Proceedings

As discussed in the Explanatory Note to this Quarterly Report, the Company did not timely file its Form 10-K for the fiscal year ending July 2, 2006 or the Quarterly Reports on Forms 10-Q for the quarters ended October 1, 2006, December 31, 2006 and April 1, 2007. As a result, the Company initially received two Nasdaq Staff Determination letters, dated September 22, 2006, and November 15, 2006, respectively, stating that the Company was not in compliance with the filing requirements of Marketplace Rule 4310(c)(14) and, therefore, that the Company s stock was subject to delisting from the Nasdaq Global Select Market. The Company appealed the determination in the September 22, 2006 letter and requested a hearing before a Nasdaq Listing Qualifications Panel. On November 9, 2006, we attended a hearing, at which we simultaneously sought appropriate exceptions to the filing requirements from the Panel pending completion and filing of both our delinquent 10-K and 10-Q report for the quarter ended October 1, 2006. On January 8, 2007, the Panel granted our request for continued listing of our stock on the Nasdaq Global Select Market, subject to the condition that we file the 10-K annual report and our Quarterly Report on Form 10-Q for the quarter ended October 1, 2006 on or before March 21, 2007.

On February 20, 2007, we received another Nasdaq Staff Determination letter, stating that we were not in compliance with the filing requirements of Marketplace Rule 4310(c)(14) because we did not timely file our Quarterly Report on Form 10-Q for the quarter ended December 31, 2006 and, therefore, that our stock was subject to delisting from the Nasdaq Global Select Market. Also on February 20, 2007, we were informed by the Nasdaq Listing and Hearings Review Council that at our request it had stayed the Panel s determination and any future Panel determinations to suspend our securities from trading pending further action by the Listing Council. On June 22, 2007, the Listing Council issued a ruling exercising its authority under Marketplace Rule 4802(b) to grant the Company an extension until July 3, 2007 to file this Report and our Quarterly Reports on Forms 10-Q for the quarters ended October 1, 2006, December 31, 2006, and April 1, 2007. On June 18, 2007, in anticipation of the Listing Council s decision, the Company requested that the Nasdaq Board of Directors provide a further extension of time to allow the Company to come into compliance. The Nasdaq Board granted that request on June 25, 2007.

With the filing of our Annual Report on Form 10-K for fiscal year 2006, this Quarterly Report and our Quarterly Reports on Forms 10-Q for the quarters ended October 1, 2006 and April 1, 2007, the Company believes that it has returned to full compliance with SEC reporting requirements and Nasdaq listing requirements. The Company therefore expects that the Nasdaq delisting matter will be closed, and will seek confirmation from Nasdaq of that result.

We cannot predict, however, whether the SEC will review these reports and, if so, whether the SEC will have comments on these reports (or other reports that we previously filed) that may require us to file amended reports with the SEC. In addition, we cannot predict whether the Nasdaq Listing Qualifications Panel or Listing Council will concur that we are in compliance with all relevant listing requirements. If either of those events occurs, we might be unable to remain in compliance with SEC reporting requirements and Nasdaq listing requirements, and, therefore, we might be unable to maintain an effective listing of our common stock on the Nasdaq Global Select Market or any other national securities exchange.

Shareholder Derivative Litigation Relating to Historical Stock Option Practices

On April 25, 2007, an individual identifying herself as a shareholder of the Company filed a derivative action in the United States District Court for the Northern District of California purporting to assert claims on behalf of and in the name of the Company against various of our current and former directors and officers relating to our stock option granting practices for stock options issued from 2000 to 2003. The complaint alleges that the individual defendants breached their fiduciary duties and other obligations to the Company and violated federal securities laws in connection with our historical stock option granting process and our accounting for past stock options.

The plaintiff has asserted claims for violations of Sections 10(b) (including Rule 10b-5 thereunder), 14(a), and 20(a) of the Securities Exchange Act of 1934, unjust enrichment, breach of fiduciary duty and aiding and abetting such breach, rescission, and a claim for an accounting of all stock option grants made to the named defendants. Extreme Networks, Inc. is named as a nominal defendant in these actions. On behalf of Extreme Networks, Inc., the plaintiff seeks unspecified monetary and other relief against the named defendants. The plaintiff is Yenna Wu. The individual named defendants are Gordon L. Stitt, Herb Schneider, Stephen Haddock, Paul Romeo, Vito Palermo, Harold Covert, Darrell Scherbarth, Christopher, N. Todd, Alexander J. Gray, Frank C. Carlucci, William R. Slakey, Charles Carinalli, Harry Silverglide, Michael West, Kenneth Levy, Robert L. Corey, Peter Wolken, and Promod Haque.

A similar derivative action was filed in the same court on May 2, 2007, by Linda Erikson, another individual identifying herself as a shareholder of the Company, alleging the same legal claims against the same individual defendants concerning the same subject matter.

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A third derivative action was filed in the same court on May 31, 2007 by Frank A. Grucel, an individual identifying himself as a shareholder of the Company, purporting to assert claims on the Company s behalf relating to the Company s historic stock options granting practices. The complaint seeks unspecified monetary and injunctive relief and asserts claims for violations of Section 14(a) of the Securities Exchange Act of 1934, an accounting of all stock option grants made to the named defendants, breach of fiduciary duty and aiding and abetting such breach, abuse of control, gross mismanagement, constructive fraud, corporate waste, unjust enrichment, rescission, violations of California Corporations Code Section 25402, and breach of fiduciary duties related to insider selling and alleged misappropriation of information. Extreme Networks, Inc. is named as a nominal defendant in this action, and the individual named defendants are Gordon L. Stitt, Herb Schneider, Stephen Haddock, Alexander J. Gray, Frank C. Carlucci, William R. Slakey, Charles Carinalli, Harry Silverglide, Michael West, Kenneth Levy, Robert L. Corey, Peter Wolken, Michael Palu, and Alicia Moore.

The foregoing actions have been related and assigned to the same judge. On June 15, 2007, Yenna Wu filed an amended complaint in her action. The amended complaint names one additional individual defendant, Mark Canepa, as well as the individual defendants named in the derivative complaints filed on April 25, 2007 and May 2, 2007, is purportedly brought both as a derivative action and as a class action on behalf of all current shareholders of the Company, and alleges a claim for violation of Delaware General Corporations Code Section 211(c), seeking an order compelling the Company to hold a shareholder s meeting. The amended complaint otherwise alleges the same claims as the derivative complaints filed on April 25, 2007 and May 2, 2007 by plaintiffs Wu and Erikson, respectively.

The foregoing actions are at an early stage. Discovery has not commenced, and the defendants are not yet required to respond to the complaints. We cannot predict whether these actions are likely to result in any material recovery by or expense to the Company.

Indemnification Obligations

Subject to certain limitations, we may be obligated to indemnify our current and former directors, officers and employees. These obligations arise under the terms of our certificate of incorporation, our bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify, where applicable, generally means that we are required to pay or reimburse, and in certain circumstances we have paid or reimbursed, the individuals reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of these claims. The cost to defend the Company and the named individuals could have a material adverse effect on our consolidated financial position, results of operations and cash flows in the future. Recovery of such costs under our directors and officers insurance coverage is uncertain.

Other Legal Matters

On April 20, 2007, Extreme Networks filed suit against Enterasys in the United States District Court for the Western District of Wisconsin, Civil Action No. 07-C-0229-C. The complaint alleges willful infringement of U.S. patents Nos. 6,104,700, 6,678,248, and 6,859,438, and seeks injunctive relief against Enterasys continuing sale of infringing goods and monetary damages. Enterasys responded to the complaint on May 30, 2007. Enterasys also filed a counterclaim alleging infringement of three U.S. patents owned by Enterasys. The case is in its early stages, however a Markman Hearing has been scheduled for October 2007, and a trial date has been set for May 2008.

On December 27, 2005, Broadband Office Inc. (Broadband) served an amended complaint, adding Extreme Networks as a defendant in its lawsuit against Technology Credit Corporation (TCC) and Key Equipment Finance, Inc., seeking recovery of an alleged preferential payment in the amount of $0.8 million plus interest, purportedly paid by Broadband to TCC within ninety days prior to Broadband s petition for bankruptcy protection. Extreme Networks disputes that it owes any money to Broadband, and intends vigorously to defend against the claims.

On June 21, 2005, Enterasys filed suit against Extreme Networks and Foundry Networks, Inc. (Foundry) in the United States District Court for the District of Massachusetts, Civil Action No.05-11298 DPW. The complaint alleges willful infringement of U. S. Patent Nos. 5,251,205; 5,390,173; 6,128,665; 6,147,995; 6,539,022; and 6,560, 236, and seeks: a) a judgment that Extreme willfully infringes each of the patents; (b) a permanent injunction from infringement, inducement of infringement and contributory infringement of each of the six patents; (c) damages and a reasonable royalty to be determined at trial; (d) trebled damages; (e) attorneys fees, costs and interest; and (f) equitable relief at the court s discretion. The Markman hearing has been rescheduled for October 2007. We intend vigorously to defend against Enterasys assertions which we believe to be without merit.

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On May 27, 2003, Lucent filed suit against Extreme Networks and Foundry in the United States District Court for the District of Delaware, Civil Action No. 03-508. The complaint alleged willful infringement of U.S. Patent Nos. 4,769,810, 4,769,811, 4,914,650, 4,922,486 and 5,245,607. After the Markman hearing, Lucent dropped its claims relating to the 5,245,607 patent. The judge split the case into three parts to be tried separately: phase 1 to cover infringement, willfulness and damages; phase 2 to cover invalidity; and phase 3 to cover equitable defenses and our counterclaims. On May 9, 2005, a jury in Delaware awarded a verdict to Extreme in the phase 1 trial of non-infringement on 18 out of the 19 claims asserted. The jury did award Lucent damages of approximately $275,000 on the remaining claim; which covers a feature that is not offered in our current product line. The parties each filed post-trial motions; and on August 16, 2005, the judge granted Lucent s motion for a new trial, ruling that Extreme impermissibly introduced to the jury evidence of its prior relationship with Lucent. Extreme s motion for reconsideration was denied. On August 9, 2006, the parties entered into a settlement agreement to resolve all outstanding claims which includes the dismissal of all claims and a patent cross-license for a defined term.

Beginning on July 6, 2001, purported securities fraud class action complaints were filed in the United States District Court for the Southern District of New York. The cases were consolidated and the litigation is now captioned as In re Extreme Networks, Inc. Initial Public Offering Securities Litigation, Civ. No. 01-6143 (SAS) (S.D.N.Y.), related to In re Initial Public Offering Securities Litigation, 21 MC 92 (SAS) (S.D.N.Y.).The operative amended complaint names as defendants Extreme Networks; six of our present and former officers and/or directors, including our CEO (the Extreme Networks Defendants); and several investment banking firms that served as underwriters of our initial public offering and October 1999 secondary offering. The complaint alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. Previously, we executed a settlement agreement presented to all issuer defendants. In that settlement, plaintiffs would dismiss and release all claims against the Extreme Network Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The Extreme Networks Defendants would not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeded the amount of the insurance coverage. The Court gave preliminary approval to the settlement in February 2005 and held a hearing in April 2006 to consider final approval of the settlement. Before the Court issued a final decision on the settlement, on December 5, 2006 the United States Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Thereafter, on December 14, 2006, the Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the Second Circuit Court of Appeals for a rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit Court of Appeals denied plaintiffs petition for a rehearing, but clarified that the plaintiffs may seek to certify a more limited class. Accordingly, the plaintiffs and issuers have stated that they are prepared to discuss how the settlement might be amended or renegotiated to comply with the decision of the Second Circuit Court of Appeals. On April 30, 2007, Plaintiffs stated that they intend to present a proposed redefined class to the Court. If the settlement is not amended or renegotiated and then approved by the Court, there can be no assurance that we will prevail in the lawsuit. Failure to prevail could have a material adverse effect on our consolidated financial position, results of operations and cash flows in the future.

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

4. Comprehensive Income (Loss)

Comprehensive income (loss) was as follows (in thousands):

	Three Months Ended		**Six Months Ended**	
	December 31, 2006	**January 1, 2006**	**December 31, 2006**	**January 1, 2006**
Net income (loss)	$ (1,860)	$ 5,650	$ (6,787)	$ 10,003
Other comprehensive income (loss):				
Change in unrealized gain on investments:				
Net unrealized gain on investments	428	435	1,528	83
		(17)		(17)

Less: Net loss on investments realized and included in interest income				
Net unrealized gain on investments	428	418	1,528	66
Net unrealized loss on derivatives	(28)	(11)	(29)	(12)
Foreign currency translation adjustments	219	(166)	297	(300)
Total comprehensive income (loss)	$ (1,241)	$ 5,891	$ (4,991)	$ 9,757

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5. Income Taxes

We recorded an income tax provision of $0.6 million and $0.9 million for the second quarter of fiscal 2007 and the second quarter of fiscal 2006, respectively. The income tax provision for the second quarter of fiscal 2007 reflects an effective tax rate of negative 45%, which differs from the statutory tax rate due to the tax impact of income from foreign operations and unbenefited losses in the U.S. taxes due to the full valuation allowance on our net deferred tax assets in accordance with SFAS 109. The income tax provision for the second quarter of fiscal 2006 reflects an effective tax rate of 13%, which differs from the statutory tax rate due to benefits to U.S. taxes from net operating loss carryforwards and tax credit carryforwards, offset by the tax impact of income from foreign operations. The effective tax rate is estimated based on estimated full year earnings, and may be subject to revision during fiscal 2007.

We recognize deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Significant management judgment is required in determining our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We make an assessment of the likelihood that our net deferred tax assets will be recovered from future taxable income, and to the extent that recovery is not believed to be likely, a valuation allowance is established.

During fiscal 2003, we established a full valuation allowance for our net deferred tax assets. The valuation allowance was calculated in accordance with the provisions of SFAS 109, which requires an assessment of both negative and positive evidence when measuring the need for a valuation allowance. In accordance with SFAS 109, evidence, such as operating results during the most recent three-year period, is given more weight than our expectations of future profitability, which are inherently uncertain. Our most recent three year history of losses, as of the date of the establishment of the valuation allowance, represented sufficient negative evidence to require a full valuation allowance against our net deferred tax assets under SFAS 109. This valuation allowance will be evaluated periodically and can be reversed partially or totally if business results have sufficiently improved to support realization of our deferred tax assets.

6. Net Income (Loss) Per Share

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period, less shares subject to repurchase, and excludes any dilutive effects of options, warrants and convertible subordinated notes. Diluted net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares used in the basic earnings (loss) per share calculation plus the dilutive effect of shares subject to repurchase, options, warrants and convertible subordinated notes.

