

NEOPHOTONICS CORP  
Form 10-Q  
June 24, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

OR

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

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

Commission File Number: 001-35061

NeoPhotonics Corporation

(Exact name of registrant as specified in its charter)

Delaware 94-3253730  
(State or other jurisdiction (I.R.S. Employer

of incorporation or organization) Identification No.)

2911 Zanker Road

San Jose, California 95134

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(Address of principal executive offices, zip code)

(408) 232-9200

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (do not check if a smaller reporting company) Smaller reporting company

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

As of June 16, 2014, there were 31,780,761 shares of the registrant's Common Stock outstanding.

NEOPHOTONICS CORPORATION

For the Quarter Ended March 31, 2014

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## PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
NEOPHOTONICS CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

| (In thousands, except per share data)                       | As of             |                      |
|---|-------------------|----------------------|
|   | March 31,<br>2014 | December 31,<br>2013 |
| <b>ASSETS</b>   |                   |                      |
| Current assets:   |                   |                      |
| Cash and cash equivalents                                   | \$53,056          | \$ 57,101            |
| Short-term investments                                      | 8,285             | 17,916               |
| Restricted cash   | 2,953             | 2,138                |
| Accounts receivable, net of allowance for doubtful accounts | 70,647            | 64,533               |
| Inventories   | 67,949            | 64,908               |
| Prepaid expenses and other current assets                   | 12,503            | 9,977                |
| Total current assets  | 215,393           | 216,573              |
| Property, plant and equipment, net                          | 66,115            | 68,851               |
| Other intangible assets, net                                | 13,972            | 15,005               |
| Other long-term assets                                      | 1,820             | 1,798                |
| Total assets  | \$297,300         | \$ 302,227           |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

|  |          |           |
|--|----------|-----------|
| Current liabilities:                   |          |           |
| Accounts payable                       | \$56,845 | \$ 48,569 |
| Notes payable                          | 11,210   | 9,738     |
| Current portion of long-term debt      | 10,395   | 10,325    |
| Accrued and other current liabilities  | 26,246   | 23,643    |
| Total current liabilities              | 104,696  | 92,275    |
| Long-term debt, net of current portion | 19,145   | 24,150    |
| Deferred income tax liabilities        | 1,205    | 1,004     |
| Other noncurrent liabilities           | 7,444    | 7,987     |
| Total liabilities                      | 132,490  | 125,416   |

Commitments and contingencies (Note 10)

Stockholders' equity:

Preferred stock, \$0.0025 par value

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At March 31, 2014 and December 31, 2013: 10,000 shares authorized, no shares issued or outstanding

|   |           |            |
|---|-----------|------------|
| Common stock, \$0.0025 par value  | —         | —          |
| At March 31, 2014: 100,000 shares authorized, 31,664 shares issued and outstanding;   |           |            |
| At December 31, 2013: 100,000 shares authorized, 31,572 shares issued and outstanding | 80        | 79         |
| Additional paid-in capital  | 449,531   | 447,467    |
| Accumulated other comprehensive income  | 10,209    | 11,687     |
| Accumulated deficit   | (295,010) | (282,422 ) |
| Total stockholders' equity  | 164,810   | 176,811    |
| Total liabilities and stockholders' equity  | \$297,300 | \$ 302,227 |

See accompanying Notes to Condensed Consolidated Financial Statements.

## NEOPHOTONICS CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| (In thousands, except per share data)  | Three Months Ended<br>March 31, |            |
|--|---------------------------------|------------|
|  | 2014                            | 2013       |
| Revenue  | \$68,168                        | \$56,063   |
| Cost of goods sold   | 54,368                          | 44,306     |
| Gross profit   | 13,800                          | 11,757     |
| Operating expenses:  |                                 |            |
| Research and development   | 12,056                          | 9,707      |
| Sales and marketing  | 3,411                           | 3,586      |
| General and administrative   | 8,987                           | 5,059      |
| Acquisition-related transaction costs  | —                               | 4,510      |
| Amortization of purchased intangible assets                                  | 379                             | 321        |
| Restructuring charges  | —                               | 325        |
| Total operating expenses   | 24,833                          | 23,508     |
| Loss from operations   | (11,033)                        | (11,751)   |
| Interest income  | 65                              | 131        |
| Interest expense   | (251)                           | (163)      |
| Other expense, net   | (607)                           | (274)      |
| Total interest and other expense, net  | (793)                           | (306)      |
| Loss before income taxes   | (11,826)                        | (12,057)   |
| Income tax expense   | (762)                           | (183)      |
| Net loss   | \$(12,588)                      | \$(12,240) |
| Basic and diluted net loss per share   | \$(0.40)                        | \$(0.40)   |
| Weighted average shares used to compute basic and diluted net loss per share | 31,610                          | 30,574     |

See accompanying Notes to Condensed Consolidated Financial Statements.

NEOPHOTONICS CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

| (In thousands)   | Three months ended |            |
|--|--------------------|------------|
|  | March 31,          |            |
|  | 2014               | 2013       |
| Net loss   | \$(12,588)         | \$(12,240) |
| Foreign currency translation adjustments, net of tax of zero | (1,599 )           | 172        |
| Defined benefit pension plans adjustment, net of tax of \$73 | 118                | -          |
| Unrealized gain (loss) on investments, net of tax of zero    | 3                  | (19 )      |
| Comprehensive loss   | \$(14,066)         | \$(12,087) |

See accompanying Notes to Condensed Consolidated Financial Statements.

## NEOPHOTONICS CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

Three Months  
Ended  
March 31,  
2014 2013

| (In thousands)  | 2014       | 2013       |
|---|------------|------------|
| Cash flows from operating activities  |            |            |
| Net loss  | \$(12,588) | \$(12,240) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |            |            |
| Depreciation and amortization   | 5,528      | 4,152      |
| Stock-based compensation expense  | 1,901      | 1,202      |
| Deferred taxes  | 76         | —          |
| Investment-related amortization and accrued interest                                      | 56         | 315        |
| Loss on disposal of property and equipment  | 15         | 111        |
| Adjustment to fair value of penalty payment derivative                                    | 186        | —          |
| Allowance for doubtful accounts   | (84 )      | 22         |
| Write-down of inventories   | 567        | 30         |
| Other, net  | (333 )     | 34         |
| Change in assets and liabilities, net of effects of acquisitions:                         |            |            |
| Accounts receivable   | (6,643 )   | 7,155      |
| Inventories   | (4,413 )   | (4,682 )   |
| Prepaid expenses and other assets   | (2,512 )   | (1,292 )   |
| Accounts payable  | 9,168      | 2,126      |
| Accrued and other liabilities   | 1,719      | 4,228      |
| Net cash provided by (used in) operating activities                                       | (7,357 )   | 1,161      |
| Cash flows from investing activities  |            |            |
| Purchase of property, plant and equipment   | (2,070 )   | (5,134 )   |
| Purchase of marketable securities   | (5,072 )   | (29,030)   |
| Proceeds from sale of marketable securities   | 9,644      | 23,747     |
| Proceeds from maturity of securities  | 5,007      | 20,900     |
| Decrease (increase) in restricted cash  | (879 )     | 524        |
| Acquisition, net of notes payable   | —          | (14,087)   |
| Net cash provided by (used in) investing activities                                       | 6,630      | (3,080 )   |
| Cash flows from financing activities  |            |            |
| Proceeds from exercise of stock options   | 303        | 151        |
| Tax withholding on restricted stock units   | (80 )      | (72 )      |
| Proceeds from bank loans  | —          | 26,443     |
| Repayment of bank loans   | (5,157 )   | (8,610 )   |
| Proceeds from issuance of notes payable   | 6,178      | 4,881      |
| Repayment of notes payable  | (4,448 )   | (6,482 )   |
| Net cash provided by (used in) financing activities                                       | (3,204 )   | 16,311     |
| Effect of exchange rates on cash and cash equivalents                                     | (114 )     | 72         |
| Net increase (decrease) in cash and cash equivalents                                      | (4,045 )   | 14,464     |



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|  |          |          |
|--|----------|----------|
| Cash and cash equivalents at the beginning of the period               | 57,101   | 36,940   |
| Cash and cash equivalents at the end of the period                     | \$53,056 | \$51,404 |
| Supplemental disclosure of noncash investing and financing activities: |          |          |
| Issuance of notes to the seller of acquired business                   | \$—      | \$11,130 |

See accompanying Notes to Condensed Consolidated Financial Statements.

NeoPhotonics Corporation

Notes to Condensed Consolidated Financial Statements

(Unaudited)

#### Note 1. Basis of presentation and significant accounting policies

##### Basis of Presentation and Consolidation

The condensed consolidated financial statements of NeoPhotonics Corporation (“NeoPhotonics” or the “Company”) as of March 31, 2014 and December 31, 2013 and for the three months ended March 31, 2014 and 2013, have been prepared in accordance with the instructions on Form 10-Q pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). In accordance with those rules and regulations, the Company has omitted certain information and notes normally provided in the Company’s annual consolidated financial statements. In the opinion of management, the condensed consolidated financial statements contain all adjustments, consisting only of normal recurring items, except as otherwise noted, necessary for the fair presentation of the Company’s financial position and results of operations for the interim periods. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles (“U.S. GAAP”). These condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013. The results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated.

##### Certain Significant Risks and Uncertainties

The Company operates in a dynamic industry and, accordingly, can be affected by a variety of factors. For example, any of the following areas could have a negative effect on the Company in terms of its future financial position, results of operations or cash flows: the general state of the U.S. and world economies, the highly cyclical nature of the industries the Company serves; the loss of any of a small number of its larger customers; ability to obtain additional financing; inability to meet certain debt covenants; failure to successfully integrate completed acquisitions; fundamental changes in the technology underlying the Company’s products; the hiring, training and retention of key employees; successful and timely completion of product design efforts; and new product design introductions by competitors.

##### Use of Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenue and expenses during the reporting period. Significant estimates made by management include: the useful lives of property, plant and equipment and intangible assets as well as future cash flows to be generated by those assets; fair values of identifiable assets acquired and liabilities assumed in business combinations; allowances for doubtful accounts; valuation allowances for deferred tax assets; write off of excess and obsolete inventories and the valuations, warranty reserves and recognition of stock-based compensation, among others. Actual results could differ from these estimates.

