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

# FORM 10-Q

(Mark One)

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

**For the quarterly period ended January 27, 2007**

**OR**

o **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: 000-25601**

# BROCADE COMMUNICATIONS SYSTEMS, INC.
(Exact name of Registrant as specified in its charter)

| **Delaware** | **77-0409517** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. employer identification no.) |

**1745 Technology Drive**
**San Jose, CA 95110**
**(408) 333-8000**
(Address, including zip code, of Registrant's principal executive offices and telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☑ No o

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

Large accelerated filer ☑ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No ☑

The number of shares outstanding of the Registrant's Common Stock on February 14, 2007 was 400,624,221shares.

**BROCADE COMMUNICATIONS SYSTEMS, INC.**

**FORM 10-Q**

**QUARTER ENDED JANUARY 27, 2007**

**INDEX**

**Forward-Looking Statements**

*This Quarterly Report on Form 10-Q contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 (the "Exchange Act"). All statements other than statements of historical fact are statements that could be deemed forward-looking statements, including, but not limited to, projections of revenue, margins, expenses, tax provisions, earnings, cash flows, benefit obligations, share repurchases or other financial items; any statements of the plans, strategies and objectives of management for future operations; any statements concerning expected development, performance or market share relating to products or services; any statements regarding future economic conditions or performance; any statements regarding pending investigations, claims or disputes; any statements of expectation or belief; and any statements of assumptions underlying any of the foregoing. Words such as "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," "continues," "may," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below, under "Part II — Other Information, Item 1A. Risk Factors" and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Further, we undertake no obligation to revise or update any forward-looking statements for any reason.*

## PART I — FINANCIAL INFORMATION

### Item 1. Financial Statements

**BROCADE COMMUNICATIONS SYSTEMS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**
**(In thousands, except per share amounts)**
**(Unaudited)**

| | Three Months Ended | |
|---|---|---|
| | January 27, 2007 | January 28, 2006 |
| Net revenues | $ 224,156 | $ 170,082 |
| Cost of revenues | 82,790 | 69,381 |
| Gross margin | 141,366 | 100,701 |
| Operating expenses: | | |
| Research and development | 42,391 | 38,742 |
| Sales and marketing | 38,587 | 30,868 |
| General and administrative | 7,404 | 7,801 |
| Legal fees associated with indemnification obligations, SEC investigation and other related costs | 5,228 | 4,029 |
| Acquisition and integration costs | 7,433 | — |
| Provision for SEC settlement | — | 7,000 |
| Amortization of intangible assets | 910 | — |
| Total operating expenses | 101,953 | 88,440 |
| Income from operations | 39,413 | 12,261 |
| Interest and other income, net | 7,456 | 7,030 |
| Interest expense | (4) | (1,777) |
| Income before provision for income taxes | 46,865 | 17,514 |
| Income tax provision | 13,547 | 7,854 |
| Net income | $ 33,318 | $ 9,660 |
| Net income per share — Basic | $ 0.12 | $ 0.04 |
| Net income per share — Diluted | $ 0.12 | $ 0.04 |
| Shares used in per share calculation — Basic | 272,855 | 269,400 |
| Shares used in per share calculation — Diluted | 285,137 | 272,101 |

See accompanying notes to condensed consolidated financial statements.

**BROCADE COMMUNICATIONS SYSTEMS, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(In thousands, except par value)**
**(Unaudited)**

| | January 27, 2007 | October 28, 2006 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 249,807 | $ 274,368 |
| Short-term investments | 319,331 | 267,694 |
| Total cash, cash equivalents and short-term investments | 569,138 | 542,062 |
| Accounts receivable, net of allowances of $4,611 and $4,842 at January 27, 2007 and October 28, 2006, respectively | 94,577 | 98,394 |
| Inventories | 10,219 | 8,968 |
| Prepaid expenses and other current assets | 49,250 | 43,365 |
| Total current assets | 723,184 | 692,789 |
| Long-term investments | 62,521 | 40,492 |
| Property and equipment, net | 110,154 | 104,299 |
| Goodwill | 49,358 | 41,013 |
| Intangible assets, net | 16,069 | 15,465 |
| Other assets | 6,741 | 6,660 |
| Total assets | $ 968,027 | $ 900,718 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 55,819 | $ 56,741 |
| Accrued employee compensation | 48,085 | 62,842 |
| Deferred revenue | 52,641 | 52,051 |
| Current liabilities associated with lease losses | 4,235 | 4,931 |
| Other accrued liabilities | 87,225 | 87,991 |
| Total current liabilities | 248,005 | 264,556 |
| Non-current liabilities associated with lease losses | 10,935 | 11,105 |
| Non-current deferred revenue | 16,562 | 8,827 |
| Total liabilities | 275,502 | 284,488 |
| Commitments and contingencies (Note 6) | | |
| Stockholders' equity: | | |
| Preferred stock, $0.001 par value 5,000 shares authorized, no shares outstanding | — | — |
| Common stock, $0.001 par value, 800,000 shares authorized: | | |
| Issued and outstanding: 285,137 and 272,141 shares at January 27, 2007 and October 28, 2006, respectively | 285 | 272 |
| Additional paid-in capital | 932,511 | 888,978 |
| Accumulated other comprehensive loss | (1,386) | (817) |
| Accumulated deficit | (238,885) | (272,203) |
| Total stockholders' equity | 692,525 | 616,230 |
| Total liabilities and stockholders' equity | $ 968,027 | $ 900,718 |

See accompanying notes to condensed consolidated financial statements.

**BROCADE COMMUNICATIONS SYSTEMS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In thousands)**
**(Unaudited)**

| | Three Months Ended January 27, 2007 | Three Months Ended January 28, 2006 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 33,318 | $ 9,660 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Excess tax benefit from employee stock plans | (6,314) | — |
| Depreciation and amortization | 8,513 | 9,403 |
| Loss on disposal of property and equipment | 148 | 41 |
| Amortization of debt issuance costs | — | 405 |
| Non-cash compensation expense | 6,725 | 6,938 |
| Provision for doubtful accounts receivable and sales returns | 127 | 598 |
| Provision for SEC settlement | — | 7,000 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 3,862 | (6,662) |
| Inventories | (958) | 2,866 |
| Prepaid expenses and other assets | (5,091) | (2,462) |
| Accounts payable | (3,171) | 4,262 |
| Accrued employee compensation | (14,757) | (883) |
| Deferred revenue | 8,325 | 5,476 |
| Other accrued liabilities and long-term debt | 4,050 | (3,391) |
| Liabilities associated with lease losses | (1,446) | (1,217) |
| Net cash provided by operating activities | 33,331 | 32,034 |
| **Cash flows from investing activities:** | | |
| Purchases of property and equipment | (13,362) | (8,174) |
| Purchases of short-term investments | (117,700) | (60,835) |
| Proceeds from maturities and sale of short-term investments | 92,603 | 52,649 |
| Purchases of long-term investments | (52,176) | (11,068) |
| Proceeds from maturities and sale of long-term investments | 3,697 | — |
| Purchases of restricted short-term investments | — | (50) |
| Proceeds from the maturities of restricted short-term investments | — | 1,208 |
| Purchases of non-marketable minority equity investments | — | (3,750) |
| Cash paid in connection with acquisitions, net of cash acquired | (7,706) | — |
| Net cash used in investing activities | (94,644) | (30,020) |
| **Cash flows from financing activities:** | | |
| Excess tax benefit from employee stock plans | 6,314 | — |
| Proceeds from issuance of common stock, net | 30,507 | 3,863 |
| Net cash provided by financing activities | 36,821 | 3,863 |
| Effect of exchange rate fluctuations on cash and cash equivalents | (69) | (6) |
| Net increase (decrease) in cash and cash equivalents | (24,561) | 5,871 |
| Cash and cash equivalents, beginning of period | 274,368 | 182,001 |
| Cash and cash equivalents, end of period | $ 249,807 | $ 187,872 |

See accompanying notes to condensed consolidated financial statements.

BROCADE COMMUNICATIONS SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

**1. Organization and Operations of Brocade**

Brocade Communications Systems, Inc. (“Brocade” or the “Company”) develops, markets, sells, and supports data storage networking products and services, offering a line of storage networking products that enable companies to implement and manage highly available, scalable, and secure environments for data storage networks. The Brocade SilkWorm ® family of storage area networking (“SAN”) products is designed to help companies reduce the cost and complexity of managing business information within a data storage environment. In addition, the Brocade Tapestry™ family of application infrastructure solutions extends the ability to proactively manage and optimize application and information resources across the enterprise. Brocade products and services are marketed, sold, and supported worldwide to end-user customers primarily through distribution partners, including original equipment manufacturers (“OEMs”), distributors, systems integrators, and value-added resellers.

Brocade was reincorporated as a Delaware corporation on May 14, 1999, succeeding operations that began in California on August 24, 1995. The Company’s headquarters are located in San Jose, California.

Brocade®, the Brocade B-wing logo™, Fabric OS®, File Lifecycle Manager®, My View®, Secure Fabric OS®, and StorageX® are registered trademarks of Brocade Communications Systems, Inc., in the United States and/or in other countries. All other brands, products, or service names identified are or may be trademarks or service marks of, and are used to identify, products or services of their respective owners.

**2. Summary of Significant Accounting Policies**

*Fiscal Year*

The Company’s fiscal year is the 52 or 53 weeks ending on the last Saturday in October. As is customary for companies that use the 52/53-week convention, every fifth year contains a 53-week year. Both fiscal years 2007 and 2006 are 52-week fiscal years.

*Basis of Presentation*

The accompanying financial data as of January 27, 2007, and for the three months ended January 27, 2007 and January 28, 2006, has been prepared by the Company, without audit, 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 U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. The October 28, 2006 Condensed Consolidated Balance Sheet was derived from audited consolidated financial statements, but does not include all disclosures required by U.S. generally accepted accounting principles. These Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended October 28, 2006.

In the opinion of management, all adjustments (which include only normal recurring adjustments, except as otherwise indicated) necessary to present a fair statement of financial position as of January 27, 2007, results of operations for the three months ended January 27, 2007 and January 28, 2006, and cash flows for the three months ended January 27, 2007 and January 28, 2006 have been made. The results of operations for the three months ended January 27, 2007 are not necessarily indicative of the operating results for the full fiscal year or any future periods.

*Reclassifications*

Certain reclassifications have been made to prior year balances in order to conform to current year presentation.

*Cash and Cash Equivalents*

The Company considers all highly liquid investments with an original or remaining maturity of three months or less at the date of purchase to be cash equivalents.

*Investments and Equity Securities*

Investment securities with original or remaining maturities of more than three months but less than one year are considered short-term investments. Investment securities with original or remaining maturities of one year or more are considered long-term investments. Short-term and long-term investments consist of auction rate securities, debt securities issued by United States government agencies, municipal government obligations, and corporate bonds and notes.