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

	Three Months Ended		Six Months Ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Net income (loss)	$ (1,860)	$ 5,650	$ (6,787)	$ 10,003
Weighted-average shares of common stock outstanding	113,644	123,007	114,469	123,013
Less: Weighted-average shares subject to repurchase				
Weighted-average shares used in per share calculation basic	113,644	123,007	114,649	123,013
Incremental shares using the treasury stock method		1,799		1,749
Weighted-average shares used in per share calculation diluted	113,644	124,806	114,649	124,762
Net income (loss) per share basic	$ (0.02)	$ 0.05	$ (0.06)	$ 0.08
Net income (loss) per share diluted	$ (0.02)	$ 0.05	$ (0.06)	$ 0.08

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The following table sets forth potential shares of common stock that are not included in the diluted net income (loss) per share calculation above because to do so would be antidilutive for the periods (in thousands):

	Three Months Ended		Six Months Ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Stock options outstanding:				
In-the-money options	640		541	
Out-of-the-money options	21,398	19,818	21,309	19,939
Warrants	857		857	
Convertible subordinated notes		9,542	9,542	9,542
Total potential shares of common stock excluded from the computation of earnings per share	22,895	29,360	32,249	29,481

The computation of diluted net income (loss) per share for the second fiscal quarter and first six months of fiscal 2007 and 2006 excludes the impact of the conversion of the convertible subordinated notes, which were convertible into approximately 9.5 million shares of common stock, as the impact of adding back to income the after tax interest expense associated with the convertible subordinated notes, and including the impact of the common shares to be issued, would be antidilutive in these periods. The convertible subordinated notes were paid in full on December 1, 2006.

Warrants and stock options with an exercise price lower than our average stock price for the periods presented (In-the-money stock options) are excluded from the calculation of diluted loss per share in the quarter and six months ended December 31, 2006 since the effect would have been antidilutive under the treasury stock method due to the net loss in the period.

Stock options outstanding with an exercise price higher than our average stock price for the periods presented (Out-of-the-money stock options) are excluded from the calculation of diluted net income (loss) per share since the effect would have been antidilutive under the treasury stock method.

7. Restructuring Liabilities

As of December 31, 2006, restructuring liabilities were $14.8 million and consisted of obligations under excess facility operating leases and severance costs. During the first quarter of fiscal 2007, we recorded a restructuring charge of $1.5 million for our Japan operations, $1.3 million of which represented severance charges and $0.2 million represented an excess facilities charge. The severance charges of $1.3 million related to a reduction in our staff in Japan during the first quarter of fiscal 2007. During the second quarter of fiscal 2007, we recorded a restructuring reversal of $231,000 for our Japan operations, which represented the proceeds from an insurance policy covering a portion of the employees retirement allowance.

An excess facility charge was initially recognized during fiscal 2002 to permanently reduce occupancy or vacate certain domestic and international facilities. The charge for excess facilities was comprised primarily of future minimum lease payments payable over the remaining life of the leases, net of total estimated sublease income. Since the commercial real estate market continued to be weak in certain areas during fiscal 2006, we concluded that we would not be able to find a suitable tenant for the remaining vacant facility and accordingly adjusted our estimate by $3.3 million to exclude any future sublease income assumption for that facility. The actual costs could differ from our estimates, and additional adjustments to the restructuring liability could be recorded if we are able to negotiate reasonable termination fees on certain facilities, if facility sub-lease rental rates change, or if other estimates and assumptions change.

Activity with respect to restructuring liabilities is as follows (in thousands):

	Excess Facilities	Severance	Total
Balance at July 2, 2006	$ 17,042	$	$ 17,042
Charges in the first six months of fiscal 2007	172	1,131	1,303

Cash payments, net	(3,088)	(434)	(3,522)
Balance at December 31, 2006	14,126	697	14,823
Less: current portion	4,500	697	5,197
Restructuring liabilities at December 31, 2006, less current portion	$ 9,626	$	$ 9,626

8. Subsequent Event

On June 25, 2007, the Company s Board of Directors, following a review of on-going expense requirements, approved a plan under which the Company will incur a restructuring charge in the fourth quarter of fiscal 2007 related to a reduction in force, the closure of a facility, and the termination of certain product development contracts. The Company expects to finalize the plan during the fourth quarter of fiscal 2007. The Company believes that all cash expenditures in connection with the plan will occur in future periods.

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

This quarterly report on Form 10-Q, including the following sections, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, particularly statements relating to our expectations regarding results of operations, our ability to expand our market penetration, our ability to expand our distribution channels, customer acceptance of our products, our ability to meet the expectations of our customers, product demand and revenue, cash flows, product gross margins, our expectations to continue to develop new products and enhance existing products, our expectations regarding the amount of our research and development expenses, our expectations relating to our selling, general and administrative expenses, our efforts to achieve additional operating efficiencies and to review and improve our business systems and cost structure, our expectations to continue investing in technology, resources and infrastructure, our expectations concerning the availability of products from suppliers and contract manufacturers, anticipated product costs and sales prices, our expectations that we have sufficient capital to meet our requirements for at least the next twelve months, our expectations regarding the rationalization of our workforce and facilities, our efforts to sell our corporate campus, and our expectations regarding materials and inventory management. These forward-looking statements involve risks and uncertainties, and the cautionary statements set forth below and those contained in the section entitled Risk Factors identify important factors that could cause actual results to differ materially from those predicted in any such forward-looking statements. We caution investors that actual results may differ materially from those projected in the forward-looking statements as a result of certain risk factors identified in this Form 10-Q and other filings we have made with the Securities and Exchange Commission.

Business Overview

We develop and sell a family of modular and stackable network infrastructure equipment and offer related service contracts for extended warranty and maintenance agreements. Substantially all of our revenue is derived from the sale of networking equipment and the related service contracts. We believe that understanding the following key developments is helpful to an understanding of our operating results for the second quarter and first half of fiscal 2007.

Increased Product Breadth

We believe that continued success in the marketplace will depend on our ability to develop new and enhanced products employing leading-edge technology. In fiscal 2006, we introduced several new products that allow for the continued deployment of secure, converged networks as well as the expansion of the ExtremeXOS operating system from the core to the edge of the network. The following products were introduced in fiscal 2006: the BlackDiamond 8806 enterprise edge modular switch, the Summit WM100 and WM1000 wireless network controllers, the Sentriant security appliance for the detection and mitigation of rapidly propagating threats, the BlackDiamond 12804 modular switch, a next generation Layer 3 chassis switch for metro Ethernet providers and enterprise converged networks and the Summit X450a 24t, Summit X450a 48t, Summit 450e 24p ExtremeXOS-based fixed switches.

Convergence of Voice, Video and Data

We have a vision of providing customers with the systems to build a converged communications infrastructure that can easily accommodate voice, video and data on a seamless wired and wireless network. We believe that these two aspects of convergence, the convergence of voice, video and data, and the convergence of wired and wireless, are important underlying demand creators in the enterprise market.

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In October 2003, we announced our comprehensive strategic alliance with Avaya, Inc. to jointly develop and market converged communications solutions. The alliance brings together Avaya s global market leadership in IP voice and telephony with Extreme s expertise in high performance IP data network infrastructure. Under a joint development agreement, the companies develop next generation, standards-based technologies in the areas of network management and provisioning, Quality of Service, security, and network resilience. Additionally, Avaya sells, services and supports Extreme s entire portfolio of data networking products through their worldwide sales organization and the Avaya Global Services organization.

Business Environment

Throughout fiscal 2003 and early 2004, the primary factor that impacted our operations and financial performance was weak demand for networking equipment resulting from the continuing weakness of the global and U.S. economies. Weak economic conditions persisted through most of fiscal 2004, but beginning in the third quarter of fiscal 2004, we began to see evidence of strengthening demand for our products. In fiscal 2005, we continued to generate revenue growth, although not each and every quarter, and not in all geographic markets. In fiscal 2006 and the first six months of fiscal 2007, however, we experienced lower revenue in the enterprise segment in the U.S. and in the service provider segment in Japan.

Results of Operations

Our operations and financial performance have been affected by the economic factors described above, and during the second quarter of fiscal 2007, we produced the following results (with comparisons to the second quarter of fiscal 2006):

Net revenues of $86.9 million, a decrease of 6.4% from net revenues of $92.8 million in the second quarter of fiscal 2006.

Service revenue of $15.8 million, which was level with the second quarter of fiscal 2006.

Total gross margin of 53.5% of net revenues, down from 54.7% in the second quarter of fiscal 2006.

Net loss of $1.9 million, a decrease from $5.7 million of net income in the second quarter of fiscal 2006.

Cash and cash equivalents, short-term investments and marketable securities was $204.2 million as of December 31, 2006. We fully paid our $200 million subordinated debentures on December 1, 2006 upon maturity. Until October 25, 2006, we continued to repurchase shares under our share repurchase program authorized by our board of directors in the first quarter of fiscal 2006 by repurchasing approximately 0.9 million shares for $3.4 million in the second quarter of fiscal 2007. On October 25, 2006, the Board of Directors terminated the share repurchase plan.

Net Revenues

The following table presents net product and service revenues for the three- and six-month periods ended December 31, 2006 and January 1, 2006 (dollars in thousands):

	Three months ended December 31, 2006		Three months ended January 1, 2006		Six months ended December 31, 2006		Six months ended January 1, 2006	
	$	% of Net Revenues	$	% of Net Revenues	$	% of Net Revenues	$	% of Net Revenues
Net Revenues:								
Product	$ 71,074	81.8%	$ 76,998	83.0%	$ 139,056	81.5%	$ 158,915	83.3%
Service	15,779	18.2%	15,789	17.0%	31,560	18.5%	31,794	16.7%

Total net revenues	$ 86,853	100.0%	$ 92,787	100.0%	$ 170,616	100.0%	$ 190,709	100.0%

Net revenues were $86.9 million in the second quarter of fiscal 2007 and $92.8 million in the second quarter of fiscal 2006, representing a decrease of 6.4% in the second quarter of fiscal 2007 from the second quarter of fiscal 2006. Net revenues were $170.6 million in the six month period ended December 31, 2006 and $190.7 million in the six-month period ended January 1, 2006, representing a decrease of 10.5%.

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Product revenue was $71.1 million for the second quarter of fiscal 2007 compared to $77.0 million for the second quarter of fiscal 2006, a decrease of 7.7%. Product revenue was $139.1 million in the six-month period of fiscal 2007 compared to $158.9 million in fiscal 2006, a decrease of 12.5%. The decrease in product revenue in both the second quarter and six month periods of fiscal 2007 as compared to fiscal 2006 was primarily due to a decrease in the volume of units sold, primarily from a decline in sales in Japan and Other, primarily Asia Pacific, offset by an increase in EMEA.

Service revenue remained level at $15.8 million in the second quarter of both fiscal 2007 and 2006. Service revenue decreased slightly to $31.6 million for the six month period ended December 31, 2006 from $31.8 million for the six-month period ended January 1, 2006, a decrease of 0.7%.

The following table presents the total net revenue geographically for the three- and six-month periods ended December 31, 2006 and January 1, 2006 (dollars in thousands):

	Three months ended December 31, 2006		Three months ended January 1, 2006		Six months ended December 31, 2006		Six months ended January 1, 2006	
	$	% of Net Revenues	$	% of Net Revenues	$	% of Net Revenues	$	% of Net Revenues
Net Revenues:								
United States	$ 31,522	36.3%	$ 31,908	34.4%	$ 65,763	38.5%	$ 77,025	40.4%
Europe, Middle East and Africa	36,353	41.9%	31,404	33.9%	69,191	40.6%	61,477	32.2%
Japan	4,619	5.3%	10,973	11.8%	9,228	5.4%	21,702	11.4%
Other	14,359	16.5%	18,501	19.9%	26,434	15.5%	30,504	16.0%
Total net revenues	$ 86,853	100.0%	$ 92,786	100.0%	$ 170,616	100.0%	$ 190,708	100.0%

Sales of products and services outside the United States accounted for approximately 64% and 62% of our business in the three and six month periods ended December 31, 2006, respectively, compared to approximately 66% and 60% in the three and six month periods ended January 1, 2006, respectively. Revenue outside the U.S., as a percentage of total net revenue, in the second quarter of fiscal 2007 decreased by 2% compared to the year-ago quarter due primarily to decreases in revenue in Japan and Other regions, primarily the Asia Pacific region. Net revenue outside the United States, increased by 2% as a percentage to total net revenue in the six-month period ended December 31, 2006 as compared to the same prior year period due to increases in revenue in Europe, Middle East and Africa, offset by a decrease in revenue in Japan and in the Other regions. We expect that export sales will continue to represent a significant portion of net revenue, although export sales may fluctuate as a percentage of net revenue. Substantially all sales transactions are denominated in United States dollars.

We rely upon multiple channels of distribution, including two-tiered distribution in which large distributors purchase our product and make it available to resellers. Revenue through the distributor channel as a percentage of total product revenue was 46% in the second quarter of fiscal 2007 and 36% in the second quarter of fiscal 2006. Revenue through the distributor channel as a percentage of total product revenue was 44% in the first six months of fiscal 2007 and 35% in the first six months of fiscal 2006. The level of sales to any one customer may vary from period to period; however, we expect that significant customer concentration will continue for the foreseeable future. One distributor accounted for 10% or more of our net revenues for the second quarter of fiscal 2007 and fiscal 2006, as well as the six-month period in fiscal 2007. No customer accounted for greater than 10% of our net revenue for the six months ended January 1, 2006.

Cost of Revenues and Gross Margin

The following table presents the gross margin on product and service revenues and the gross margin percentage of product and service revenues for the three- and six-month periods ended December 31, 2006 and January 1, 2006 (dollars in thousands):

	Three months ended December 31, 2006		Three months ended January 1, 2006		Six months ended December 31, 2006		Six months ended January 1, 2006	
	$	Gross Margin %	$	Gross Margin %	$	Gross Margin %	$	Gross Margin %

Gross margin:								
Product	$ 39,106	55.0%	$ 43,481	56.5%	$ 75,289	54.1%	$ 89,472	56.3%
Service	7,370	46.7%	7,301	46.2%	14,338	45.4%	14,598	45.9%
Total gross margin	$ 46,476	53.5%	$ 50,782	54.7%	$ 89,627	52.5%	$ 104,070	54.6%

Gross margin was $46.5 million in the second quarter of fiscal 2007 and $50.8 million in the second quarter of fiscal 2006, representing a decrease of 8.5%. Gross margin was $89.6 million in the first six months of fiscal 2007 compared to $104.1 million in the first six months of fiscal 2006. Gross margin as a percentage of net revenues was 53.5% and 54.7% in the second quarter of fiscal 2007 and the second quarter of fiscal 2006, respectively.

Cost of product revenue includes costs of raw materials, amounts paid to third-party contract manufacturers, costs related to warranty obligations, charges for excess and obsolete inventory, royalties under technology license agreements, and internal costs associated with manufacturing overhead, including management, manufacturing engineering, quality assurance, development of test plans and document control. Product gross margin in the second quarter of fiscal 2007 was $39.1 million, representing 55.0% of product revenues as compared to $43.5 million in the second quarter of fiscal 2006, or 56.5% of product revenue. The decrease in product gross margin as a percentage of product revenues was primarily due to lower revenue, offset by lower per-unit product costs due to a shift in product mix and lower operations costs. Cost of product revenue in the second quarter of fiscal 2007 includes an inventory write-down of approximately $1.4 million of which approximately $1.0 million relates to the discontinuance of a product. Product gross margin in the six months ended December 31, 2006 was $75.3 million, representing 54.1% of product revenues as compared to $89.5 million in the six months ended January 1, 2006, or 56.3% of product revenue. The decrease in product gross margin as a percentage of product revenues was primarily due to lower revenue, offset by lower per-unit product costs due to a shift in product mix and lower operations costs.

