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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 quarter ended March 28, 2004

OR

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

For the transition period from ______ to ______

Commission file number 000-25711

EXTREME NETWORKS, INC.
(Exact name of Registrant as specified in its charter)

DELAWARE **[State or other jurisdiction of incorporation or organization]**	**77-0430270** **[I.R.S. Employer Identification No.]**
3585 Monroe Street **Santa Clara, California** **[Address of principal executive offices]**	**95051** **[Zip Code]**

Registrant's telephone number, including area code: (408) 579-2800

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No ☐

The number of shares of the Registrant's Common Stock, $.001 par value, outstanding at April 26, 2004 was 119,962,046.

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Part I. Financial Information

Item 1. Financial Statements

EXTREME NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	March 28, 2004	June 29, 2003
	(Unaudited)	(Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 64,395	$ 44,340
Short-term investments	115,922	119,277
Accounts receivable, net	30,748	26,794
Inventories, net	24,226	18,710
Prepaid expenses and other current assets	14,183	16,878
Total current assets	249,474	225,999
Property and equipment, net	63,736	73,767
Marketable securities	236,561	238,540
Other assets	28,804	11,951
TOTAL ASSETS	$ 578,575	$ 550,257
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 22,560	$ 19,020
Accrued compensation and benefits	14,358	14,665
Restructuring liabilities	5,200	6,812
Lease liability	2,826	4,396
Accrued warranty	8,936	10,200
Deferred revenue	54,693	48,298
Other accrued liabilities	22,580	25,317
Total current liabilities	131,153	128,708
Restructuring liabilities, less current portion	17,385	21,358
Other long-term liabilities	970	955
Convertible subordinated notes	200,000	200,000
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock	—	—
Common stock and capital in excess of par value	685,418	652,091
Deferred stock compensation	(260)	(1,708)
Accumulated other comprehensive income	1,459	2,306
Accumulated deficit	(457,550)	(453,453)
Total stockholders' equity	229,067	199,236
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 578,575	$ 550,257

See accompanying notes to the unaudited condensed consolidated financial statements.

EXTREME NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
Net revenues:				
Product	$ 76,059	$ 76,356	$ 224,315	$ 248,076
Service	12,815	8,857	35,375	27,922
Total net revenues	88,874	85,213	259,690	275,998
Cost of revenues:				
Product	34,422	41,315	101,959	129,810
Service	8,979	9,978	26,913	28,509
Total cost of revenues	43,401	51,293	128,872	158,319
Gross margin:				
Product	41,637	35,041	122,356	118,266
Service	3,836	(1,121)	8,462	(587)
Total gross margin	45,473	33,920	130,818	117,679
Operating expenses:				
Sales and marketing	23,343	25,006	68,779	78,055
Research and development	15,001	13,749	42,867	41,676
General and administrative	8,043	6,328	22,934	19,992
Amortization of deferred stock compensation	198	994	931	3,336
Restructuring charge	—	—	962	14,187
Property and equipment write-off	—	—	—	12,678
Total operating expenses	46,585	46,077	136,473	169,924
Operating loss	(1,112)	(12,157)	(5,655)	(52,245)
Other income, net	345	990	2,707	2,860
Loss before income taxes	(767)	(11,167)	(2,948)	(49,385)
Provision (benefit) for income taxes	339	(4,105)	1,149	(19,295)
Net loss	$ (1,106)	$ (7,062)	$ (4,097)	$ (30,090)
Net loss per share – basic and diluted	$ (0.01)	$ (0.06)	$ (0.03)	$ (0.26)
Shares used in per share calculation – basic and diluted	118,832	115,501	117,706	114,913

See accompanying notes to the unaudited condensed consolidated financial statements.

EXTREME NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended	
	March 28, 2004	March 30, 2003
Cash flows from operating activities:		
Net loss	$ (4,097)	$ (30,090)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	15,550	20,227
Provision for doubtful accounts (reversal)	(200)	—
Deferred income taxes	—	(19,385)
Amortization of deferred stock compensation	931	3,336
Amortization of warrant-related costs	3,153	—
Restructuring charge	962	26,865
Changes in operating assets and liabilities:		
Accounts receivable	(3,754)	32,694
Inventories	(5,516)	633
Prepaid expenses and other current assets, and Other assets	5,388	(6,785)
Accounts payable	3,540	(5,983)
Accrued compensation and benefits	(307)	(1,997)
Restructuring liabilities	(6,425)	(5,041)
Lease liability	(1,570)	(1,677)
Accrued warranty	(1,264)	1,118
Deferred revenue	6,395	6,723
Other accrued liabilities	(2,722)	(5,675)
Net cash provided by operating activities	10,064	14,963
Cash flows from investing activities:		
Capital expenditures	(5,641)	(13,638)
Purchases of investments	(215,027)	(392,005)
Sales and maturities of investments	219,514	354,202
Net cash used in investing activities	(1,154)	(51,441)
Cash flows from financing activities:		
Proceeds from issuance of common stock	11,145	4,365
Net cash provided by financing activities	11,145	4,365
Net increase (decrease) in cash and cash equivalents	20,055	(32,113)
Cash and cash equivalents at beginning of period	44,340	71,830
Cash and cash equivalents at end of period	$ 64,395	$ 39,717

See accompanying notes to the unaudited condensed consolidated financial statements.

EXTREME NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements of Extreme Networks, Inc. (referred to as “Extreme Networks” and as “we”, “us”, and “our”) included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated balance sheet at June 29, 2003 was derived from audited financial statements as of that date but does not include all disclosures required by generally accepted accounting principles for complete financial statements. These interim financial statements and notes should be read in conjunction with our audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 29, 2003.

The unaudited condensed consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, that, in the opinion of management, are necessary for a fair presentation of the results of operations and cash flows for the interim periods presented and the financial condition of Extreme Networks at March 28, 2004. The results of operations for the three and nine months ended March 28, 2004 are not necessarily indicative of the results that may be expected for fiscal 2004 or any future periods.

Reclassifications

Certain items previously reported in specific financial statement captions have been reclassified to conform to the fiscal 2004 presentation. Such reclassifications have not impacted previously reported revenue, operating loss or net loss. During fiscal 2003, net revenue from service fees increased to greater than 10% of total net revenues, requiring us to separately report product and service revenues. In connection with the revised presentation of service revenue and cost of service revenue, we reclassified $4.8 million and $15.4 million, respectively, of service expenses for the three and nine months ended March 30, 2003 that had previously been included in operating expenses.

Revenue Recognition

We derive the majority of our revenue from sales of our modular and stackable networking equipment, with the remaining revenue generated from service fees relating to the maintenance and training on our products. Our revenue recognition policy follows SEC Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*. We generally recognize product revenue from end-user and reseller customers at the time of shipment, provided that persuasive evidence of an arrangement exists, delivery has occurred, the price of the product is fixed or determinable and collection of the sales proceeds is reasonably assured. Revenue from service obligations under maintenance contracts is deferred and recognized on a straight-line basis over the contractual period in accordance with FASB Technical Bulletin 90.1. Maintenance contracts typically range from one to five years. When sales arrangements contain multiple elements such as hardware, maintenance and other services, we allocate revenue to each element based on the guidance provided by Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* (“EITF 00-21”), which is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. EITF 00-21 addresses certain aspects of accounting by a vendor for arrangements under which the vendor will perform multiple revenue generating activities. We adopted EITF 00-21 prospectively and the adoption of EITF 00-21 did not have a material impact on our results of operations or financial position.

We make certain sales to partners in two-tier distribution channels. The first tier consists of a limited number of independent distributors that sell primarily to resellers and, on occasion, to end-user customers. Under specified conditions, we grant these distributors the right to return a portion of unsold inventory to us for the purpose of stock rotation. We defer recognition of revenue on all sales to these distributors until the distributors sell the product, as evidenced by a monthly sales-out report that the distributors provide to us. The second tier of the distribution channel consists of a large number of third-party resellers that sell directly to end-users and are generally not granted return privileges, except for defective products during the warranty period. We reduce product revenue for certain price protection rights that may occur under contractual arrangements we have with our customers.