Short-term and long-term investments are maintained at three major financial institutions, are classified as available-for-sale, and are recorded on the accompanying Condensed Consolidated Balance Sheets at fair value. Fair value is determined using quoted market prices for those securities. Unrealized holding gains and losses are included as a separate component of accumulated other comprehensive income on the accompanying Condensed Consolidated Balance Sheets, net of any related tax effect. Realized gains and losses are calculated based on the specific identification method and are included in interest and other income, net, on the Condensed Consolidated Statements of Income.

The Company recognizes an impairment charge when the declines in the fair values of its investments below the cost basis are judged to be other-than-temporary. The Company considers various factors in determining whether to recognize an impairment charge, including the length of time and extent to which the fair value has been less than the Company’s cost basis, the financial condition and near-term prospects of the investee, and the Company’s intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

Equity securities consist of equity holdings in public companies and are classified as available-for-sale when there are no restrictions on the Company’s ability to immediately liquidate such securities. Marketable equity securities are recorded on the accompanying Condensed Consolidated Balance Sheets at fair value. Fair value is determined using quoted market prices for those securities. Unrealized holding gains and losses are included as a separate component of accumulated other comprehensive income on the accompanying Condensed Consolidated Balance Sheets, net of any related tax effect. Realized gains and losses are calculated based on the specific identification method and are included in interest and other income, net on the Condensed Consolidated Statements of Income.

From time to time the Company makes equity investments in non-publicly traded companies. These investments are included in other assets on the accompanying Condensed Consolidated Balance Sheets, and are generally accounted for under the cost method as the Company does not have the ability to exercise significant influence over the respective company’s operating and financial policies. The Company monitors its investments for impairment on a quarterly basis and makes appropriate reductions in carrying values when such impairments are determined to be other-than-temporary. Impairment charges are included in interest and other income, net on the Condensed Consolidated Statements of Income. Factors used in determining an impairment include, but are not limited to, the current business environment including competition and uncertainty of financial condition; going concern considerations such as the rate at which the investee company utilizes cash, and the investee company’s ability to obtain additional private financing to fulfill its stated business plan; the need for changes to the investee company’s existing business model due to changing business environments and its ability to successfully implement necessary changes; and comparable valuations. If an investment is determined to be impaired, a determination is made as to whether such impairment is other-than-temporary. As of January 27, 2007 and October 28, 2006, the carrying values of the Company’s equity investments in non-publicly traded companies were $0.8 million and $0.8 million, respectively.

*Goodwill and Intangible Assets*

The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (“SFAS 142”). SFAS 142 requires that goodwill be capitalized at cost and tested annually for impairment. The Company evaluates goodwill on an annual basis during its second fiscal quarter, or whenever events and changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized to the extent that the carrying amount exceeds the asset’s implied fair value. Events which might indicate impairment include, but are not limited to, strategic decisions made in response to economic and competitive conditions, the impact of economic environment on the Company’s customer base, material negative changes in relationships with significant customers, and/or a significant decline in the Company’s stock price for a sustained period. No goodwill impairment was recorded for the periods presented.

Intangible assets other than goodwill are amortized over their estimated useful lives, unless these lives are determined to be indefinite. Intangible assets are carried at cost less accumulated amortization. Amortization is recognized over the estimated useful life of the respective asset. Intangible assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). The Company performs impairment tests for long-lived assets on an annual basis or whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Examples of such events or circumstances include significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of acquired assets or the strategy for its business, significant negative industry or economic trends, and/or a significant decline in the Company's stock price for a sustained period. Impairments are recognized based on the difference between the fair value of the asset and its carrying value, and fair value is generally measured based on discounted cash flow analyses. No intangible asset impairment was recorded for the periods presented.

*Concentrations*

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash, cash equivalents, short-term and long-term investments, and accounts receivable. Cash, cash equivalents, and short-term and long-term investments are primarily maintained at five major financial institutions in the United States. Deposits held with banks may be redeemed upon demand and may exceed the amount of insurance provided on such deposits. The Company principally invests in United States government debt securities, United States government agency debt securities and corporate bonds and notes, and limits the amount of credit exposure to any one entity.

A majority of the Company's trade receivable balance is derived from sales to OEM partners in the computer storage and server industry. As of January 27, 2007, three customers accounted for 32 percent, 24 percent, and 12 percent respectively, of total accounts receivable. As of October 28, 2006, three customers accounted for 44 percent, 21 percent, and 8 percent, respectively, of total accounts receivable. The Company performs ongoing credit evaluations of its customers and generally does not require collateral on accounts receivable balances. The Company has established reserves for credit losses, sales returns, and other allowances. While the Company has not experienced material credit losses in any of the periods presented, there can be no assurance that the Company will not experience material credit losses in the future.

For the three months ended January 27, 2007 and January 28, 2006, three customers each represented ten percent or more of the Company's total revenues for combined totals of 72 percent and 72 percent of total revenues, respectively. The level of sales to any one of these customers may vary, and the loss of, or a decrease in the level of sales to, any one of these customers could seriously harm the Company's financial condition and results of operations.

The Company currently relies on single and limited supply sources for several key components used in the manufacture of its products. Additionally, the Company relies on one contract manufacturer for the production of its products. The inability of any single and limited source suppliers or the inability of the contract manufacturer to fulfill supply and production requirements, respectively, could have a material adverse effect on the Company's future operating results.

The Company's business is concentrated in the SAN industry, which from time to time has been impacted by unfavorable economic conditions and reduced information technology ("IT") spending rates. Accordingly, the Company's future success depends upon the buying patterns of customers in the SAN industry, their response to current and future IT investment trends, and the continued demand by such customers for the Company's products. The Company's future success, in part, will depend upon its ability to enhance its existing products and to develop and introduce, on a timely basis, new cost-effective products and features that keep pace with technological developments and emerging industry standards.

*Revenue Recognition*

Product revenue. Product revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. However, for newly introduced products, many of the Company's large OEM customers require a product qualification period during which the Company's products are tested and approved by the OEM customer for sale to its customers. Revenue recognition, and related cost, is deferred for shipments to new OEM customers and for shipments of newly introduced products to existing OEM customers until satisfactory evidence of completion of the product qualification has been received from the OEM customer. Revenue from sales to the Company's master reseller customers is recognized in the same period in which the product is actually sold by the master reseller (sell-through).

The Company reduces revenue for estimated sales returns, sales programs, and other allowances at the time of shipment. Sales returns, sales programs, and other allowances are estimated based upon historical experience, current trends, and the

Company's expectations regarding future experience. In addition, the Company maintains allowances for doubtful accounts, which are also accounted for as a reduction in revenue. The allowance for doubtful accounts is estimated based upon analysis of accounts receivable, historical collection patterns, customer concentrations, customer creditworthiness, current economic trends, and changes in customer payment terms and practices.

Service revenue. Service revenue consists of training and maintenance arrangements, including post-contract customer support ("PCS") services. PCS services are offered under renewable, annual fee-based contracts or as part of multiple element arrangements and typically include upgrades and enhancements to the Company's software operating system, and telephone support. Service revenue, including revenue allocated to PCS elements, is deferred and recognized ratably over the contractual period. Service contracts are typically one to three years in length. Training revenue is recognized upon completion of the training. Service and training revenues were not material in any of the periods presented.

Multiple-element arrangements. The Company's multiple-element product offerings include computer hardware and software products, and support services. The Company also sells certain software products and support services separately. The Company's software products are essential to the functionality of its hardware products and are, therefore, accounted for in accordance with Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended. The Company allocates revenue to each element in a multiple element arrangement based upon vendor-specific objective evidence ("VSOE") of the fair value of the element or, if VSOE is not available for the delivered element, by application of the residual method. In the application of the residual method, we allocate revenue to the undelivered elements based on VSOE for those elements and allocate the residual revenue to the delivered elements. VSOE of the fair value for an element is based upon the price charged when the element is sold separately. Revenue allocated to each element is then recognized when the basic revenue recognition criteria are met for each element.

Warranty Expense. The Company provides warranties on its products ranging from one to three years. Estimated future warranty costs are accrued at the time of shipment and charged to cost of revenues based upon historical experience.

*Stock-Based Compensation*

Effective October 30, 2005, the Company began recording compensation expense associated with stock-based awards and other forms of equity compensation in accordance with Statement of Financial Accounting Standards No. 123-R, *Share-Based Payment*, ("SFAS 123R") as interpreted by SEC Staff Accounting Bulletin No. 107. The Company adopted the modified prospective transition method provided for under SFAS 123R. Under this transition method, compensation cost associated with stock-based awards recognized beginning in the first quarter of fiscal year 2006 includes 1) quarterly amortization related to the remaining unvested portion of stock-based awards granted prior to October 30, 2005, based on the grant date fair value estimated in accordance with the original provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*, ("SFAS 123"); and 2) quarterly amortization related to stock-based awards, stock options and restricted stock, granted subsequent to October 30, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. In addition, the Company records expense over the offering period and vesting term in connection with shares issued under its employee stock purchase plan. The compensation expense for stock-based awards includes an estimate for forfeitures and is recognized over the expected term of the award under an accelerated vesting method.

Prior to October 30, 2005, the Company accounted for stock-based awards using the intrinsic value method of accounting in accordance with Accounting Principles Board Opinion No. 25, "*Accounting for Stock Issued to Employees*" ("APB 25"), whereby the difference between the exercise price and the fair market value on the date of grant is recognized as compensation expense. Under the intrinsic value method of accounting, no compensation expense was recognized in the Company's Condensed Consolidated Statements of Income when the exercise price of the Company's employee stock option grant equals the market price of the underlying common stock on the date of grant, and the measurement date of the option grant is certain. The measurement date is certain when the date of grant is fixed and determinable. Prior to October 30, 2005, when the measurement date was not certain, the Company recorded stock-based compensation expense using variable accounting under APB 25. From May 1999 through July 2003, the Company granted 98.8 million options that were subject to variable accounting under APB 25 because the measurement date of the options granted was not certain. Effective October 30, 2005, if the measurement date is not certain, the Company records stock-based compensation expense under SFAS 123R. Under SFAS 123R, the Company remeasures the intrinsic value of the options at the end of each reporting period until the options are exercised, cancelled or expire unexercised. As of January 27, 2007, 1.7 million options with a weighted average exercise price of $16.19 and a weighted average remaining life of 4.3 years remain outstanding and continue to be remeasured at the intrinsic value at the end of each reporting period. Compensation expense in any given period is calculated as the difference between total earned compensation at the end of the period, less total earned compensation at the beginning of the period. Compensation earned is calculated under a graded vesting method.