Cost of product revenue in all periods includes the cost of our manufacturing overhead. We outsource substantially all of our manufacturing and supply chain management operations, and we conduct quality assurance, manufacturing engineering, document control and repairs at our facility in Santa Clara, California. Accordingly, a significant portion of our cost of product revenue consists of payments to our contract manufacturer, Flextronics International, Ltd. located in San Jose, California, and Guadalajara, Mexico, and to our original design manufacturer, Alpha Networks, Inc located in Hsinchu, Taiwan, R.O.C. and Dongguan City, China.

Our cost of service consists primarily of labor, overhead, repair and freight costs and the cost of spares used in providing support under customer service contracts. Service gross margin in the second quarter of fiscal 2007 was $7.4 million, representing 46.7% of service revenues as compared to $7.3 million in the second quarter of fiscal 2006, or 46.2% of service revenue. Service gross margin in the six months of fiscal 2007 was $14.3 million, representing 45.4% of service revenue as compared to $14.6 million in the same six month period of fiscal 2006, or 45.9% of service revenue.

Our product and service gross margins are variable and dependent on many factors, some of which are outside of our control. Some of the primary factors affecting gross margin include demand for our products, changes in our pricing policies and those of our competitors, and the mix of products sold. Our gross margin may be adversely affected by increases in material or labor costs, increases in warranty expense, the cost of providing services under extended service contracts, heightened price competition, obsolescence charges and higher inventory balances. In addition, our gross margin may fluctuate due to the mix of distribution channels through which our products are sold, including the effects of our two-tier distribution model. Any significant decline in sales to our resellers, distributors or end-user customers, or the loss of any of our key resellers, distributors or end-user customers could have a material adverse effect on our business, operating results and financial condition. In addition, an increase in distribution channels generally makes it more difficult to forecast the mix of products sold and the timing of orders from our customers. New product introductions may result in excess or obsolete inventories, which may also reduce our gross margin.

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Share-Based Compensation Costs

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

	Three Months Ended		Six Months Ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Cost of product revenue	$ 201	$ 196	$ 398	$ 366
Cost of service revenue	116	92	239	200
Sales and marketing	635	594	1,302	1,376
Research and development	564	442	1,122	967
General and administrative	292	250	597	535
Total share-based compensation expense	1,808	1,574	3,658	3,444
Share-based compensation cost capitalized in inventory	1	1	1	25
Total share-based compensation cost	$ 1,809	$ 1,575	$ 3,659	$ 3,469

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option valuation model with the weighted average assumptions noted in the table in Note 2 to the Condensed Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report on Form 10-Q. The expected term of options granted is derived from historical data on employee exercise and post-vesting employment termination behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. Expected volatility is based on both the implied volatilities from traded options on our stock and historical volatility on our stock.

The Black-Scholes-Merton option valuation model requires the input of highly subjective assumptions, including the expected life of the share-based award and stock price volatility. The assumptions used in calculating the fair value of share-based compensation represent management s best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if other assumptions had been used, our share-based compensation expense could have been materially different. In addition, we are required to estimate the expected forfeiture rate and only recognize expense for those awards expected to vest. If our actual forfeiture rate is materially different from our estimate, the share-based compensation expense could be materially different.

Sales and Marketing Expenses

Sales and marketing expenses consist of salaries, commissions and related expenses for personnel engaged in marketing and sales functions, as well as trade shows and promotional expenses. Sales and marketing expenses were $25.8 million for the second quarter of fiscal 2007 compared to $24.0 million for the second quarter of fiscal 2006, an increase of $1.8 million. The increase in the current quarterly period was primarily due to increased payroll and related personnel expenses due to increased headcount and increased costs associated with sales conferences, offset by decreased professional fees. Sales and marketing expenses were $51.3 million for the first six months of fiscal 2007 compared to $49.9 million for the first six months of fiscal 2006, an increase of $1.4 million. The increase in the six month period was primarily due to increased payroll and related personnel expenses due to increased headcount and increased costs associated with sales conferences. The level of our sales and marketing spending in the future, in dollars and as a percentage of net revenues, will depend on many factors, including the rate at which we expand our sales force and the rate at which our net revenues change.

Research and Development Expenses

Research and development expenses consist principally of salaries and related personnel expenses, consultant fees and prototype expenses related to the design, development and testing of our products. Research and development expenses decreased slightly to $15.6 million for the second quarter of fiscal 2007 from $15.7 million for the second quarter of fiscal 2006, a decrease of $0.1 million. Research and development expenses decreased to $31.4 million for the first six months of fiscal 2007 from $31.9 million for the first six months of fiscal 2006, a decrease of $0.5 million. This decrease was due to a reduction in the amortization of the Avaya warrant of approximately $1.0 million due to the extension of the development agreement with Avaya which decreased the quarterly expense amount, as well as a decrease in engineering project expenses. We expense all research and development costs as incurred. We believe that continued investment in research and development is critical to attaining our strategic objectives and as a result, we expect research and development expenses to increase in absolute dollars.

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General and Administrative Expenses

General and administrative expenses consist primarily of salaries and related expenses for executive, finance and administrative personnel, legal fees, professional fees and other general corporate expenses. General and administrative expenses increased to $8.8 million for the second quarter of fiscal 2007 from $6.1 million for the second quarter of fiscal 2006, an increase of $2.7 million. This increase was primarily due to increased outside professional fees of $2.8 million related to an investigation by a special committee of our Board of Directors of our historical practices for stock option grants and the accounting for option grants. Legal expenses related to intellectual property litigation are expected to continue at higher levels in fiscal 2007 than in fiscal 2006. In addition, we also expect to incur higher professional fees in the coming periods as a result of the stock option investigation. General and administrative expenses increased to $16.4 million for the first six months of fiscal 2007 from $13.2 million for the first six months of fiscal 2006, an increase of $3.2 million. This increase was primarily due to increased legal and professional fees of $1.3 million related to intellectual property litigation and $2.8 million related to the stock option investigation. Expenses as a result of compliance with the Sarbanes-Oxley Act of 2002, and Section 404 thereof, are expected to continue at levels similar to fiscal 2006.

Restructuring Charge

During the first quarter of fiscal 2007, we recorded a restructuring charge of $1.5 million for our Japan operations, $1.3 million of which represented severance charges and $0.2 million represented an excess facilities charge. The severance charges of $1.3 million related to a reduction in our Japan staff during the first quarter of fiscal 2007. During the second quarter of fiscal 2007, we recorded a restructuring reversal of $231,000 related to the payment received on an insurance policy covering a portion of the employees retirement allowance.

Other Income, Net

Other income, net was $2.2 million for the second quarter of fiscal 2007 compared to $1.4 million in the second quarter of fiscal 2006, an increase of $0.8 million. This increase is attributable principally to increased interest income of $0.3 million due to an increase in average interest rates and decreased interest expense of $0.6 million due to the payment of our convertible debentures. Other income, net was $5.3 million for the first six months of fiscal 2007 compared to $2.4 million in the first six months of fiscal 2006, an increase of $2.9 million. This increase is primarily attributed to increased interest income of $1.9 million and decreased interest expense of $0.6 million due to the full payment of our convertible debentures on December 1, 2006.

Provision for Income Taxes

The provisions for income taxes of $0.6 million and $0.9 million for the second quarter of fiscal 2007 and the second quarter of fiscal 2006, respectively, were recorded for estimated taxes due on income generated in certain state and foreign tax jurisdictions. The income tax provision for the second quarter of fiscal 2007 reflects actual results related to the impact of income from foreign operations, minor state and local taxes and unbenefited losses in the U.S. due to the full valuation allowance on our net deferred tax assets in accordance with SFAS 109. The income tax provision for the second quarter of fiscal 2006 reflects an effective tax rate of 13%, which differs from the statutory tax rate due to benefits to U.S. taxes from net operating loss carryforwards and tax credit carryforwards, offset by the tax impact of income from foreign operations. The provision for income taxes was $1.4 million for both the six month period ended December 31, 2006 and the six month period ended January 1, 2006.

We have provided a full valuation allowance for our net deferred tax assets. We initially recorded this charge during fiscal 2003 in accordance with SFAS No. 109, which places greater weight on previous cumulative losses than the outlook for future profitability when determining whether deferred tax assets can be realized. Based upon our most recent three-year history of losses, as of the date of determining the charge, and relying on other guidance specified in SFAS 109, we determined that it was appropriate to establish a full valuation allowance against our deferred tax assets. This valuation allowance will be evaluated periodically and can be reversed partially or totally if business results have sufficiently improved to support realization of our deferred tax assets.

Critical Accounting Policies and Estimates

Our significant accounting policies are more fully described in Note 2 of Notes to Consolidated Financial Statements included in our Form 10-K for the year ended July 2, 2006. The preparation of consolidated financial statements in accordance with generally accepted accounting principles requires management to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period reported. By their nature, these estimates, assumptions and judgments are subject to an inherent degree of uncertainty. We base our estimates, assumptions and judgments on historical experience, market trends and other factors that are believed to be reasonable under the circumstances. Estimates, assumptions and judgments are reviewed on an ongoing basis and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies have been discussed with the Audit Committee of the Board of Directors. We believe there have been no material changes to our critical accounting policies and estimates during the three- and six-month periods ended December 31, 2006 compared to those discussed in our Annual Report of Form 10-K for the year ended July 2, 2006.

Recently Issued Accounting Standards

Fair Value Measurements

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*. SFAS 157 replaces the different definitions of fair value in the accounting literature with a single definition. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 is effective for fair-value measurements already required or permitted by other standards for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. We currently are in the process of determining the impact of adopting the provisions of SFAS 157 on our financial position, results of operations and cash flows.

Fair Value Option for Financial Assets and Liabilities

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115* (FAS 159). FAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value and establishes presentation and disclosure requirements designed to facilitate comparisons between companies that choose different measurement attributes for similar types of assets and liabilities. The provisions of FAS 159 become effective for fiscal years beginning after November 15, 2007. We believe that the adoption of SFAS 159 will not have a material effect on our financial statements.

Accounting for Electronic Equipment Waste Obligations

In June 2005, the FASB issued FSP No. FAS 143-1, *Accounting for Electronic Equipment Waste Obligations* (FSP 143-1). FSP 143-1 provides guidance in accounting for obligations associated with Directive 2002/96/EC (the Directive) on Waste Electrical and Electronic Equipment adopted by the European Union. FAS 143-1 is required to be applied to the later of the first reporting period ending after June 6, 2005 or the date of the Directive s adoption into law by the applicable EU member countries in which we have significant operations. The Directive distinguishes between new and historical waste. New waste relates to products put on the market after August 13, 2005. FSP 143-1 directs commercial users to apply the provisions of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, and the related FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*, for the measurement and recognition of the liability and asset retirement obligation associated with the historical waste management requirements of the Directive. Additionally, FSP 143-1 provides guidance for the accounting by producers for the financing of the obligations of historical waste held by private households.

The adoption of FAS 143-1 in the first quarter of fiscal 2006 did not have a material impact on our consolidated financial position and results of operations. We are continuing to analyze the impact of the Directive, and FSP 143-1, on our consolidated financial position and results of operations as additional EU member countries adopt the Directive.

Accounting for Income Taxes

In July 2006, the Financial Accounting Standards Board (FASB) released its final Interpretation on uncertain tax positions, FIN 48, *Accounting for Uncertainty in Income Taxes an interpretation of FAS 109.* This Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax

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return. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The guidance will become effective as of the beginning of a company s fiscal year beginning after December 15, 2006. The Company is currently assessing the impact of adopting this standard.

Liquidity and Capital Resources

Cash and cash equivalents, short-term investments and marketable securities decreased to $204.2 million at December 31, 2006 from $433.1 million at July 2, 2006, a decrease of $228.9 million. This decrease was primarily due to cash used to pay off our $200 million subordinated debentures, repurchase treasury stock of $14.6 million, capital expenditures of $2.7 million and operating activities of $13.8 million, partially offset by an increase in the unrealized gain on investments of $1.5 million and proceeds from issuance of common stock of $0.6 million.

We used $13.8 million in cash from operations in the first six months of fiscal 2007. Net loss was $6.8 million and included significant non-cash charges including depreciation of $4.1 million, $3.7 million in share-based compensation expense, restructuring expense of $1.3 million and warrant amortization expense of $2.0 million. Accounts receivable, net, increased to $30.2 million at December 31, 2006 from $27.7 million at July 2, 2006. Days sales outstanding (DSO) in receivables was 31 days at December 31, 2006 and 30 days at July 2, 2006. Net inventory levels increased to $23.2 million at December 31, 2006 from $19.3 million at July 2, 2006. Inventory management remains an area of focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times and avoid stock-outs with the risk of inventory excess or obsolescence because of declining demand, rapidly changing technology and customer requirements. Deferred revenue decreased to $43.5 million at December 31, 2006 from $45.1 million at July 2, 2006. This decrease was due primarily to the first half being a seasonally low time for service contract renewals.

We have a revolving line of credit for $10.0 million with a major lending institution. As of December 31, 2006, there were no outstanding borrowings under this facility. The line of credit contains a provision for the issuance of letters of credit not to exceed the unused balance of the line. As of December 31, 2006, we had letters of credit totaling $0.8 million. These letters of credit were primarily issued to satisfy requirements of certain of our customers for performance bonds. The line of credit requires us to maintain specified financial covenants related to tangible net worth and liquidity with which we were not in compliance as of December 31, 2006. Subsequently, we received a waiver from the bank on the non-compliant covenant. The line of credit originally expired on January 25, 2007, and was subsequently renewed with a new expiration date of January 24, 2008.

In December 2001, we completed a private placement of $200.0 million of convertible subordinated notes. The notes matured on December 1, 2006 and were fully paid at that time. Interest was payable semi-annually at 3.5% per annum.

On October 20, 2005, our Board of Directors authorized the repurchase of up to $50 million of our common stock. This authorization originally was to expire in October 2007, but on October 25, 2006, the Board of Directors terminated the share repurchase plan. From the beginning of the share repurchase program until October 25, 2006, we used $48.3 million to repurchase 11.1 million shares of stock, primarily through open market purchases. The repurchases were made in compliance with the Securities and Exchange Commission s Rule 10b-18.

We own our corporate headquarters in Santa Clara, California. The campus is located on approximately 16 acres of property in an area that may ultimately be suitable for residential development. On April 24 2006, we announced that we had entered into a contract for the sale of our corporate headquarters campus in Santa Clara, California at a price of $70 million (the Campus Sale Agreement). Under the Campus Sale Agreement, completion of the transaction was contingent upon the satisfaction of certain conditions. On October 31, 2006, we announced that the Campus Sale Agreement now has expired under its terms. Accordingly, the parties are no longer bound to proceed with the transaction, and the proposed purchaser has the right not to proceed with the transaction. We continue to review our alternatives with respect to this matter, but cannot make any predictions at this time.