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Inventories

Inventories consist of (in thousands):

	March 28, 2004	June 29, 2003
Raw materials	$ 1,947	$ 3,600
Finished goods	28,843	23,439
Total	30,790	27,039
Allowance for excess and obsolete inventory	(6,564)	(8,329)
Inventories, net	$ 24,226	$ 18,710

Product Warranties

Our standard hardware warranty period is typically 12 months from the date of shipment to end-users and 14 months from the date of shipment to channel partners, which include resellers and distributors. Upon shipment of products to our customers, including both end users and channel partners, we estimate expenses for the cost to repair or replace products that may be returned under warranty and accrue a liability for this amount. The determination of warranty requirements is based on actual historical experience with the product or product family, estimates of repair and replacement costs and any product warranty problems that are identified after shipment. We estimate and adjust these accruals at each balance sheet date in accordance with changes in these factors. Changes in our warranty accrual are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
Balance beginning of period	$ 8,739	$ 10,211	$ 10,200	$ 9,055
Warranties issued	3,945	3,990	8,573	12,695
Settlements made	(3,748)	(4,001)	(9,837)	(11,550)
Balance end of period	$ 8,936	$ 10,200	$ 8,936	$ 10,200

Deferred Support Revenue

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

	Nine Months Ended	
	March 28, 2004	March 30, 2003
Balance beginning of period	$ 44,223	$ 32,334
New support arrangements	37,810	31,945
Recognition of support revenue	(31,681)	(22,577)
Balance end of period	$ 50,352	$ 41,702

Stock Based Compensation

We issue stock options to our employees and outside directors and provide employees the right to purchase our stock pursuant to stockholder approved stock option and employee stock purchase programs. Currently we account for our stock-based compensation plans under the intrinsic value method of accounting as defined by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. The following table depicts the effect on net loss and net loss per share if we had accounted for our stock option and stock purchase plans under the fair value method of accounting under SFAS No. 123, *Accounting for Stock Based Compensation*:

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
Net loss – as reported	$ (1,106)	$ (7,062)	$ (4,097)	$ (30,090)
Add: APB 25 stock-based employee compensation expense, as reported	111	646	696	2,168
Less: Stock-based employee compensation expense determined under fair value based method, net of tax	(2,912)	(7,126)	(15,679)	(28,494)
Pro forma net loss	$ (3,907)	$ (13,542)	$ (19,080)	$ (56,416)
Basic and diluted net loss per share:				
As reported	$ (0.01)	$ (0.06)	$ (0.03)	$ (0.26)
Pro forma	$ (0.03)	$ (0.12)	$ (0.16)	$ (0.49)

We estimated the fair value of our options using the Black-Scholes option valuation model, which is one of the several methods that can be used to estimate options values. The Black-Scholes model requires the input of highly subjective assumptions, including the expected stock price volatility, and changes in the subjective input assumptions can materially affect the fair value estimates.

Recently Issued Accounting Standards

Consolidation of Variable Interest Entities

In January 2003, the FASB issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"). FIN 46 requires that if an entity has a controlling financial interest in a variable interest entity, the assets, liabilities and results of activities of the variable interest entity ("VIE") should be included in the consolidated financial statements of the entity. For arrangements entered into after January 31, 2003, FIN 46 was effective immediately. For arrangements entered into prior to February 1, 2003, FIN 46 was scheduled to be effective at the end of the period ending after December 15, 2003. In December 2003, FIN 46 was revised to require application in financial statements of public entities that have interests in special-purpose entities for periods ending after December 15, 2003. For all other types of variable interest entities, application is required for periods ending after March 15, 2004. The adoption of the remaining provisions of FIN 46, as revised, in our third quarter of fiscal 2004 did not have a material impact on our results of operations or financial condition.

2. Commitments, Contingencies and Leases

Line of Credit

We have a revolving line of credit for $10.0 million with Silicon Valley Bank. Borrowings under this line of credit bear interest at the bank's prime rate. As of March 28, 2004, there were no outstanding borrowings under this line of credit. The line of credit contains a provision for the issuance of letters of credit not to exceed the unused balance of the line. As of March 28, 2004, we had letters of credit totaling $0.9 million. These letters of credit were primarily issued to satisfy requirements of certain of our customers for performance bonds. The line of credit requires us to maintain specified financial covenants related to tangible net worth and liquidity with which we were in compliance as of March 28, 2004. The line of credit expires on January 27, 2005.

Lease Liability

As part of our business relationship with MCMS, Inc. ("MCMS"), the predecessor-in-interest to Plexus Corp., we entered into a $9.0 million operating equipment lease for manufacturing equipment in September 2000 with a third-party financing company; we, in turn, subleased the equipment to MCMS. The equipment lease with the third-party financing company requires us to make monthly payments through September 2005 and to maintain certain specified financial covenants with which we were in compliance as of March 28, 2004. During the first quarter of fiscal 2002, due to the liquidity problems at MCMS and its voluntary filing for protection under Chapter 11, we recorded a charge of $9.0 million related to this lease. The liability, net of payments, related to this lease is included in lease liability on the condensed consolidated balance sheets.

Purchase Commitments

We currently have arrangements with one contract manufacturer and other suppliers for the manufacture of our products. Our arrangements allow them to procure long lead-time component inventory on our behalf based upon a rolling production forecast provided by us. We are obligated to the purchase of long lead-time component inventory that our contract manufacturer procures in accordance with our forecast, unless we give notice of order cancellation outside of applicable component lead-times. As of March 28, 2004, we were committed to purchase approximately $24.7 million of such inventory during the fourth quarter of fiscal 2004.

Legal Proceedings

On May 27, 2003, Lucent Technologies, Inc. ("Lucent") filed suit against Extreme Networks and Foundry Networks, Inc. ("Foundry") in the United States District Court for the District of Delaware, Civil Action No. 03-508. The complaint alleges willful infringement of U.S. Patent Nos. 4,769,810, 4,769,811, 4,914,650, 4,922,486 and 5,245,607 and seeks a judgment: (a) determining that we have willfully infringed each of the five patents; (b) determining that Foundry has willfully infringed four of the five patents; (c) permanently enjoining us from infringement, inducement of infringement and contributory infringement of each of the five patents; (d) permanently enjoining Foundry from infringement, inducement of infringement and contributory infringement of four of the five patents; and (e) awarding Lucent unspecified amounts of trebled damages, together with expenses, costs and attorneys' fees.

We answered Lucent's complaint on July 16, 2003, denying that we have infringed any of the five patents and also asserting various affirmative defenses and counterclaims that seek judgment: (a) that Lucent's complaint be dismissed and Lucent be denied all requested relief; (b) declaring that we do not infringe, induce infringement or contribute to the infringement of any valid and enforceable claim of the five patents, (c) that each of the five patents be declared invalid; (d) finding the case exceptional within the definition of 35 U.S.C. § 285; and (e) that Lucent pay our attorneys' fees and costs.

Discovery is proceeding. As set forth above, we have denied Lucent's allegations and intend to defend the action vigorously. We cannot be certain, however, that we will prevail in this litigation, which could have a material, adverse effect on our financial position, results of operations and cash flows in the future.

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

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

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

We have decided to accept a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Extreme Networks Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The Extreme Networks Defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which we do not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement. If the settlement is not approved, we cannot be certain that we will prevail in the lawsuit. Failure to prevail could have a material adverse effect on our consolidated financial position, results of operations and cash flows in the future.

We are subject to other legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters, including the specific matters discussed above, is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

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3. Comprehensive Loss

Comprehensive loss was as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
Net loss	$ (1,106)	$ (7,062)	$ (4,097)	$ (30,090)
Other comprehensive income (loss):				
Change in unrealized gain on investments:				
Change in net unrealized gain on investments	(66)	234	(1,295)	1,431
Less: Net gain on investments realized and included in interest income	6	203	27	245
Change in unrealized gain on investments	(72)	31	(1,322)	1,186
Change in unrealized gain on derivatives	—	8	(1)	114
Foreign currency translation adjustments	20	324	476	303
Total comprehensive loss	$ (1,158)	$ (6,699)	$ (4,944)	$ (28,487)

4. Income Taxes

For the third quarter and first nine months of fiscal 2004, we recorded an income tax provision of $0.3 million and $1.1 million, respectively, as compared with an income tax benefit of $4.1 million and $19.3 million for the corresponding periods of fiscal 2003. For fiscal 2004, this income tax provision was recorded for taxes due on income generated in certain state and foreign tax jurisdictions. Income tax benefits have been recorded on the quarter and year-to-date fiscal 2004 pre-tax loss and we have provided a full valuation allowance against such benefits.

5. Net Loss Per Share

Basic earnings (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period, less shares subject to repurchase, and excludes any dilutive effects of options, warrants and convertible subordinated notes. Dilutive earnings per share is calculated by dividing net income by the weighted average number of common shares used in the basic earnings (loss) per share calculation plus the dilutive effect, if any, of shares subject to repurchase, options, warrants and convertible subordinated notes. Diluted net loss per share was the same as basic net loss per share for the three and nine months ended March 28, 2004 and March 30, 2003 because we had net losses in those periods.

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

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
Net loss	$ (1,106)	$ (7,062)	$ (4,097)	$ (30,090)
Weighted-average shares of common stock outstanding	118,896	115,887	117,837	115,552
Less: Weighted-average shares subject to repurchase	(64)	(386)	(131)	(639)
Weighted-average shares used in per share calculation — basic and diluted	118,832	115,501	117,706	114,913
Net loss per share – basic and diluted	$ (0.01)	$ (0.06)	$ (0.03)	$ (0.26)

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

	Three Months Ended		Nine Months Ended	
	March 28, 2004	March 30, 2003	March 28, 2004	March 30, 2003
Stock options outstanding	2,920	1,116	2,547	1,587
Unvested common stock subject to repurchase	64	386	131	639
Warrants outstanding	2,459	—	1,392	—
Convertible subordinated notes	9,542	9,542	9,542	9,542
Total potential shares of common stock excluded from the computation of diluted earnings per share	14,985	11,044	13,612	11,768

6. Restructuring Charge

During the first quarter of fiscal 2004, we recorded a restructuring charge of approximately $1.0 million, $0.9 million of which represented increases to the initial excess facilities charges recognized during fiscal 2003 and fiscal 2002 for domestic and international facilities discussed below. The commercial real estate market has continued to deteriorate since the previous charges were recorded in the third quarter of fiscal 2002 and in the second quarter of fiscal 2003 and current estimated sublease proceeds differ from our initial estimates.