## Summary of Significant Accounting Policies

There have been no changes in the Company's significant accounting policies for the three months ended March 31, 2014, as compared to the significant accounting policies described in its Annual Report on Form 10-K for the year ended December 31, 2013.

### Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). The standard provides companies with a single model for use in accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU 2014-08") which raises the threshold for a disposal to qualify as a discontinued operation and requires new disclosures of both discontinued

operations and certain other disposals that do not meet the definition of a discontinued operation. ASU 2014-08 is effective for annual periods beginning on or after December 15, 2014. Early adoption is permitted but only for disposals that have not been reported in financial statements previously issued. The Company is currently in the process of evaluating the impact of the adoption on its consolidated financial statements.

In July 2013, the FASB issued amendments to the FASB Accounting Standard Codification on Income Taxes, to improve the presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance is expected to reduce diversity in practice and is expected to better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exists. This guidance is effective for reporting periods beginning after December 15, 2013. The adoption of this guidance did not have an impact on the Company's consolidated financial statements.

#### Note 2. Net loss per share

The following table sets forth the computation of the basic and diluted net loss per share for the periods indicated (in thousands, except per share amounts):

|  | Three months ended<br>March 31, |                  |
|--|---------------------------------|------------------|
|  | 2014                            | 2013             |
| <b>Numerator:</b>  |                                 |                  |
| Net loss   | \$(12,588)                      | \$(12,240)       |
| <b>Denominator:</b>  |                                 |                  |
| Weighted average shares used to compute basic and diluted net loss per share | 31,610                          | 30,574           |
| <b>Basic and diluted net loss per share</b>                                  | <b>\$(0.40 )</b>                | <b>\$(0.40 )</b> |

The Company has excluded the impact of outstanding employee stock options, restricted stock units, common stock warrants and shares expected to be issued under its employee stock purchase plan from the computation of diluted net loss per share attributable to NeoPhotonics Corporation common stockholders, as their effect would have been antidilutive. The shares potentially issuable for each of these outstanding awards at March 31, 2014 and 2013 were as follows (in thousands):

|                              | March 31, |       |
|------------------------------|-----------|-------|
|                              | 2014      | 2013  |
| Employee stock options       | 3,952     | 2,759 |
| Restricted stock units       | 1,134     | 849   |
| Employee stock purchase plan | 469       | 484   |
| Common stock warrants        | 4         | 4     |
|                              | 5,559     | 4,096 |



## Note 3. Cash equivalents and investments

The following table summarizes the Company's unrealized gains and losses related to the cash equivalents and investments in marketable securities designated as available-for-sale (in thousands):

|                                     | As of March 31, 2014 |                        |                         |                | As of December 31, 2013 |                        |                         |                 |
|-------------------------------------|----------------------|------------------------|-------------------------|----------------|-------------------------|------------------------|-------------------------|-----------------|
|                                     | Amortized Cost       | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value     | Amortized Cost          | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value      |
| <b>Cash and cash equivalents</b>    |                      |                        |                         |                |                         |                        |                         |                 |
| Money market funds                  | \$16                 | \$ —                   | \$ —                    | \$16           | \$11                    | \$ —                   | \$ —                    | \$11            |
| Time deposits                       | —                    | —                      | —                       | —              | 6,540                   | —                      | —                       | 6,540           |
| <b>Short-term investments</b>       |                      |                        |                         |                |                         |                        |                         |                 |
| Money market funds                  | —                    | —                      | —                       | —              | 4,577                   | —                      | —                       | 4,577           |
| Corporate bonds                     | 4,571                | —                      | —                       | 4,571          | 6,708                   | 3                      | (5 )                    | 6,706           |
| Foreign bonds and notes             | 2,008                | 6                      | —                       | 2,014          | 4,827                   | 5                      | —                       | 4,832           |
| Variable rate demand notes          | 1,700                | —                      | —                       | 1,700          | 1,801                   | —                      | —                       | 1,801           |
| <b>Total short-term investments</b> | <b>8,279</b>         | <b>6</b>               | <b>—</b>                | <b>8,285</b>   | <b>17,913</b>           | <b>8</b>               | <b>(5 )</b>             | <b>17,916</b>   |
| <b>Total investments</b>            | <b>\$8,295</b>       | <b>\$ 6</b>            | <b>\$ —</b>             | <b>\$8,301</b> | <b>\$24,464</b>         | <b>\$ 8</b>            | <b>\$ (5 )</b>          | <b>\$24,467</b> |

As of March 31, 2014 and December 31, 2013, maturities of marketable securities were as follows (in thousands):

|                     | March 31, 2014  | December 31, 2013 |
|---------------------|-----------------|-------------------|
| Less than 1 year    | \$ 4,587        | \$ 20,658         |
| Due in 1 to 2 years | 2,014           | 2,008             |
| Due in 2 to 5 years | —               | —                 |
| Due after 5 years   | 1,700           | 1,801             |
| <b>Total</b>        | <b>\$ 8,301</b> | <b>\$ 24,467</b>  |

The Company may sell its investments in the future to fund future operating needs. As a result, the Company recorded all its marketable securities in short-term investment as of March 31, 2014 and December 31, 2013, regardless of the contractual maturity date of the securities.

Realized gains and losses on the sale of marketable securities during the three months ended March 31, 2014 and 2013 were immaterial. The Company did not recognize any impairment losses on its marketable securities during the three months ended March 31, 2014 or 2013. As of March 31, 2014, the Company did not have any investments in marketable securities that were in an unrealized loss position for a period in excess of 12 months.

## Note 4. Fair value disclosures

## Assets and Liabilities Measured at Fair Value on a Recurring Basis

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The following table presents the Company's assets that are measured at fair value on a recurring basis (in thousands):

|   | As of March 31, 2014 |          |         |          | As of December 31, 2013 |           |         |           |
|---|----------------------|----------|---------|----------|-------------------------|-----------|---------|-----------|
|   | Level 1              | Level 2  | Level 3 | Total    | Level 1                 | Level 2   | Level 3 | Total     |
| Cash, cash equivalents and short-term investments |                      |          |         |          |                         |           |         |           |
| Money market funds                                | \$ 16                | \$ —     | \$ —    | \$ 16    | \$ 4,588                | \$ —      | \$ —    | \$ 4,588  |
| Time deposits                                     | —                    | —        | —       | —        | —                       | 6,540     | —       | 6,540     |
| Corporate bonds                                   | —                    | 4,571    | —       | 4,571    | —                       | 6,706     | —       | 6,706     |
| U.S. federal agencies                             | —                    | —        | —       | —        | —                       | —         | —       | —         |
| Foreign bonds and notes                           | —                    | 2,014    | —       | 2,014    | —                       | 4,832     | —       | 4,832     |
| Variable rate demand notes                        | —                    | 1,700    | —       | 1,700    | —                       | 1,801     | —       | 1,801     |
|   | \$ 16                | \$ 8,285 | \$ —    | \$ 8,301 | \$ 4,588                | \$ 19,879 | \$ —    | \$ 24,467 |
| Mutual funds held in Rabbi Trust                  | \$ 484               | \$ —     | \$ —    | \$ 484   | \$ 442                  | \$ —      | \$ —    | \$ 442    |

The Company offers a Non-Qualified Deferred Compensation Plan ("NQDC Plan") to a select group of its highly compensated employees. The NQDC Plan provides participants the opportunity to defer payment of certain compensation as defined in the NQDC

Plan. A Rabbi Trust has been established to fund the NQDC Plan obligation, which was fully funded at March 31, 2014. The assets held by the Rabbi Trust are substantially in the form of exchange traded mutual funds and are included in the Company's other long-term assets on its condensed consolidated balance sheets at March 31, 2014 and December 31, 2013.

The following table presents the Company's liabilities that are measured at fair value on a recurring basis (in thousands):

|                                      | As of March 31, 2014 |      |          |          | As of December 31, 2013 |         |          |          |         |       |
|--------------------------------------|----------------------|------|----------|----------|-------------------------|---------|----------|----------|---------|-------|
|                                      | Level 1              |      | Level 2  | Level 3  | Total                   | Level 1 |          | Level 2  | Level 3 | Total |
|                                      | 1                    | 2    | Level 3  | Total    | 1                       | 2       | Level 3  | Total    |         |       |
| Contingent consideration (Note 10)   | \$—                  | \$ — | \$ 1,985 | \$ 1,985 | \$—                     | \$ —    | \$ 1,985 | \$ 1,985 |         |       |
| Penalty payment derivative (Note 10) | \$—                  | \$ — | \$ 425   | \$ 425   | \$—                     | \$ —    | \$ 239   | \$ 239   |         |       |

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

There were no assets or liabilities measured at fair value on a nonrecurring basis at March 31, 2014 or December 31, 2013.

#### Assets and Liabilities Not Measured at Fair Value

The carrying values of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and notes payable approximate their fair values due to the short-term nature and liquidity of these financial instruments.

The fair values of the Company's long-term debt have been calculated using an estimate of the interest rate the Company would have had to pay on the issuance of liabilities with a similar maturity and discounting the cash flows at that rate which it considers to be a level 2 fair value measurement. The fair values do not necessarily give an indication of the amount that the Company would currently have to pay to extinguish any of this debt.

The fair value of the Company's variable rate bank borrowings and acquisition-related debt was not materially different than its carrying value at March 31, 2014 and December 31, 2013 as the interest rates approximated rates currently available to the Company.

#### Note 5. Business combination

On March 29, 2013 (the "closing date") the Company acquired certain assets and assumed certain liabilities related to the semiconductor Optical Components Business Unit (the "OCU") of LAPIS Semiconductor Co., Ltd., a wholly owned subsidiary of Rohm Co., Ltd ("LAPIS") of Japan with the intention of operating the OCU as an ongoing business. The business is now known as NeoPhotonics Semiconductor.

Total consideration for NeoPhotonics Semiconductor was \$24.3 million, including cash of \$14.1 million paid upon closing and notes payable of \$11.1 million (see Note 8), partially offset by a net receivable from Lapis of \$1.0 million that was received subsequent to March 31, 2013. The cash paid includes \$2.0 million that was withheld and placed into escrow to cover certain indemnity obligations.