The following summarizes our contractual obligations (including interest payments) at December 31, 2006, and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	Total	Less Than 1 Year	1 3 Years	3 5 Years	After Five Years
Contractual Obligations:					
Non-cancelable inventory					
Purchase commitments	$ 22,623	$ 22,623	$	$	$
Non-cancelable operating lease obligations	21,229	6,440	8,801	5,989	

Other non-cancelable purchase commitments	5,000	1,500	2,500	1,000	
Total contractual obligations	$ 48,852	$ 30,563	$ 11,301	$ 6,989	$

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We did not have any material commitments for capital expenditures as of December 31, 2006. Other non-cancelable purchase commitments represent manufacturing and technology agreements. We did not have any off-balance sheet arrangements as of December 31, 2006.

We require substantial capital to fund our business, particularly to finance inventories and accounts receivable and for capital expenditures. As a result, we could be required to raise substantial additional capital at any time. To the extent that we raise additional capital through the sale of equity or convertible debt securities, the issuance of such securities could result in dilution to existing stockholders. If additional funds are raised through the issuance of debt securities, these securities may have rights, preferences and privileges senior to holders of common stock and the terms of such debt could impose restrictions on our operations. If we are unable to obtain such additional capital, we may be required to reduce the scope of our planned product development and marketing efforts, which would materially adversely affect our business, financial condition and operating results.

We believe that our current cash and cash equivalents, short-term investments, marketable securities and cash available from credit facilities and future operations will enable us to meet our working capital requirements for at least the next 12 months.

Risk Factors

We are subject to a number of risks. Some of these risks are endemic to the networking industry and are the same or similar to those disclosed in our previous SEC filings. The following is a list of risks and uncertainties which may have a material and adverse effect on our business, financial condition or results of operations. The risks and uncertainties set out below are not the only risks and uncertainties we face.

The Special Committee investigation of our historical stock option practices and resulting restatements has been time consuming and expensive, and may have a material adverse effect on us.

The Special Committee investigation and restatement activities have required us to expend significant management time and to incur significant legal, accounting, and other expenses. Although the Special Committee has concluded its investigation, the Special Committee may continue to assist the Company with follow-up activities arising from the restatement or otherwise related to its investigation. The issues surrounding the historical stock option grant practices are complex and require substantial resources to resolve. The cost and time to complete the amendment of our financial reports and to conclude any follow-up activities by the Special Committee may have a material adverse effect on our operating results or our common stock price. The period of time necessary to resolve any such follow-up matters is uncertain, and these matters could require significant additional attention and resources.

The discovery that we had not accounted correctly for historical stock option grants has had, and may continue to have, a material adverse effect on our financial results.

We cannot predict the outcome of any government inquiry or the pending shareholder derivative lawsuits, and we may face future government actions, shareholder lawsuits and other legal proceedings related to our historical stock option practices. All of these events have required us, and will continue to require us, to expend significant management time and to incur significant accounting, legal, and other expenses. This has and could continue to divert attention and resources from the operation of our business and adversely affects our financial condition and results of operations.

Any government inquiry relating to our historical stock option practices may be time consuming and expensive and could result in injunctions, fines and penalties that may have a material adverse effect on our financial condition and results of operations.

The SEC issued an informal request to us for information relating to our historical stock option grant practices. We have responded to the SEC s inquiry and will respond to inquiries from other government authorities if made. The SEC and/or other government authorities may conduct a formal investigation into our historical stock option grant practices. The period of time necessary to resolve any such inquiry is uncertain, and we cannot predict the outcome of any such inquiry or whether we will face additional government inquiries, investigations or other actions related to our historical stock option practices, or otherwise. These matters will likely require us to continue to expend significant management time and incur significant legal and other expenses, and could result in civil and criminal actions seeking, among other things, injunctions against the Company and the payment of significant fines and penalties by the Company, which may have a material adverse effect on our financial condition, results of operations and cash flow. A formal investigation by the SEC and/or other government authorities could adversely affect our business, results of operations, financial position and cash flows.

We have not been in compliance with SEC reporting requirements and Nasdaq listing requirements and may continue to face compliance issues with both. If we are unable to remain in compliance with SEC reporting requirements and Nasdaq listing requirements, there may be a material adverse effect on the Company and our stockholders.

Pending completion of our Special Committee investigation, we were delinquent in filing certain of our periodic reports with the SEC, and consequently we were not in compliance with Nasdaq s Marketplace Rules. As a result, we underwent a review and hearing process with Nasdaq to determine our listing status. Nasdaq ultimately permitted our securities to remain listed on the Nasdaq Global Select Market, but our securities could be delisted in the future if we do not maintain compliance with applicable listing requirements. For example, due to the delinquency in filing our periodic reports, we will be unable to hold our annual meeting of stockholders within the time required under Nasdaq Marketplace Rules, and it is possible that further Nasdaq delisting proceedings could begin if we are unable to resolve that deficiency within the time allowed to do so. If this happens, the price of our stock, the ability of our stockholders to trade in our stock, and our ability to raise capital could be adversely affected. If we are unable to remain in compliance with the SEC reporting requirements, we would be subject to a number of restrictions regarding the registration of our stock under federal securities laws, and we may not be able to issue stock options or other equity awards to our employees or allow them to exercise their outstanding options, which would adversely affect our business and results of operations.

We have been named as a party to shareholder derivative lawsuits relating to our historical stock option practices, and we may be named in additional lawsuits in the future. This litigation could become time consuming and expensive and could result in the payment of significant judgments and settlements, which could have a material adverse effect on our financial condition and results of operations.

In connection with our historical stock option practices and resulting restatements, derivative actions were filed against certain of our current and former directors and officers purporting to assert claims on the Company s behalf. There may be additional lawsuits including securities class action lawsuits and other derivative actions filed in the future. We cannot predict the outcome of these lawsuits, nor can we predict the amount of time and expense that will be required to resolve these lawsuits. If these lawsuits become time consuming and expensive, or if there are unfavorable outcomes in any of these cases, there could be a material adverse effect on our business, financial condition and results of operations.

Our insurance coverage will not cover all of our liabilities and expenses in these lawsuits, in part because we have a significant deductible on certain aspects of the coverage. In addition, subject to certain limitations, we may be obligated to indemnify our current and former directors, officers and employees. We currently hold insurance policies for the benefit of our directors and officers, however our insurance coverage may not be sufficient in some or all of these matters to cover all of the costs the Company may need to incur. Furthermore, the insurers may seek to deny or limit coverage in some or all of these matters, in which case we may have to self-fund all or a substantial portion of our indemnification obligations. If we need to self-fund, there is no assurance that we will prevail in our efforts to recover payment from our insurers.

Our efforts to correct a material weakness in our internal control over financial reporting may not have been sufficient, and we may discover additional material weaknesses in our internal control over financial reporting.

As a result of the Special Committee investigation and management s internal review of our historical stock option practices and related matters, we identified a material weakness in our internal control over financial reporting related to our ability to retrospectively identify material accounting errors resulting from our historical stock option grants (see Item 4 Controls and Procedures). A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement in our financial statements will not be prevented or detected. We believe that we have subsequently remedied this material weakness in our internal controls over financial reporting, but there can be no assurance that our corrections were sufficient or fully effective, or that we will not discover additional material weaknesses in our internal controls over financial reporting in the future.

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Failure to maintain effective internal controls over financial reporting may cause us to delay filing our periodic reports with the SEC, affect our Nasdaq listing, and adversely affect our stock price.

The Securities and Exchange Commission, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a report of management on internal control over financial reporting in their annual reports on Form 10-K that contain an assessment by management of the effectiveness of the Company s internal control over financial reporting. In addition, our independent registered public accounting firm must attest to and report on management s assessment of the effectiveness of the internal control over financial reporting. Although we review our internal control over financial reporting in order to ensure compliance with the Section 404 requirements, if our independent registered public accounting firm is not satisfied with our internal control over financial reporting or the level at which these controls are documented, designed, operated or reviewed, or if the independent registered public accounting firm interprets the requirements, rules and/or regulations differently from our interpretation, then they may decline to attest to management s assessment or may issue a report that is qualified. This could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could negatively impact our stock price.

Federal securities laws, rules and regulations, as well as Nasdaq rules and regulations, require companies to maintain extensive corporate governance measures, impose comprehensive reporting and disclosure requirements, set strict independence and financial expertise standards for audit and other committee members and impose civil and criminal penalties for companies and their chief executive officers, chief financial officers and directors for securities law violations. These laws, rules and regulations have increased and will continue to increase the scope, complexity and cost of our corporate governance, reporting and disclosure practices, which could harm our results of operations and divert management s attention from business operations.

It may be difficult or costly to obtain director and officer insurance coverage as a result of our stock option related issues.

We expect that the issues arising from our previous historical stock option grant practices and related accounting will make it more difficult to obtain director and officer insurance coverage in the future. If we are able to obtain this coverage, it could be significantly more costly than in the past, which would have an adverse effect on our financial results and cash flow. As a result of this and related factors, our directors and officers could face increased risks of personal liability in connection with the performance of their duties. As a result, we may have difficultly attracting and retaining qualified directors and officers, which could adversely affect our business.

We Cannot Assure You That We Will Be Profitable in the Future.

While we have reported profits in both fiscal 2006 and 2005, we were not profitable in each quarter during those years, nor were we profitable in our quarter and six months ended December 31, 2006. In addition, we reported losses for fiscal 2004, 2003, 2002 and 2001 and our revenue declined in each of the four quarters of fiscal 2006 and the first six months of fiscal 2007. We anticipate continuing to incur significant sales and marketing, product development and general and administrative expenses and, as a result, we will continue to need to rationalize expense levels and increase revenue levels to achieve sustained profitability in future fiscal periods.

A Number of Factors Could Cause Our Quarterly Financial Results to Be Worse Than Expected, Resulting in a Decline in Our Stock Price.

Our ability to control our operating expenses at a level that is consistent with anticipated revenue is significant to our financial results. A high percentage of our expenses are fixed in the short term, so any delay in generating or recognizing revenue could cause our quarterly operating results to fall below the expectations of public market analysts or investors, which could cause the price of our stock to fall.

Orders in our backlog at the beginning of each quarter do not equal expected revenues for that quarter and are generally cancelable at any time. Accordingly, we are dependent upon obtaining orders during a quarter and shipping those orders in the same quarter to achieve our revenue objectives. In addition, the timing of product releases and purchase orders, and product availability, often results in a majority of our product shipments being scheduled near the end of a quarter. Failure to ship these products by the end of a quarter may adversely affect our operating results. Our customer agreements generally allow customers to delay scheduled delivery dates or to cancel orders within specified timeframes without significant charges to the

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customers. Furthermore, some of our customers require that we provide installation or inspection services that may delay the recognition of revenue for both products and services, and some of our customer agreements include acceptance provisions that prevent our ability to recognize revenue upon shipment.

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

- changes in general and/or specific economic conditions in the networking industry;
- seasonal fluctuations in demand for our products and services, particularly in Asia-Pacific and Europe;
- the level of attrition of our employees, and of our sales force in particular;
- a disproportionate percentage of our sales occurring in the last month of the quarter;
- reduced visibility into the implementation cycles for our products and our customers spending plans;
- our ability to forecast demand for our products, which in the case of lower-than-expected sales, may result in excess or obsolete inventory in addition to non-cancelable purchase commitments for component parts;
- product returns or the cancellation or rescheduling of orders;
- our ability to develop, introduce, ship and support new products and product enhancements and manage product transitions;
- announcements and new product introductions by our competitors;
- our ability to develop and support relationships with enterprise customers, service providers and other potential large customers;
- our ability to achieve targeted cost reductions;
- fluctuations in warranty or other service expenses actually incurred;
- our ability to obtain sufficient supplies of sole- or limited-source components for our products on a timely basis;
- increases in the prices of the components that we purchase;

- decreases in the prices of the products that we sell;
- our ability to achieve and maintain desired production volumes and quality levels for our products;
- the mix of products sold and the mix of distribution channels through which products are sold;
- impairment charges associated with long-lived assets;
- restructuring costs associated with adjustments to the size of our operations;
- costs relating to possible acquisitions and the integration of technologies or businesses;
- the effect of amortization of purchased intangibles resulting from new transactions; and
- costs relating to the recognition of share-based payments.

In fiscal 2006 and the first half of fiscal 2007, we reported revenues below our expectations. Our results were particularly impacted by lower sales in the United States and Japan in fiscal 2006 and the first half of fiscal 2007, offset in part by increased service revenue and increased product revenue in the Asia Pacific region. We believe that revenues will increase in coming quarters; however, our future results could be adversely affected if longer term economic or industry trends are unfavorable.

Due to the foregoing factors, we believe that period-to-period comparisons of our operating results should not be relied upon as an indicator of our future performance.

Intense Competition in the Market for Networking Equipment Could Prevent Us from Increasing Revenue and Returning to Profitability.

The market for networking equipment is intensely competitive. The market for switches is part of the broader market for networking equipment, which is dominated by a few large companies, particularly Cisco Systems. In addition, there are a number of large telecommunications equipment providers, including Alcatel and Nortel Networks, which have entered the market for network equipment, particularly through acquisitions of public and privately held companies. We expect to face increased competition, particularly price competition, from these and other telecommunications equipment providers. We also compete with other public and private companies that offer switching solutions, including Enterasys Networks, Inc., Foundry Networks, Inc., Huawei Technologies Corporation, 3Com Corporation, Hewlett-Packard Company and Dell Computer Corporation. These vendors offer products with functionality similar to our products or provide alternative network solutions. Current and potential competitors have established or may establish cooperative relationships among themselves or with third parties to develop and offer competitive products. Furthermore, we compete with numerous companies that offer routers and other technologies and devices that traditionally have managed the flow of traffic on the enterprise or Metro networks.

Some of our current and potential competitors have longer operating histories and substantially greater financial, technical, sales, marketing and other resources, as well as greater name recognition and a larger installed customer base, than we do. As a result, these competitors are able to devote greater resources to the development, promotion, sale and support of their products. In addition, competitors with a large installed customer base may have a significant competitive advantage over us. We have encountered, and expect to continue to encounter, many potential customers who are confident in and committed to the product offerings of our principal competitors, including Cisco Systems. Accordingly, these potential customers may not consider or evaluate our products. When such potential customers have considered or evaluated our products, we have in the past lost, and expect in the future to lose, sales to some of these customers as large competitors have offered significant price discounts to secure these sales.

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

To remain competitive, we believe that we must, among other things, invest significant resources in developing new products, improve our current products and maintain customer satisfaction. Such investment will increase our expenses and affect our profitability. If we fail to make this investment, we may not be able to compete successfully with our competitors, which could have a material adverse effect on our revenue and future profitability.

When Our Products Contain Undetected Errors, We May Incur Significant Unexpected Expenses and Could Lose Sales.

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

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

Our Future Success Will Depend in Part Upon Increasing Our Revenue in the U.S. Market.