On November 10, 2005, the Financial Accounting Standards Board issued FASB Staff position No. FAS 123R-3, *Transition Election Related to Accounting for tax Effects of Share-Based Payment Awards* ("FAS 123R-3"). The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of equity-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the Additional Paid-In Capital Pool ("APIC Pool") related to the tax effects of employee equity-based compensation, and to determine the subsequent impact on the APIC pool and Condensed Consolidated Statement of Cash Flows of the tax effects of employee equity-based compensation awards that were outstanding upon the implementation of SFAS 123R.

*Employee Stock Plans*

The Company has several stock-based compensation plans (the "Plans") that are described in the Company's Annual Report on Form 10-K for the fiscal year ended October 28, 2006. The Company, under the various equity plans, grants stock options for shares of the Company's common stock to its employees and directors. The Company has also issued restricted stock under the Plans. In accordance with the Plans, incentive stock options may not be granted at less than 100 percent of the estimated fair market value of the common stock, and incentive stock options granted to a person owning more than 10 percent of the combined voting power of all classes of stock of the Company must be issued at 110 percent of the fair market value of the stock on the date of grant. Nonstatutory stock options may be granted at any price. Under the Plans, options or restricted stock typically have a maximum term of seven or ten years. The majority of options granted under the Plans vest over a period of four years. Certain options granted under the Plans vest over shorter or longer periods. At January 27, 2007, an aggregate of 122.3 million shares were authorized for future issuance under the Plans, which includes Stock Options, shares issued pursuant to the Employee Stock Purchase Plan, and Restricted Stock Awards. A total of 84.8 million shares of common stock were available for grant under the Plans as of January 27, 2007. Awards that expire, or are cancelled without delivery of shares, generally become available for issuance under the Plans.

*Stock Options*

When the measurement date is certain, the fair value of each option grant is estimated on the date of grant using the Black-Scholes valuation model and the assumptions noted in the following table. The expected term of stock options is based on the midpoint of the historical exercise behavior and uniform exercise behavior. The expected volatility is based on an equal weighted average of implied volatilities from traded options of the Company's stock and historical volatility of the Company's stock. The risk free interest rate is based on the implied yield on a U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the option. The dividend yield reflects that Brocade has not paid any cash dividends since inception and does not anticipate paying cash dividends in the foreseeable future.

| | Three Months Ended | |
|---|---|---|
| **Stock Options** | January 27, 2007 | January 28, 2006 |
| Expected dividend yield | 0.0% | 0.0% |
| Risk-free interest rate | 4.5 — 4.9% | 4.5 — 4.6% |
| Expected volatility | 48.1% | 52.8% |
| Expected term (in years) | 3.3 | 3.3 |

The Company recorded $4.2 million and $4.4 million of compensation expense relative to stock options for the quarters ended January 27, 2007 and January 28, 2006, respectively, in accordance with SFAS 123R. A summary of stock option activity under the Plans for the three months ended January 27, 2007 and January 28, 2006 is presented as follows:

| | Shares (in thousands) | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value ($000) |
|---|---|---|---|---|
| Outstanding, October 28, 2006 | 39,954 | $ 6.35 | | |
| Granted | 2,180 | $ 9.14 | | |
| Exercised | (4,249) | $ 5.58 | | |
| Forfeited or Expired | (546) | $ 5.28 | | |
| Outstanding, January 27, 2007 | 37,339 | $ 6.62 | 5.5 | $ 89,937 |
| Ending Vested and Expected to Vest | 35,220 | $ 6.64 | 5.5 | $ 85,067 |
| Exercisable and Vested, January 27, 2007 | 21,720 | $ 7.11 | 5.3 | $ 50,923 |

| | Shares (in thousands) | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value ($000) |
|---|---|---|---|---|
| Outstanding, October 29, 2005 | 45,179 | $ 6.59 | | |
| Granted | 1,165 | $ 4.19 | | |
| Exercised | (204) | $ 0.68 | | |
| Forfeited or Expired | (3,209) | $ 6.14 | | |
| Outstanding, January 28, 2006 | 42,931 | $ 6.57 | 6.3 | $ 7,716 |
| Ending Vested and Expected to Vest | 40,776 | $ 6.66 | 6.4 | $ 7,079 |
| Exercisable and Vested, January 28, 2006 | 26,516 | $ 7.46 | 6.4 | $ 3,356 |

The weighted-average fair value of employee stock options granted during the three months ended January 27, 2007 and January 28, 2006 were $3.42 and $1.70, respectively. The total intrinsic value of stock options exercised for the three months ended January 27, 2007 and January 28, 2006 were $14.5 million and $0.7 million, respectively.

As of January 27, 2007 and January 28, 2006, there was $18.4 million and $15.9 million, respectively, of total unrecognized compensation costs related to stock options. These costs are expected to be recognized over a weighted average period of 1.5 years.

*Employee Stock Purchase Plan*

Under Brocade's Employee Stock Purchase Plan, eligible employees can participate and purchase shares semi-annually through payroll deductions at the lower of 85% of the fair market value of the stock at the commencement or end of the offering period. The Purchase Plan permits eligible employees to purchase common stock through payroll deductions for up to 15% of qualified compensation. The Company accounts for the Employee Stock Purchase Plan as a compensatory plan and recorded compensation expense of $1.2 million and $0.9 million for the quarter ended January 27, 2007 and January 28, 2006, respectively, in accordance with SFAS 123R.

The fair value of the option component of the Employee Stock Purchase Plan shares was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

| | Three Months Ended | |
|---|---|---|
| **Employee Stock Purchase Plan** | January 27, 2007 | January 28, 2006 |
| Expected dividend yield | 0.0% | 0.0% |
| Risk-free interest rate | 5.1 — 5.2% | 3.4 — 4.4% |
| Expected volatility | 53.5% | 44.3% |
| Expected term (in years) | 0.5 | 0.5 |

As of January 27, 2007 and January 28, 2006, there was $1.7 million and $1.5 million, respectively, of total unrecognized compensation costs related to employee stock purchases. These costs were expected to be recognized over a weighted average period of 0.3 years and 0.2 years, respectively.

*Restricted Stock Awards*

For the three months ended January 27, 2007 and January 28, 2006, Brocade issued restricted stock awards of 0.1 million shares and 1.9 million shares, respectively, to certain eligible employees at a purchase price of $0.00 and $0.001 per share, respectively. These restricted shares are not transferable until fully vested and are subject to repurchase for all unvested shares upon termination. The fair value of each award is based on the Company's closing stock price on the date of grant. Compensation expense computed under the fair value method for stock awards issued is being amortized under a graded vesting method over the awards' vesting period and was $2.6 million and $0.8 million, for the three months ended January 27, 2007 and January 28, 2006, respectively.

The weighted-average fair value of the restricted stock awards granted in the three months ended January 27, 2007 and January 28, 2006 was $8.98 and $4.43, respectively. The total fair value of stock awards vested for both the three months ended January 27, 2007 and January 28, 2006 was zero. At January 27, 2007, unrecognized costs related to restricted stock awards totaled approximately $4.1 million. These costs are expected to be recognized over a weighted average period of one year. A summary of the nonvested shares for the three months ended January 27, 2007 and January 28, 2006, respectively, is presented as follows:

| | Shares (in thousand) | Weighted Average Grant-Date Fair Value |
|---|---|---|
| Nonvested, October 28, 2006 | 1,848 | $ 4.44 |
| Granted | 130 | $ 8.98 |
| Vested | (3) | $ 7.05 |
| Forfeited | — | — |
| Nonvested, January 27, 2007 | 1,975 | $ 4.73 |
| Expected to vest, January 27, 2007 | 1,650 | $ 4.73 |

| | Shares (in thousand) | Weighted Average Grant-Date Fair Value |
|---|---|---|
| Nonvested, October 29, 2005 | 13 | $ 7.05 |
| Granted | 1,923 | $ 4.43 |
| Vested | (3) | $ 7.05 |
| Forfeited | — | — |
| Nonvested, January 28, 2006 | 1,933 | $ 4.44 |
| Expected to vest, January 28, 2006 | 1,614 | $ 4.44 |

*Restricted Stock Units*

For the three months ended January 27, 2007, Brocade issued restricted stock units of 0.3 million shares. No restricted stock units were issued for the three months ended January 28, 2006. Typically, vesting of restricted stock units occurs over two years and is subject to the employee's continuing service to Brocade. The compensation expense of $0.1 million related to these awards was determined using the fair market value of Brocade's common stock on the date of the grant and is recognized under a graded vesting method over the vesting period.

A summary of the changes in restricted stock units outstanding under Brocade's equity-based compensation plans during the three months ended January 27, 2007 is presented as follows:

| | Shares (in thousand) | Weighted Average Grant-Date Fair Value |
|---|---|---|
| Nonvested restricted stock units, October 28, 2006 | — | — |
| Granted | 346 | $ 9.19 |
| Vested | — | — |
| Forfeited | — | — |
| Nonvested restricted stock units, January 27, 2007 | 346 | $ 9.19 |
| Nonvested restricted stock units expected to vest at January 27, 2007 | 266 | $ 9.19 |

As of January 27, 2007, Brocade had $2.2 million of total unrecognized compensation expense, net of estimated forfeitures, related to restricted stock unit grants, which is expected to be recognized over the weighted average period of 2.5 years.

*Tender Offer*

On June 12, 2006, the Company completed a tender offer that allowed employees to amend or cancel certain options to remedy potential adverse personal tax consequences. As a result, the Company amended certain options granted after August 14, 2003 that were or may have been granted at a discount to increase the option grant price to the fair market value on the date of grant, and to give the employee a cash payment for the difference in option grant price between the amended option and the original discounted price. In addition, for certain options granted prior to August 14, 2003 that were or may have been granted at a discount, the Company canceled the options in exchange for a cash payment based on the Black-Scholes estimate of fair value of the option. The Company accounted for these modifications and settlements in accordance with SFAS 123R and as a result recorded incremental compensation expense of $2.1 million during the three months ended July 29, 2006 and recognized a liability of $3.3 million for the cash payments. The liability was paid in January 2007.

*Computation of Net Income per Share*

Basic net income per share is computed using the weighted-average number of common shares outstanding during the period, less shares subject to repurchase. Diluted net income per share is computed using the weighted-average number of common shares and dilutive potential common shares outstanding during the period. Dilutive potential common shares result from the assumed exercise of outstanding stock options, by application of the treasury stock method, that have a dilutive effect on earnings per share.