During the nine months ended March 30, 2003, we recorded a restructuring charge of $14.2 million. The restructuring charge included excess facilities charges of $9.6 million, severance charges of $2.7 million and asset impairments of $1.9 million. The excess facilities charge represents an increase to the charge recognized during the third quarter of fiscal 2002. Because the commercial real estate market continued to deteriorate since we took the initial charge in the third quarter of fiscal 2002, we were required to increase our reserves to take into account the unfavorable difference between lease obligation payments and projected sublease receipts. The severance charges were related to a reduction in total staff of approximately 100 people, or 10% of the total workforce, across all departments. The asset impairment charge relates to the write-off of leasehold improvements and office furniture related to excess facilities. As a result of these charges, our expense levels will be lowered in future quarters.

The actual costs and sublease recoveries could differ from these estimates, and additional facilities charges could be incurred if we are unsuccessful in negotiating reasonable termination fees on certain facilities, if facility operating lease rental rates continue to decrease in the relevant real estate markets, if it takes longer than expected to find a suitable tenant to sublease these facilities, or if other estimates and assumptions change.

Restructuring liabilities consist of (in thousands):

	Purchase of Leased Properties	Excess Facilities	Asset Impairments	Severance	Total
Charge in third quarter of fiscal 2002	$ 39,000	$ 25,432	$ 9,138	$ —	$ 73,570
Write-offs	—	—	(9,138)	—	(9,138)
Cash payments	(39,000)	(2,011)	—	—	(41,011)
Balance at June 30, 2002	—	23,421	—	—	23,421
Charge in second quarter of fiscal 2003	—	9,576	1,893	2,718	14,187
Charge in fourth quarter of fiscal 2003	—	—	—	1,752	1,752
Write-offs	—	—	(1,893)	—	(1,893)
Cash payments	—	(6,579)	—	(2,718)	(9,297)
Balance at June 29, 2003	—	26,418	—	1,752	28,170
Charge in first quarter of fiscal 2004	—	876	122	(36)	962
Write-offs	—	—	(122)	—	(122)
Cash payments	—	(4,806)	—	(1,619)	(6,425)
Balance at March 28, 2004	—	22,488	—	97	22,585
Less: current portion	—	5,103	—	97	5,200
Restructuring liabilities at March 28, 2004, less current portion	$ —	$ 17,385	$ —	$ —	$ 17,385

7. Stock Option Exchange Program

On March 25, 2003, we filed a Tender Offer Statement on Schedule TO with the Securities and Exchange Commission related to a voluntary stock option exchange program for our employees. Our executive officers, directors and sales executives who report directly to the Vice President, Worldwide Sales were not eligible to participate in this program. Under the program, eligible employees were given the opportunity to voluntarily cancel unexercised vested and unvested stock options previously granted to them that had an exercise price greater than $12.00. For each option for five shares tendered for cancellation, a new option for three shares was granted to employees who elected to participate in the option exchange program. In order to receive new stock options, an employee must have been employed by us or by one of our subsidiaries on October 23, 2003 when the replacement options were granted. Participants who elected to exchange any options were required to exchange all eligible options and were also required to exchange any other options granted to him or her in the previous six months. The replacement stock options vested 25% on October 23, 2003 and the remaining 75% of the replacement stock options vest monthly over 24 to 36 months based on the employee’s hire date. Options for approximately 11.0 million shares of common stock held by 570 employees were eligible for exchange under the program. Options for approximately 9.3 million shares of common stock held by 435 employees were accepted for exchange under this program and, accordingly, were canceled on April 22, 2003. Replacement options for approximately 5.1 million shares of common stock were issued on October 23,2003 at an exercise price of $7.07 per share, which was the fair market value of our common stock on October 23, 2003. The stock option exchange program did not result in any stock compensation expense or variable accounting for replacement awards.

8. Alliance with Avaya Inc.

On October 30, 2003, Extreme Networks and Avaya Inc. entered into a strategic alliance to jointly develop and market converged communications solutions, by executing a joint development agreement, and a distribution agreement under which Avaya is entitled to resell Extreme Networks products. Extreme issued to Avaya a warrant with a ten-year expiration period to purchase up to 2.6 million shares of Extreme Networks common stock at a price of $0.01 per share, with Avaya having the right to exercise the warrant with respect to one third of such shares 90 days after the date of the agreements, and the remaining shares become exercisable based upon the completion of certain milestones by Avaya. Even if the milestones are not completed, however, the warrant will become fully exercisable for all shares 90 days prior to the expiration of the warrant. Avaya exercised the warrant with respect to one third of the shares subject to the warrant on March 17, 2004 and, accordingly, approximately 859,000 shares of our common stock were issued to Avaya on that date.

Extreme Networks engaged an independent valuation firm to estimate the fair value of the warrant and to assist with the allocation of the fair value to the agreements entered into. The independent valuation firm estimated the fair value of the warrant at $22.7 million which has been allocated $17.9 million to the joint development agreement and $4.8 million to the distribution agreement based on the assumptions provided by management related to the projected revenue and expenses for the respective agreements.

The values assigned to the respective agreements will be amortized over a three-year period as the agreements span a three-year period. Management believes that it would not be prudent to assume there would be any benefit beyond the three-year period due to the nature of the industry it operates in. The amortization of the warrant cost related to the joint development agreement charged as research and development expense was $1.5 million and $2.5 million, respectively, in the three and nine month periods ending March 28, 2004. The amortization related to the distribution agreement included as contra-revenue in product net revenue was $0.4 million in the third quarter of fiscal 2004 and $0.7 million in the nine months ended March 28, 2004.

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

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

Critical Accounting Policies and Estimates

Our significant accounting policies are more fully described in Note 1 of Notes to Consolidated Financial Statements included in our Form 10-K for the year ended June 29, 2003. The preparation of our consolidated financial statements in accordance with generally accepted accounting principles requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenue and expenses during the period reported. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty. We base our estimates and judgments on historical experience, market trends and other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. We believe the critical accounting policies stated below, among others, affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

We derive the majority of our revenue from sales of our modular and stackable networking equipment, with the remaining revenue generated from service fees relating to the maintenance and training on our products. Our revenue recognition policy follows SEC Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*. We generally recognize product revenue from our end-user and reseller customers at the time of shipment, provided that persuasive evidence of an arrangement exists, delivery has occurred, the price of the product is fixed or determinable and collection of the sales proceeds is reasonably assured. Revenue from service obligations under maintenance contracts is deferred and recognized on a straight-line basis over the contractual period in accordance with FASB Technical Bulletin 90.1. Maintenance contracts typically range from one to five years. When sales arrangements contain multiple elements such as hardware, maintenance and other services, we allocate revenue to each element based on the guidance provided by Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables* ("EITF 00-21"), which is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. EITF 00-21 addresses certain aspects of accounting by a vendor for arrangements under which the vendor will perform multiple revenue generating activities. We adopted EITF 00-21 prospectively and the adoption of EITF 00-21 did not have a material impact on our results of operations or financial position.

We make certain sales to partners in two-tier distribution channels. The first tier consists of a limited number of independent distributors that sell primarily to resellers and, on occasion, to end-user customers. Under specified conditions, we grant these distributors the right to return a portion of unsold inventory to us for the purpose of stock rotation. We defer recognition of revenue on all sales to these distributors until the distributors sell the product, as evidenced by a monthly sales-out report that the distributors provide to us. The second tier of the distribution channel consists of a large number of third-party resellers that sell directly to end-users and are generally not granted return privileges, except for defective products during the warranty period. We reduce product revenue for certain price protection rights that may occur under contractual arrangements we have with our customers.

We provide an allowance for sales returns based on our historical returns, analysis of credit memo data and our return policies. The allowance is charged to net revenues in the accompanying condensed unaudited consolidated statements of operations. If the historical data we use to calculate the estimated sales returns and allowances does not properly reflect future levels of product returns, these estimates are revised, thus resulting in an impact on future net revenues. We estimate and adjust this allowance at each balance sheet date.