Our recent revenues in the U.S. have not met our expectations. We believe a number of factors have contributed to a decline in our revenues in the U.S., including attrition in our sales and marketing personnel, intense competition, as well as the timing of customer purchase decisions. Our success will depend upon increasing our revenue in the United States and we may need to identify new strategies or markets to increase revenue. We are initiating a number of programs to increase sales personnel, improve retention and to compete more effectively in the U.S. market. If these efforts are not successful, our ability to sustain and grow our revenue and to achieve increased profitability would be adversely affected.

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We Depend Upon International Sales for a Significant Portion of Our Revenue and Our Ability to Grow Our International Sales Depends on Successfully Expanding Our International Operations.

International sales constitute a significant portion of our net revenues. Our ability to grow will depend in part on the expansion of international sales. Sales to customers outside of the United States accounted for approximately 64% and 66% of our net revenues for the second quarter of each of fiscal 2007 and 2006, respectively. Our international sales primarily depend on the success of our resellers and distributors. The failure of these resellers and distributors to sell our products internationally would limit our ability to sustain and grow our revenue. There are a number of risks arising from our international business, including:

- longer accounts receivable collection cycles;
- difficulties in managing operations across disparate geographic areas;
- difficulties associated with enforcing agreements through foreign legal systems;
- the payment of operating expenses in local currencies, which exposes us to risks of currency fluctuations;
- higher credit risks requiring cash in advance or letters of credit;
- difficulty in safeguarding intellectual property;
- political and economic turbulence;
- potential adverse tax consequences; and
- unexpected changes in existing regulatory requirements and the addition of new regulatory requirements.

Our international sales currently are U.S. dollar-denominated. Future increases in the value of the U.S. dollar relative to foreign currencies could make our products less competitive in international markets. In the future, we may elect to invoice some of our international customers in local currency, which will expose us to fluctuations in exchange rates between the U.S. dollar and the particular local currency. If we do so, we may decide to engage in hedging transactions to minimize the risk of such fluctuations.

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

Conducting our Business on a Global Basis Requires Us to Comply with Various Foreign and Domestic Regulatory Requirements.

Conducting our business on a global basis subjects us to a number of frequently changing and complex regulatory requirements, and as we expand our operations into new territories, we may become subject to an increasing number of such regulatory requirements. These regulatory requirements vary from jurisdiction to jurisdiction, and may be inconsistent with one another. Our efforts to comply with the new and differing requirements increases our cost of goods and other expenses and may delay the production and shipment of our products, which could adversely impact revenue recognition and harm our financial results. In addition, failure to comply with the requirements of a single jurisdiction may adversely impact our ability to do business in that jurisdiction as well as other jurisdictions, which would harm our financial results.

Trade measures, environmental and import and export requirements are among the regulations with which we must comply. Failure to comply with such requirements may result in the imposition of financial penalties and restrictions on our ability to conduct business in and with certain countries, which may harm our business and damage our reputation. In the past, we were subject to an investigation by the U.S. Department of Commerce in connection with the possible violation of certain export regulations. The Department of Commerce has completed an investigation and we were required to pay a fine of $35,000. While this matter was resolved and we have also implemented procedures to reduce the risk of violations in the future, there can be no assurances that we will not become subject to such investigations in the future.

In connection with compliance with regulatory requirements, from time to time, we have been and may in the future become subject to audit by various governmental agencies seeking to review the compliance of our products or business practices with their regulations. When such audits occur and whether or not we are in compliance with the particular regulation, we may be required to cease shipment or production of our product in that particular jurisdiction while we seek to show our compliance with such regulations and our business may be adversely affected as a result.

We Expect the Average Selling Prices of Our Products to Decrease, Which May Reduce Gross Margin and/or Revenue.

The network equipment industry has traditionally experienced a rapid erosion of average selling prices due to a number of factors, including competitive pricing pressures, promotional pricing and technological progress. We anticipate that the average selling prices of our products will decrease in the future in response to competitive pricing pressures, excess inventories, increased sales discounts and new product introductions by us or our competitors, including, for example, competitive products manufactured with low-cost merchant silicon. We may experience substantial decreases in future operating results due to the erosion of our average selling prices. To maintain our gross margin, we must develop and introduce on a timely basis new products and product enhancements and continually reduce our product costs. Our failure to do so would likely cause our revenue and gross margins to decline, which could have a material adverse effect on our operating results and cause the price of our common stock to decline.

Some of Our Customers May Not Have the Resources to Pay for Our Products as a Result of the Current Economic Environment.

As of December 31, 2006, one customer accounted for more than 10% of our accounts receivable balance. Some of our customers are likely to experience serious cash flow problems and, as a result, may find it difficult to obtain financing, if financing is available at all. If our customers are not successful in generating sufficient revenue or securing alternate financing arrangements, they may not be able to pay, or may delay payment of, the amounts that they owe us.

In addition, sales to the service provider market are especially volatile and continued declines or delays in sale orders from this market may harm our financial condition. Furthermore, they may not order as many products from us as originally forecast, or cancel orders with us entirely. The inability of some of our potential customers to pay us for our products may adversely affect our cash flow, the timing of our revenue recognition and the amount of revenue, which may cause our stock price to decline.

If We Lose Key Personnel or are Unable to Hire Additional Qualified Personnel as Necessary, We May Not Be Able to Successfully Manage Our Business or Achieve Our Goals.

Our success depends to a significant degree upon the continued contributions of our key management, engineering, sales and marketing, service and operations personnel, many of whom would be difficult to replace. We do not have employment contracts with these individuals nor do we carry life insurance on any of our key personnel and we have experienced significant turn over in our executive personnel.

We believe our future success will also depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing, service, finance and operations personnel. The market for these personnel is competitive, especially in the San Francisco Bay Area, and we have had difficulty in hiring employees, particularly engineers, in the timeframe we desire. In addition, retention has become more difficult for us and other public technology companies as a result of the stock market decline, which caused the price of many of our employees stock options to be above the current market price of our stock and we are experiencing a high level of attrition. There can be no assurance that we will be successful in attracting and retaining our key personnel. We have and are initiating a number of employee retention programs, but we can not assure you that these will be successful. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel in the future or delays in hiring desired personnel, particularly engineers and sales personnel, could make it difficult for us to manage our business and meet key objectives, such as new product introductions. In addition, companies in the networking industry whose employees accept positions with competitors frequently claim that competitors have engaged in unfair hiring practices. We have from time to time been involved in claims like this with other companies and, although to date they have not resulted in material litigation, we do not know whether we will be involved in additional claims in the future as we seek to hire and retain qualified personnel or that such claims will not result in material litigation. We could incur substantial costs in litigating any such claims, regardless of the merits.

The Market in Which We Compete is Subject to Rapid Technological Progress and to Compete We Must Continually Introduce New Products that Achieve Broad Market Acceptance.

The network equipment market is characterized by rapid technological progress, frequent new product introductions, changes in customer requirements and evolving industry standards. If we do not regularly introduce new products in this dynamic environment, our product lines will become obsolete. Developments in routers and routing software could also significantly reduce demand for our products. Alternative technologies could achieve widespread market acceptance and displace the Ethernet technology on which we have based our product architecture. We cannot assure you that our technological approach will achieve broad market acceptance or that other technologies or devices will not supplant our own products and technology.

When we announce new products or product enhancements that have the potential to replace or shorten the life cycle of our existing products, customers may defer or cancel orders for our existing products. These actions could have a material adverse effect on our operating results by unexpectedly decreasing sales, increasing inventory levels of older products and exposing us to greater risk of product obsolescence. The market for switching products is evolving and we believe our ability to compete successfully in this market is dependent upon the continued compatibility and interoperability of our products with products and architectures offered by other vendors.

In particular, the networking industry has been characterized by the successive introduction of new technologies or standards that have dramatically reduced the price and increased the performance of switching equipment. To remain competitive, we need to introduce products in a timely manner that incorporate, or are compatible with, these emerging technologies. We are particularly dependent upon the successful introduction of new products. We cannot ensure that any new products we introduce will be commercially successful. We have experienced delays in releasing new products and product enhancements in the past that resulted in lower quarterly revenue than anticipated. We may experience similar delays in product development and releases in the future, and any delay in product introduction could adversely affect our ability to compete, causing our operating results to be below our expectations or the expectations of public market analysts or investors.

Our Limited Ability to Protect Our Intellectual Property May Adversely Affect Our Ability to Compete.

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

Claims of Infringement by Others May Increase and the Resolution of such Claims May Adversely Affect our Ability to Compete and Our Operating Results.

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patents, copyrights, including rights to open source software, and other intellectual property rights. Because of the existence of a large number of patents in the networking field, the secrecy of some pending patents and the issuance of new patents as a rapid pace, it is not possible to determine in advance if a product or component might infringe the patent rights of others. Because of the potential for courts awarding substantial damages and the lack of predictability of such awards, it is not uncommon for companies in our and similar industries to settle even potentially unmeritorious claims for very substantial amounts. We expect to increasingly be subject to infringement claims asserted by third parties as the numbers of products and competitors in the market for network switches grow and product functionality overlaps.

In addition, products or technologies acquired by us may include so-called open source software. Open source software is typically licensed for use at no initial charge, but imposes on the user of the open source software certain requirements to license to others both the open source software as well as the software that relates to, or interacts with, the open source software. Our use of open source software subjects us to certain additional risks for the following reasons:

- open source license terms may be ambiguous and may result in unanticipated obligations regarding our products;
- open source software cannot be protected under trade secret law; and
- it may be difficult for us to accurately determine the developers of the open source code and whether the acquired software infringes third-party intellectual property rights

We are actively involved in disputes and licensing discussions with, and have received notices from, third parties regarding their claimed proprietary rights. As the functionality and features of our products expands and as the functionality

of our software increases, these disputes and discussions could increase or become harder to resolve. The corporations with whom we have or could have disputes or discussions include corporations with extensive patent portfolios and substantial financial assets who are actively engaged in programs to generate substantial revenues from their patent portfolios, and who are seeking or may seek significant payments or royalties from us and others in our industry. We cannot ensure that we will always be able successfully to defend ourselves against such claims or conclude licensing discussions on favorable terms. If we are found to infringe the proprietary rights of others, or if we otherwise settle such claims or enter into licensing arrangement to resolve potential disputes, we could be compelled to pay damages, royalties or other payments and either obtain a license to those intellectual property rights or alter our products so that they no longer infringe upon such proprietary rights. Any license could be very expensive to obtain or may not be available at all. Similarly, changing our products or processes to avoid infringing the rights of others may be costly or impractical. Litigation resulting from claims that we are infringing the proprietary rights of others has resulted and could in the future result in substantial costs and a diversion of resources, and could have a material adverse effect on our business, financial condition and results of operations. Due to the number of companies with extensive patent portfolios in our industry who are or may be actively involved in licensing programs, as well as the increasing number of trade secret and open source disputes, we believe that even if we do not infringe the rights of others, we will incur significant expenses in the future due to disputes or licensing negotiations, though the amounts can not be determined. We cannot assure you that any such expenses will not be material or otherwise adversely affect our operating results.

We Are Engaged in Litigation Regarding Intellectual Property Rights, and an Adverse Outcome Could Harm Our Business and Require Us to Incur Significant Costs.

We have received notice from some companies alleging that we may be infringing their patents. One company, Enterasys Networks, Inc., recently filed a claim against us alleging patent infringement. We are evaluating the merits of the claim and have filed counter claims in the matter. Without regard to the merits of this or any other claim, if judgments by a court of law on this or any other claim received in the future were to be upheld, or if we were otherwise to agree to the settlement of such claims, the consequences to us may be severe and could require us, among other actions to:

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

If we are compelled to take any of the foregoing actions, our business could be severely harmed.

Adjustments to the Size of Our Operations May Require Us to Incur Unanticipated Costs.

Prior to the quarter ended April 1, 2001, we experienced rapid growth and expansion that placed a significant strain on our resources. Subsequent to that period, we have from time to time incurred unanticipated costs to reduce the scope of our operations to a level consistent with lower forecasted sales. In the first quarter of fiscal 2007, we reduced our operations in Japan and recognized $1.3 million in termination benefits provided to employees affected by the downsizing and recognized costs of $0.2 million associated with excess facilities. We may make mistakes in structuring or operating our business, such as inaccurate sales forecasting or incorrect material planning. Any of these mistakes may lead to unanticipated fluctuations in our operating results. We cannot assure you that we will be able to size our operations in accordance with fluctuations of our business in the future.

We Must Continue to Develop and Increase the Productivity of Our Indirect Distribution Channels to Increase Net Revenues and Improve Our Operating Results.

Our distribution strategy focuses primarily on developing and increasing the productivity of our indirect distribution channels. If we fail to develop and cultivate relationships with significant resellers, or if these resellers are not successful in their sales efforts, sales of our products may decrease and our operating results could suffer. Many of our resellers also sell products from other vendors that compete with our products.

We cannot assure you that we will be able to enter into additional reseller and/or distribution agreements or that we will be able to successfully manage our product sales channels. Our failure to do any of these could limit our ability to grow or sustain revenue. In addition, our operating results will likely fluctuate significantly depending on the timing and amount of orders from our resellers. We cannot assure you that our resellers and/or distributors will continue to market or sell our products effectively or continue to devote the resources necessary to provide us with effective sales, marketing and technical support.

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Most of Our Revenue is Derived From Sales of Three Product Families, So We are Dependent on Widespread Market Acceptance of These Products.

We derive substantially all of our revenue from sales of our Summit, BlackDiamond and Alpine products and related services. We expect that revenue from these product families will account for a substantial portion of our revenue for the foreseeable future. Accordingly, widespread market acceptance of our product families is vital to our future success. Factors that may affect the sales of our products, some of which are beyond our control, include:

- the demand for switching products (Gigabit Ethernet and Layer 3 switching technologies in particular) in the enterprise and service provider markets;
- the performance, price and total cost of ownership of our products;
- the availability and price of competing products and technologies;
- our ability to match supply with demand for certain products; and
- the success and development of our resellers, distributors and field sales channels.

We may not be able to achieve widespread market acceptance of our product families, which could reduce our revenue.

Future Performance Will Depend on the Introduction and Acceptance of New Products.

Our future performance will also depend on the successful development, introduction, and market acceptance of new and enhanced products that address customer requirements in a timely and cost-effective manner. In particular, we are dependent upon the successful introduction of new products. In the past, we have experienced delays in product development and such delays may occur in the future. We have recently announced a number of new or enhanced products. The introduction of new and enhanced products may cause our customers to defer or cancel orders for existing products. Therefore, to the extent customers defer or cancel orders in the expectation of new product releases, any delay in the development or introduction of new products could cause our operating results to suffer. The inability to achieve and maintain widespread levels of market acceptance for our current and future products may significantly impair our revenue growth.

Our Reliance on Industry Standards, Technological Change in the Marketplace and New Product Initiatives May Cause our Sales to Fluctuate or Decline.

The network equipment industry in which we compete is characterized by rapid changes in technology and customers requirements and evolving industry standards. As a result, our success depends on

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

Slow market acceptance of new technologies, products or industry standards could adversely affect our sales or overall results of operations. In addition, if our technology is not included in an industry standard on a timely basis or if we fail to achieve timely certification of compliance to industry standards for our products, our sales of such products or our results of operations could be adversely affected.