*Comprehensive Income*

The components of comprehensive income, net of tax, are as follows (in thousands):

| | Three Months Ended | |
|---|---|---|
| | January 27, 2007 | January 28, 2006 |
| Net income | $ 33,318 | $ 9,660 |
| Other comprehensive income: | | |
| Change in net unrealized gains (losses) on marketable equity securities and investments | (43) | 477 |
| Cumulative translation adjustments | (526) | (6) |
| Total comprehensive income | $ 32,749 | $ 10,131 |

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**3. Balance Sheet Details**

The following tables provide details of selected balance sheet items (in thousands):

| | January 27, 2007 | October 28, 2006 |
|---|---|---|
| **Inventories:** | | |
| Raw materials | $ 390 | $ 82 |
| Finished goods | 9,829 | 8,886 |
| Total | $ 10,219 | $ 8,968 |
| **Property and equipment, net:** | | |
| Computer equipment and software | $ 80,864 | $ 73,421 |
| Engineering and other equipment | 147,659 | 144,530 |
| Furniture and fixtures | 5,917 | 4,360 |
| Leasehold improvements | 43,819 | 43,519 |
| Land and building | 30,000 | 30,000 |
| Subtotal | 308,259 | 295,830 |
| Less: Accumulated depreciation and amortization | (198,105) | (191,531) |
| Total | $ 110,154 | $ 104,299 |

| | January 27, 2007 | October 28, 2006 |
|---|---|---|
| **Other accrued liabilities:** | | |
| Income taxes payable | $ 43,018 | $ 39,076 |
| Accrued warranty | 2,335 | 2,230 |
| Inventory purchase commitments | 4,209 | 6,104 |
| Accrued sales programs | 10,341 | 12,051 |
| Other | 27,322 | 28,530 |
| Total | $ 87,225 | $ 87,991 |

Leasehold improvements as of January 27, 2007 and October 28, 2006, are shown net of estimated asset impairments related to facilities lease losses (see Note 5).

**4. Investments and Equity Securities**

The following tables summarize the Company's investments and equity securities (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **January 27, 2007** | | | | |
| U.S. government and its agencies and municipal obligations | $ 172,244 | $ 1 | $ (470) | $ 171,775 |
| Corporate bonds and notes | 210,800 | 28 | (751) | 210,077 |
| Total | $ 383,044 | $ 29 | $ (1,221) | $ 381,852 |
| | | | | |
| Reported as: | | | | |
| Short-term investments | | | | $ 319,331 |
| Long-term investments | | | | 62,521 |
| Total | | | | $ 381,852 |
| | | | | |
| **October 28, 2006** | | | | |
| U.S. government and its agencies and municipal obligations | $ 124,105 | $ 5 | $ (556) | $ 123,554 |
| Corporate bonds and notes | 185,183 | 32 | (583) | 184,632 |
| Total | $ 309,288 | $ 37 | $ (1,139) | $ 308,186 |

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Reported as: | | | | |
| Short-term investments | | | | $ 267,694 |
| Long-term investments | | | | 40,492 |
| Total | | | | $ 308,186 |

For both the three months ended January 27, 2007 and January 28, 2006, no gains were realized on the sale of investments or marketable equity securities. As of January 27, 2007 and October 28, 2006, net unrealized holding losses of $1.2 million and $1.1 million, respectively, were included in accumulated other comprehensive income in the accompanying Condensed Consolidated Balance Sheets.

**5. Liabilities Associated with Facilities Lease Losses**

During the three months ended October 27, 2001, the Company recorded a charge of $39.8 million related to estimated facilities lease losses, net of expected sublease income, and a charge of $5.7 million in connection with the estimated impairment of certain related leasehold improvements. These charges represented the low-end of an estimated range of $39.8 million to $63.0 million and have been adjusted upon the occurrence of certain triggering events.

During the three months ended July 27, 2002, the Company completed a transaction to sublease a portion of these vacant facilities. Accordingly, based on then current market data, the Company revised certain estimates and assumptions, including those related to estimated sublease rates, estimated time to sublease the facilities, expected future operating costs, and expected future use of the facilities. The Company reevaluates its estimates and assumptions on a quarterly basis and makes adjustments to the reserve balance if necessary.

In November 2003, the Company purchased a previously leased building. In addition, the Company consolidated the engineering organization and development, test and interoperability laboratories into the purchased facilities and vacated other existing leased facilities. As a result, the Company recorded adjustments to the facilities lease loss reserve recorded in fiscal year 2001 described above, and recorded additional reserves in connection with the facilities consolidation.

During the three months ended April 29, 2006, the Company recorded a charge of $3.8 million related to estimated facilities lease losses, net of expected sublease income. This charge represents an estimate based on current market data. As a result, the Company revised certain estimates and assumptions, including those related to estimated sublease rates, estimated time to sublease the facilities, expected future operating costs, and expected future use of the facilities.

In January 2007, the Company recorded a charge of $0.6 million related to estimated lease losses, net of expected sublease income as a result of the acquisition of Silverback Systems, Inc. The Company reevaluates its estimates and assumptions on a quarterly basis and makes adjustments to the reserve balance if necessary.

The following table summarizes the activity related to the facilities lease losses reserve, net of expected sublease income (in thousands), as of January 27, 2007:

| | Lease Loss Reserve |
|---|---|
| Reserve balances at October 28, 2006 | $ 16,036 |
| Additional reserves related to Silverback acquisition | 579 |
| Cash payments on facilities leases | (1,431) |
| Non-cash charges | (14) |
| Reserve balance at January 27, 2007 | $ 15,170 |

Cash payments for facilities leases related to the above noted facilities lease losses will be paid over the respective lease terms through fiscal year 2010.

**6. Commitments and Contingencies**

*Leases*

The Company leases its facilities and certain equipment under various operating lease agreements expiring through August 2010. In connection with its facilities lease agreements, the Company has signed unconditional, irrevocable letters of credit totaling $2.7 million as security for the leases. Future minimum lease payments under all non-cancelable operating leases as of January 27, 2007 were $53.9 million, net of contractual sublease income of $6.6. In addition to base rent, many of the facilities lease agreements require that the Company pay a proportional share of the respective facilities' operating expenses.

As of January 27, 2007, the Company had recorded $15.2 million in facilities lease loss reserves related to future lease commitments, net of expected sublease income (see Note 5).

*Product Warranties*

The Company provides warranties on its products ranging from one to three years. Estimated future warranty costs are accrued at the time of shipment and charged to cost of revenues based upon historical experience. The Company's accrued liability for estimated future warranty costs is included in other accrued liabilities on the accompanying Condensed Consolidated Balance Sheets. The following table summarizes the activity related to the Company's accrued liability for estimated future warranty costs during the three months ended January 27, 2007 and January 28, 2006 (in thousands), respectively:

| | January 27, 2007 | January 28, 2006 |
|---|---|---|
| Beginning Balance | $ 2,230 | $ 1,746 |
| Liabilities accrued for warranties issued during the period | 444 | 394 |
| Warranty claims paid during the period | (74) | (124) |
| Changes in liability for pre-existing warranties during the period | (265) | (29) |
| Ending Balance | $ 2,335 | $ 1,987 |

In addition, the Company has standard indemnification clauses contained within its various customer contracts. As such, the Company indemnifies the parties to whom it sells its products with respect to the Company's product infringing upon any patents, trademarks, copyrights, or trade secrets, as well as against bodily injury or damage to real or tangible personal property caused by a defective Company product. As of January 27, 2007, there have been no known events or circumstances that have resulted in a customer contract related indemnification liability to the Company.

*Manufacturing and Purchase Commitments*

The Company has a manufacturing agreement with Hon Hai Precision Industry Co. ("Foxconn") under which the Company provides twelve-month product forecasts and places purchase orders in advance of the scheduled delivery of products to the Company's customers. The required lead-time for placing orders with Foxconn depends on the specific product. As of January 27, 2007, the Company's aggregate commitment to Foxconn for inventory components used in the manufacture of Brocade products was $73.6 million, net of purchase commitment reserves of $4.2 million, which the Company expects to utilize during future normal ongoing operations. The Company's purchase orders placed with Foxconn are cancelable, however if cancelled, the agreement with Foxconn requires the Company to purchase from Foxconn all inventory components not returnable, usable by, or sold to, other customers of Foxconn. The Company's purchase commitments reserve reflects the Company's estimate of purchase commitments it does not expect to consume in normal operations.

*Legal Proceedings*

From time to time, claims are made against Brocade in the ordinary course of its business, which could result in litigation. Claims and associated litigation are subject to inherent uncertainties and unfavorable outcomes could occur, such as monetary damages, fines, penalties or injunctions prohibiting Brocade from selling one or more products or engaging in other activities. The occurrence of an unfavorable outcome in any specific period could have a material adverse affect on the Brocade's results of operations for that period or future periods.

On July 20, 2001, the first of a number of putative class actions for violations of the federal securities laws was filed in the United States District Court for the Southern District of New York against Brocade, certain of its officers and directors, and certain of the underwriters for Brocade's initial public offering of securities. A consolidated amended class action captioned *In Re Brocade Communications Systems, Inc. Initial Public Offering Securities Litigation* was filed on April 19, 2002. The complaint generally alleges that various underwriters engaged in improper and undisclosed activities related to the allocation of shares in Brocade's initial public offering and seeks unspecified damages on behalf of a purported class of purchasers of common stock from May 24, 1999 to December 6, 2000. The lawsuit against Brocade is being coordinated for pretrial proceedings with a number of other pending litigations challenging underwriter practices in over 300 cases as *In Re Initial Public Offering Securities Litigation*, 21 MC 92(SAS). In October 2002, the individual defendants were dismissed without prejudice from the action, pursuant to a tolling agreement. On February 19, 2003, the Court issued an Opinion and Order dismissing all of the plaintiffs' claims against Brocade. In June 2004, a stipulation of settlement for the claims against the issuer defendants, including Brocade, was submitted to the Court for approval. On August 31, 2005, the Court granted preliminary approval of the settlement. On April 24, 2006, the Court held a fairness hearing in connection with the motion for final approval of the settlement. The Court has yet to issue a ruling on the motion for final approval. The settlement is subject to a number of conditions, including final approval by the Court. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the court's October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceeding. Brocade is not one of the test cases and it is unclear what impact this will have on Brocade's case. On January 5, 2007, plaintiffs filed a petition for rehearing en banc by the Second Circuit.