In connection with the acquisition, the Company incurred approximately \$4.5 million in acquisition-related transaction costs during the three months ended March 31, 2013 related to investment banking, legal, accounting and other professional services and transfer taxes related to real property acquired. The acquisition costs were expensed as



incurred and were included in operating expenses in the Company's condensed consolidated statement of operations.

NeoPhotonics Semiconductor's results of operations between the closing date of March 29, 2013 and the Company's quarter end date of March 31, 2013 were immaterial.

The Company accounted for its acquisition of the NeoPhotonics Semiconductor assets and assumed liabilities as a business combination. NeoPhotonics Semiconductor's tangible and identifiable intangible assets acquired and liabilities assumed were recorded based upon their estimated fair values as of the closing date of the acquisition. The estimated fair values of the identifiable assets acquired and liabilities assumed approximated the purchase price; therefore, no goodwill was recorded. The following table summarizes the acquisition accounting and the tangible and intangible assets acquired as of the date of acquisition and subsequent adjustments (in thousands):

|  |           |
|--|-----------|
| Total purchase consideration:          |           |
| Cash paid                              | \$ 14,087 |
| Net receivable from LAPIS              | (959 )    |
| Notes payable                          | 11,130    |
|  | \$24,258  |
| Liabilities assumed:                   |           |
| Pension and retirement obligations     | \$6,471   |
| Other compensation-related liabilities | 1,083     |
| Other current liabilities              | 1,265     |
|  | \$8,819   |
| Fair value of assets acquired:         |           |
| Inventory                              | \$13,309  |
| Other current assets                   | 35        |
| Land, property, plant and equipment    | 14,433    |
| Intangible assets acquired:            |           |
| Developed technology                   | 2,120     |
| Customer relationships                 | 3,180     |
|  | \$33,077  |

The following unaudited supplemental pro forma information presents the combined results of operations of NeoPhotonics Corporation and NeoPhotonics Semiconductor for the three months ended March 31, 2013 as though the companies had been combined as of the beginning of the period presented. The pro forma financial information includes elimination of \$4.5 million of transaction costs and \$1.9 million of revenue and \$1.8 million of costs related to sales from NeoPhotonics Semiconductor to the Company.

The unaudited pro forma results do not assume any operating efficiencies as a result of the consolidation of operations (in thousands, except per share data):

|                                      |  |
|--------------------------------------|--|
|                                      | Three<br>Months<br>Ended<br>March<br>31,<br>2013 |
| Revenue                              | \$68,754   |
| Net loss                             | \$(5,277 )                                       |
| Basic and diluted net loss per share | \$(0.17 )  |

Note 6. Balance sheet components

Accounts receivable, net

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

|                                 | March 31, 2014 | December 31, 2013 |
|---------------------------------|----------------|-------------------|
| Accounts receivable             | \$ 64,586      | \$ 57,010         |
| Trade notes receivable          | 6,480          | 8,054             |
| Allowance for doubtful accounts | (419 )         | (531 )            |
|                                 | \$ 70,647      | \$ 64,533         |

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## Inventories

Inventories consist of the following (in thousands):

|                               | March 31, 2014 | December 31, 2013 |
|-------------------------------|----------------|-------------------|
| Raw materials                 | \$ 27,876      | \$ 26,379         |
| Work in process               | 22,844         | 14,341            |
| Finished goods <sup>(1)</sup> | 17,229         | 24,188            |
|                               | \$ 67,949      | \$ 64,908         |

<sup>(1)</sup>Finished goods inventory at customer vendor managed inventory locations was \$4.9 million and \$5.4 million as of March 31, 2014 and December 31, 2013, respectively.

## Purchased intangible assets

Purchased intangible assets consist of the following (in thousands):

|                        | March 31, 2014 |                          |            | December 31, 2013 |                          |            |
|------------------------|----------------|--------------------------|------------|-------------------|--------------------------|------------|
|                        | Gross Assets   | Accumulated Amortization | Net Assets | Gross Assets      | Accumulated Amortization | Net Assets |
| Technology and patents | \$34,250       | \$ (26,337 )             | \$7,913    | \$34,524          | \$ (25,931 )             | \$8,593    |
| Customer relationships | 14,920         | (9,967 )                 | 4,953      | 15,004            | (9,732 )                 | 5,272      |
| Leasehold interest     | 1,373          | (267 )                   | 1,106      | 1,406             | (266 )                   | 1,140      |
| Noncompete agreements  | 950            | (950 )                   | —          | 950               | (950 )                   | —          |
|                        | \$51,493       | \$ (37,521 )             | \$13,972   | \$51,884          | \$ (36,879 )             | \$15,005   |

Amortization expense relating to technology and patents and the leasehold interest intangible assets is included within cost of goods sold, and customer relationships within operating expenses. The following table presents details of the amortization expense of the Company's purchased intangible assets as reported in the condensed consolidated statements of operations (in thousands):

|                    | Three Months Ended |        |
|--------------------|--------------------|--------|
|                    | March 31, 2014     | 2013   |
| Cost of goods sold | \$ 714             | \$ 428 |
| Operating expenses | 379                | 321    |
| Total              | \$ 1,093           | \$ 749 |

The estimated future amortization expense of purchased intangible assets as of March 31, 2014, is as follows (in thousands):

|                           |         |
|---------------------------|---------|
| 2014 (remaining 9 months) | \$3,275 |
| 2015                      | 4,426   |
| 2016                      | 3,682   |

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|            |          |
|------------|----------|
| 2017       | 807      |
| 2018       | 591      |
| Thereafter | 1,191    |
|            | \$13,972 |

Accrued and other current liabilities

Accrued and other current liabilities consist of the following (in thousands):

|                                   | March 31, 2014 | December 31, 2013 |
|-----------------------------------|----------------|-------------------|
| Employee-related accrued expenses | \$ 14,449      | \$ 12,297         |
| Other accrued expenses            | 11,372         | 11,346            |
| Penalty payment derivative        | 425            | —                 |
|                                   | \$ 26,246      | \$ 23,643         |

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## Warranty Accrual

The table below summarizes the movement in the warranty accrual, which is included in accrued and other current liabilities (in thousands):

|                             | Three Months Ended |          |
|-----------------------------|--------------------|----------|
|                             | March 31,          |          |
|                             | 2014               | 2013     |
| Beginning balance           | \$ 1,737           | \$ 1,072 |
| Warranty accruals           | 289                | 26       |
| Settlements and adjustments | (357 )             | 86       |
| Ending balance              | \$ 1,669           | \$ 1,184 |

## Other noncurrent liabilities

Other noncurrent liabilities consist of the following (in thousands):

|                                    | March 31, 2014 | December 31, 2013 |
|------------------------------------|----------------|-------------------|
| Pension and other employee-related | \$ 6,098       | \$ 6,206          |
| Penalty payment derivative         | —              | 239               |
| Other                              | 1,346          | 1,542             |
|                                    | \$ 7,444       | \$ 7,987          |

## Note 7. Restructuring

The following table summarizes activity associated with restructuring obligations during the three months ended March 31, 2014 (in thousands):

|  | Facilities | Contract    |        |
|--|------------|-------------|--------|
|  |            | Termination | Total  |
| Restructuring obligations, December 31, 2013 | \$ 211     | \$ 66       | \$ 277 |
| Restructuring costs incurred                 | —          | —           | —      |
| Cash payments                                | (27 )      | (66 )       | (93 )  |
| Non-cash settlements and other               | —          | —           | —      |
| Restructuring obligations, March 31, 2014    | \$ 184     | \$ —        | \$ 184 |

## Note 8. Debt

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The table below summarizes the carrying amount and weighted average interest rate of the Company's notes payable and long-term debt (in thousands, except percentages):

|  | March 31, 2014 |          | December 31, 2013 |          |
|--|----------------|----------|-------------------|----------|
|  | Carrying       | Weighted | Carrying          | Weighted |
|  | Amount         | Average  | Amount            | Average  |
|  |                | Interest |                   | Interest |
|  |                | Rate     |                   | Rate     |
| Notes payable                                | \$11,210       |          | \$9,738           | —        |
| Long-term debt:                              |                |          |                   |          |
| Acquisition-related                          | \$6,790        | 1.50 %   | \$9,975           | 1.50 %   |
| Bank borrowings                              | 22,750         | 3.15 %   | 24,500            | 2.92 %   |
|  | 29,540         |          | 34,475            |          |
| Less: current portion of long-term debt      | (10,395)       |          | (10,325 )         |          |
| Total long-term debt, net of current portion | \$19,145       |          | \$24,150          |          |

Notes payable

The Company regularly issues notes payable to its suppliers in China in exchange for accounts payable. These notes are supported by noninterest bearing bank acceptance drafts and are due three to six months after issuance. As a condition of the notes payable arrangements, the Company is required to keep a compensating balance at the issuing banks that is a percentage of the total

notes payable balance until the amounts are settled. These balances are classified as restricted cash on the Company's consolidated balance sheets. As of March 31, 2014 and December 31, 2013, restricted cash totaled \$3.0 million and \$2.1 million, respectively. In May 2014, one of the Company's subsidiaries in China issued a 90-day bank acceptance draft of \$8.0 million to another of the Company's subsidiaries that required a compensating balance of \$2.4 million. This bank acceptance draft can be sold for cash at a discount prior to its expiration.

At March 31, 2014, the Company's subsidiaries in China had two short-term line of credit facilities with banking institutions, both of which subsequently expired. In June 2014, one of the credit facilities was renewed. Under the renewed agreement, which expires in June 2015, the Company's subsidiaries in China have a short-term line of credit of RMB 160.0 million (\$25.7 million) of which the full amount can be used for bank acceptance drafts (with a 25% compensating balance requirement) and up to RMB 120.0 million (\$19.3 million) can be used for short-term loans, which will bear interest at varying rates depending upon the term. The second credit facility is in the process of being renewed.

#### Acquisition-related

In connection with the acquisition of NeoPhotonics Semiconductor on March 29, 2013, the Company was obligated to pay 1,050 million Japanese Yen in three equal installments on the first, second and third anniversaries of the closing date for the purchase of the real estate used by NeoPhotonics Semiconductor, of which 700 million Japanese Yen (\$6.8 million) was outstanding at March 31, 2014. The obligation bears interest at 1.5% per year, payable annually, and is secured by the acquired real estate property.