If a Key Reseller, Distributor, or Other Significant Customer Cancels or Delays a Large Purchase, Our Net Revenues May Decline and the Price of Our Stock May Fall.

To date, a limited number of resellers, distributors and other customers have accounted for a significant portion of our revenue. One distributor, Tech Data, accounted for 10% or more of our net revenue for the second quarter of each of fiscal 2007 and 2006. In addition, while no other distributor or customer has accounted for 10% or more of revenue in the recent fiscal years, sales to several distributors represent a high percentage of our sales. If any of our large customers stop or delay purchases, our revenue and profitability would be adversely affected.

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Our expense levels are based on our expectations as to future revenue and to a large extent are fixed in the short term, so a substantial reduction or delay in sales of our products to a significant reseller, distributor or other customer could harm our business, operating results and financial condition. Although our largest customers may differ from period-to-period, we anticipate that our operating results for any given period will continue to depend to a significant extent on large orders from a relatively small number of customers.

While our financial performance depends on large orders from a limited number of key resellers, distributors and other significant customers, we do not have binding purchase commitments from any of them. For example:

- our service providers and enterprise customers can stop purchasing, and our resellers and distributors can stop marketing, our products at any time;
- our reseller agreements are non-exclusive and are for one-year terms, with no obligation upon the resellers to renew the agreements; and
- our reseller, distributor and end-user customer agreements generally do not require minimum purchases.

Under specified conditions, some third-party distributors are allowed to return products to us. We do not recognize revenue on sales to distributors until the distributors sell the product to their customers.

The Sales Cycle for Our Products is Long and We May Incur Substantial Non-Recoverable Expenses or Devote Significant Resources to Sales that Do Not Occur When Anticipated.

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

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

We Purchase Several Key Components for Products From Single or Limited Sources and Could Lose Sales if These Suppliers Fail to Meet Our Needs.

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

- ASICs;
- microprocessors;
- programmable integrated circuits;
- selected other integrated circuits;
- custom power supplies; and
- custom-tooled sheet metal.

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Our principal limited-source components include:

- flash memories;
- DRAMs, SRAMs and CAMs; and
- printed circuit boards.

We use our forecast of expected demand to determine our material requirements. Lead times for materials and components we order vary significantly, and depend on factors such as the specific supplier, contract terms and demand for a component at a given time. If forecasts exceed orders, we may have excess and/or obsolete inventory on hand or under non-cancelable purchase commitments that could have a material adverse effect on our operating results and financial condition. If orders exceed forecasts, we may have inadequate supplies of certain materials and components, which could have a material adverse effect on our operating results and financial condition. We do not have agreements fixing long-term prices or minimum volume requirements from suppliers. From time to time we have experienced shortages and allocations of certain components, resulting in delays in filling orders. Qualifying new suppliers to compensate for such shortages may be time-consuming and costly, and may increase the likelihood of errors in design or production. In addition, during the development of our products, we have experienced delays in the prototyping of our chipsets, which in turn has led to delays in product introductions. We cannot ensure that similar delays will not occur in the future. Furthermore, we cannot ensure that the performance of the components as incorporated in our products will meet the quality requirements of our customers.

Our Dependence on One Contract Manufacturer for All of Our Manufacturing Requirements Could Harm Our Operating Results.

If the demand for our products grows, we will need to increase our material purchases, contract manufacturing capacity, and internal test and quality functions. Any disruptions in product flow could limit our revenue, adversely affect our competitive position and reputation, and result in additional costs or cancellation of orders under agreements with our customers.

We rely on one independent contractor, Flextronics International, Ltd., to manufacture our products. This company s facilities are located in San Jose, California and Guadalajara, Mexico. Our commitment with Flextronics is formalized through a one-year contract. We have experienced delays in product shipments from contract manufacturers in the past, which in turn delayed product shipments to our customers. These or similar problems may arise in the future, such as products of inferior quality, insufficient quantity of products, or the interruption or discontinuance of operations of a manufacturer, any of which could have a material adverse effect on our business and operating results.

We do not know whether we will effectively manage our contract manufacturer or that this manufacturer will meet our future requirements for timely delivery of products of sufficient quality and quantity. We intend to introduce new products and product enhancements, which will require that we rapidly achieve volume production by coordinating our efforts with those of our suppliers and contract manufacturer. The inability of our contract manufacturer to provide us with adequate supplies of high-quality products may cause a delay in our ability to fulfill orders and may have a material adverse effect on our business, operating results and financial condition. Moreover, our current dependence on a single manufacturer makes us particularly vulnerable to these risks.

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

If We Do Not Adequately Manage and Evolve Our Financial Reporting and Managerial Systems and Processes, Our Ability to Manage and Grow Our Business May Be Harmed.

Our ability to successfully implement our business plan and comply with regulations requires an effective planning and management process. We need to continue improving our existing, and implement new, operational and financial systems, procedures and controls. Any delay in the implementation of, or disruption in the transition to, new or enhanced systems, procedures or controls, could harm our ability to record and report financial and management information on a timely and accurate basis, or to forecast future results.

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We May Be Unable to Reasonably Anticipate Whether a Change in Our Process Will Have a Material Affect on Our Internal Control Over Financial Reporting.

As we improve our controls and procedures in our ongoing effort to improve our business systems, we may be required to make changes to our internal control over financial reporting. We may be unable to reasonably anticipate, both during the period in which such changes are made and at the time we file the periodic reports covering such period, that such changes will have a material affect on our internal control over financial reporting. If we are unable to reasonably anticipate such material affect, it will have an adverse effect on our ability to accurately report our changes in internal control over financial reporting.

Changes in Financial Accounting Standards May Cause Adverse Unexpected Revenue Fluctuations and Affect Our Reported Results of Operations.

A change in accounting policies can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New pronouncements and varying interpretations of existing pronouncements have occurred with frequency and may occur in the future. Changes to existing rules, or changes to the interpretations of existing rules could lead to the questioning of our accounting practices, which may cause us to reevaluate or change such practices, and such changes could adversely affect our reported financial results or the way we conduct our business.

In particular, in December 2004 the Financial Accounting Standards Board issued a statement requiring companies to record stock option grants as compensation expense in their income statements. This statement was effective for us beginning with the first quarter of fiscal 2006. The methodology for expensing such stock options is based on, among other things, the historical volatility of the underlying stock and the expected life of our stock options. Our stock price has been historically volatile. Therefore, the adoption of this accounting standard has, and will continue to, negatively impact our profitability and may adversely impact our stock price. In addition, our adoption of this standard could limit our ability to continue to use stock options as an incentive and retention tool, which could, in turn, hurt our ability to recruit employees and retain existing employees.

In addition, various accounting rules and regulations have been established over the recent past relating to revenue recognition. These regulations frequently require judgments in their application, and are subject to numerous subsequent clarifications and interpretations, some of which may require changes in the way we recognize revenue and may require restatement of prior period revenue and results, either of which could adversely affect our reported results.

Our Business Substantially Depends Upon the Continued Growth of the Internet and Internet-Based Systems.

A substantial portion of our business and revenue depends on growth of the Internet and on the deployment of our products by customers that depend on the continued growth of the Internet. As a result of the recent economic slowdown and reduction in capital spending, which have particularly affected telecommunications service providers, spending on Internet infrastructure has declined, which has materially harmed our business. To the extent that the recent economic slowdown and reduction in capital spending continue to adversely affect spending on Internet infrastructure, we could continue to experience material harm to our business, operating results, and financial condition.

Because of the rapid introduction of new products, and changing customer requirements related to matters such as cost-effectiveness and security, we believe that there could be certain performance problems with Internet communications in the future, which could receive a high degree of publicity and visibility. As we are a large supplier of networking products, our business, operating results, and financial condition may be materially adversely affected, regardless of whether or not these problems are due to the performance of our own products. Such an event could also result in a material adverse effect on the market price of our common stock independent of direct effects on our business.

Compliance with Changing Regulation of Corporate Governance and Public Disclosure May Result in Additional Expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and NASDAQ Stock Market rules, are creating uncertainty for companies such as

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ours. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we are investing all reasonably necessary resources to comply with evolving standards and changing interpretations of existing standards and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities and efforts to evaluate current practices and achieve compliance.

We Have Been Named as a Defendant in a Shareholder Class Action Lawsuit Arising Out of Our Public Offerings of Securities in 1999.

Beginning on July 6, 2001, purported securities fraud class action complaints were filed in the United States District Court for the Southern District of New York. The cases were consolidated and the litigation is now captioned as In re Extreme Networks, Inc. Initial Public Offering Securities Litigation, Civ. No. 01-6143 (SAS) (S.D.N.Y.), related to In re Initial Public Offering Securities Litigation, 21 MC 92 (SAS) (S.D.N.Y.).

The operative amended complaint is brought purportedly on behalf of all persons who purchased Extreme Networks common stock from April 8, 1999 through December 6, 2000. It names as defendants Extreme Networks; six of our present and former officers and/or directors, including our CEO (the Extreme Networks Defendants); and several investment banking firms that served as underwriters of our initial public offering and October 1999 secondary offering. Subsequently, plaintiffs and one of the individual defendants stipulated to a dismissal of that defendant without prejudice. The complaint alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. The Securities Act allegations against the Extreme Networks Defendants are made as to the secondary offering only. The amended complaint also alleges that false analyst reports were issued. No specific damages are claimed.

Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. On February 19, 2003, the Court ruled on all defendants motions to dismiss. The Court denied the motions to dismiss the claims in our case under the Securities Act of 1933. The Court denied the motion to dismiss the claim under Section 10(a) of the Securities Exchange Act of 1934 against Extreme Networks and 184 other issuer defendants, on the basis that the complaints alleged that the respective issuers had acquired companies or conducted follow-on offerings after their initial public offerings. The Court denied the motion to dismiss the claims under Section 10(a) and 20(a) of the Securities Exchange Act of 1934 against the remaining Extreme Networks Defendants and 59 other individual defendants, on the basis that the respective amended complaints alleged that the individuals sold stock.

Previously, we executed a settlement agreement presented to all issuer defendants. In that settlement, plaintiffs would dismiss and release all claims against the Extreme Network Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The Extreme Networks Defendants would not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeded the amount of the insurance coverage. The Court gave preliminary approval to the settlement in February 2005 and held a hearing in April 2006 to consider final approval of the settlement. Before the Court issued a final decision on the settlement, on December 5, 2006 the United States Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Thereafter, on December 14, 2006, the Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the Second Circuit Court of Appeals for a rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit Court of Appeals denied plaintiffs petition for a rehearing, but clarified that the plaintiffs may seek to certify a more limited class. Accordingly, the plaintiffs and issuers have stated that they are prepared to discuss how the settlement might be amended or renegotiated to comply with the decision of the Second Circuit Court of Appeals. On April 30, 2007, Plaintiffs stated that they intend to present a proposed redefined class to the Court. If the settlement is not amended or renegotiated and then approved by the Court, we cannot assure you that we will prevail in the lawsuit. Failure to prevail could have a material adverse effect on our consolidated financial position, results of operations and cash flows in the future.

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In addition, in the past, we have, and may in the future, become subject to other types of litigation, and may in the future become subject to other types of litigation. Litigation is often expensive and diverts management s attention and resources, which could materially and adversely affect our business.

Our Headquarters and Some Significant Supporting Businesses Are Located in Northern California and Other Areas Subject to Natural Disasters That Could Disrupt Our Operations and Harm Our Business.

Our corporate headquarters are located in Silicon Valley in Northern California. Historically, this region has been vulnerable to natural disasters and other risks, such as earthquakes, fires and floods, which at times have disrupted the local economy and posed physical risks to our property. We have a contract manufacturer located in Northern California and in Mexico where similar natural disasters and other risks may disrupt the local economy and pose physical risks to our property and the property of our contract manufacturer.

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

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

Failure of Our Products to Comply With Evolving Industry Standards and Complex Government Regulations May Cause Our Products to Not Be Widely Accepted, Which May Prevent Us From Growing Our Net Revenues or Achieving Profitability on a Fiscal Year Basis.

The market for network equipment products is characterized by the need to support industry standards as different standards emerge, evolve and achieve acceptance. We will not be competitive unless we continually introduce new products and product enhancements that meet these emerging standards. In the past, we have introduced new products that were not compatible with certain technological standards, and in the future we may not be able to effectively address the compatibility and interoperability issues that arise as a result of technological changes and evolving industry standards. Our products must comply with various United States federal government regulations and standards defined by agencies such as the Federal Communications Commission, in addition to standards established by governmental authorities in various foreign countries and recommendations of the International Telecommunication Union. If we do not comply with existing or evolving industry standards or if we fail to obtain timely domestic or foreign regulatory approvals or certificates we will not be able to sell our products where these standards or regulations apply, which may prevent us from sustaining our net revenue or achieving profitability on a fiscal year basis.

Production and marketing of products in certain states and countries may subject us to environmental and other regulations including, in some instances, the requirement to provide customers the ability to return product at the end of its useful life, and place the responsibility for environmentally safe disposal or recycling with us. Additionally, certain states and countries may pass regulations requiring our products to meet certain requirements to use environmentally friendly components. Such laws and regulations have recently been passed in several jurisdictions in which we operate, including the European Union which issued a Directive 2002/96/EC Waste Electrical and Electronic Equipment (WEEE) to mandate funding, collection, treatment, recycling and recovery of WEEE by producers of electrical or electronic equipment into Europe. China is in the final approval stage of compliance programs which will harmonize with the European Union WEEE. In the future, Japan and other countries are expected to adopt environmental compliance programs. If we fail to comply with these regulations, we may not be able to sell our products in jurisdictions where these regulations apply, which would have a material adverse affect on our results of operations.

In addition, the EU also adopted Directive 2002/95/EC on Restriction on the Certain Hazardous Substances in Electrical and Electronic Equipment (the RoHS Directive). The RoHS Directive bans in the EU the use of certain hazardous materials in electrical and electronic equipment. The RoHS Directive went into effect on July 1, 2006, the date by which each EU-member country was required to adopt legislation implementing the RoHS Directive in that country. Certain EU-member countries where we import products have adopted such implementing legislation effective July 1, 2006, while other EU-member countries have either not yet adopted implementing legislation or have not yet adopted rules under their implementing legislation. The manner of implementation of the RoHS Directive in each EU country will likely vary, and we will face challenges complying with the differing implementation of the RoHS Directive in each country. Failure to comply with the regulatory requirements in one jurisdiction may adversely impact our ability to do business in that jurisdiction as well as others. We have incurred higher manufacturing costs, experienced component part constraints in our supply chain in the fourth fiscal quarter of 2006, and increased our European service spare parts inventory by approximately $5.1 million as of July 2, 2006 as a result of complying with the RoHS Directive. We might incur further increased manufacturing costs, production delays and/or increased finished goods inventory and service spare parts inventory in complying with implementing legislation under the RoHS Directive, but we cannot currently estimate those costs because of uncertainty on how the RoHS Directive will be implemented in each EU-member country where we manufacture or import electrical or electronic equipment. We have experienced RoHS compliant product shortages during the initial implementation period that has caused, and may in the future cause, product shipments and revenue to be below expectations. To the extent those costs or delays are substantial, our financial condition or results of operations could be materially adversely affected. In addition, similar legislation has been or could be enacted in other countries outside the EU, the cumulative impact of which could similarly impact our financial condition or results of operations.