Inventories

The networking industry is characterized by rapid technological change, frequent new product introductions, changes in customer requirements and evolving industry standards. We perform a detailed assessment of inventory at each balance sheet date, which includes a review of, among other factors, demand requirements, product lifecycle and product development plans and quality issues. Based on this analysis, we record adjustments, when appropriate, to reflect inventory at net realizable value. In fiscal 2003, demand for our products was adversely affected by the downturn in the global economy and reduced telecommunications and infrastructure capital spending, particularly in the United States. Although we make every effort to ensure the accuracy of our forecasts of product demand, any significant unanticipated changes in demand or technological developments would significantly impact the value of our inventory and our reported operating results. In the future, if we find that our estimates are too optimistic and we determine that our inventory needs to be written down, we will be required to recognize such costs in our cost of revenue at the time of such determination. Conversely, if we find our estimates are too pessimistic and we subsequently sell product that has previously been written down, our gross margin in that period will be favorably impacted.

Warranty Reserves

Networking products may contain undetected hardware or software errors when new products or new versions or updates of existing products are released to the marketplace. We have experienced such errors in connection with products and product upgrades. Our standard hardware warranty period is typically 12 months from the date of shipment to end-users and 14 months from the date of shipment to channel partners, which include resellers and distributors. Upon shipment of products to our customers, including both end-users and channel partners, we estimate expenses for the cost to repair or replace products that may be returned under warranty and accrue a liability for this amount.

The determination of our warranty requirements is based on our actual historical experience with the product or product family, estimates of repair and replacement costs and any product warranty problems that are identified after shipment. We estimate and adjust these accruals at each balance sheet date in accordance with changes in these factors. While we believe that our warranty accrual is adequate and that the judgments applied in calculating this accrual are appropriate, the assumptions used are based on estimates and these estimated amounts could differ materially from our actual warranty expenses in the future.

Allowance for Doubtful Accounts

We continually monitor and evaluate the collectibility of our trade receivables based on a combination of factors. We record specific allowances for bad debts in general and administrative expense when we become aware of a specific customer’s inability to meet its financial obligation to us, such as in the case of bankruptcy filings or deterioration of financial position. Estimates are used in determining our allowances for all other customers based on factors such as current trends in the length of time the receivables are past due and historical collection experience. We mitigate some collection risk by requiring most of our customers in the Asia-Pacific region, excluding Japan, to pay cash in advance or secure letters of credit when placing an order with us.

Deferred Tax Asset Valuation Allowance

We calculate deferred tax assets and liabilities based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Significant management judgment is required in determining our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We make an assessment of the likelihood that our net deferred tax assets will be recovered from future taxable income, and to the extent that recovery is not believed to be likely, a valuation allowance is established. During the fourth quarter of fiscal 2003, we established a full valuation allowance for our net deferred tax assets.

The valuation allowance was calculated in accordance with the provisions of Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (“SFAS 109”), which requires an assessment of both negative and positive evidence when measuring the need for a valuation allowance. In accordance with SFAS 109, evidence, such as operating results during the most recent three-year period, is given more weight than our expectations of future profitability, which are inherently uncertain. Our net losses in recent periods represented sufficient negative evidence to require a full valuation allowance against our net deferred tax assets under SFAS 109. This valuation allowance will be evaluated periodically and can be reversed partially or totally if business results have sufficiently improved to support realization of our deferred tax assets.

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Legal Contingencies

We are currently involved in various claims and legal proceedings. Periodically, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be estimated, we accrue a liability for the estimated loss. Because of uncertainties related to these matters, accruals, if any, are based only on the most current and dependable information available at any given time. As additional information becomes available, we may reassess the potential liability from pending claims and litigation and the probability of claims being successfully asserted against us. As a result, we may revise our estimates related to these pending claims and litigation. Such revisions in the estimates of the potential liabilities could have a material impact on our consolidated results of operations, financial position and cash flows in the future. For further detail, see Note 2 of Notes to Condensed Consolidated Financial Statements for a description of legal proceedings.

Results of Operations

Net revenues. Our product revenue is derived primarily from sales of our Summit, BlackDiamond and Alpine product families. Service revenue comprises fees for services relating to the maintenance of our products and, to a lesser extent, from providing training services. Maintenance billings are deferred and recognized ratably over the service period obligations, which typically range from one to five years. During fiscal 2003, revenue from service fees increased to greater than 10% of total net revenues, requiring us to separately report product and service revenues.

Product revenue decreased to $76.1 million for the third quarter of fiscal 2004 from $76.4 million for the third quarter of fiscal 2003, a decrease of $0.3 million. This slight decrease was primarily due to decreases of $6.0 million in our revenue in international markets, offset by an increase of $5.7 million in our revenue in the United States. Product revenue decreased to $224.3 million for the first nine months of fiscal 2004 from $248.1 million for the first nine months of fiscal 2003, a decrease of $23.8 million. This decrease was primarily due to decreases of $11.3 million, $9.1 million and $3.6 million in our business in the United States, Japan and Asia, respectively. The decreases in our revenue in the United States for the nine months ended March 28, 2004 was primarily due to weakness in demand in the U.S. enterprise networking market in the first two quarters of the current fiscal year. We are experiencing some erosion of average selling prices of our products due to a number of factors, including competitive pricing pressures, promotional pricing and rapid technological change. The Avaya warrant amortization included as contra-revenue in product net revenue was $0.4 million in the third quarter of fiscal 2004 and $0.7 million in the nine months ended March 29, 2004.

Service revenue increased to $12.8 million for the third quarter of fiscal 2004 from $8.9 million for the third quarter of fiscal 2003, an increase of $3.9 million. Service revenue increased to $35.4 million for the first nine months of fiscal 2004 from $27.9 million for the first nine months of fiscal 2003, an increase of $7.5 million. These increases were primarily due to increases in our installed base of equipment and renewal of our service contracts outstanding.

Sales of products and services outside the United States accounted for approximately 60% of our business in the first nine months of fiscal 2004 and fiscal 2003. We expect that export sales will continue to represent a significant portion of net revenues, although export sales may fluctuate as a percentage of net revenues. Substantially all sales transactions are denominated in United States dollars.

The world economy in general, and the United States economy in particular have experienced a prolonged downturn for information technology products which we believe has adversely affected demand for our products and has made it increasingly difficult to accurately forecast future production requirements. While we are seeing indications that the economic outlook is no longer deteriorating, we cannot predict the extent, timing or duration of any improvement in the economies where we sell our products. Further, we expect that our net revenues during fiscal 2004 will be significantly affected by the timing and success of the introduction of new products during the fiscal year.

No customer accounted for greater than 10% of our net revenues for the three and nine months ended March 28, 2004. Two distributors, Westcon Corp and Tech Data Corporation, accounted for 13% and 11%, respectively, of our net revenues and one reseller, Hitachi Cable Ltd., accounted for 10% of our net revenues for the three months ended March 30, 2003. Tech Data Corporation accounted for 12% of our net revenues for the nine months ended March 30, 2003. The level of sales to any customer may vary from period to period; however, we expect that sales to a few key customers will represent a high percentage of revenue for the foreseeable future.

Gross margin. Cost of product revenues includes costs of raw materials, direct labor, manufacturing overhead, amounts paid to third-party contract manufacturers and costs related to warranty. Product gross margin increased to 54.7% for the third quarter of fiscal 2004 from 45.9% for the third quarter of fiscal 2003. Product gross margin increased to 54.5% for the first nine months of fiscal 2004 from 47.7% for the first nine months of fiscal 2003. The increase in product gross margin was primarily due to lower per-unit product costs and the effect of our cost reduction programs including lower warranty costs and lower overhead costs. The lower per-unit product cost was achieved as a result of our consolidation of all manufacturing to one contract manufacturer.

During the first nine months of fiscal 2003, we experienced a higher than normal rate of product warranty expense due to problems with various component parts within our products and our election, in some cases, to address those problems by replacing such products with new rather than refurbished replacements. The lower warranty expense in the first nine months of fiscal 2004 was attributable to operational changes we implemented to reduce these expenses. The lower overhead costs were due to cost reduction plans we put in place beginning in the first quarter of 2003.

We expect to realize lower per-unit product costs from our contract manufacturer as a result of volume and improved efficiencies as production matures. However, we do not know if or when such per unit cost reductions will occur. The failure to obtain these cost reductions could have a material adverse effect upon our gross margin and operating results. We anticipate some of these ongoing cost improvements will be offset by higher per unit costs of products we are currently introducing which are incurring higher costs during the pre-production phase of their manufacturing cycle.

Our cost of service consists primarily of labor, overhead, repair and freight costs and the cost of spares used in providing support under customer service contracts.

Service gross margin increased to 29.9% for the third quarter of fiscal 2004 from a negative 12.7% for the third quarter of fiscal 2003. Service gross margin increased to 23.9% for the first nine months of fiscal 2004 from a negative 2.1% for the first nine months of fiscal 2003. Service gross margin for the three and nine months ended March 30, 2003 was negatively impacted by a number of programs that we implemented to improve service delivery productivity and to enhance customer satisfaction. These programs included expenses incurred to increase service revenue and reduce service infrastructure, including outsourcing certain service functions. The service margins in the three and nine months ended March 28, 2004 reflect the benefits we achieved from these programs.