#### Bank borrowings

The Company has a credit agreement with Comerica Bank as lead bank in the U.S., which has been amended several times. The components of the available credit facilities are as follows:

A revolving credit facility under which there was nothing outstanding at March 31, 2014 or December 31, 2013 and \$20.0 million was available for borrowing at March 31, 2014, subject to covenant requirements. Amounts borrowed are due on or before March 2016 and borrowings bear interest at an interest rate option of a base rate as defined in the agreement plus 1.75% or LIBOR plus 2.75%. As of March 31, 2014 the rate on the LIBOR option was 2.90%.

A term loan facility of \$28.0 million, under which \$22.8 million and \$24.5 million was outstanding at March 31, 2014 and December 31, 2013, respectively. Interest is payable quarterly in arrears and the principal is paid in equal quarterly installments over the term of the loan ending in June 2017. Borrowings under the term loan bear interest at an interest rate option of a base rate as defined in the agreement plus 2.0% or LIBOR plus 3.0%. As of March 31, 2014 the rate on the LIBOR option was 3.15%.

The Company's credit agreement requires the maintenance of specified financial covenants, including a debt to EBITDA ratio and liquidity ratios. The agreement also restricts the Company's ability to incur certain additional debt or to engage in specified transactions, restricts the payment of dividends and is secured by substantially all of its U.S. assets, other than intellectual property assets. The Company was not in compliance with the debt to EBITDA covenant at March 31, 2014, which noncompliance was effectively waived in the amendment described below.

On May 19, 2014, the Company executed an amendment to the credit agreement that waived the testing of certain covenants for compliance, including the March 31, 2014 debt to EBITDA covenant, provided that the Company maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. The Company intends to work with the bank in the coming months to restructure the credit agreement, including the covenant requirements. In the absence of a restructured agreement, the Company believes it will need to continue to maintain the compensating balances at least through the end of 2014. As of May 19, 2014, the amount of the Company's cash and short-term investments in these compensating balance accounts was



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\$21.1 million, which will be classified as restricted cash on the Company's June 30, 2014 condensed consolidated balance sheet.

At March 31, 2014, maturities of long-term debt were as follows (in thousands):

|                              |          |
|------------------------------|----------|
| 2014 (remaining nine months) | \$5,250  |
| 2015                         | 10,395   |
| 2016                         | 10,395   |
| 2017                         | 3,500    |
|                              | \$29,540 |

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On May 23, 2014, one of the Company’s subsidiaries in China borrowed CNY 50 million (\$8.0 million) under a working capital loan agreement with a bank. The loan bears interest at 7% per annum. Interest is payable monthly and the principal is due on November 23, 2014.

Note 9. Japan pension plans

In connection with its acquisition of NeoPhotonics Semiconductor on March 29, 2013, the Company assumed responsibility for two defined benefit plans that provide retirement benefits to its NeoPhotonics Semiconductor employees in Japan: the Retirement Allowance Plan (“RAP”) and the Defined Benefit Corporate Pension Plan (“DBCPP”). The RAP is an unfunded plan administered by the Company. Effective February 28, 2014, the DBCPP was converted to a defined contribution plan (“DCP”). In May 2014, LAPIS transferred approximately \$2.0 million into the newly formed DCP which is the allowable amount that can be transferred according to the Japanese regulations. LAPIS also will pay the Company approximately \$0.3 million in connection with the conversion of the plan, which the Company has included in prepaid expenses and other current assets at March 31, 2014. Additionally, the Company transferred the net unfunded projected benefit obligation amount from the DBCPP to the RAP and froze the RAP benefit at the February 28, 2014 amount.

As a result of these changes to the DBCPP and the RAP, the Company recorded a curtailment gain of \$0.1 million in the quarter ended March 31, 2014. The pension liability at March 31, 2014 was \$5.7 million.

The Company contributed \$15,000 to the DBCPP from January 1, 2014 to February 28, 2014. Because the DBCPP transitioned to the DCP on that date, no further contributions to the DBCPP are required.

Net periodic pension cost associated with these plans for the period from December 31, 2013 to February 28, 2014 included the following components (in thousands):

|                            |      |
|----------------------------|------|
| Service cost               | \$53 |
| Interest cost              | 13   |
| Amortization               | 1    |
| Net periodic pension costs | \$67 |

Note 10. Commitments and contingencies

Litigation

From time to time, the Company is subject to various claims and legal proceedings, either asserted or unasserted, that arise in the ordinary course of business. The Company accrues for legal contingencies if the Company can estimate the potential liability and if the Company believes it is more likely than not that the case will be ruled against it. If a legal claim for which the Company did not accrue is resolved against it, the Company would record the expense in the period in which the ruling was made. The Company does not believe that the ultimate amount of liability, if any, for any pending claims of any type (alone or combined) will materially affect the Company’s financial position, results of operations or cash flows. The ultimate outcome of any litigation is uncertain, however, and unfavorable outcomes

could have a material negative impact on the Company's financial condition and operating results. Regardless of outcome, litigation can have an adverse impact on the Company because of defense costs, negative publicity, diversion of management resources and other factors.

On January 5, 2010, Finisar Corporation, or Finisar, filed a complaint in the U.S. District Court for the Northern District of California against Source Photonics, Inc., MRV Communications, Inc., Oplink Communications, Inc. and the Company, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the codefendants' respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products. On March 23, 2010, the Company filed an answer to the complaint and counterclaims, asserting two claims of patent infringement and additional claims asserting that Finisar has violated state and federal competition laws and violated its obligations to license on reasonable and non-discriminatory terms. On May 5, 2010, the court dismissed without prejudice all co-defendants (including the Company) except Source Photonics, Inc., on grounds that such claims should have been asserted in four separate lawsuits, one against each defendant. This dismissal without prejudice does not prevent Finisar from bringing a new similar lawsuit against the Company. On January 18, 2011, the Company and Finisar agreed to suspend their respective claims and not to refile the originally asserted claims against each other until at least 90 days after one or more specified events occur resulting in the partial or complete resolution of litigation involving the same Finisar patents between Oplink Communications, Inc. and Finisar. This tolling period expired on April 30, 2012. On May 3, 2012 the Company and Finisar agreed to further toll their respective claims until the refiling of certain of the previously asserted claims from this dispute. As a result, Finisar is permitted to bring a new lawsuit against the Company if it chooses to do so, and the Company may bring new claims against Finisar upon seven days written notice prior to filing such claims. The Company is

currently unable to predict the outcome of this dispute and therefore cannot determine the likelihood of loss nor estimate a range of possible loss.

#### Indemnifications

In the normal course of business, the Company enters into agreements that contain a variety of representations and warranties and provide for general indemnification. The Company's exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations. As of March 31, 2014, the Company does not have any material indemnification claims that were probable or reasonably possible.

#### Leases

The Company leases various facilities under non-cancelable operating leases expiring through 2023. Future minimum payments under these operating leases totaled \$6.3 million as of March 31, 2014. Rent expense was \$0.5 million and \$0.6 million for the three months ended March 31, 2014 and 2013, respectively.

#### Settlement with Santur

In May 2014, the Company entered into a settlement agreement covering the outstanding claims in connection with its 2011 acquisition of Santur Corporation ("Santur"). Under the terms of the settlement agreement, a net amount of \$1.9 million was paid to the Company from the escrow account that was set up under the original merger agreement. This amount comprises \$3.9 million related to certain indemnification claims by the Company ("Indemnification Amount") which were partially offset by \$2.0 million related to additional consideration for the business acquisition that was contingent upon Santur's gross profit performance during 2012 ("Contingent Consideration Amount"). The Company had recorded the entire \$2.0 million as its estimated fair value of the Contingent Consideration Amount as of December 31, 2013. Because it is considered to be a contingent gain, the \$3.9 million Indemnification Amount will not be recognized until the quarter ended June 30, 2014 (the quarter in which it was received).

#### Penalty Payment Derivative

In connection with a private placement transaction in 2012, the Company agreed to certain performance obligations including establishing a wholly-owned subsidiary in the Russian Federation and making a \$30.0 million investment commitment (the 'Investment Obligation') towards the Company's Russian operations. The Investment Obligation can be partially satisfied by investment outside of the Russian Federation and/or by way of non-cash asset transfers, including but not limited to capital equipment, small tools, intellectual property, and other intangibles. A minimum of \$15.0 million of the Investment Obligation is required to be satisfied by making capital expenditures and the remaining \$15.0 million can be satisfied through general working capital and research and development expenditures. All of the amount for general working capital can be spent either inside or outside of Russia. However, at least 80% of the amount expended for research and development expenditure must be spent inside Russia. General working capital can include acquisition of other businesses or portions thereof to be owned by the Russian subsidiary.

The purchaser of the common stock has non-transferable veto rights over the Company's Russian subsidiary's annual budget during the investment period and must approve non-cash asset transfers to be made in satisfaction of the Investment Obligation. Spending and/or commitments to spend for general working capital and research and development do not require approval by the purchaser. There are no legal restrictions on the specific usage of the \$39.8 million received in the private placement transaction or on withdrawal from the Company's bank accounts for use in general corporate purposes.

The Company is required to satisfy the Investment Obligation by July 31, 2014 or, in the event the Company has not recorded aggregate revenue from sales of its products in the Russian Federation of at least \$26.8 million during the period beginning July 1, 2012 and ending June 30, 2014, then will be automatically extended from July 31, 2014 to March 31, 2015. The Company expects the date for achievement of the Investment Obligation will be extended to March 31, 2015. Therefore, the Company intends to meet its Investment Obligation by March 31, 2015. If the Company fails to meet the Investment Obligation by the deadline, including failure to meet the Investment Obligation because the purchaser of the common stock does not approve the transfer of non-cash assets, the Company will be required to pay a \$5.0 million penalty (the 'Penalty Payment') as the sole and exclusive remedy for damages and monetary relief available to the purchaser for failure to meet the Investment Obligation.