McDATA Corporation, Mr. John F. McDonnell, the former Chairman of the board of directors of McDATA, Mrs. Dee J. Perry and Mr. Thomas O. McGimpsey, both former officers of McDATA were named as defendants in purported securities class action lawsuits filed in the United States District Court, Southern District of New York. The first of these lawsuits, filed on July 20, 2001, is captioned *Gutner v. McDATA Corporation, Credit Suisse First Boston (CSFB), Merrill Lynch, Pierce Fenner & Smith Incorporated, Bear, Stearns & Co., Inc., FleetBoston Robertson Stephens et al., No. 01 CIV. 6627.* Three other similar suits were filed against McDATA and the individuals. The complaints are identical to numerous other complaints filed against other companies that went public in 1999 and 2000. These lawsuits generally allege, among other things, that the registration statements and prospectus filed with the SEC by such companies were materially false and misleading because they failed to disclose (a) that certain underwriters had allegedly solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriters allocated to those investors material portions of shares in connection with the initial public offerings, or IPOs, and (b) that certain of the underwriters had allegedly entered into agreements with customers whereby the underwriters agreed to allocate IPO shares in exchange for which the customers agreed to purchase additional company shares in the aftermarket at pre-determined prices. The complaints allege claims against McDATA, the named individuals, and CSFB, the lead underwriter of McDATA's August 9, 2000 initial public offering, under Sections 11 and 15 of the Securities Act. The complaints also allege claims solely against CSFB and the other underwriter defendants under Section 12(a) (2) of the Securities Act, and claims against the individual defendants under Section 10(b) of the Securities Exchange Act. Although management believes that all of the lawsuits are without legal merit and they intend to defend against them vigorously, there is no assurance that McDATA will prevail. In September 2002, plaintiffs' counsel in the above-mentioned lawsuits offered to individual defendants of many of the public companies being sued, including McDATA, the opportunity to enter into a Reservation of Rights and Tolling Agreement that would dismiss without prejudice and without costs, all claims against such persons if the company itself had entity coverage insurance. This agreement was signed by Mr. John F. McDonnell, the former Chairman of McDATA, Mrs. Dee J. Perry, the former chief financial officer of McDATA, and Mr. Thomas O. McGimpsey, the former General Counsel and Vice President of Business Development of McDATA and the plaintiffs' executive committee. Under the Reservation of Rights and Tolling Agreement, the plaintiffs dismissed the claims against such individuals. On February 19, 2003, the court in the above-mentioned lawsuits entered a ruling on the pending motions to dismiss, which dismissed some, but not all, of the plaintiffs' claims against McDATA. These lawsuits have been consolidated as part of *In Re Initial Public Offering Securities Litigation (SDNY).* McDATA has considered and agreed to enter into a proposed settlement offer with representatives of the plaintiffs in the consolidated proceeding. On August 31, 2005, the court preliminarily approved the proposed settlement. On April 24, 2006, the Court held a fairness hearing in connection with the motion for final approval of the settlement. The Court has yet to issue a ruling on the motion for final approval. The settlement remains subject to a number of conditions, including final court approval. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the court's October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceeding. McDATA is not one of the test cases and it is unclear what impact this will have on McDATA's case. On January 5, 2007, plaintiffs filed a petition for rehearing en banc by the Second Circuit.

A shareholder class action lawsuit was filed against Inrange and certain of its officers on November 30, 2001, in the United States District Court for the Southern District of New York, seeking recovery of damages caused by Inrange's alleged violation of securities laws, including section 11 of the Securities Act of 1933 and section 10(b) of the Exchange Act of 1934. The complaint, which was also filed against the various underwriters that participated in Inrange's initial public offering (IPO), is identical to hundreds of shareholder class actions pending in this court in connection with other recent IPOs and is generally referred to as *In re Initial Public Offering Securities Litigation.* The complaint alleges, in essence, (a) that the underwriters combined and conspired to increase their respective compensation in connection with the IPO by (i) receiving excessive, undisclosed commissions in exchange for lucrative allocations of IPO shares, and (ii) trading in Inrange's stock after creating artificially high prices for the stock post-IPO through "tie-in" or "laddering" arrangements (whereby recipients of allocations of IPO shares agreed to purchase shares in the aftermarket for more than the public offering price for Inrange shares) and dissemination of misleading market analysis on Inrange's prospects; and (b) that Inrange violated federal securities laws by not disclosing these underwriting arrangements in its prospectus. The defense has been tendered to the carriers of Inrange's director and officer liability insurance, and a request for indemnification has been made to the various underwriters in the IPO. At this point, the insurers have issued a reservation of rights letter and the underwriters have refused indemnification. The court has granted Inrange's motion to dismiss claims under section 10(b) of the Securities Exchange Act of 1934 because of the absence of a pleading of intent to defraud. The court granted plaintiffs leave to replead these claims, but no further amended complaint has been filed. The court denied Inrange's motion to dismiss claims under section 11 of the Securities Act of 1933. The court has also dismissed Inrange's individual officers without prejudice, after they entered into a tolling agreement with the plaintiffs. On July 25, 2003, Inrange's board of directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of Inrange and of the individual defendants for the conduct alleged in the action to be wrongful in the complaint. Inrange would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims Inrange may have against its underwriters. In June 2004, an agreement of settlement was submitted to the court for preliminary approval. On August 31, 2005, the court preliminarily approved the proposed settlement. On April 24, 2006, the Court held a fairness hearing in connection with the motion for final approval of the settlement. The Court has yet to issue a ruling on the motion for final approval. The settlement remains subject to a number of conditions, including final court approval. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the court's October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceeding. Inrange is not one of the test cases and it is unclear what impact this will have on Inrange's case. On January 5, 2007, plaintiffs filed a petition for rehearing en banc by the Second Circuit.

On May 16, 2005, Brocade announced that the SEC and the Department of Justice, or the DOJ, are conducting an investigation regarding Brocade's historical stock option granting processes. Brocade has been cooperating with the SEC and DOJ. During the first quarter of fiscal year 2006, Brocade began active settlement discussions with the Staff of the SEC's Division of Enforcement, or the Staff, regarding its financial restatements related to stock option accounting. As a result of these discussions, for the three months ended January 28, 2006, Brocade recorded a $7.0 million provision for an estimated settlement expense. The $7.0 million estimated settlement expense is based on an offer of settlement that Brocade made to the Staff and which the Staff has noted it intends to recommend to the SEC's Commissioners. The offer of settlement is contingent upon final approval by the SEC's Commissioners.

Beginning on or about May 19, 2005, several securities class action complaints were filed against Brocade and certain of its current and former officers. These actions were filed in the United States District Court for the Northern District of California on behalf of purchasers of Brocade's stock from February 2001 to May 2005. These lawsuits followed Brocade's restatement of certain financial results due to stock-based compensation accounting issues. On January 12, 2006, the Court appointed a lead plaintiff and lead counsel. On April 14, 2006, the lead plaintiff filed a consolidated complaint on behalf of purchasers of Brocade's stock from May 2000 to May 2005. The consolidated complaint alleges, among other things, violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The consolidated complaint generally alleges that Brocade and the individual defendants made false or misleading public statements regarding Brocade's business and operations and seeks unspecified monetary damages and other relief against the defendants. These lawsuits followed Brocade's restatement of certain financial results due to stock-based compensation accounting issues.

Beginning on or about May 24, 2005, several derivative actions were also filed against certain of Brocade's current and former directors and officers. These actions were filed in the United States District Court for the Northern District of California and in the California Superior Court in Santa Clara County. The complaints allege that certain of Brocade's officers and directors breached their fiduciary duties to Brocade by engaging in alleged wrongful conduct including conduct complained of in the securities litigation described above. Brocade is named solely as a nominal defendant against whom the plaintiffs seek no recovery. The derivative actions pending in the District Court for the Northern District of California were consolidated and the Court created a Lead Counsel structure. The derivative plaintiffs filed a consolidated complaint in the District Court for the Northern District of California on October 7, 2005, and Brocade filed a motion to dismiss that action on October 27, 2005. On January 6, 2006, Brocade’s motion was granted and the consolidated complaint in the District Court for the Northern District of California was dismissed with leave to amend. The parties to this action subsequently reached a preliminary settlement, which remains subject to approval by the Court.

The derivative actions pending in the Superior Court in Santa Clara County were consolidated. The derivative plaintiffs filed a consolidated complaint in the Superior Court in Santa Clara County on September 19, 2005. Brocade filed a motion to stay that action in deference to the substantially identical consolidated derivative action pending in the District Court for the Northern District of California, and on November 15, 2005, the Court stayed the action. In October 2006, the Court partially lifted the stay and granted plaintiffs leave to file an amended complaint. On November 13, 2006, plaintiffs filed an amended complaint.

No amounts have been recorded in Brocade’s Consolidated Financial Statements associated with these matters as the amounts are not probable or reasonably estimable other than the $7.0 million provision for an estimated settlement expense with the SEC as noted above.

*Integration costs*

In connection with the acquisition of McDATA, the Company recorded acquisition and integration costs of $7.4 million for the three months ended January 27, 2007, which consisted primarily of costs incurred for consulting services and other professional fees. No amounts have been recorded in Brocade’s Condensed Consolidated Financial Statements associated with acquisition and integration costs for the three months ended January 28, 2006.

***Derivative Accounting Policies***

The derivatives entered into by the Company qualify for, and are designated as, foreign-currency cash flow hedges as per the definitions of Statement of Financial Accounting Standards No. 133, “*Accounting for Derivative Instruments and Hedging Activities*, as amended and interpreted, incorporating FASB Statements No. 137, 138 and 149” (SFAS No. 133).

The Company considers whether any provisions in non-derivative contracts represent “embedded” derivative instruments as described in SFAS No. 133. As of January 27, 2007, we have concluded that no “embedded” derivative instruments warrant separate fair value accounting under SFAS No. 133.

The derivatives are recognized on the balance sheet at their fair value. Unrealized gain positions are recorded as other current assets. Unrealized loss positions are recorded as other liabilities or other non-current liabilities. Changes in fair values of outstanding cash flow hedges that are highly effective as per the definition of SFAS 133 are recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the underlying hedged transaction. In most cases amounts recorded in other comprehensive income will be released to earnings at maturity of the related derivative. The recognition of effective hedge results in the consolidated statement of income offsets the gains or losses on the underlying exposure. Cash flows from derivative transactions are classified according to the nature of the risk being hedged.

The Company formally documents all relationships between hedging instruments and hedged items, as well as the risk-management objective and strategy for undertaking hedge transactions. This process includes linking all derivatives either to specific assets and liabilities on the balance sheet or specific firm commitments or forecasted transactions. The Company also formally assesses both at the hedge’s inception and on an ongoing basis, whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not, or has ceased to be, highly effective as a hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when (1) the derivative is no longer highly effective, as per SFAS No. 133, in offsetting changes in the cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; or (4) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When the Company discontinues hedge accounting but it continues to be probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in accumulated other comprehensive income and is reclassified into earnings when the forecasted transaction affects earnings. However, if it is no longer probable that a forecasted transaction will occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in other comprehensive income will be recognized immediately in earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Company will carry the derivative at its fair value on the balance sheet until maturity, recognizing future changes in the fair value in current-period earnings. Any hedge ineffectiveness, as per SFAS 133, is recorded in current-period earnings in other expense (income), net. Effectiveness is assessed based on the comparison of current forward rates to the rates established on the Company's hedges.