Our gross margin is variable and dependent on many factors, some of which are outside of our control. Some of the primary factors affecting gross margin include demand for our products, changes in our pricing policies and those of our competitors, and the mix of products sold. Our gross margin may be adversely affected by increases in material or labor costs, increases in warranty expense or the cost of providing services under extended service contracts, heightened price competition and obsolescence charges. In addition, our gross margin may fluctuate due to the mix of distribution channels through which our products are sold, including the effects of our two-tier distribution model. Any significant decline in sales to our resellers, distributors or end-user customers, or the loss of any of our key resellers, distributors or end-user customers could have a material adverse effect on our business, operating results and financial condition. In addition, an increase in distribution channels generally makes it more difficult to forecast the mix of products sold and the timing of orders from our customers. New product introductions may result in excess or obsolete inventories, which may also reduce our gross margin. Furthermore, if we are not able to reduce product or related warranty costs in future quarters, gross margin would be adversely affected.

Sales and marketing expenses. Sales and marketing expenses consist of salaries, commissions and related expenses for personnel engaged in marketing and sales functions, as well as trade shows and promotional expenses. Sales and marketing expenses decreased to $23.3 million for the third quarter of fiscal 2004 from $25.0 million for the third quarter of fiscal 2003, a decrease of $1.7 million. This decrease was primarily due to reduced spending for advertising and marketing programs of $1.7 million, decreased depreciation expense of $0.3 million and decreased travel expenses of $0.3 million, offset by an increase of outside professional services of $0.5 million. Sales and marketing expenses decreased to $68.8 million for the first nine months of fiscal 2004 from $78.1 million for the first nine months of fiscal 2003, a decrease of $9.3 million. This decrease was primarily due to decreased payroll and related personnel expenses of $2.6 million, reduced spending for advertising and marketing programs of $3.4 million, decreased depreciation expense of $1.6 million, decreased travel expenses of $1.0 million and decreases in other expenses consistent with a lower level of sales, offset by an increase of outside professional services of $0.9 million. The decreases in payroll and related personnel expenses during the first nine months of fiscal 2004 resulted from the reductions in staff in the second and fourth quarters of fiscal 2003 and reductions in commissions earned due to reduced net revenues. The decrease in depreciation was due to the fixed asset write-offs recorded in the second quarter of fiscal 2003. The rate of future spending in our sales and marketing expenses will largely depend on the pace of recovery in the market for networking products.

Research and development expenses. Research and development expenses consist principally of salaries and related personnel expenses, consultant fees and prototype expenses related to the design, development, testing and enhancement of our products. Research and development expenses increased to $15.0 million for the third quarter of fiscal 2004 from $13.7 million for the third quarter of fiscal 2003, an increase of $1.3 million. This increase was primarily due to amortization expense of $1.5 million related to the $17.9 million of the fair value of the warrant allocated to the joint development agreement with Avaya. Research and development expenses increased to $42.9 million for the first nine months of fiscal 2004 from $41.7 million for the first nine months of fiscal 2003, an increase of $1.2 million. This result was due to increased amortization expense of $2.5 million related to the joint development agreement with Avaya and increased fees for outside professional services of $0.7 million, offset by decreased payroll and related personnel expenses of approximately $1.4 million and decreased depreciation expense of $0.6 million. The decreases in payroll and related personnel expenses resulted from the reductions in staff in the second and fourth quarters of fiscal 2003 and the decrease in depreciation is due to the fixed asset write-offs recorded in the second quarter of fiscal 2003. We expense all research and development costs as incurred. We believe that continued investment in research and development is critical to attaining our strategic objectives and as a result we expect these expenses will continue to be significant in future periods.

General and administrative expenses. General and administrative expenses consist principally of salaries and related expenses for executive, finance and administrative personnel, professional fees and other general corporate expenses. General and administrative expenses increased to $8.0 million for the third quarter of fiscal 2004 from $6.3 million for the third quarter of fiscal 2003, an increase of $1.7 million. General and administrative expenses increased to $22.9 million for the first nine months of fiscal 2004 from $20.0 million for the first nine months of fiscal 2003, an increase of $2.9 million. The increases in both periods were primarily due to increases in legal fees relating to litigation. The rate of future spending in our general and administrative expenses will largely depend on the pace of recovery in the market for networking products and upon the cost of outside services and professional fees, including legal fees relating to litigation.

Amortization of deferred stock compensation. Amortization of deferred stock compensation decreased to $0.2 million for the third quarter of fiscal 2004 from $1.0 million for the third quarter of fiscal 2003, a decrease of $0.8 million. Amortization of deferred stock compensation decreased to $0.9 million for the first nine months of fiscal 2004 from $3.3 million for the first nine months of fiscal 2003, a decrease of $2.4 million. Deferred stock compensation is amortized as charges to operations, using the graded vesting method, over the vesting periods of the individual stock options, generally four years. Upon termination of an employee, the amount of expense recognized under the graded vesting method that is in excess of the amount actually earned is reversed. We reversed $0.1 million and $0.6 million of excess compensation expense related to terminated employees for the third quarter of fiscal 2004 and fiscal 2003, respectively. We reversed $0.3 million and $2.0 million of excess compensation expense related to terminated employees for the first nine months of fiscal 2004 and fiscal 2003, respectively.

Restructuring charge. During the first quarter of fiscal 2004, we recorded a restructuring charge of approximately $1.0 million, $0.9 million of which represented increases to the initial excess facilities charges recognized during fiscal 2003 and fiscal 2002 for domestic and international facilities discussed below. The commercial real estate market has continued to deteriorate since the previous charges were recorded in the third quarter of fiscal 2002 and in the second quarter of fiscal 2003 and current estimated sublease proceeds differ from our initial estimates.

During the nine months ended March 30, 2003, we recorded a restructuring charge of $14.2 million. The restructuring charge included excess facilities charges of $9.6 million, severance charges of $2.7 million and asset impairments of $1.9 million. The excess facilities charge represents an increase to the charge recognized during the third quarter of fiscal 2002. Because the commercial real estate market continued to deteriorate since we took the initial charge in the third quarter of fiscal 2002, we were required to increase our reserves to take into account the unfavorable difference between lease obligation payments and projected sublease receipts. The severance charges were related to a reduction in total staff of approximately 100 people, or 10% of the total workforce, across all departments. The asset impairment charge relates to the write-off of leasehold improvements and office furniture related to excess facilities. As a result of these charges, our expense levels will be lowered in future quarters.

Property and equipment write-off. During the second quarter of fiscal 2003, we completed a property and equipment inventory in conjunction with the implementation of our new enterprise resource planning, or ERP, system. The property and equipment inventory resulted in the identification of $12.7 million of property and equipment that was written off during the second quarter of fiscal 2003. As a result of this charge, depreciation expense is lower in fiscal 2004 and is expected to continue to be lower in future quarters.

O*ther income, net.* Other income, net decreased to $0.3 million for the third quarter of fiscal 2004 from $1.0 million for the third quarter of fiscal 2003, a decrease of $0.7 million. This decrease was primarily due to a decrease in interest income due to lower interest rates. Other income, net decreased to $2.7 million for the first nine months of fiscal 2004 from $2.9 million for the first nine months of fiscal 2003, a decrease of $0.2 million. This decrease was primarily due to a decrease in interest income of approximately $2.2 million due to lower interest rates offset by the settlement of litigation, net of related expenses, of $2.2 million.

Income taxes. For the third quarter and first nine months of fiscal 2004, we recorded an income tax provision of $0.3 million and $1.1 million, respectively as compared with an income tax benefit of $4.1 million and $19.3 million for the corresponding periods of fiscal 2003. For fiscal 2004, this income tax provision was recorded for taxes due on income generated in certain state and foreign tax jurisdictions. Income tax benefits have been recorded on the quarter and year-to-date fiscal 2004 pre-tax loss and we have provided a full valuation allowance against such benefits.

We estimate our income taxes based on the various jurisdictions where we conduct business. Our tax provision for the remainder of fiscal 2004 and future years will be largely dependent on our profitability in specific jurisdictions and could fluctuate significantly. Tax benefits associated with operating losses and tax credits generated in the U.S. will be offset by full valuation allowances until such time as we are able to demonstrate a history of operating income in the U.S.

Liquidity and Capital Resources

Cash and cash equivalents, short-term investments and marketable securities increased to $416.9 million at March 28, 2004 from $402.2 million at June 29, 2003, an increase of $14.7 million. This increase was primarily due to cash provided by operating activities of $10.1 million and proceeds from issuance of common stock of $11.1 million, partially offset by capital expenditures of $5.6 million.