The Company has accounted for the \$5.0 million Penalty Payment as an embedded derivative instrument, with the underlying being the performance or nonperformance of meeting the Investment Obligation by the extended deadline of March 31, 2015. The fair value of the Penalty Payment derivative has been estimated at the date of the original common stock sale (April 27, 2012) and at each

subsequent balance sheet date using a probability-weighted discounted future cash flow approach using unobservable inputs, which are classified as Level 3 within the fair value hierarchy. The primary inputs for this approach include the probability of achieving the Investment Obligation and a discount rate that approximates the Company's incremental borrowing rate. After the initial measurement, changes in the fair value of this derivative were recorded in other income (expense). The estimated fair value of this derivative was \$0.4 million and \$0.2 million at March 31, 2014 and December 31, 2013, respectively.

#### Note 11. Stockholders' equity

##### Common Stock

As of March 31, 2014, the Company had reserved 7,076,987 common stock shares for issuance under its stock option plans, 969,878 common stock shares for issuance under its stock purchase plan and 4,482 common stock shares to be issued upon exercise of the outstanding warrants.

##### Accumulated Deficit

Approximately \$6.5 million of the Company's accumulated deficit at December 31, 2013 was subject to restriction due to the fact that the Company's subsidiaries in China are required to set aside at least 10% of their respective accumulated profits each year to fund statutory common reserves as well as allocate a discretionary portion of their after-tax profits to their staff welfare and bonus fund.

#### Note 12. Stock-based compensation

The following table summarizes the stock-based compensation expense recognized for the three months ended March 31, 2014 and 2013 (in thousands):

|                            | Three Months<br>Ended March 31, |         |
|----------------------------|---------------------------------|---------|
|                            | 2014                            | 2013    |
| Cost of goods sold         | \$330                           | \$243   |
| Research and development   | 707                             | 418     |
| Sales and marketing        | 373                             | 238     |
| General and administrative | 491                             | 303     |
|                            | \$1,901                         | \$1,202 |

##### Determining Fair Value

The Company estimated the fair value of certain stock-based awards using a Black-Scholes-Merton valuation model with the following assumptions:

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|  | Three Months Ended March |               |
|--|--------------------------|---------------|
|  | 31,                      |               |
|  | 2014                     | 2013          |
| Stock options                          |                          |               |
| Weighted-average expected term (years) | 5.12                     | 6.55          |
| Weighted-average volatility            | 72%                      | 76%           |
| Risk-free interest rate                | 1.75%                    | 1.08%         |
| Expected dividends                     | — %                      | — %           |
| Stock appreciation units               |                          |               |
| Weighted-average expected term (years) | 2.15                     | 2.61          |
| Weighted-average volatility            | 59%                      | 63%           |
| Risk-free interest rate                | 0.13% – 0.78%            | 0.20% – 0.46% |
| Expected dividends                     | — %                      | — %           |
| ESPP                                   |                          |               |
| Weighted-average expected term (years) | 0.76                     | 0.74          |
| Weighted-average volatility            | 54%                      | 48%           |
| Risk-free interest rate                | 0.10 – 0.13%             | 0.13 – 0.16%  |
| Expected dividends                     | — %                      | — %           |

### Stock Options

The Company granted 20,600 and 17,800 stock options during the three months ended March 31, 2014 and 2013, with weighted-average grant-date fair values per share of \$4.68 and \$3.80, respectively. Options for 113,184 and 14,472 shares were forfeited during the three months ended March 31, 2014 and 2013, respectively. As of March 31, 2014, there were 3,952,356 unexercised stock options outstanding.

### Restricted Stock Units (“RSUs”)

The Company granted 22,500 and 12,200 RSUs during the three months ended March 31, 2014 and 2013, with weighted-average grant-date fair values per share of \$7.98 and \$5.74, respectively. As of March 31, 2014, there were 1,134,317 RSUs outstanding.

### Stock appreciation units (“SAUs”)

The Company did not grant any SAUs during the three months ended March 31, 2014 or 2013. As of March 31, 2014, there were 414,655 SAUs outstanding. SAUs are liability classified share-based awards which are re-measured each reporting period at fair value.

### Employee Stock Purchase Plan (“ESPP”)

At March 31, 2014 there was \$0.4 million of unrecognized stock-based compensation expense for stock purchase rights that will be recognized over the remaining offering period, through November 2014. Due to the delay in filing its Annual Report on Form 10-K, in May 2014 the Compensation Committee of the Company’s Board of Directors (the Committee) rescheduled the May 15 purchase date under the current offering period to the date that is three business days after the later of (i) the filing of its Annual Report on Form 10-K and (ii) the Company’s general public release of its revenues for the first quarter of 2014, which occurred on June 17, 2014. Additionally, the Committee waived the existing purchase limits for the upcoming purchase date only, creating a modification of the purchase price formula for the current offering period.

### Note 13. Income taxes

The Company’s income tax expense for the three months ended March 31, 2014 and 2013 was primarily related to income taxes of the Company’s non-U.S. operations.

The Company conducts its business globally and its operating income is subject to varying rates of tax in the United States, China and Japan. Consequently, the Company’s effective tax rate is dependent upon the geographic distribution of its earnings or losses and the tax laws and regulations in each geographical region. Historically, the Company has experienced net losses in the United States and in the short term, expects this trend to continue. One of the Company’s subsidiaries in China has historically qualified for a preferential 15% tax rate available for high technology enterprises as opposed to the statutory 25% tax rate. The Company intends to reapply for the preferential rate for 2014 to 2016.

Due to historic losses in the US, the Company has a full valuation allowance on its US federal and state deferred tax assets. Management continues to evaluate the realizability of deferred tax assets and the related valuation allowance. If management's assessment of the deferred tax assets or the corresponding valuation allowance were to change, the Company would record the related adjustment to income during the period in which management makes the determination.



As of March 31, 2014, there were no material changes to either the nature or the amounts of the uncertain tax positions previously determined for the year ended December 31, 2013.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes thereto included elsewhere in this Quarterly Report on Form 10-Q for the period ended March 31, 2014 and the audited consolidated financial statements and notes thereto and management's discussion and analysis of financial condition and results of operations for the year ended December 31, 2013 included in our Annual Report on Form 10-K. References to "NeoPhotonics" "we," "our" and "us" are to NeoPhotonics Corporation unless otherwise specified or the context otherwise requires.

This Quarterly Report on Form 10-Q for the period ended March 31, 2014 contains "forward-looking statements" that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. The statements contained in this Quarterly Report on Form 10-Q for the period ended March 31, 2014 that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Terminology such as "believe," "may," "might," "objective," "estimate," "continue," "anticipate," "intend," "should," "plan," "expect," "predict," "potential," or the negative of these terms or similar expressions is intended to identify forward-looking statements.

We have based these forward-looking statements largely on our current expectations and projections about future events and industry and financial trends that we believe may affect our financial condition, results of operations, business strategy and financial needs. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified in "Part II —Item 1A. Risk Factors" below, and those discussed in the sections titled "Special Note Regarding Forward-Looking Statements" and "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on June 4, 2014. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

### Business overview

We are a leading designer and manufacturer of photonic integrated circuit, or PIC-based optoelectronic modules and subsystems for bandwidth-intensive, high-speed communications networks.

Our products are designed to enable high-speed transmission rates and efficient allocation of bandwidth over optical networks with high quality and low costs. Our PIC technology utilizes proprietary design elements that provide optical functionality on a silicon or indium phosphide or hybrid chip. PIC devices can integrate many more functional elements than discretely packaged components, enabling increased functionality in a small form factor while reducing packaging and interconnection costs. In addition, the cost advantages of PIC-based components are similar to the economics of semiconductor wafer mass manufacturing, where the marginal cost of producing an incremental chip is much less than that of a discrete component.

We have research and development and wafer fabrication facilities in San Jose and Fremont, California and in Tokyo, Japan which coordinate with our research and development and manufacturing facilities in Shenzhen and Wuhan, China and Ottawa, Canada. We utilize proprietary design tools and design-for-manufacturing techniques to align our design process with our precision nanoscale, vertically integrated manufacturing and testing capabilities. We sell our products to the leading network equipment vendors globally, including ADVA AG Optical Networking Ltd.,

Alcatel-Lucent SA, Ciena Corporation, Cisco Systems, Inc., Coriant GmbH & Co. KG (formerly Nokia Siemens Networks B.V.), ECI Telecom, Ltd., FiberHome Technologies Group, Fujitsu Limited, Huawei Technologies Co., Ltd, Juniper Networks, Inc., Mitsubishi Electric Corporation, NEC Corporation, Telefonaktiebolaget LM Ericsson and ZTE Corporation. We refer to these companies as our Tier 1 customers.

On March 29, 2013, we acquired the optical semiconductor business unit of LAPIS Semiconductor Co., Ltd., now known as NeoPhotonics Semiconductor Godo Keisha (“NeoPhotonics Semiconductor”). NeoPhotonics Semiconductor is a leading provider of lasers, drivers, and detectors for high speed 100Gbps applications and is located in Japan. We believe the acquisition of NeoPhotonics Semiconductor enhances our competitive position in 100Gbps products.

In the three months ended March 31, 2014, our revenue growth of 22% over the three months ended March 31, 2013 was driven primarily by demand for our 100Gbps speed products, as carriers continued to accelerate deployment of high capacity optical transport networks and by our acquisition of NeoPhotonics Semiconductor, many of whose products are 100Gbps.

We expect continued volume growth for our 100Gbps products, although quarter-to-quarter results may show considerable variability as is usual in a rapid initial ramp-up for a new technology. Similar to revenue, our gross margins can fluctuate materially depending on a variety of factors including average selling price changes, product mix, volume, manufacturing utilization and ongoing manufacturing process improvements.

#### Critical accounting policies and estimates

There have been no material changes to our critical accounting policies and estimates during the three months ended March 31, 2014 from those disclosed in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations in our 2013 Form 10-K.

#### Results of operations

##### Revenue

We sell substantially all of our products to original equipment manufacturers, or OEMs. Revenue is recognized when title of our products passes to the OEM. We price our products based on market and competitive conditions and may periodically reduce the price of our products as market and competitive conditions change and as manufacturing costs are reduced. Our sales transactions to customers are denominated primarily in Chinese Renminbi ("RMB"), Japanese Yen ("JPY") or U.S. dollars. We have generated most of our revenue from a limited number of customers. Our top ten customers represented 88% and 91% of our revenue in the three months ended March 31, 2014 and 2013, respectively.