Failure to Successfully Expand Our Sales and Support Teams or Educate Them In Regard to Technologies and Our Product Families May Harm Our Operating Results.

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

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

We May Engage in Future Acquisitions that Dilute the Ownership Interests of Our Stockholders, Cause Us to Incur Debt and Assume Contingent Liabilities.

As part of our business strategy, we review acquisition and strategic investment prospects that we believe would complement our current product offerings, augment our market coverage or enhance our technical capabilities, or otherwise offer growth opportunities. From time to time we review investments in new businesses and we expect to make investments in, and to acquire, businesses, products, or technologies in the future. In the event of any future acquisitions, we could:

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

These actions could have a material adverse effect on our operating results or the price of our common stock. Moreover, even if we do obtain benefits in the form of increased sales and earnings, there may be a lag between the time when the expenses associated with an acquisition are incurred and the time when we recognize such benefits. This is particularly relevant in cases where it is necessary to integrate new types of technology into our existing portfolio and new types of products may be targeted for potential customers with which we do not have pre-existing relationships. Acquisitions and investment activities also entail numerous risks, including:

- difficulties in the assimilation of acquired operations, technologies and/or products;
- unanticipated costs associated with the acquisition or investment transaction;

- the diversion of management s attention from other business concerns;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering markets in which we have no or limited prior experience;
- the potential loss of key employees of acquired organizations; and
- substantial charges for the amortization of certain purchased intangible assets, deferred stock compensation or similar items.

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

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We May Need Additional Capital to Fund Our Future Operations and, If It Is Not Available When Needed, We May Need to Reduce Our Planned Development and Marketing Efforts, Which May Reduce Our Net Revenues and Prevent Us From Achieving Profitability on a Fiscal Year Basis.

We believe that our existing working capital and cash available from credit facilities and future operations will enable us to meet our working capital requirements for at least the next 12 months. However, if cash from future operations is insufficient, or if cash is used for acquisitions or other currently unanticipated uses, we may need additional capital. The development and marketing of new products and the expansion of reseller and distribution channels and associated support personnel requires a significant commitment of resources. In addition, if the markets for our products develop more slowly than anticipated, or if we fail to establish significant market share and achieve sufficient net revenues, we may continue to consume significant amounts of capital. As a result, we could be required to raise additional capital. To the extent that we raise additional capital through the sale of equity or convertible debt securities, the issuance of such securities could result in dilution of the shares held by existing stockholders. If additional funds are raised through the issuance of debt securities, such securities may provide the holders certain rights, preferences, and privileges senior to those of common stockholders, and the terms of such debt could impose restrictions on our operations. We cannot assure you that additional capital, if required, will be available on acceptable terms, or at all. If we are unable to obtain sufficient amounts of additional capital, we may be required to reduce the scope of our planned product development and marketing efforts, which could harm our business, financial condition and operating results.

We Have Entered into Long-Term Lease Agreements for Several Facilities that are Currently Vacant and May be Difficult to Sublease due to Current Real Estate Market Conditions.

We have certain long-term real estate lease commitments carrying future obligations for non-cancelable lease payments. Reductions in our workforce and the restructuring of operations since fiscal 2002 have resulted in the need to consolidate certain of these leased facilities, located primarily in Northern California, for which we recorded excess facilities charges of approximately $3.3 million in fiscal 2006, $6.5 million in fiscal 2004, and $9.6 million in fiscal 2003. For more information, see Note 13 of Notes to Condensed Consolidated Financial Statements in our Annual Report on Form 10-K for fiscal year ended July 2, 2006. We may incur additional charges for excess facilities as a result of additional reductions in our workforce or future restructuring of operations. We will continue to be responsible for all carrying costs of these facilities until such time as we can sublease these facilities or terminate the applicable leases based on the contractual terms of the lease agreements, and these costs may have an adverse effect on our business, operating results and financial condition.

Our Stock Price Has Been Volatile In the Past and Our Stock Price May Significantly Fluctuate in the Future.

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

In addition, fluctuations in our stock price and our price-to-earnings multiple may make our stock attractive to momentum, hedge or day-trading investors who often shift funds into and out of stock rapidly, exacerbating price fluctuations in either direction, particularly when viewed on a quarterly basis.

Securities We Issue to Fund Our Operations Could Dilute Your Ownership.

We may decide to raise additional funds through public or private debt or equity financing to fund our operations. If we raise funds by issuing equity securities, the percentage ownership of current stockholders will be reduced and the new equity securities may have rights prior to those of our common stock, including the common stock issuable upon conversion of the notes. We may not obtain sufficient financing on terms that are favorable to you or us. We may delay, limit or eliminate some or all of our proposed operations if adequate funds are not available.

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Provisions in Our Charter Documents and Delaware Law and Our Adoption of a Stockholder Rights Plan May Delay or Prevent an Acquisition of Extreme, Which Could Decrease the Value of Our Common Stock and the Notes.

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

Our Board of Directors adopted a stockholder rights plan, pursuant to which we declared and paid a dividend of one right for each share of common stock held by stockholders of record as of May 14, 2001. Under the plan, each right will entitle stockholders to purchase a fractional share of our preferred stock for $150.00. Each such fractional share of the new preferred stock has terms designed to make it substantially the economic equivalent of one share of common stock. Initially the rights will not be exercisable and will trade with our common stock. Generally, the rights may become exercisable if a person or group acquires beneficial ownership of 15% or more of our common stock or commences a tender or exchange offer upon consummation of which such person or group would beneficially own 15% or more of our common stock. When the rights become exercisable, our Board of Directors has the right to authorize the issuance of one share of our common stock in exchange for each right that is then exercisable.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity

The primary objective of our investment activities is to preserve principal while at the same time maximize the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, other non-government debt securities and money market funds. In general, money market funds are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate. The following table presents the amounts of our cash equivalents, short-term investments, marketable securities and long-term debt that are subject to market risk by range of expected maturity and weighted-average interest rates as of December 31, 2006. This table does not include money market funds because those funds are generally not subject to market risk.

			Maturing in		
	Three months or less	Three months to one year	Greater than one year	Total	Fair Value
Included in cash and cash equivalents	$ 21,903			$ 21,903	$ 21,903
Weighted average interest rate	5.37%				
Included in short-term investments	$ 61,512	$ 50,970		$ 112,482	$ 112,482
Weighted average interest rate	3.96%	4.02%			
Included in marketable securities			$ 27,010	$ 27,010	$ 27,010
Weighted average interest rate			4.82%		

Exchange Rate Sensitivity

Currently, substantially all of our sales and the majority of our expenses are denominated in United States dollars and, as a result, we have experienced no significant foreign exchange gains and losses to date. While we conduct some sales transactions and incur certain operating expenses in foreign currencies and expect to continue to do so, we do not anticipate that foreign exchange gains or losses will be significant, in part because of our foreign exchange risk management process discussed below.

Foreign Exchange Forward Contracts

We enter into foreign exchange forward contracts to hedge foreign currency forecasted transactions related to certain operating expenses, denominated in Japanese Yen, the Euro, the Swedish Krona and the British Pound. These derivatives are

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designated as cash flow hedges under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted* (SFAS 133). At December 31, 2006, these forward foreign currency contracts had a notional principal amount of $5.2 million (fair value of $500). These contracts have maturities of less than 60 days.

Additionally, we enter into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the remeasurement of certain assets and liabilities denominated in Japanese Yen, the Euro, the Swedish Krona and the British Pound. These derivatives are not designated as hedges under SFAS 133. At December 31, 2006, we held foreign currency forward contracts with a notional principal amount of $5.4 million (fair value of $41,000). These contracts have maturities of less than 45 days. Changes in the fair value of these foreign exchange forward contracts are offset largely by remeasurement of the underlying assets and liabilities.

We do not enter into foreign exchange forward contracts for speculative or trading purposes. Foreign currency transaction gains and losses from operations, including the impact of hedging, were a loss of $0.2 million in the second quarter of fiscal 2007 and a gain of $0.4 million for the first six months of fiscal 2007. Foreign currency transaction losses from operations, including the impact of hedging, were $0.3 million in the second quarter of fiscal 2006 and $0.5 million for the first six months of fiscal 2006.

Item 4. Controls and Procedures
Material Weakness in Prior Period

As described in our 2006 Form 10-K, management identified a material weakness in the Company s internal control over financial reporting as of July 2, 2006, in that the design and operation of the Company s internal controls were not effective to provide reasonable assurance that material errors in the Company s historical share-based compensation would be detected, in that, in light of the circumstances that existed as of July 2, 2006, the Company lacked effective procedures to retrospectively identify as of that date the material accounting errors in the Company s historical financial statements that were later discovered and which have now been corrected in connection with the restatement of the Company s 2000 through 2005 financial statements. As a result, the Company s internal control over financial reporting was not effective as it related to the Company s ability to retrospectively identify material accounting errors resulting from the Company s historical stock option grants. Additionally, the Company recorded a material adjustment to its consolidated balance sheet as of July 2, 2006 as a result of these errors. The principal accounts affected by this material weakness as of July 2, 2006 were common stock and accumulated deficit.

As a result of the above material weakness, the Company concluded that, as of July 2, 2006, the Company s internal control over financial reporting was not effective.

Remedial Measures Instituted by Extreme

On September 11, 2006, based on information developed by Company management and at the Audit Committee s recommendation, the Board of Directors appointed the Special Committee to conduct an independent investigation of our historical practices for granting and accounting for stock options and to present findings and recommendations to the Board.

The Special Committee found deficiencies in the Company s processes for approving and documenting options grants, which resulted in the Company erroneously treating the stated grant date as the measurement date for financial accounting purposes with respect to certain options. These deficiencies occurred predominantly during 1999 through 2001 (fiscal years 2000 through 2002), but continued in some respects during fiscal years 2003 and 2004. The Special Committee found no issues with the accounting for options granted during fiscal years 2005 and 2006. Based on the Special Committee s review, the Company confirmed that it had correctly accounted for the majority of its stock option grants during the Review Period, but that recognition of non-cash share-based compensation charges was necessary with respect to certain grants, for reasons that varied with the particular facts and circumstances of each affected grant, including: grants that pre-dated the effective date of employment of the grantee; grants that were not approved until after the stated grant date; grants that were dated and priced at a time when lists of grant recipients and share allocations were not yet complete; grant dates that appeared to have been selected retrospectively, in some cases apparently due to price considerations; grants that were not accurately and timely documented; and grants that were completed and subsequently modified. The Special Committee found that the Company s options granting and documentation processes improved substantially following the passage of the Sarbanes-Oxley Act of 2002 and the implementation of new controls and procedures under the current Vice President of Human Resources (who joined the Company in May 2003) and the current Vice President, Corporate Business Development, General Counsel and Secretary (who joined the Company in February 2004). The Company determined that its procedures were effective in enabling the Company

to appropriately determine measurement date(s) for options grants made subsequent to fiscal 2004, and that the Company s controls during the periods from the end of fiscal 2004 through fiscal 2006 were effective in enabling the Company to properly account for stock option grants made during that period. The material weakness identified by the Company as of July 2, 2006 did not affect the Company s internal controls related to recording of and accounting for stock options granted during that period.

In light of the Special Committee investigation and the review of the Company s stock option granting practices through December 31, 2006, we believe that the possibility that material errors in the Company s historical share-based compensation could exist without detection by the Company was no more than remote as of the close of the quarter ended December 31, 2006, such that our internal control over financial reporting was effective as of that date.

The Special Committee recommended, and the Board adopted, new processes with regard to grants of equity compensation awards to Board members, officers, and non-officer employees alike. These new processes adopted by the Board in April 2007, described below, are designed to ensure that the Company continues to employ best practices and procedures with respect to equity compensation awards:

- The general practice for grants to all new hires, and for out of cycle promotions and merit purposes will be to make such grants once per quarter, during open trading windows only, on the second trading day following the public announcement of quarterly financial results, pursuant to a list to be circulated to the appropriate granting authority prior to the proposed approval date.

- All grants to officers, Vice Presidents and members of the Board of Directors are to be approved by the Board.

- All other grants are to be approved by the Compensation Committee.

- Grants are to be approved at Board or Compensation Committee meetings (not by unanimous written consent (UWC), except in extraordinary circumstances).

- There is to be no delegated granting authority to management.

- The Board and management are to continue monitoring processes and policies recommended by the SEC, self-regulatory authorities and outside advisors.

- All Board and Committee minutes are to be circulated to the directors as soon as reasonably practicable (generally, within two weeks of meeting). Counsel should attend all Board and Compensation Committee meetings.

- The Board has directed management to propose a mechanism for monitoring compliance with and reporting to the Board on the Company s policies and procedures relating to options grants.

Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) are controls and procedures designed to reasonably assure that information required to be disclosed in the Company s reports filed under the Exchange Act, such as this Report, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and to reasonably assure that such information is accumulated and communicated to the Company s management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in reaching a reasonable level of assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the SEC s rules and forms.

Change in Internal Control over Financial Reporting

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within an organization have been detected. We are continuously seeking to improve the efficiency and effectiveness of our operations and of our internal controls. This results in refinements to processes throughout our organization. During the quarter ended October 1, 2006, we commenced the investigation by the Special Committee and the review of the Company s stock option granting practices through December 31, 2006. With the exception of those measures, there were no changes in our internal control over financial reporting during the quarter to which this Report on Form 10-Q applies that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

As described in our Annual Report on Form 10-K for the fiscal year ended July 2, 2006, we are involved in the following legal proceedings:

Government Inquiries Relating to Historical Stock Option Practices

On June 27, 2006, the Company received an informal inquiry letter from the Staff of the SEC Enforcement Division requesting that the Company voluntarily provide documents related to its policies, practices and procedures for granting stock options for the period since its initial public offering on April 9, 1999 (IPO). The Company responded to the request, is cooperating fully with the SEC inquiry, and intends to continue to do so.

This inquiry likely will require the Company to expend significant management time and incur significant legal and other expenses, and could result in civil actions seeking, among other things, injunctions against the Company and the payment of significant fines and penalties by the Company, which may adversely affect the Company s results of operations and cash flow.

The Company cannot predict how long it will take to or how much more time and resources the Company will have to expend to resolve this government inquiry, nor can we predict the outcome of this inquiry. Also, there can be no assurance that other inquiries, investigations or actions will not be started by other United States federal or state regulatory agencies or by foreign governmental agencies.