We generated $10.1 million in cash from operations in the first nine months of fiscal 2004. Accounts receivable increased to $30.7 million at March 28, 2004 from $26.8 million at June 29, 2003. Days sales outstanding (“DSO”) in receivables increased to 32 days at March 28, 2004 from 28 days at June 29, 2003. The increases in our accounts receivable balance, as well as the increase in DSO, was primarily due to shipment linearity, with more of our sales occurring at the end of the quarter. Inventory levels increased to $24.2 million at March 28, 2004 from $18.7 million at June 29, 2003. We increased our new product inventory levels in the current quarter after experiencing some modest product constraints in recent quarters. Inventory management remains an area of focus as we balance the need to maintain strategic inventory levels to ensure competitive lead times and avoid stock-outs with the risk of inventory excess or obsolescence caused by, among other things, declining demand, rapidly changing technology and customer requirements. Any significant increase in our inventory levels can be expected to reduce cash and cash equivalents, short-term investments and marketable securities.

We have a revolving line of credit for $10.0 million with Silicon Valley Bank. Borrowings under this line of credit bear interest at the bank’s prime rate. As of March 28, 2004, there were no outstanding borrowings under this line of credit. The line of credit contains a provision for the issuance of letters of credit not to exceed the unused balance of the line. As of March 28, 2004, we had letters of credit totaling $0.9 million. These letters of credit were primarily issued to satisfy requirements of certain of our customers for performance bonds. The line of credit requires us to maintain specified financial covenants related to tangible net worth and liquidity with which we were in compliance as of March 28, 2004. The line of credit expires on January 27, 2005. It is our intention to renew this line of credit when it expires.

As part of our business relationship with MCMS, Inc. (“MCMS”), the predecessor-in-interest to Plexus Corp., we entered into a $9.0 million operating equipment lease for manufacturing equipment in September 2000 with a third-party financing company; we, in turn, loaned the equipment to MCMS. The equipment lease with the third-party financing company requires us to make monthly payments through September 2005 and to maintain certain specified financial covenants with which we were in compliance as of March 28, 2004. During the first quarter of fiscal 2002, due to the liquidity problems at MCMS and its voluntary filing for protection under Chapter 11, we recorded a charge of $9.0 million related to this lease. The liability, net of payments, related to this lease is included in lease liability on the condensed consolidated balance sheet.

In December 2001, we completed a private placement of $200.0 million of convertible subordinated notes. The notes mature on December 1, 2006. Interest is payable semi-annually at 3.5% per annum. The notes are convertible at the option of the holders into our common stock at an initial conversion price of $20.96 per share, subject to adjustment. The notes are redeemable in cash at our option at an initial redemption price of 101.4% of the principal amount on or after December 2004 if not converted to common stock prior to the redemption date. Each holder of the notes has the right to cause us to repurchase all of such holder’s convertible notes at 100% of the principal amount plus accrued interest upon a change of control of ownership of Extreme Networks, as defined in the offering documents, however an acquisition of Extreme Networks for stock listed on U.S. exchanges would generally not qualify as a change of control.

The following summarizes our contractual obligations, including interest payments, at March 28, 2004, and the effect such obligations are expected to have on our liquidity and cash flow in future periods, in thousands:

	Total	Less Than 1 Year	1 – 3 Years	3 – 5 Years	After Three Years
Contractual Obligations:					
Convertible subordinated notes	$ 221,000	$ 7,000	$ 214,000	$ —	$ —
Inventory purchase commitments	24,682	24,682	—	—	—
Non-cancelable operating lease obligations	38,785	10,203	15,039	7,293	6,250
Total contractual cash obligations	$ 284,467	$ 41,885	$ 229,039	$7,293	$ 6,250

We did not have any material commitments for capital expenditures or other non-cancelable purchase commitments as of March 28, 2004. We did not have any off-balance sheet arrangements as of March 28, 2004.

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

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

Risk Factors

We Are Not Profitable and We Cannot Assure You That We Will Be Profitable in the Future

Fiscal 2000 was the only year in which we achieved profitability for the full year. We reported losses for fiscal 2003, fiscal 2002 and fiscal 2001. We anticipate continuing to incur significant sales and marketing, product development and general and administrative expenses and, as a result, we will continue to need to rationalize expense levels and increase revenue levels to achieve profitability in future fiscal quarters.

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

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

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

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

- changes in general and/or specific economic conditions in the networking industry;
- seasonal fluctuations in demand for our products and services, particularly in Asia-Pacific and Europe;

- linearity of quarterly sales have historically reflected a pattern in which a disproportionate percentage of such sales occur in the last month of the quarter;
- reduced visibility into the implementation cycles for our products and our customers' spending plans;
- our ability to accurately forecast demand for our products, which in the case of lower-than-expected sales, may result in excess or obsolete inventory in addition to non-cancelable purchase commitments for component parts;
- product returns or the cancellation or rescheduling of orders;
- our ability to develop, introduce, ship and support new products and product enhancements and manage product transitions;
- announcements and new product introductions by our competitors;
- our ability to develop and support relationships with enterprise customers, service providers and other potential large customers;
- our ability to achieve targeted cost reductions;
- our ability to obtain sufficient supplies of sole- or limited-source components for our products on a timely basis;
- increases in the prices of the components that we purchase;
- decreases in the prices of the products that we sell;
- our ability to achieve and maintain desired production volumes and quality levels for our products;
- the mix of products sold and the mix of distribution channels through which products are sold;
- downward adjustments resulting from other-than-temporary declines in the carrying value of long-lived assets;
- costs associated with adjustments to the size of our operations;
- costs relating to possible acquisitions and the integration of technologies or businesses; and
- the effect of amortization of deferred compensation and purchased intangibles resulting from existing or new transactions.

On April 14, 2004, we announced that our senior vice president of Worldwide Sales was leaving Extreme Networks. Our Chief Executive Officer will be responsible for sales as we conduct an active and accelerated-replacement search. While we believe we have significantly strengthened our executive team overall, a recent high level of attrition in our sales organization, including the departure of the senior vice president, could adversely affect sales until a successor is retained.

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

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

The market for networking equipment is intensely competitive. Our principal competitors include Cisco Systems, Enterasys Networks, Foundry Networks, Inc., Nortel Networks and 3Com Corporation. In addition, a number of private companies and foreign competitors have announced plans for new products, or have introduced products, that may compete with our own products. Some of our current and potential competitors have superior market leverage, longer operating histories and substantially greater financial, technical, sales and marketing resources, in addition to wider name recognition and larger installed customer bases. Foreign competitors may have competitive advantages due to significantly lower costs or strong ties to customers in their home countries. These competitors may have developed, or may in the future develop, new competing products based on technologies that compete with our own products or render our products obsolete. Furthermore, a number of these competitors may merge or form strategic partnerships that enable them to offer or bring to market competitive products. Consolidation within our industry could lead to increased competition and could harm our operating results.

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

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

When Our Products Contain Undetected Software or Hardware Errors, We Incur Significant Unexpected Expenses and Could Lose Sales

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

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

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

International sales constitute a significant portion of our net revenues. Our ability to grow will depend in part on the continued expansion of international sales. Sales to customers outside of the United States accounted for approximately 60% of our net revenues for the first nine months of fiscal 2004 and fiscal 2003. Our international sales primarily depend on the success of our resellers and distributors. The failure of these resellers and distributors to sell our products internationally would limit our ability to sustain and grow our revenue. There are a number of risks arising from our international business, including:

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

In addition, conducting our business on a global basis subjects us to a number of frequently changing and complex trade protection measures and import or export regulatory requirements. Our failure to comply with these measures and regulatory requirements may result in the imposition of financial penalties and restrictions on our ability to conduct business in and with certain countries, which may harm our business and damage our reputation. Pursuant to regulations of the U.S. Department of Commerce providing for voluntary disclosure, in the fourth quarter of fiscal 2002 we disclosed information regarding a possible violation of certain export regulations. Following such disclosures the Department of Commerce will determine whether to conduct an investigation. If an investigation is commenced, we believe that these matters will be resolved without a material adverse effect on our business, and we have implemented procedures to reduce the risk of violations in the future.

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

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

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

The network equipment industry has traditionally experienced a rapid erosion of average selling prices due to a number of factors, including competitive pricing pressures, promotional pricing and technological progress. In addition, companies have lowered their prices in order to liquidate excess inventory that has accumulated as a result of the economic slowdown. We anticipate that the average selling prices of our products will decrease in the future in response to competitive pricing pressures, excess inventories, increased sales discounts and new product introductions by us or our competitors, including, for example, competitive products manufactured with low-cost merchant silicon. We may experience substantial decreases in future operating results due to the erosion of our average selling prices. Competitive pressures are expected to increase as a result of the industry slowdown that began in the first half of 2001, coupled with the downturn in the broader economy. To maintain our gross margin, we must develop and introduce on a timely basis new products and product enhancements and continually reduce our product costs. Our failure to do so would likely cause our revenue and gross margins to decline, which could have a material adverse effect on our operating results and cause the price of our common stock to decline.