As of January 27, 2007, losses of $428 thousand which represented effective hedges of net investments, were reported as a component of accumulated other comprehensive loss within unrealized translation adjustment. Hedge ineffectiveness, which is reported in the consolidated statements of income as other expense, was not significant.

### 7. Segment Information

The Company is organized and operates as one operating segment: the design, development, marketing and selling of infrastructure for SANs. The Company's Chief Executive Officer is the Company's Chief Operating Decision Maker (CODM), as defined by SFAS 131, "*Disclosures about Segments of an Enterprise and Related Information*." The CODM allocates resources and assesses the performance of the Company based on total revenues and overall profitability.

Revenues are attributed to geographic areas based on the location of the customer to which products are shipped. Domestic revenues include sales to certain OEM customers who take possession of Brocade products domestically and then distribute these products to their international customers. Domestic and international revenues were approximately 59 percent and 41 percent of total revenues, respectively, for the three months ended January 27, 2007 compared to 63 percent and 37 percent of total revenues, respectively, for the three months ended January 28, 2006. To date, service revenue has not exceeded 10 percent of total revenues. Identifiable assets located in foreign countries were not material as of January 27, 2007 and October 28, 2006. For each of the three months ended January 27, 2007 and January 28, 2006, three customers accounted for 72 percent of our total revenues.

### 8. Net Income per Share

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

| | Three Months Ended | |
|---|---|---|
| | January 27, 2007 | January 28, 2006 |
| Net income | $ 33,318 | $ 9,660 |
| Basic and diluted net income per share: | | |
| Weighted-average shares of common stock outstanding | 275,177 | 271,335 |
| Less: Weighted-average shares of common stock subject to repurchase | (2,322) | (1,935) |
| Weighted-average shares used in computing basic net income per share | 272,855 | 269,400 |
| Dilutive effect of common share equivalents | 12,282 | 2,701 |
| Weighted-average shares used in computing diluted net income per share | 285,137 | 272,101 |
| Basic net income per share | $ 0.12 | $ 0.04 |
| Diluted net income per share | $ 0.12 | $ 0.04 |

For the three months ended January 27, 2007 and January 28, 2006, potential common shares in the form of stock options to purchase 3.3 million and 42.5 million weighted-average shares of common stock, respectively, were antidilutive and, therefore, not included in the computation of diluted earnings per share. For the three months ended January 28, 2006, potential common shares resulting from the potential conversion, on a weighted average basis, of the Company's convertible subordinated debt of 6.4 million common shares were antidilutive and therefore not included in the computation of diluted earnings per share for that period.

**9. Acquisitions**

***Silverback Systems, Inc.***

On January 5, 2007, the Company completed its acquisition of Silverback Systems, Inc. ("Silverback"), a privately held provider of network acceleration technology headquartered in Campbell, California. This acquisition enables the Company to provide communications solutions for SAN networks.

The results of operations of Silverback are included in the accompanying Condensed Consolidated Statement of Income from the date of the acquisition. The Company does not consider the acquisition of Silverback to be material to its results of operations, and therefore is not presenting pro forma statements of income for the three months ended January 27, 2007.

The total purchase price was $7.8 million, consisting of $4.5 million cash consideration and $3.3 million related to cash settlement of debt assumed. Of the $4.5 million cash consideration, $1.2 million will be held in escrow for a period of 18 months from the transaction date and will be released subject to certain contingencies. In addition, the Company paid direct acquisition costs of $0.4 million.

In connection with this acquisition, the Company allocated the total purchase consideration to the net assets and liabilities acquired, including identifiable intangible assets, based on their respective fair values at the acquisition date, resulting in goodwill of approximately $8.3 million which is not expected to be deductible for income tax purposes. The following table summarizes the allocation of the purchase price to the fair value of the assets and liabilities acquired (in thousands):

| | |
|---|---|
| Assets acquired | |
| Cash | $ 98 |
| Accounts receivable | 172 |
| Identifiable intangible assets | |
| Tradename | 100 |
| Core/Developed technology | 590 |
| Customer relationships | 400 |
| Non-compete agreements | 370 |
| Backlog | 80 |
| Goodwill | 8,345 |
| Other assets | 1,644 |
| Total assets acquired | 11,799 |
| Liabilities assumed Accounts payable and accrued liabilities | 3,995 |
| Total liabilities assumed | 3,995 |
| Net assets acquired | $ 7,804 |

Additionally, for the three months ended January 27, 2007, the Company recorded total acquisition-related bonus compensation expense of $1.5 million. Of that amount, $1.4 million was related to the acquisition of NuView, Inc. in March 2006 and $0.1 million was related to the acquisition of Silverback.

**10. Goodwill and Intangible Assets**

The Company's carrying value of goodwill as of January 27, 2007 consisted of the following (in thousands):

| | |
|---|---|
| Balance at October 28, 2006 | $ 41,013 |
| Silverback acquisition | 8,345 |
| Balance at January 27, 2007 | $ 49,358 |

The Company amortizes intangible assets over a useful life ranging from 6 months to 6 years. Intangible assets as of January 27, 2007 consisted of the following (in thousands):

| | Gross Carrying Value | Accumulated Amortization | Net Carrying Value |
|---|---|---|---|
| Tradename | $ 1,032 | $ 269 | $ 763 |
| Core/Developed technology | 8,486 | 1,335 | 7,151 |
| Customer relationships | 9,331 | 1,593 | 7,738 |
| Non-compete agreements | 370 | 21 | 349 |
| Backlog | 80 | 12 | 68 |
| Total intangible assets | $ 19,299 | $ 3,230 | $ 16,069 |

The Company had no unamortized intangible assets as of January 28, 2006. For the three months ended January 27, 2007, total amortization expense related to intangible assets of $0.9 million is included in operating expenses in the Condensed Consolidated Statement of Income. The following table presents the estimated future amortization of intangible assets (in thousands):

| Fiscal Years | Future Estimated Amortization |
|---|---|
| 2007 (1) | $ 3,095 |
| 2008 | 3,882 |
| 2009 | 3,699 |
| 2010 | 3,734 |
| 2011 | 1,474 |
| 2012 | 182 |
| 2013 | 3 |
| Total | $ 16,069 |

(1) Reflects the remaining 9 months of fiscal 2007.

**11. Subsequent Events**

*McDATA Acquisition*

On January 29, 2007, the Company completed its acquisition of McDATA Corporation by the merger of Worldcup Merger Corporation (“Merger Sub”), a Delaware corporation and wholly-owned subsidiary of the Company, with and into McDATA, in accordance with the Agreement and Plan of Reorganization, dated as of August 7, 2006, as amended, by and among the Company, Merger Sub and McDATA, which we refer to as the Merger Agreement. As a result of the Merger, McDATA is now a wholly-owned subsidiary of the Company. McDATA provides storage networking and data infrastructure solutions.

Pursuant to the terms of the Merger Agreement, each outstanding share of Class A and Class B common stock of McDATA was converted into the right to receive 0.75 shares of the Company’s common stock. Additionally, each outstanding option to purchase McDATA Class A or Class B common stock was assumed by the Company and now represents an option to acquire shares of common stock of the Company, subject to the applicable conversion ratio, on the terms and conditions set forth in the Merger Agreement. Based on Brocade’s closing stock price on January 26, 2007, the transaction is valued at approximately $973 million.

*McDATA debt redemption*

Effective upon the consummation of the merger with McDATA, the Company fully and unconditionally guaranteed, and became a co-obligor, in the $122.4 million outstanding 3.00% Convertible Subordinated Notes due February 15, 2007, previously issued by Computer Network Technology, Inc. (“CNT”), and assumed on June 1, 2005 by McDATA, upon McDATA’s acquisition of CNT. On February 15, 2007, the Company redeemed the total outstanding notes for a total of $124.2 million, consisting of $122.4 million in principal and $1.8 million in interest.

*Stock Repurchase Plan*

On January 29, 2007, the Company announced the authorization of an additional $200 million for stock repurchases, which is in addition to the $52.7 million remaining under the previously announced $100 million stock repurchase program.

Such repurchases may be made from time to time on the open market, in negotiated transactions off the market or pursuant to a plan adopted by the Company. The timing and amount of any shares repurchased under the program will depend on a variety of factors, including price, corporate and regulatory requirements, capital availability and other market conditions.

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

*You should read the following discussion and analysis in conjunction with the condensed consolidated financial statements and notes thereto included in Item 1 of this Quarterly Report and with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report filed on Form 10-K with the Securities and Exchange Commission on January 9, 2007.*

**Results of Operations**

The following table sets forth certain financial data for the periods indicated as a percentage of total net revenues:

| | Three Months Ended | |
|---|---|---|
| | January 27, 2007 | January 28, 2006 |
| Net revenues | 100.0% | 100.0% |
| Cost of revenues | 36.9 | 40.8 |
| Gross margin | 63.1 | 59.2 |
| Operating expenses: | | |
| Research and development | 18.9 | 22.4 |
| Sales and marketing | 17.2 | 18.1 |
| General and administrative | 3.3 | 4.6 |
| Legal fees associated with indemnification obligations, SEC investigation and other related costs | 2.4 | 2.4 |
| Acquisition and integration costs | 3.3 | 0.0 |
| Provision for SEC settlement | 0.0 | 4.1 |
| Amortization of intangible assets | 0.4 | 0.4 |
| Total operating expenses | 45.5 | 52.0 |
| Income from operations | 17.6 | 7.2 |
| Interest and other income, net | 3.3 | 4.1 |
| Interest expense | (0.0) | (1.0) |
| Income before provision for income taxes | 20.9 | 10.3 |
| Income tax provision | 6.0 | 4.6 |
| Net income | 14.9% | 5.7% |

*Revenues.* Our revenues are derived primarily from sales of our family of SAN products. Our fabric switches and directors, which range in size from 8 ports to 512 ports, connect servers and storage devices creating a SAN.

From a geographical perspective, our total net revenues for the three months ended January 27, 2007 and January 28, 2006 were as follows (in thousands):

| | Three Months Ended | | | | | |
|---|---|---|---|---|---|---|
| | January 27, 2007 | | January 28, 2006 | | Increase/ (Decrease) | % Change |
| Domestic | $ 133,183 | 59% | $ 108,030 | 63% | $ 25,153 | 23% |
| International | 90,973 | 41% | 62,052 | 37% | 28,921 | 47% |
| Total Net Revenue | $ 224,156 | 100% | $ 170,082 | 100% | $ 54,074 | 32% |

Net revenues for the three months ended January 27, 2007 were $224.2 million, an increase of 32 percent compared with net revenues of $170.1 million for the three months ended January 28, 2006. The increase in net revenues for the period reflected a 50 percent increase in the number of ports shipped, partially offset by an 11 percent decline in average selling price per port. The declines in average selling prices are the result of a continuing competitive pricing environment. We believe the increase in the number of ports shipped reflects higher demand for our products as end-users continue to consolidate storage and servers infrastructures using SANs, expand SANs to support more applications, and deploy SANs in new environments.