Late SEC Filing and Nasdaq Delisting Proceedings

As discussed in the Explanatory Note to this Quarterly Report, the Company did not timely file its Form 10-K for the fiscal year ending July 2, 2006 or the Quarterly Reports on Forms 10-Q for the quarters ended October 1, 2006, December 31, 2006 and April 1, 2007. As a result, the Company initially received two Nasdaq Staff Determination letters, dated September 22, 2006, and November 15, 2006, respectively, stating that the Company was not in compliance with the filing requirements of Marketplace Rule 4310(c)(14) and, therefore, that the Company s stock was subject to delisting from the Nasdaq Global Select Market. The Company appealed the determination in the September 22, 2006 letter and requested a hearing before a Nasdaq Listing Qualifications Panel. On November 9, 2006, we attended a hearing, at which we simultaneously sought appropriate exceptions to the filing requirements from the Panel pending completion and filing of both our delinquent 10-K and 10-Q report for the quarter ended October 1, 2006. On January 8, 2007, the Panel granted our request for continued listing of our stock on the Nasdaq Global Select Market, subject to the condition that we file the 10-K annual report and our Quarterly Report on Form 10-Q for the quarter ended October 1, 2006 on or before March 21, 2007.

On February 20, 2007, we received another Nasdaq Staff Determination letter, stating that we were not in compliance with the filing requirements of Marketplace Rule 4310(c)(14) because we did not timely file our Quarterly Report on Form 10-Q for the quarter ended December 31, 2006 and, therefore, that our stock was subject to delisting from the Nasdaq Global Select Market. Also on February 20, 2007, we were informed by the Nasdaq Listing and Hearings Review Council that at our request it had stayed the Panel s determination and any future Panel determinations to suspend our securities from trading pending further action by the Listing Council. On June 22, 2007, the Listing Council issued a ruling exercising its authority under Marketplace Rule 4802(b) to grant the Company an extension until July 3, 2007 to file this Report and our Quarterly Reports on Forms 10-Q for the quarters ended October 1, 2006, December 31, 2006, and April 1, 2007. On June 18, 2007, in anticipation of the Listing Council s decision, the Company requested that the Nasdaq Board of Directors provide a further extension of time to allow the Company to come into compliance. The Nasdaq Board granted that request on June 25, 2007.

With the filing of our Annual Report on Form 10-K for fiscal year 2006, this Quarterly Report and our Quarterly Reports on Forms 10-Q for the quarters ended October 1, 2006 and April 1, 2007, the Company believes it has returned to full compliance with SEC reporting requirements and Nasdaq listing requirements. The Company therefore expects that the Nasdaq delisting matter will be closed and will seek confirmation from Nasdaq of that result.

We cannot predict, however, whether the SEC will review these reports and, if so, whether the SEC will have comments on these reports (or other reports that we previously filed) that may require us to file amended reports with the SEC. In addition, we cannot predict whether the Nasdaq Listing Qualifications Panel or Listing Council will concur that we are in

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compliance with all relevant listing requirements. If either of those events occurs, we might be unable to remain in compliance with SEC reporting requirements and Nasdaq listing requirements, and, therefore, we might be unable to maintain an effective listing of our common stock on the Nasdaq Global Select Market or any other national securities exchange.

Shareholder Litigation Relating to Historical Stock Option Practices

On April 25, 2007, an individual identifying herself as a shareholder of the Company filed a derivative action in the United States District Court for the Northern District of California purporting to assert claims on behalf of and in the name of the Company against various of our current and former directors and officers relating to our stock option granting practices for stock options issued from 2000 to 2003. The complaint alleges that the individual defendants breached their fiduciary duties and other obligations to the Company and violated federal securities laws in connection with our historical stock option granting process and our accounting for past stock options.

The plaintiff has asserted claims for violations of Sections 10(b) (including Rule 10b-5 thereunder), 14(a), and 20(a) of the Securities Exchange Act of 1934, unjust enrichment, breach of fiduciary duty and aiding and abetting such breach, rescission, and a claim for an accounting of all stock option grants made to the named defendants. Extreme Networks, Inc. is named as a nominal defendant in these actions. On behalf of Extreme Networks, Inc., the plaintiff seeks unspecified monetary and other relief against the named defendants. The plaintiff is Yenna Wu. The individual named defendants are Gordon L. Stitt, Herb Schneider, Stephen Haddock, Paul Romeo, Vito Palermo, Harold Covert, Darrell Scherbarth, Christopher, N. Todd, Alexander J. Gray, Frank C. Carlucci, William R. Slakey, Charles Carinalli, Harry Silverglide, Michael West, Kenneth Levy, Robert L. Corey, Peter Wolken, and Promod Haque.

A similar derivative action was filed in the same court on May 2, 2007, by Linda Erikson, another individual identifying herself as a shareholder of the Company, alleging the same legal claims against the same individual defendants concerning the same subject matter.

A third derivative action was filed in the same court on May 31, 2007 by Frank A. Grucel, an individual identifying himself as a shareholder of the Company, purporting to assert claims on the Company s behalf relating to the Company s historic stock options granting practices. The complaint seeks unspecified monetary and injunctive relief and asserts claims for violations of Section 14(a) of the Securities Exchange Act of 1934, an accounting of all stock option grants made to the named defendants, breach of fiduciary duty and aiding and abetting such breach, abuse of control, gross mismanagement, constructive fraud, corporate waste, unjust enrichment, rescission, violations of California Corporations Code Section 25402, and breach of fiduciary duties related to insider selling and alleged misappropriation of information. Extreme Networks, Inc. is named as a nominal defendant in this action, and the individual named defendants are Gordon L. Stitt, Herb Schneider, Stephen Haddock, Alexander J. Gray, Frank C. Carlucci, William R. Slakey, Charles Carinalli, Harry Silverglide, Michael West, Kenneth Levy, Robert L. Corey, Peter Wolken, Michael Palu, and Alicia Moore.

The foregoing actions have been related and assigned to the same judge. On June 15, 2007, Yenna Wu filed an amended complaint in her action. The amended complaint names one additional individual defendant, Mark Canepa, as well as the individual defendants named in the derivative complaints filed on April 25, 2007 and May 2, 2007, is purportedly brought both as a derivative action and as a class action on behalf of all current shareholders of the Company, and alleges a claim for violation of Delaware General Corporations Code Section 211(c), seeking an order compelling the Company to hold a shareholder s meeting. The amended complaint otherwise alleges the same claims as the derivative complaints filed on April 25, 2007 and May 2, 2007 by plaintiffs Wu and Erikson, respectively.

The foregoing actions are at an early stage. Discovery has not commenced, and the defendants are not yet required to respond to the complaints. We cannot predict whether these actions are likely to result in any material recovery by or expense to the Company.

Indemnification Obligations

Subject to certain limitations, we may be obligated to indemnify our current and former directors, officers and employees. These obligations arise under the terms of our certificate of incorporation, our bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify, where applicable, generally means that we are required to pay or reimburse, and in certain circumstances we have paid or reimbursed, the individuals reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. It is not possible to estimate the maximum potential amount under these indemnification agreements due to the limited history of these claims. The cost to defend the Company and the named individuals could have a material adverse effect on our consolidated financial position, results of operations and cash flows in the future. Recovery of such costs under our directors and officers insurance coverage is uncertain.

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Other Legal Matters

On April 20, 2007, Extreme Networks filed suit against Enterasys in the United States District Court for the Western District of Wisconsin, Civil Action No. 07-C-0229-C. The complaint alleges willful infringement of U.S. patents Nos. 6,104,700, 6,678,248, and 6,859,438, and seeks injunctive relief against Enterasys continuing sale of infringing goods and monetary damages. Enterasys responded to the complaint on May 30, 2007. Enterasys also filed a counterclaim alleging infringement of three U.S. patents owned by Enterasys. The case is in its early stages, however a Markman Hearing has been scheduled for October 2007, and a trial date has been set for May 2008.

On December 27, 2005, Broadband Office Inc. (Broadband) served an amended complaint, adding Extreme Networks as a defendant in its lawsuit against Technology Credit Corporation (TCC) and Key Equipment Finance, Inc., seeking recovery of an alleged preferential payment in the amount of $0.8 million plus interest, purportedly paid by Broadband to TCC within ninety days prior to Broadband s petition for bankruptcy protection. Extreme disputes that it owes any money to Broadband, and intends vigorously to defend against the claims.

On June 21, 2005, Enterasys filed suit against Extreme Networks and Foundry Networks, Inc. (Foundry) in the United States District Court for the District of Massachusetts, Civil Action No.05-11298 DPW. The complaint alleges willful infringement of U. S. Patent Nos. 5,251,205; 5,390,173; 6,128,665; 6,147,995; 6,539,022; and 6,560, 236, and seeks: a) a judgment that Extreme willfully infringes each of the patents; (b) a permanent injunction from infringement, inducement of infringement and contributory infringement of each of the six patents; (c) damages and a reasonable royalty to be determined at trial; (d) trebled damages; (e) attorneys fees, costs and interest; and (f) equitable relief at the court s discretion. The Markman hearing has been rescheduled for October 2007. We intend vigorously to defend against Enterasys assertions, which we believe to be without merit.

On May 27, 2003, Lucent filed suit against Extreme Networks and Foundry in the United States District Court for the District of Delaware, Civil Action No. 03-508. The complaint alleged willful infringement of U.S. Patent Nos. 4,769,810, 4,769,811, 4,914,650, 4,922,486 and 5,245,607. After the Markman hearing, Lucent dropped its claims relating to the 5,245,607 patent. The judge split the case into three parts to be tried separately: phase 1 to cover infringement, willfulness and damages; phase 2 to cover invalidity; and phase 3 to cover equitable defenses and our counterclaims. On May 9, 2005, a jury in Delaware awarded a verdict to Extreme in the phase 1 trial of non-infringement on 18 out of the 19 claims asserted. The jury did award Lucent damages of approximately $275,000 on the remaining claim; which covers a feature that is not offered in our current product line. The parties each filed post-trial motions; and on August 16, 2005, the judge granted Lucent s motion for a new trial, ruling that Extreme impermissibly introduced to the jury evidence of its prior relationship with Lucent. Extreme s motion for reconsideration was denied. On August 9, 2006, the parties entered into a settlement agreement to resolve all outstanding claims which includes the dismissal of all claims and a patent cross-license for a defined term.

Beginning on July 6, 2001, purported securities fraud class action complaints were filed in the United States District Court for the Southern District of New York. The cases were consolidated and the litigation is now captioned as In re Extreme Networks, Inc. Initial Public Offering Securities Litigation, Civ. No. 01-6143 (SAS) (S.D.N.Y.), related to In re Initial Public Offering Securities Litigation, 21 MC 92 (SAS) (S.D.N.Y.).The operative amended complaint names as defendants Extreme Networks; six of our present and former officers and/or directors, including our CEO (the Extreme Networks Defendants); and several investment banking firms that served as underwriters of our initial public offering and October 1999 secondary offering. The complaint alleges liability under Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, on the grounds that the registration statement for the offerings did not disclose that: (1) the underwriters had agreed to allow certain customers to purchase shares in the offerings in exchange for excess commissions paid to the underwriters; and (2) the underwriters had arranged for certain customers to purchase additional shares in the aftermarket at predetermined prices. Similar allegations were made in other lawsuits challenging over 300 other initial public offerings and follow-on offerings conducted in 1999 and 2000. The cases were consolidated for pretrial purposes. Previously, we executed a settlement agreement presented to all issuer defendants. In that settlement, plaintiffs would dismiss and release all claims against the Extreme Network Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The Extreme Networks Defendants would not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeded the amount of the insurance coverage. The Court gave preliminary approval to the settlement in February 2005 and held a hearing in April 2006 to consider final approval of the settlement. Before the Court issued a final decision on the settlement, on December 5, 2006 the United States Court of Appeals for the Second Circuit vacated the class certification of plaintiffs claims against the underwriters in six cases designated as focus or test cases. Thereafter, on December 14, 2006, the Court ordered a stay of all proceedings in all of the lawsuits pending the outcome of plaintiffs petition to the Second Circuit Court of Appeals for a rehearing en banc and resolution of the class certification issue. On April 6, 2007, the Second Circuit Court of Appeals denied plaintiffs petition for a rehearing, but clarified that the plaintiffs may seek to certify a more limited class. Accordingly, the plaintiffs and issuers have stated that they are prepared to discuss how the settlement might be amended or renegotiated to comply with the decision of the Second Circuit Court of Appeals. On April 30, 2007, Plaintiffs stated that they intend to present a proposed redefined class to the Court. If the settlement is not amended or renegotiated and then approved by the Court, we cannot assure you that we will prevail in the lawsuit. Failure to prevail could have a material adverse effect on our consolidated financial position, results of operations and cash flows in the future.

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

Item 1A. Risk Factors

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended July 2, 2006.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table sets forth certain information regarding purchases by us of shares of our common stock during the second quarter of fiscal 2007:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
October 1, 2006 through October 28, 2006	868,254(2)	$ 3.92	868,254(2)	$ 1,697,397
Total	868,254	$ 3.92(3)	868,254	$ 1,697,397

(1) We announced on October 26, 2005 that on October 20, 2005 our Board of Directors authorized, subject to certain specifications, the repurchase of shares of our common stock up to an aggregate maximum amount of $50 million on the open market or in negotiated transactions through October 2007. On October 25, 2006, the Board of Directors terminated the share repurchase plan, and as of that date, we had repurchased approximately 11.1 million shares for approximately $48.3 million.

(2) As part of our share repurchase program, we have entered into and we may continue to enter into structured share repurchase transactions with financial institutions. During the second quarter of fiscal 2007, we repurchased 0.9 million shares of our common stock for $3.4 million under structured share repurchase transactions. From the beginning of the share repurchase program until October 25, 2006, we used $48.3 million to repurchase 11.1 million shares, primarily through open market purchases. These transactions required that we make up-front payments. The repurchases were made in compliance with the Securities and Exchange Commission s Rule 10b-18.

(3) Represents average price paid per share during the second quarter of fiscal 2007.

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Item 3. Defaults Upon Senior Securities None

Item 4. Submission of Matters to a Vote of Security Holders None

Item 5. Other Information None

Item 6. Exhibits

a) Exhibits:

3.4	Amended and Restated Bylaws of Extreme Networks, Inc. (incorporated by reference from Exhibit 99.1 to our Current Report on Form 8-K filed on October 31, 2006).
10.11	Revised compensation policies for non-employee service on the Board of Directors and its committees (incorporated by reference from the disclosures set forth in Item 1.01 to our Current Report on Form 8-K filed on October 31, 2006).
10.12	Extreme Networks, Inc. Fiscal 2007 Executive Incentive Bonus Plan (incorporated by reference from Exhibit 99.1 to our Current Report on Form 8-K filed on November 21, 2006).
10.13	Fiscal 2007 commission bonus plan for Senior Vice President, Sales (incorporated by reference from the disclosures set forth in Item 5.02 to our Current Report on Form 8-K filed on November 21, 2006).
31.1	Section 302 Certification of Chief Executive Officer
31.2	Section 302 Certification of Chief Financial Officer
32.1	Section 906 Certification of Chief Executive Officer
32.2	Section 906 Certification of Chief Financial Officer

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SIGNATURES

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

EXTREME NETWORKS, INC.
(Registrant)

/S/ KAREN ROGGE
KAREN ROGGE
Senior Vice President and Chief Financial Officer
June 28, 2007

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