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

At March 28, 2004, two customers, Hitachi Cable Ltd. and NextCom K.K., accounted for 18% and 12%, respectively, of our accounts receivable balance. Some of our customers are forecasting that their revenue for the foreseeable future will generally be lower than originally anticipated. Some customers are experiencing, or are likely to experience, serious cash flow problems and, as a result, may find it increasingly difficult to obtain financing, if financing is available at all. If our customers are not successful in generating sufficient revenue or securing alternate financing arrangements, they may not be able to pay, or may delay payment of, the amounts that they owe us. In particular, sales to the service provider market are especially volatile and continued declines or delays in sale orders from this market may harm our financial condition. Furthermore, they may not order as many products from us as originally forecast, or cancel orders with us entirely. The inability of some of our potential customers to pay us for our products may adversely affect our cash flow, the timing of our revenue recognition and the amount of revenue, which may cause our stock price to decline.

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

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

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

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

Our Limited Ability to Protect Our Intellectual Property and Defend Against Claims May Adversely Affect Our Ability to Compete

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

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. We are actively involved in disputes and licensing discussions with, and have received notices from, others regarding their claimed proprietary rights and cannot assure you that we will always successfully defend ourselves against such claims. If we are found to infringe the proprietary rights of others, or if we otherwise settle such claims, we could be compelled to pay damages or royalties and either obtain a license to those intellectual property rights or alter our products so that they no longer infringe upon such proprietary rights. Any license could be very expensive to obtain or may not be available at all. Similarly, changing our products or processes to avoid infringing the rights of others may be costly or impractical. Litigation resulting from claims that we are infringing the proprietary rights of others has resulted and could in the future result in substantial costs and a diversion of resources, and could have a material adverse effect on our business, financial condition and results of operations.

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

We have received notice from several companies alleging that we are infringing their patents. One of these companies, Lucent Technologies, Inc., filed a claim against us alleging patent infringement and we are in litigation as of the date of this filing. Following examination of this claim, we believe it is without merit and we have responded accordingly. Without regard to the merits of this or any other claim, if judgments by a court of law on this or any other claim received in the future were to be upheld, or if we otherwise agree to the settlement of such claims, the consequences to us may be severe and could require us to, among other actions:

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

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

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

Prior to the quarter ended April 1, 2001, we experienced rapid growth and expansion that placed a significant strain on our resources. Subsequent to that period, we have from time to time incurred unanticipated costs to downsize our operations to a level consistent with lower forecast sales. Even if we manage the current period of instability effectively, as well as possible expansion in the future, we may make mistakes in restructuring or operating our business, such as inaccurate sales forecasting or incorrect material planning. Any of these mistakes may lead to unanticipated fluctuations in our operating results. We cannot assure you that we will be able to size our operations in accordance with fluctuations of our business in the future.

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

Our distribution strategy focuses primarily on developing and increasing the productivity of our indirect distribution channels. If we fail to develop and cultivate relationships with significant resellers, or if these resellers are not successful in their sales efforts, sales of our products may decrease and our operating results could suffer. Many of our resellers also sell products from other vendors that compete with our products. We cannot assure you that we will be able to enter into additional reseller and/or distribution agreements or that we will be able to successfully manage our product sales channels. Our failure to do any of these could limit our ability to grow or sustain revenue. In addition, our operating results will likely fluctuate significantly depending on the timing and amount of orders from our resellers. We cannot assure you that our resellers and/or distributors will continue to market or sell our products effectively or continue to devote the resources necessary to provide us with effective sales, marketing and technical support.

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

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

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

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

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

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

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

To date, a limited number of resellers, distributors and other customers have accounted for a significant portion of our revenue. While no customer has accounted for 10% or more of revenue in the current fiscal quarter and year to date period, sales to Westcon Corp, Tech Data Corporation, and Hitachi Cable Ltd, represent a high percentage of our sales and these customers have individually accounted for 10% or more of revenue in prior periods. If any of our large customers stop or delay purchases, our revenue and profitability would be adversely affected.

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

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

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

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

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

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

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

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

We currently purchase several key components used in the manufacture of our products from single or limited sources and are dependent upon supply from these sources to meet our needs. Certain components such as capacitors, static random access memory, or SRAM, dynamic random access memory, or DRAM, and printed circuit boards are not currently, but have been, and may in the future be, in short supply. We have in the past encountered, and are likely in the future to encounter, shortages and delays in obtaining these or other components, and this could have a material adverse effect on our ability to meet customer orders. Our principal sole-source components include:

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

Our principal limited-source components include:

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

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

Our Dependence on Contract Manufacturers for Substantially All of Our Manufacturing Requirements Could Harm Our Operating Results

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

We rely on independent contractors to manufacture our products. We do not have long-term contracts with any of these manufacturers. We currently utilize one company for the manufacture of our products – Flextronics International, Ltd., located in San Jose, California and Guadalajara, Mexico. We have experienced delays in product shipments from contract manufacturers in the past, which in turn delayed product shipments to our customers. These or similar problems may arise in the future, such as products of inferior quality, insufficient quantity of products, or the interruption or discontinuance of operations of a manufacturer, any of which could have a material adverse effect on our business and operating results.

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

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

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

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

In particular, if we are required to record stock option grants as compensation expense on our income statement, our profitability may be reduced significantly. The current methodology for expensing such stock options is based on, among other things, the historical volatility of the underlying stock. Our stock price has been historically volatile. Therefore, the adoption of an accounting standard requiring companies to expense stock options would negatively impact our profitability and may adversely impact our stock price. In addition, the adoption of such a standard could limit our ability to continue to use stock options as an incentive and retention tool, which could, in turn, hurt our ability to recruit employees and retain existing employees.

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

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

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq Stock Market rules, are creating uncertainty for companies such as ours. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we are investing all reasonably necessary resources to comply with evolving standards, and this investment may result in increased general and administrative expenses and a diversion of additional management time and attention from revenue-generating activities to compliance activities.

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

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

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

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

We have decided to accept a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Extreme Network Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The Extreme Networks Defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which we do not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement. If the settlement is not approved, we cannot assure you that we will prevail in the lawsuit. Failure to prevail could have a material adverse effect on our consolidated financial position, results of operations and cash flows in the future.

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

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

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

In addition, terrorist acts or acts of war targeted at the United States, and specifically Silicon Valley, could cause damage or disruption to us, our employees, facilities, partners, suppliers, distributors and resellers, and customers, which could have a material adverse effect on our operations and financial results.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We Have Substantial Debt Obligations

In connection with the sale of convertible subordinated notes in December 2001, we incurred $200 million of indebtedness. We will require substantial amounts of cash to fund scheduled payments of interest on the convertible notes, payment of the principal amount of the convertible notes, future capital expenditures, payments on our leases and any increased working capital requirements. If we are unable to meet our cash requirements out of cash flow from operations, there can be no assurance that we will be able to obtain alternative financing. The degree to which we are financially leveraged could materially and adversely affect our ability to obtain financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures. In the absence of such financing, our ability to respond to changing business and economic conditions, to make future acquisitions, to absorb adverse operating results or to fund capital expenditures or increased working capital requirements would be significantly reduced. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, some of which are beyond our control. If we do not generate sufficient cash flow from operations to repay the notes at maturity, we could attempt to refinance the notes; however, no assurance can be given that such a refinancing would be available on terms acceptable to us, if at all. Any failure by us to satisfy our obligations with respect to the notes at maturity (with respect to payments of principal) or prior thereto (with respect to payments of interest or required repurchases) would constitute a default under the indenture and could cause a default under agreements governing our other indebtedness.

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

We have certain long-term real estate lease commitments carrying future obligations for non-cancelable lease payments. Reductions in our workforce and the restructuring of operations since fiscal 2002 have resulted in the need to consolidate certain of these leased facilities, located primarily in Northern California, for which we recorded excess facilities charges of approximately $0.9 million in the first quarter of fiscal 2004, $9.6 million in fiscal 2003 and $25.4 million during fiscal 2002. For more information, see Note 6 of Notes to Condensed Consolidated Financial Statements. We continue to attempt to sublease certain of these facilities and may obtain sublease income to offset the carrying costs of these facilities. However, we may not be able to sublease these facilities at the times or on the terms we anticipated when we took the excess facilities charge and therefore if the market does not improve, we may incur additional charges in the future. In addition, we may incur additional charges for excess facilities as a result of additional reductions in our workforce or future restructuring of operations. We will continue to be responsible for all carrying costs of these facilities until such time as we can sublease these facilities or terminate the applicable leases based on the contractual terms of the lease agreements, and these costs may have an adverse effect on our business, operating results and financial condition.

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

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

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

Securities We Issue to Fund Our Operations Could Dilute Your Ownership

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

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

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Sensitivity

The primary objective of our investment activities is to preserve principal while at the same time maximize the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of securities, including commercial paper, other non-government debt securities and money market funds. In general, money market funds are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate. The following table presents the amounts of our cash equivalents and short-term investments that are subject to market risk by range of expected maturity and weighted-average interest rates as of March 28, 2004. This table does not include money market funds because those funds are not subject to market risk.