Going forward, we expect the number of ports shipped to fluctuate depending on the demand for our existing and recently introduced products as well as the timing of product transitions by our OEM customers. We also expect that average selling prices per port will likely decline at rates consistent with historical rates, unless they are adversely affected by accelerated pricing pressures, new product introductions by us or our competitors, our acquisition of McDATA, or other factors that may be beyond our control. We expect quarterly fluctuations in revenue to be consistent with historic seasonal trends. Historically, our second fiscal quarter is down from a seasonally strong first fiscal quarter due to a typically slower growth period.

Historically, domestic revenues have been between 60 percent and 75 percent of total revenues. Domestic and international revenues were approximately 59 percent and 41 percent of our total revenues, respectively, for the three months ended January 27, 2007 compared to 63 percent and 37 percent of total revenues, respectively, for the three months ended January 28, 2006. Revenues are attributed to geographic areas based on the location of the customer to which our products are shipped. International revenues primarily consist of sales to customers in Western Europe and the greater Asia Pacific region. For the three months ended January 27, 2007 and January 28, 2006, international revenues have increased primarily as a result of faster growth in the European region relative to North America. However, certain OEM customers take possession of our products domestically and then distribute these products to their international customers. Because we account for all of those OEM revenues as domestic revenues, we cannot be certain of the extent to which our domestic and international revenue mix is impacted by the practices of our OEM customers, and we believe international revenue is a larger percent of our revenue than the attributed revenues may indicate.

A significant portion of our revenue is concentrated among a relatively small number of OEM customers. For the three months ended January 27, 2007, three customers each represented ten percent or more of our total revenues for a combined total of 72 percent of our total revenues. For the three months ended January 28, 2006, three customers each represented ten percent or more of our total revenues for combined total of 72 percent of total revenues. We expect that a significant portion of our future revenues will continue to come from sales of products to a relatively small number of OEM customers. Therefore, the loss of, or a decrease in the level of sales to, or a change in the ordering pattern of, any one of these customers could seriously harm our financial condition and results of operations.

*Cost of Goods Sold.* Cost of goods sold consists of product costs, which typically vary with volume and manufacturing operations costs, which do not change directly with volume.

Cost of goods sold for the three months ended January 27, 2007 and January 28, 2006 were as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Points Change |
|---|---|---|---|---|
| $82,790 | 37% | $69,381 | 41% | (4)% |

Gross margin for the three months ended January 27, 2007 was 63.1 percent, an increase of 3.9 percentage points from 59.2 percent for the three months ended January 28, 2006. For the three months ended January 27, 2007, product costs relative to net revenues decreased by 3.3 percentage points as compared to the three months ended January 28, 2006 due to the transition from 2 Gbit products to new 4 Gbit products and an increase in the volume of shipments. Manufacturing operation costs and service operation costs decreased slightly, by 0.3 of a percentage point relative to net revenues primarily due to engineering charges as products transitioned into sustaining engineering from development. In addition, stock-based compensation expense in the three months ended January 27, 2007 decreased by 0.3 of a percentage point relative to net revenues primarily as a result of variable stock compensation expense.

Gross margin is primarily affected by average selling price per port, number of ports shipped, and cost of goods sold. We expect that average selling prices per port for our products will continue to decline at rates consistent with historical rates, unless they are further affected by accelerated pricing pressures, new product introductions by us or our competitors, or other factors that may be beyond our control. We believe that we have the ability to partially mitigate the effect of declines in average selling price per port on gross margins through our product and manufacturing operations cost reductions. However, the average selling price per port could decline at a faster pace than we anticipate. If this dynamic occurs, we may not be able to reduce our costs fast enough to prevent a decline in our gross margins. In addition, we must also maintain or increase the current volume of ports shipped to maintain our current gross margins. If we are unable to offset future reductions of average selling price per port with reductions in product and manufacturing operations costs, or if as a result of future reductions in average selling price per port our revenues do not grow, our gross margins would be negatively affected.

We recently introduced several new products and expect to introduce additional new products in the future. As new or enhanced products are introduced, we must successfully manage the transition from older products in order to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories, and provide sufficient supplies of new products to meet customer demands. Our gross margins would likely be adversely affected if we fail to successfully manage the introductions of these new products.

Excluding any stock-based compensation expenses related to awards remeasured at their intrinsic value, which will vary depending on the changes in the market value of our common stock, we currently anticipate that cost of goods sold related expenses for the three months ending April 28, 2007 will increase in absolute dollars as a result of increased headcount resulting from our acquisition of McDATA.

*Research and development expenses.* Research and development ("R&D") expenses consist primarily of salaries and related expenses for personnel engaged in engineering and R&D activities; fees paid to consultants and outside service providers; nonrecurring engineering charges; prototyping expenses related to the design, development, testing and enhancement of our products; depreciation related to engineering and test equipment; and IT and facilities expenses.

Research and development expenses for the three months ended January 27, 2007 and January 28, 2006 were as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Points Change |
|---|---|---|---|---|
| $42,391 | 19% | $38,742 | 23% | (4)% |

For the three months ended January 27, 2007, R&D expenses increased by $3.7 million, or 9 percentage points, to $42.4 million, compared with $38.7 million for the three months ended January 28, 2006. This increase is primarily due to a $5.3 million increase in salaries and headcount related and $1.6 million additional outside service related expenses resulting from growth in product development and new product introductions, $0.3 million increase in stock-based compensation expense, and $0.6 million increase in outside services, offset by a decrease of $4.1 million related to more products transitioned into sustaining engineering from development.

Excluding any stock-based compensation expenses related to awards remeasured at their intrinsic value, which will vary depending on the changes in the market value of our common stock, we currently anticipate that R&D expenses for the three months ending April 28, 2007 will increase in absolute dollars as a result of increased headcount resulting from our acquisition of McDATA.

*Sales and marketing expenses.* Sales and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in marketing and sales; costs associated with promotional and travel expenses; and IT and facilities expenses.

Sales and marketing expenses for the three months ended January 27, 2007 and January 28, 2006 were as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Points Change |
|---|---|---|---|---|
| $38,587 | 17% | $30,868 | 18% | (1)% |

For the year three months ended January 27, 2007, sales and marketing expenses increased by $7.7 million, or 25 percentage points, to $38.6 million, compared with $30.9 million for the three months ended January 28, 2006. This increase is primarily due to a $3.8 million increase in salaries and headcount related expenses, including higher commissions and higher compensation and bonus expenses due to higher revenues and a $1.5 million increase in sales and marketing program expenses.

Excluding any stock-based compensation expenses related to awards remeasured at their intrinsic value, which will vary depending on the changes in the market value of our common stock, we currently anticipate that sales and marketing expenses for the three months ended April 28, 2007 will increase in absolute dollars as a result of increased headcount resulting from the acquisition of McDATA.

*General and administrative expenses.* General and administrative ("G&A") expenses consist primarily of salaries and related expenses for corporate executives, finance, human resources and investor relations, as well as recruiting expenses, professional fees, corporate legal expenses, other corporate expenses, and IT and facilities expenses.

General and administrative expenses for the three months ended January 27, 2007 and January 28, 2006 were as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Points Change |
|---|---|---|---|---|
| $7,404 | 3% | $7,801 | 5% | (2)% |

G&A expenses for the three months ended January 27, 2007 decreased by $0.4 million, or 5 percentage points, to $7.4 million, compared with $7.8 million for the three months ended January 28, 2006. The decrease in G&A is primarily due to a decrease in depreciation related expenses due to fixed assets reaching the end of their life.

Excluding any stock-based compensation expenses related to awards remeasured at their intrinsic value, which will vary depending on the changes in the market value of our common stock, we currently anticipate that G&A expenses for the three months ending April 28, 2007 to increase in absolute dollars resulting from the acquisition of McDATA.

*Legal fees associated with indemnification obligations, SEC investigation and other related costs.* These expenses consist of professional legal and accounting service fees for various matters, including applicable indemnification obligations, the completed internal reviews and the ongoing SEC and Department of Justice ("DOJ") joint investigations.

Legal fees associated with indemnification obligations, SEC investigation and other related costs for the three months ended January 27, 2007 and January 28, 2006 were as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Points Change |
|---|---|---|---|---|
| $5,228 | 2% | $4,029 | 2% | —% |

On January 24, 2005, we announced that our Audit Committee completed an internal review regarding historical stock option granting practices. Following the January 2005 Audit Committee internal review, on May 16, 2005, we announced that additional information had come to our attention that indicated that certain guidelines regarding stock option granting practices were not followed and our Audit Committee had commenced an internal review of our stock option accounting focusing on leaves of absence and transition and advisory roles. This Audit Committee review was completed in November 2005. We are currently undergoing an SEC and DOJ joint investigation regarding our historical stock option granting practices.

*Acquisition and integration costs.*

Acquisition and integration costs for the three months ended January 27, 2007 and January 28, 2006 were as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Points Change |
|---|---|---|---|---|
| $7,433 | 3% | $— | —% | 3% |

In connection with our acquisition of McDATA (see Note 11 “Subsequent Events”, of the Notes to Condensed Consolidated Financial Statements), we recorded acquisition and integration costs of $7.4 million in the three months ended January 27, 2007, which consisted primarily of costs incurred for consulting services and other professional fees.

*Provision for SEC settlement.*

Provision for SEC settlement for the three months ended January 27, 2007 and January 28, 2006 was as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Points Change |
|---|---|---|---|---|
| $— | —% | $7,000 | 4% | (4)% |

During the three months ended January 28, 2006 we began active settlement discussions with the Staff of the SEC’s Division of Enforcement (the “Staff”) regarding our financial restatements related to stock option accounting. As a result of these discussions, for the three months ended January 28, 2006 we recorded a $7.0 million provision for an estimated settlement expense. The $7.0 million estimated settlement expense is based on an offer of settlement that the Company made to the Staff and which the Staff intends to recommend to the SEC’s Commissioners. The offer of settlement is contingent upon final approval by the SEC’s Commissioners. No other provision amounts have been recorded in the Condensed Consolidated Financial Statements for the periods presented as the amounts are not reasonably estimable.