For the three months ended March 31, 2014, Huawei Technologies Co., Ltd. (35%), Ciena Corporation (14%) and Alcatel-Lucent SA (13%) each accounted for 10% or more of our total revenue. For the three months ended March 31, 2013, Huawei Technologies Co., Ltd. (27%), Ciena Corporation (22%), Alcatel-Lucent SA (13%) and Cisco Systems, Inc. (11%) each accounted for 10% or more of our total revenue. No other customers accounted for 10% or more of total revenue. We expect that a significant portion of our revenue will continue to be derived from a limited number of customers. As a result, the loss of, or a significant reduction in, orders from any of our other key customers would materially affect our revenue and results of operations.

|                |          | Three Months Ended March 31, |          |
|----------------|----------|------------------------------|----------|
|                |          | \$                           | %        |
| (in thousands) | 2014     | 2013                         | Change   |
| Total revenue  | \$68,168 | \$56,063                     | \$12,105 |
|                |          |                              | 22 %     |

Our first quarter revenue is typically seasonally the lowest revenue quarter of the year. The revenue increase in the three months ended March 31, 2014 compared to the same period in 2013 was primarily due to \$13.7 million in higher revenue from our Speed and Agility products, including strong growth in 40Gps/100Gps products. The increase in revenue from our Speed and Agility products includes \$11.2 million from Neophotonics Semiconductor, which was acquired on March 29, 2013. The increase from Speed and Agility product revenue was partially offset by a \$1.4 million decrease in revenue from our Access products.

#### Cost of goods sold and gross margin

Our cost of goods sold consists primarily of the cost to produce wafers and to manufacture and test our products. Additionally, our cost of goods sold includes stock-based compensation, write-downs of excess and obsolete inventory, royalty payments, amortization of certain purchased intangible assets, depreciation, acquisition-related fair

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value adjustments, restructuring cost, warranty, shipping and allocated facilities and IT costs.

|                    | Three Months Ended March 31,<br>2014         |                 | 2013     |                 |          | \$<br>Change | %<br>Change |
|--------------------|--|-----------------|----------|-----------------|----------|--------------|-------------|
|                    | (in thousands, except percentages)<br>Amount | % of<br>Revenue | Amount   | % of<br>Revenue |          |              |             |
| Cost of goods sold | \$54,368                                     | 80 %            | \$44,306 | 79 %            | \$10,062 | 23 %         |             |

|              | Three Months Ended<br>March 31,<br>2014 |  | 2013 |  |
|--------------|---|--|------|--|
| Gross margin | 20 %                                    |  | 21 % |  |

Gross profit as a percentage of total revenue, or gross margin, has been and is expected to continue to be affected by a variety of factors including the introduction of new products, production volume, production volume compared to sales over time, the mix of products sold, inventory changes, changes in the average selling prices of our products, changes in the cost and volumes of materials purchased from our suppliers, changes in labor costs, changes in overhead costs or requirements, revaluation of stock appreciation unit awards that are impacted by our stock price, write-downs of excess and obsolete inventories and warranty costs. In addition, we periodically negotiate pricing with certain customers which can cause our gross margins to fluctuate, particularly in the quarters in which the negotiations occurred. Our first quarter gross margins are typically seasonally lower than the rest of the year due to lower capacity utilization and the impact on average selling prices from annual price negotiations.

### Operating expenses

Personnel costs are the most significant component of operating expenses and consist of costs such as salaries, benefits, bonuses, stock-based compensation and, with regard to sales and marketing expense, sales commissions. Our operating expenses are denominated primarily in RMB, JPY and U.S. dollars.

| (in thousands, except percentages)          | Three Months Ended March 31, |        | 2013         |          | \$ | % | Change  | %      |              |
|---|------------------------------|--------|--------------|----------|----|---|---------|--------|--------------|
|   | 2014                         | Amount | % of Revenue | Amount   |    |   |         |        | % of Revenue |
| Research and development                    | \$12,056                     | 18     | %            | \$9,707  | 17 | % | \$2,349 | 24     | %            |
| Sales and marketing                         | 3,411                        | 5      | %            | 3,586    | 6  | % | (175 )  | (5 )   | %            |
| General and administrative                  | 8,987                        | 13     | %            | 5,059    | 9  | % | 3,928   | 78     | %            |
| Amortization of purchased intangible assets | 379                          | —      | %            | 321      | 1  | % | 58      | 18     | %            |
| Restructuring charges                       | —                            | —      | %            | 325      | 1  | % | (325 )  | (100 ) | %            |
| Acquisition-related transaction costs       | —                            | —      | %            | 4,510    | 8  | % | (4,510) | (100 ) | %            |
| Total operating expenses                    | \$24,833                     | 36     | %            | \$23,508 | 42 | % | \$1,325 | 6      | %            |

### Research and development

Research and development expense consists of personnel costs, including stock-based compensation, for our research and development personnel, and product development costs, including engineering services, development software and hardware tools, depreciation of equipment and facility costs. We record all research and development expense as incurred.

Research and development expense increased by \$2.3 million in the three months ended March 31, 2014 compared to the same period in 2013, representing a 24% increase. The acquisition of NeoPhotonics Semiconductor increased our research and development expense by \$1.3 million. Other increases in 2014 included \$0.9 million for new and ongoing research and development projects and \$0.4 million in higher stock-based compensation, travel expense and supplies purchases, partially offset by \$0.3 million in lower personnel-related costs in China.

We intend to continue to invest in research and development and expect this expense to increase as we grow our business over time. As a percentage of total revenue, our research and development expense may vary with changes in our revenue.

### Sales and marketing

Sales and marketing expense consists primarily of personnel costs, including stock-based compensation and sales commissions, costs related to sales and marketing programs and services and facility costs.

Sales and marketing expense decreased by \$0.2 million in the three months ended March 31, 2014 compared to the same period in 2013 primarily due to lower commission expense in the 2014 period.

We expect our sales and marketing expense to increase as we grow our business, expand our marketing activities, increase the number of sales and marketing professionals and incur employee-related costs accordingly. As a percentage of total revenue, our sales and marketing expense may vary as our revenue changes over time.

#### General and administrative

General and administrative expense consists primarily of personnel costs, including stock-based compensation, for our finance, legal, human resources and information technology personnel and certain executive officers, as well as professional services costs related to accounting, tax, banking, legal and information technology services, depreciation, facility costs and restructuring charges.

General and administrative expense increased by \$3.9 million in the three months ended March 31, 2014 compared to the same period in 2013, representing a 78% increase. Audit and consulting fees represented \$2.7 million of the increase, with the remainder related primarily to costs from NeoPhotonics Semiconductor which was acquired at the end of the 2013 quarter. The higher audit and consulting fees related to the restatement of our Quarterly Reports on Form 10-Q for the quarters ended March 31 and June 30, 2013 and resources to provide technical accounting support and to assist us in the process of strengthening our internal controls.

We anticipate continuing to incur higher general and administrative expenses, in-line with the March 2014 quarter, through the second quarter of 2014 as we complete our audit work and continue to enhance our internal controls, after which we anticipate quarterly general and administrative costs to be approximately \$1.0 million lower.

#### Amortization of purchased intangible assets

Our intangible assets are being amortized over their estimated useful lives. Amortization expense relating to technology, patents and leasehold interests are included within cost of goods sold, and expense from amortization of customer relationships is recorded within operating expenses. Amortization of purchased intangibles included in operating expenses increased by \$0.1 million in the three months ended March 31, 2014 due to intangible assets from our acquisition of NeoPhotonics Semiconductor in 2013.

#### Restructuring charges

In the first quarter of 2013, we exited and closed one facility at our headquarters location to align our facilities usage with our current size. As a result, we recorded a restructuring charge of \$0.3 million.

#### Acquisition-related transaction costs

In connection with our acquisition of NeoPhotonics Semiconductor in 2013, we incurred \$4.5 million in acquisition-related transaction costs during the three months ended March 31, 2013 related to investment banking, legal, accounting and other professional services as well as transfer and acquisition taxes related to real property acquired.

#### Interest and other expense, net

Interest income consists of income earned on our cash, cash equivalents and short-term investments. Interest expense consists of amounts paid for interest on our bank and other borrowings. Other income (expense), net is primarily made up of government subsidies, and foreign currency transaction gains and losses. The functional currency of our subsidiaries in China is the RMB and of our subsidiaries in Japan is the JPY. The foreign currency transaction gains and losses of our subsidiaries in China and Japan primarily result from their transactions in U.S. dollars.

| (in thousands)              | Three Months Ended |         |         |        |
|-----------------------------|--------------------|---------|---------|--------|
|                             | March 31,          |         | \$      | %      |
|                             | 2014               | 2013    | Change  | Change |
| Interest income             | \$65               | \$131   | \$(66)  | (50)%  |
| Interest expense            | (251)              | (163)   | (88)    | 54%    |
| Other income (expense), net | (607)              | (274)   | (333)   | 122%   |
| Total                       | \$(793)            | \$(306) | \$(487) | 159%   |



Total interest and other expense, net, increased by \$0.5 million in the three months ended March 31, 2014 compared to the same period in 2013, largely due to a \$0.2 million adjustment to the fair value of a penalty payment derivative (see Note 10), a \$0.1 million increase in interest expense resulting from higher interest rates in the 2014 period and a \$0.1 million decrease in interest income on lower invested balances.

#### Income taxes

We conduct our business globally. Therefore, our operating income is subject to varying rates of tax in the United States, China, Japan and other various foreign jurisdictions. Consequently, our effective tax rate is dependent upon the geographic distribution of our earnings or losses and the tax laws and regulations in each geographical region. We expect that our income taxes will vary in relation to our profitability and the geographic distribution of our profits. Historically, we have experienced net losses in the U.S. and in the short term, we expect this trend to continue. In China, one of our subsidiaries has historically qualified for a preferential 15% tax rate available for high technology enterprises as opposed to the statutory 25% tax rate. We are in the process of reapplying for the preferential rate for 2014-2016.

| (in thousands)             | Three Months Ended |        |
|----------------------------|--------------------|--------|
|                            | March 31,          |        |
|                            | 2014               | 2013   |
| Provision for income taxes | \$ 762             | \$ 183 |

Our income tax expense for the three months ended March 31, 2014 was primarily related to income taxes of our non-U.S. operations.