	Maturing in				
	Three months or less	**Three months to one year**	**Greater than one year**	**Total**	**Fair Value**
Included in cash and cash equivalents	$ 9,319			$ 9,319	$ 9,319
Weighted average interest rate	0.92%				
Included in short-term investments	$29,097	$ 86,825		$ 115,922	$ 115,922
Weighted average interest rate	1.40%	2.77%			
Included in marketable securities	$ 3,421		$ 233,140	$ 236,561	$ 236,561
Weighted average interest rate	2.10%		2.37%		
Long-term debt			$ 200,000	$ 200,000	$ 181,900
Average fixed rate			3.50%		

Exchange Rate Sensitivity

Currently, all of our sales and the majority of our expenses are denominated in United States dollars and as a result, we have experienced no significant foreign exchange gains and losses to date. While we have conducted some transactions in foreign currencies during the first nine months of fiscal 2004 and expect to continue to do so, we do not anticipate that foreign exchange gains or losses will be significant, in part because of our foreign exchange risk management process discussed below.

Foreign Exchange Forward Contracts

We enter into foreign exchange forward contracts to hedge foreign currency forecasted transactions related to certain operating expenses, denominated in Japanese Yen, the Euro, the Swedish Krona and the British Pound. These derivatives are designated as cash flow hedges under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities, as amended and interpreted* ("SFAS 133"). At March 28, 2004, these forward foreign currency contracts had a notional principal amount of $5.1 million (fair value of $500). These contracts have maturities of less than 60 days.

Additionally, we enter into foreign exchange forward contracts to mitigate the effect of gains and losses generated by the remeasurement of certain assets and liabilities denominated in Japanese Yen, the Euro, the Swedish Krona and the British

Pound. These derivatives are not designated as hedges under SFAS 133. At March 28, 2004, we held foreign currency forward contracts with a notional principal amount of $1.2 million (fair value of $149,000). These contracts have maturities of less than 45 days. Changes in the fair value of these foreign exchange forward contracts are offset largely by remeasurement of the underlying assets and liabilities.

We do not enter into foreign exchange forward contracts for speculative or trading purposes. Foreign currency transaction losses from operations, including the impact of hedging, were not significant for the third quarter of fiscal 2004. Foreign currency transaction gains from operations, including the impact of hedging, were $0.2 million for the third quarter of fiscal 2003. Foreign currency transaction losses from operations, including the impact of hedging, were $(0.1) million for the first nine months of fiscal 2004. Foreign currency transaction gains from operations, including the impact of hedging, were $0.2 million for the first nine months of fiscal 2003.

Investments in Equity Securities

We have historically made investments in several privately held companies. These nonmarketable investments are accounted for under the cost method, as ownership is less than 20 percent and we do not have the ability to exercise significant influence over the operating, financing and investing activities of the investee companies. These investments are inherently risky as the market for the technologies or products they have under development are typically in the early stages and may never materialize. It is possible that we could lose our entire initial investment in these companies. As a part of management's process of regularly reviewing these investments for impairment, we recorded write-downs of $0.2 million and $9.7 million on certain investments, which were determined to be other than temporarily impaired in fiscal 2003 and fiscal 2002, respectively. At March 28, 2004, the carrying value of our remaining investments was zero.

Item 4. Controls and Procedures

Under the supervision and with the participation of our management, including our chief executive officer and our chief financial officer we evaluated the effectiveness of our disclosure controls and procedures, as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended. Based on this evaluation, our chief executive officer and our chief financial officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this quarterly report in providing reasonable assurance that information required to be disclosed by Extreme Networks in reports that it files under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. No significant changes were made to Extreme Networks' internal controls during our most recent quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. Other Information

Item 1. Legal Proceedings

On May 27, 2003, Lucent filed suit against Extreme Networks and Foundry Networks, Inc. ("Foundry") in the United States District Court for the District of Delaware, Civil Action No. 03-508. The complaint alleges willful infringement of U.S. Patent Nos. 4,769,810, 4,769,811, 4,914,650, 4,922,486 and 5,245,607 and seeks a judgment: (a) determining that we have willfully infringed each of the five patents; (b) determining that Foundry has willfully infringed four of the five patents; (c) permanently enjoining us from infringement, inducement of infringement and contributory infringement of each of the five patents; (d) permanently enjoining Foundry from infringement, inducement of infringement and contributory infringement of four of the five patents; and (e) awarding Lucent unspecified amounts of trebled damages, together with expenses, costs and attorneys' fees.

We answered Lucent's complaint on July 16, 2003, denying that we have infringed any of the five patents and also asserting various affirmative defenses and counterclaims that seek judgment: (a) that Lucent's complaint be dismissed and Lucent be denied all requested relief; (b) declaring that we do not infringe, induce infringement or contribute to the infringement of any valid and enforceable claim of the five patents, (c) that each of the five patents be declared invalid; (d) finding the case exceptional within the definition of 35 U.S.C. § 285; and (e) that Lucent pay our attorneys' fees and costs.

Discovery is proceeding. As set forth above, we have denied Lucent's allegations and intend to defend the action vigorously. We cannot assure you, however, that we will prevail in this litigation, which could have a material, adverse effect on our financial position, results of operations and cash flows in the future.

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

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

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

We have decided to accept a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Extreme Network Defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of control of certain claims we may have against the underwriters. The Extreme Networks Defendants will not be required to make any cash payments in the settlement, unless the pro rata amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which we do not believe will occur. The settlement will require approval of the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement. If the settlement is not approved, we cannot assure you that we will prevail in the lawsuit. Failure to prevail could have a material adverse effect on our consolidated financial position, results of operations and cash flows in the future.

Other than the proceedings stated above, we are not aware of any pending legal proceedings against us that, individually or in the aggregate, would have a material adverse effect on our business, operating results or financial condition. We may in the future be party to litigation arising in the course of our business, including claims that we allegedly infringe third-party trademarks and other intellectual property rights. Such claims, even if not meritorious, could result in the expenditure of significant financial and managerial resources.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities – None

Item 3. Defaults Upon Senior Securities – None

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

Item 5. Other Information – None

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Item 6. Exhibits and Reports on Form 8-K

a) Exhibits:

		INCORPORATED BY REFERENCE			
		Form	Filing Date	Number	Filed Herewith
31.1	Section 302 Certification of Gordon L. Stitt as Chief Executive Officer				X
31.2	Section 302 Certification of William R. Slakey as Chief Financial Officer				X
32.1	Section 906 Certification of Gordon L. Stitt as Chief Executive Officer				X
32.2	Section 906 Certification of William R. Slakey as Chief Financial Officer				X

b) Reports on Form 8-K

Extreme Networks filed or furnished the following reports on Form 8-K during the third quarter of fiscal 2004:

DATE OF REPORT:	ITEM(S):	DESCRIPTION:
January 15, 2004	7 & 12	Extreme Networks announced financial results for its second quarter ended December 28, 2003 and included the press release and transcript of the conference call relating thereto.

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SIGNATURES

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

EXTREME NETWORKS, INC.
(Registrant)

/S/ WILLIAM R. SLAKEY

WILLIAM R. SLAKEY
Chief Financial Officer

May 12, 2004

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EXHIBIT INDEX

		INCORPORATED BY REFERENCE			
		Form	Filing Date	Number	Filed Herewith
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31.2	Section 302 Certification of William R. Slakey as Chief Financial Officer				X
32.1	Section 906 Certification of Gordon L. Stitt as Chief Executive Officer				X
32.2	Section 906 Certification of William R. Slakey as Chief Financial Officer				X

EXHIBIT 31.1

SECTION 302 CERTIFICATION OF GORDON L. STITT
AS CHIEF EXECUTIVE OFFICER

I, Gordon L. Stitt, certify that:

1. I have reviewed this Form 10-Q of Extreme Networks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 12, 2004

/s/ GORDON L. STITT

Gordon L. Stitt
Chief Executive Officer

EXHIBIT 31.2

SECTION 302 CERTIFICATION OF WILLIAM R. SLAKEY
AS CHIEF FINANCIAL OFFICER

I, William R. Slakey, certify that:

1. I have reviewed this Form 10-Q of Extreme Networks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: May 12, 2004

/s/ WILLIAM R. SLAKEY

William R. Slakey
Chief Financial Officer

EXHIBIT 32.1

CERTIFICATION OF GORDON L. STITT AS CHIEF EXECUTIVE OFFICER, PURUSANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Extreme Networks, Inc. (the “Company”) on Form 10-Q for the period ended March 28, 2004, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Gordon L. Stitt, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ GORDON L. STITT

Gordon L. Stitt
Chief Executive Officer
May 12, 2004

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by section 906, has been provided to Extreme Networks, Inc., and will be retained by Extreme Networks, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

CERTIFICATION OF WILLIAM R. SLAKEY AS CHIEF FINANCIAL OFFICER, PURUSANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Extreme Networks, Inc. (the “Company”) on Form 10-Q for the period ended March 28, 2004, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, William R. Slakey, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(3) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and

(4) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ WILLIAM R. SLAKEY

William R. Slakey
Chief Financial Officer
May 12, 2004

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by section 906, has been provided to Extreme Networks, Inc., and will be retained by Extreme Networks, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.