#### Liquidity and capital resources

At March 31, 2014, we had working capital of \$110.7 million and total cash, cash equivalents and short-term investments of \$61.3 million, of which 23% was held in accounts by our subsidiaries in China and 31% was held in accounts by our subsidiaries in Japan. As of May 19, 2014, \$21.1 million of our cash and short-term investments was moved to compensating balance accounts in accordance with an amendment to our credit agreement (see below).

Approximately \$6.5 million of our accumulated deficit at December 31, 2013 was subject to restriction due to the fact that our subsidiaries in China are required to set aside at least 10% of their respective accumulated profits each year to fund statutory common reserves as well as allocate a discretionary portion of their after-tax profits to their staff welfare and bonus fund. This restricted amount is not distributable as cash dividends except in the event of liquidation.

We have a bank credit agreement with Comerica Bank as the lead bank. As of March 31, 2014 this credit agreement included the following:

A revolving credit facility under which there was no amount outstanding at March 31, 2014 or December 31, 2013 and \$20.0 million was available for borrowing at March 31, 2014, subject to covenant requirements. Amounts borrowed are due on or before March 2016 and borrowings bear interest at an interest rate option of a base rate as defined in the agreement plus 1.75% or LIBOR plus 2.75%. As of March 31, 2014 the rate on the LIBOR option was 2.90%.

A term loan facility under which \$22.8 million was outstanding at March 31, 2014. Interest is payable quarterly in arrears and the principal is paid in equal quarterly installments over the term of the loan ending in June 2017.

Borrowings under the term loan bear interest at an interest rate option of a base rate as defined in the agreement plus 2.0% or LIBOR plus 3.0%. As of March 31, 2013 the rate on the LIBOR option was 3.15%.

Our credit agreement requires the maintenance of specified financial covenants, including a debt to EBITDA ratio and liquidity ratios. The agreement also restricts our ability to incur certain additional debt or to engage in specified transactions, restricts the payment of dividends and is secured by substantially all of our U.S. assets, other than intellectual property assets. We were not in compliance with the debt to EBITDA covenant at March 31, 2014, which noncompliance was effectively waived in the amendment described below.

On May 19, 2014 we executed an amendment to the credit agreement that waived the testing of certain covenants for compliance, including the March 31, 2014 debt to EBITDA covenant, provided that we maintain compensating balances equal to outstanding amounts under the credit agreement in accounts for which the bank will have sole access. We intend to work with the bank to restructure the credit agreement, including the covenant requirements. In the absence of a restructured agreement, we believe we may need to continue to maintain the compensating balances at least through the end of 2014. As of May 19, 2014, the amount of our cash and short-term investments in these compensating balance accounts was \$21.1 million, which will be classified as restricted cash on our June 30, 2014 condensed consolidated balance sheet.

At March 31, 2014 our subsidiaries in China had two short-term line of credit facilities with banking institutions, which have subsequently expired. In June 2014, one of the credit facilities was renewed. Under the renewed agreement, which expires in June 2015, the Company's subsidiaries in China have a short-term line of credit of RMB 160.0 million (\$25.7 million), of which the full amount can be used for bank acceptance drafts (with a 25% compensating balance requirement) and up to RMB 120.0 million (\$19.3 million) can be used for short-term loans, which will bear interest at varying rates depending upon the term. The second credit facility is in the process of being renewed.

We also issue notes payable to our suppliers in China in exchange for accounts payable. These notes are supported by non-interest bearing bank acceptance drafts and are due three to six months after issuance. As a condition of the notes payable arrangements, we are required to keep a compensating balance at the issuing banks that is a percentage of the total notes payable balance until the amounts are settled. These balances are classified as restricted cash on our consolidated balance sheets. As of March 31, 2014, our restricted cash totaled \$3.0 million. In May 2014, one of our subsidiaries in China issued a 90-day bank acceptance

draft of \$8.0 million to another of our subsidiaries that required a compensating balance of \$2.4 million. This bank acceptance draft can be sold for cash at a discount prior to its expiration.

On May 23, 2014, one of our subsidiaries in China borrowed CNY 50 million (\$8.0 million) under a working capital loan agreement with a bank. The loan bears interest at 7% per annum. Interest is payable monthly and the principal is due on November 23, 2014.

In connection with the acquisition of NeoPhotonics Semiconductor on March 29, 2013, we were obligated to pay 1,050 million Japanese Yen in three equal installments on the first, second and third anniversaries of the closing date for the purchase of the real estate used by NeoPhotonics Semiconductor, of which 700 million Japanese Yen (\$6.8 million) was outstanding at March 31, 2014. The obligation bears interest at 1.5% per year, payable annually, and is secured by the acquired real estate property.

From time to time we accept notes receivable in exchange for accounts receivable from certain of our customers in China. These notes receivable are non-interest bearing and are generally due within six months. Historically, we have collected on the notes receivable in full at the time of maturity.

We believe that our existing cash, cash equivalents and cash flows from our operating activities will be sufficient to meet our anticipated cash needs for at least the next 12 months, even with the compensating balance requirement discussed above. Our future capital requirements will depend on many factors including our growth rate, the timing and extent of spending to support development efforts, the expansion of sales and marketing activities, the introduction of new and enhanced products, the costs to increase our manufacturing capacity and our foreign operations, the continuing market acceptance of our products and acquisitions of businesses and technology. In the event that additional financing is required from outside sources, we may not be able to raise it on terms acceptable to us or at all. If we are unable to raise additional capital when desired, our business, operating results and financial condition would be adversely affected.

#### Private placement transaction

In connection with the 2012 private placement transaction, we agreed to certain performance obligations including establishing a wholly-owned subsidiary in Russia and making a \$30.0 million investment commitment (the 'Investment Obligation') towards our Russian operations. The Investment Obligation can be partially satisfied by cash and/or stock investment inside or outside of Russia and/or by way of non-cash asset transfers, including but not limited to capital equipment, small tools, intellectual property, and other intangibles. A minimum of \$15.0 million of the Investment Obligation is required to be satisfied by making capital expenditure investments and we expect that the remaining \$15.0 million will be satisfied through cash and non-cash general working capital and research and development expenditures and commitments. All of the amount for general working capital can be spent either inside or outside of Russia. However, at least 80% of the amount expended for research and development must be spent inside Russia. General working capital can include cash or stock acquisition of technology and other businesses or portions thereof to be owned by the Russian subsidiary. Our current plan is to substantially meet the \$15.0 million capital expenditure portion of the Investment Obligation by transferring non-cash assets from other entities within the consolidated Company to the Russian subsidiary, subject to the purchaser's approval as required in the rights agreement. We expect that the remaining \$15.0 million will be satisfied through some combination of working capital and research and development spending, which may include technology or other acquisitions acquired by cash or stock through March 2015. The exact timing and composition of those expenditures has not yet been determined.

The purchaser of the common stock in the private placement transaction has nontransferable veto rights over our Russian subsidiary's annual budget during the investment period, and non-cash asset transfers to be made in satisfaction of the Investment Obligation requires approval by the purchaser. Spending and/or commitments to spend

for general working capital and research and development do not require approval by the purchaser. There are no legal restrictions on the specific usage of amounts received in the private placement transaction or on withdrawal from our bank accounts for use in general corporate purposes.

We are required to satisfy the Investment Obligation by July 31, 2014, or, in the event we have not recorded aggregate revenue from sales of our products in the Russian Federation of at least \$26.8 million during the period beginning July 1, 2012 and ending June 30, 2014, then by March 31, 2015. We expect the date for achievement of the Investment Obligation will be extended to March 31, 2015. Therefore, we intend to meet the Investment Obligation by March 31, 2015. If we fail to meet the Investment Obligation by the deadline, including failure to meet the Investment Obligation because the purchaser of the common stock does not approve the transfer of non-cash assets, we will be required to pay a \$5.0 million penalty as the sole and exclusive remedy for damages and monetary relief available to the purchaser for failure to meet the Investment Obligation.

## Cash flow discussion

The table below sets forth selected cash flow data for the periods presented:

| (in thousands)  | Three Months<br>Ended March 31, |          |
|---|---------------------------------|----------|
|   | 2014                            | 2013     |
| Net cash provided by (used in) operating activities   | \$(7,357)                       | \$1,161  |
| Net cash provided by (used in) investing activities   | 6,630                           | (3,080)  |
| Net cash provided by (used in) financing activities   | (3,204)                         | 16,311   |
| Effect of exchange rates on cash and cash equivalents | (114)                           | 72       |
| Net increase (decrease) in cash and cash equivalents  | \$(4,045)                       | \$14,464 |

## Operating activities

Net cash used in operating activities was \$7.4 million in the three months ended March 31, 2014, which was an \$8.5 million change from \$1.2 million provided by operating activities in the 2013 quarter. Contributing to the change was an increase in accounts receivable primarily from collection timing differences and an increase in prepaid expenses and other assets related to timing of value-added tax payments, partially offset by an increase in accounts payable related to inventory purchases during the 2014 quarter.

## Investing activities

Net cash provided by investing activities was \$6.6 million in the three months ended March 31, 2014, which was a \$9.7 million change from \$3.1 million used in investing activities in the 2013 quarter. The change was driven by \$14.1 million used in the 2013 quarter for the purchase of NeoPhotonics Semiconductor, partially offset by lower net proceeds from the sale and maturity of marketable securities.

## Financing activities

Net cash used in financing activities was \$3.2 million in the three months ended March 31, 2014, which was a \$19.5 million change from \$16.3 million provided by financing activities in the 2013 quarter. The change was largely due to lower net borrowings in the 2014 quarter.

## Contractual obligations and commitments

As of March 31, 2014, our principle commitments consist of obligations under operating leases, purchase commitments, debt, Santur contingent consideration related to our Santur acquisition and other contractual obligations. There have been no significant changes to these obligations during the three months ended March 31, 2014 compared to the contractual obligations disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations, set forth in Part II, Item 7, of our Annual Report on Form 10-K for the fiscal year ended December 31, 2013.

## Off-balance sheet arrangements

During the three months ended March 31, 2014, we did not have any significant off-balance sheet arrangements.

## Recent accounting pronouncements

See Note 1 “Basis of presentation and significant accounting policies” in the Notes to Condensed Consolidated Financial Statements on this Quarterly Report on Form 10-Q for a description of recent accounting pronouncements and accounting changes.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposures to market risk have not changed materially since December 31, 2013. For quantitative and qualitative disclosures about market risk, see Item 7A Quantitative and Qualitative Disclosures About Market Risk, in our Annual Report on Form 10-K for the year ended December 31, 2013.

### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2014. The term “disclosure controls and procedures,” as defined in

Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered in this report, our disclosure controls and procedures were not effective as a result of the material weaknesses that existed in our internal control over financial reporting.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis.

The following material weaknesses in our internal control over financial reporting were identified during 2013 and had not been remediated at March 31, 2014:

**Control Environment** — We did not maintain an effective control environment, which is the foundation for the discipline and structure necessary for effective internal control over financial reporting, as evidenced by: (i) an insufficient number of personnel appropriately qualified to perform control monitoring activities, including the recognition of the risks and complexities of our transactions and business operations, (ii) an insufficient number of personnel with an appropriate level of GAAP knowledge and experience or ongoing training in the application of GAAP commensurate with our financial reporting requirements, which resulted in erroneous judgments regarding the proper application of GAAP and (iii) insufficient corporate involvement to identify and resolve errors in recording transactions and financial results at our non-US subsidiaries. This control environment material weakness was exacerbated by our acquisition of NeoPhotonics Semiconductor in March 2013 and contributed to the following additional material weaknesses.

**Accounting for complex transactions** — We did not maintain effective internal controls related to complex transactions, including the acquisition of NeoPhotonics Semiconductor. Our controls over the accounting, process and procedures for the NeoPhotonics Semiconductor acquisition were not effective to provide reasonable assurance that (i) the business combination accounting identified and considered all known acquired liabilities, (ii) the business combination accounting reflected the appropriate application of GAAP and (iii) there was appropriate review of the purchase price allocation entries recorded in the consolidated financial statements. This material weakness resulted in the restatement of our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013.

**Preparation and review of consolidated financial statements** — We did not maintain effective internal control over financial reporting related to the preparation and review of our consolidated financial statements. Specifically, we did not execute controls related to the review of transactions and balances for proper classification in our balance sheet, statement of operations and statement of cash flows. This material weakness resulted in the restatement of our condensed consolidated financial statements for the quarters ended March 31, 2013 and June 30, 2013.

#### Remedial Measures

Our management continued significant efforts during 2013 and the first quarter of 2014 to establish a framework to improve internal controls over financial reporting. We committed considerable resources to the design, implementation, documentation, and testing of our internal controls. Additional efforts were required to remediate and re-test certain internal control deficiencies. Our management believes that these efforts have improved our internal control over financial reporting. With the oversight of senior management and our audit committee, we have taken steps and plan to take additional measures to remediate the underlying causes of the material weaknesses described



above. Our management, audit committee and board of directors have taken the following steps as part of our ongoing remediation efforts to address these material weaknesses:

Hired a new Chief Financial Officer;

Hired a new World-Wide Corporate Controller;

Hired a World-Wide Operations Controller;

Implemented enhanced communication and monitoring processes and the appropriate documentation of such to ensure the audit committee's effectiveness in executing its oversight responsibilities; and

Engaged an external team of experienced senior finance and accounting consultants to review and analyze our consolidated financial statement close and reporting processes.

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While these steps have helped address some of the root causes of the material weaknesses noted above, they have not been sufficient to fully remediate the material weaknesses that existed as of March 31, 2014. We intend to take the following additional steps to remediate these material weaknesses:

Add additional key positions to the finance team;

Increase management oversight by expanding our disclosure process to include all senior managers with responsibility for responding to issues raised during the financial reporting process and enhanced required certifications from all executive management;

Improve the documentation, communication and periodic review of our accounting policies throughout our domestic and international locations for consistency and application with generally accepted accounting principles, and

Enhance the training and education for our world-wide finance and accounting personnel.

Notwithstanding the identified material weaknesses, management believes that the consolidated financial statements contained in this report present fairly our financial condition, results of operations, and cash flows for the periods covered thereby in all material respects. To address the material weaknesses in our internal control over financial reporting, we also performed additional manual procedures and analysis and other post-closing procedures in order to prepare the consolidated financial statements included in this Quarterly Report on Form 10-Q.

While management is dedicated to improving our internal controls over financial reporting, the nature and significance of the outstanding material weaknesses may prevent successful remediation of all material weaknesses during 2014.

#### Changes in Internal Control over Financial Reporting

There have not been any changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities and Exchange Act of 1934, as amended) as of March 31, 2014 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### Inherent Limitation on the Effectiveness of Internal Controls

The effectiveness of any system of internal control over financial reporting is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, any system of internal control over financial reporting can only provide reasonable, not absolute assurances. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. We intend to continue to monitor and upgrade our internal controls as necessary or appropriate for our business, but cannot assure that such improvements will be sufficient to provide us with effective internal control over financial reporting.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in litigation that we believe is of the type common to companies engaged in our line of business, including commercial disputes and employment issues. As of the date of this Quarterly Report on Form 10-Q, other than as described below, we are not involved in any pending legal proceedings that we believe could have a material adverse effect on our financial condition, results of operations or cash flows. However, as described below, a certain dispute involves a claim by a third party that our activities infringe their intellectual property rights. This and other types of intellectual property rights claims generally involve the demand by a third party that we cease the manufacture, use or sale of the allegedly infringing products, processes or technologies and/or pay substantial damages or royalties for past, present and future use of the allegedly infringing intellectual property. Claims that our products or processes infringe or misappropriate any third-party intellectual property rights (including claims arising through our contractual indemnification of our customers) often involve highly complex, technical issues, the outcome of which is inherently uncertain. Moreover, from time to time, we may pursue litigation to assert our intellectual property rights. Regardless of the merit or resolution of any such litigation, complex intellectual property litigation is generally costly and diverts the efforts and attention of our management and technical personnel which could adversely affect our business.

On January 5, 2010, Finisar Corporation, or Finisar, filed a complaint in the U.S. District Court for the Northern District of California against Source Photonics, Inc., MRV Communications, Inc., Oplink Communications, Inc. and us, or collectively, the co-defendants. In the complaint, Finisar alleged infringement of certain of its U.S. patents arising from the codefendants' respective manufacture, importation, use, sale of or offer to sell certain optical transceiver products. On March 23, 2010, we filed an answer to the complaint and counterclaims, asserting two claims of patent infringement and additional claims asserting that Finisar has violated state and federal competition laws and violated our obligations to license on reasonable and non-discriminatory terms. On May 5, 2010, the court dismissed without prejudice all co-defendants (including us) except Source Photonics, Inc., on grounds that such claims should have been asserted in four separate lawsuits, one against each defendant. This dismissal without prejudice does not prevent Finisar from bringing a new similar lawsuit against us. On January 18, 2011, we and Finisar agreed to suspend our respective claims and not to refile the originally asserted claims against each other until at least 90 days after one or more specified events occur resulting in the partial or complete resolution of litigation involving the same Finisar patents between Oplink Communications, Inc. and Finisar. This tolling period expired on April 30, 2012. On May 3, 2012 we and Finisar agreed to further toll our respective claims until the refiling of certain of the previously asserted claims from this dispute. As a result, Finisar is permitted to bring a new lawsuit against us if it chooses to do so, and we may bring new claims against Finisar upon seven days written notice prior to filing such claims.

### ITEM 1A. RISK FACTORS

The risk factors facing our company have not changed materially from those set forth in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on June 4, 2014.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See Index to Exhibits at the end of this report.

SIGNATURE

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.

NeoPhotonics Corporation  
Date: June 24, 2014 By: /S/ CLYDE RAYMOND WALLIN  
Clyde Raymond Wallin  
Chief Financial Officer and Senior Vice President  
(Principal Financial and Accounting Officer)

## EXHIBIT INDEX

| Exhibit no. | Description of exhibit  | Form     | SEC File No. | Exhibit | Filing Date       | Filed Herewith |
|-------------|---|----------|--------------|---------|-------------------|----------------|
| 3.1         | Amended and Restated Certificate of Incorporation of NeoPhotonics Corporation.  | Form 8-K | 001-35061    | 3.1     | February 10, 2011 |                |
| 3.2         | Amended and Restated Bylaws of NeoPhotonics Corporation.  | Form S-1 | 333-166096   | 3.4     | November 22, 2010 |                |
| 4.1         | Specimen Common Stock Certificate of NeoPhotonics Corporation.  | Form S-1 | 333-166096   | 4.1     | April 15, 2010    |                |
| 4.2         | 2008 Investors' Rights Agreement by and between NeoPhotonics Corporation and the investors listed on Exhibit A thereto, dated May 14, 2008.                   | Form S-1 | 333-166096   | 4.2     | April 15, 2010    |                |
| 4.3         | Warrant to Purchase Common Stock by and between NeoPhotonics Corporation and Comerica Bank, dated December 20, 2007.  | Form S-1 | 333-166096   | 4.3     | April 15, 2010    |                |
| 10.1        | First Amendment to Credit Agreement, dated January 16, 2014, by and among NeoPhotonics Corporation, Comerica Bank, as Agent, and the lenders party thereto.   | Form 8-K | 001-35061    | 10.1    | January 17, 2014  |                |
| 10.2        | Second Amendment to Credit Agreement, dated February 14, 2014, by and among NeoPhotonics Corporation, Comerica Bank, as Agent, and the lenders party thereto. | Form 8-K | 001-35061    | 10.1    | February 18, 2014 |                |
| 10.3        | Third Amendment to Credit Agreement, dated March 6, 2014, by and among NeoPhotonics Corporation, Comerica Bank, as Agent, and the lenders party thereto.      | Form 8-K | 001-35061    | 10.1    | March 10, 2014    |                |

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|---------|---|---|
| 10.4+   | Severance Rights Agreement, dated January 6, 2014, by and between NeoPhotonics Corporation and Clyde R. Wallin.   | X |
| 31.1    | Certification pursuant to Rule 13a-14(a)/15d-14(a).   | X |
| 31.2    | Certification pursuant to Rule 13a-14(a)/15d-14(a).   | X |
| 32.1    | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | X |
| 101.INS | XBRL Instance Document.   |   |
| 101.SCH | XBRL Taxonomy Extension Schema Document.  |   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document.  |   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document.   |   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document.  |   |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document.   |   |
|         | + Management compensatory plan or arrangement.  |   |