*Amortization of intangible assets.*

Amortization of intangible assets for the three months ended January 27, 2007 and January 28, 2006 was as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Point Change |
|---|---|---|---|---|
| $910 | 0.4% | $— | —% | 0.4% |

During the three months ended January 27, 2007, we recorded amortization of intangible assets of $0.9 million related to the acquisitions of Silverback and NuView. We account for intangible assets in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (“SFAS 142”). Intangible assets are recorded based on estimates of fair value at the time of the acquisition and identifiable intangible assets are amortized on a straight line basis over their estimated useful lives (see Note 10: “Goodwill and Identifiable Intangible Assets,” of the Notes to Condensed Consolidated Financial Statements).

*Interest and other income, net.*

Interest and other income, net, for the three months ended January 27, 2007 and January 28, 2006 was as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Point Change |
|---|---|---|---|---|
| $7,456 | 3% | $7,030 | 4% | (1)% |

Interest and other income was $7.4 million and $7.0 million for three months ended January 27, 2007 and January 28, 2006, respectively. For the three months ended January 27, 2007, the increase was primarily due to higher average rates of return due to investment mix and increase in interest rates, as well as increased average cash, cash equivalent, and short-term and long-term investment balances.

*Interest expense.*

Interest expense for the three months ended January 27, 2007 and January 28, 2006 was as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Point Change |
|---|---|---|---|---|
| $(4) | —% | $(1,777) | (1%) | 1% |

Interest expense was $4 thousand and $1.8 million for the three months ended January 27, 2007 and January 28, 2006, respectively. Interest expense primarily represents the interest cost associated with our convertible subordinated debt. The decrease in interest expense was primarily the result of the liquidation of our convertible subordinated debt during the fourth quarter of fiscal year 2006. As of January 27, 2007 and January 28, 2006, the outstanding balance of our convertible subordinated debt was $0.0 and $278.9 million, respectively.

*Provision for income taxes*

Provision for income taxes for the three months ended January 27, 2007 and January 28, 2006 were as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Point Change |
|---|---|---|---|---|
| $13,547 | 6% | $7,854 | 5% | 1% |

Estimates and judgments are required in the calculation of certain tax liabilities and in the determination of the recoverability of certain of the deferred tax assets, which arise from variable stock option expenses, net operating losses, tax carryforwards and temporary differences between the tax and financial statement recognition of revenue and expense. SFAS No. 109, *"Accounting for Income Taxes"* ("SFAS 109"), also requires that the deferred tax assets be reduced by a valuation allowance, if based on the weight of available evidence, it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods.

In evaluating our ability to recover our deferred tax assets, in full or in part, we consider all available positive and negative evidence including our past operating results, the existence of cumulative losses in the most recent fiscal years and our forecast of future taxable income on a jurisdiction by jurisdiction basis. In determining future taxable income, we are responsible for assumptions utilized including the amount of state and federal pre-tax operating income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgments about the forecasts of future taxable income and are consistent with the plans and estimates we are using to manage the underlying businesses. We will reevaluate our position for a full valuation allowance at the combined business date of Brocade and McData. As of January 27, 2007, we had a valuation allowance against the deferred tax assets, which we intend to maintain until sufficient positive evidence exists to support reversal of the valuation allowance. Future reversals or increases to our valuation allowance could have a significant impact on our future earnings.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations in a multitude of jurisdictions. We recognize potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will be due. If events occur and the payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary. If our estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result.

For the three months ended January 27, 2007, we have recorded an income tax provision of $13.5 million, compared to income tax provisions of $7.9 million for the three months ended January 28, 2006. For the three months ended January 27, 2007, our income tax provision is based on both domestic and international operations. We expect to continue to record an income tax provision for our international and domestic operations in the future. We expect our effective tax rate for the three months ended April 28, 2007 to be higher due to the McData acquisition. Since we have a full valuation allowance against deferred tax assets which result from U.S. operations, U.S. income tax expense or benefits are offset by releasing or increasing, respectively, the valuation allowance. Our U.S. federal income tax liability is reduced by the utilization of net operating loss and credit carryforwards from prior years such that only alternative minimum tax results. To the extent these carryforwards are fully utilized against future earnings, our U.S. federal effective tax rate is expected to increase. To the extent that international revenues and earnings differ from those historically achieved, a factor largely influenced by the buying behavior of our OEM partners, or unfavorable changes in tax laws and regulations occur, our income tax provision could change.

In November 2005, we were notified by the Internal Revenue Service that our domestic federal income tax return for the year ended October 25, 2003 was subject to audit. We believe we have adequate reserves to cover any potential assessments that may result from the examination.

In April 2006, we were notified by the Franchise Tax Board ("FTB") that our California income tax returns for the years ended October 25, 2003 and October 30, 2004 were subject to audit. The FTB Audit is ongoing and we believe our reserves are adequate to cover any potential assessments that may result from the examination.

*Stock compensation expense*.

Stock compensation expense for the three months ended January 27, 2007 and January 28, 2006 was as follows (in thousands):

| January 27, 2007 | % of Net Revenue | January 28, 2006 | % of Net Revenue | % Point Change |
|---|---|---|---|---|
| $6,725 | 3% | $6,936 | 4% | (1)% |

Total stock-based compensation expense for the three months ended January 27, 2007 was $6.7 million. Of this amount, $1.8 million was included in cost of sales, $2.3 million in research and development, $1.7 million in sales and marketing, $0.8 million in general and administrative expenses, and $0.1 million in amortization of deferred stock-based compensation related to prior acquisitions. Total stock-based compensation expense for the three months ended January 28, 2006 was $6.9 million. Of this amount, of $1.8 million was included in cost of sales, $2.0 million in research and development, $1.6 million in sales and marketing, $0.8 million in general and administrative expenses, and $0.6 million in amortization of deferred stock-based compensation related to prior acquisitions.

We have stock-based compensation arising from stock option grants remeasured at their intrinsic value and subject to change in measurement date. For the three months ended January 27, 2007, total compensation benefit of $44 thousand resulting from stock option grants remeasured at their intrinsic value was included in cost of sales, research and development, sales and marketing, or general and administrative expenses by employee in the same manner as our payroll related expenses. For the three months ended January 28, 2006, total compensation expense of $0.3 million resulting from stock option grants remeasured at their intrinsic value and subject to change in measurement date are included in cost of sales, research and development, sales and marketing, or general and administrative expenses, by employee in the same manner as our payroll related expenses. The stock-based compensation expense associated with remeasuring awards at their intrinsic value each reporting period will vary significantly as a result of future changes in the market value of our common stock. The change in stock-based compensation related to awards remeasured at their intrinsic value during the three months ended January 27, 2007 as compared to the three months ended January 28, 2006 is due to a change in market values of our common stock during the reported periods.

In addition to the stock-based compensation expense recorded for stock-based awards, for the three months ended January 27, 2007 and January 28, 2006, we recorded $0.1 million and $0.6 million, respectively, in amortization of stock-based compensation in connection with prior acquisitions. The amortized stock-based compensation expense represents the fair value of unvested restricted common stock and assumed stock options, and is being amortized over the respective remaining service periods on a straight-line basis. As of January 27, 2007, the remaining unamortized balance of stock-based compensation related to prior acquisitions was approximately $0.6 million.

**Liquidity and Capital Resources**

| | Three Months Ended | | |
|---|---|---|---|
| | January 27, 2007 | October 28, 2006 | Increase/ (Decrease) |
| | | (in thousands) | |
| Cash and cash equivalents | $ 249,807 | $ 274,368 | $ (24,561) |
| Short-term investments | 319,331 | 267,694 | 51,637 |
| Long-term investments | 62,521 | 40,492 | 22,029 |
| Total | $ 631,659 | $ 582,554 | $ 49,105 |
| Percentage of total assets | 65% | 65% | |

Cash, cash equivalents, restricted short-term investments, and short-term and long-term investments were $631.7 million as of January 27, 2007, an increase of $49.1 million over the prior quarter total of $582.6 million. For the three months ended January 27, 2007, we generated $33.3 million in cash from operating activities, which was in line with net income for the three months ended January 27, 2007. Days sales outstanding in receivables for the three months ended January 27, 2007 was 38 days, compared with 41 days for the three months ended January 28, 2006.

Net cash used in investing activities for the three months ended January 27, 2007 totaled $94.6 million and was the result of $169.9 million in cash used for purchases of short-term and long-term investments and $13.4 million invested in capital equipment, offset by $96.3 million in net proceeds from sales and maturities of short-term and long term investments.

Net cash provided by financing activities for the three months ended January 27, 2007 totaled $36.8 million. Net cash provided by financing activities was primarily the result of proceeds from the issuance of common stock.

Net proceeds from the issuance of common stock related to employee participation in employee stock programs have historically been a significant component of our liquidity. The extent to which our employees participate in these programs generally increases or decreases based upon changes in the market price of our common stock. As a result, our cash flow resulting from the issuance of common stock related to employee participation in employee stock programs will vary. As a result of our voluntary stock options exchange program, which was completed in July 2003, we expect to continue to generate significant cash flow from the issuance of common stock related to employee participation in employee stock programs during fiscal year 2007 unless our future common stock price does not exceed $6.54 per share, which is the exercise price of the stock options granted under the exchange program.

We have a manufacturing agreement with Foxconn under which we provide twelve-month product forecasts and place purchase orders in advance of the scheduled delivery of products to our customers. The required lead-time for placing orders with Foxconn depends on the specific product. As of January 27, 2007, our aggregate commitment to Foxconn for inventory components used in the manufacture of Brocade products was $73.6 million, net of purchase commitment reserves of $4.2 million, which we expect to utilize during future normal ongoing operations. Although the purchase orders we place with Foxconn are cancelable, the terms of the agreement requires us to purchase from Foxconn all inventory components not returnable or usable by, or sold to, other customers of Foxconn. Our purchase commitments reserve reflects our estimate of purchase commitments we do not expect to consume in normal operations.

On November 18, 2003, we purchased a previously leased building located near our San Jose headquarters, and issued a $1.0 million guarantee as part of the purchase agreements.

The following table summarizes our contractual obligations (including interest expense) and commitments as of January 27, 2007 (in thousands):

| | Total | Less than 1 Year | 1—3 Years | 3—5 Years | More than 5 Years |
|---|---|---|---|---|---|
| **Contractual Obligations:** | | | | | |
| Non-cancelable operating leases | 53,936(1) | 16,218 | 29,212 | 8,506 | — |
| Purchase commitments, gross | 73,573(2) | 73,573 | — | — | — |
| Total contractual obligations | $ 127,509 | $ 89,791 | $ 29,212 | $ 8,506 | $ — |
| **Other Commitments:** | | | | | |
| Standby letters of credit | $ 2,693 | $ n/a | $ n/a | $ n/a | $ n/a |
| Guarantee | $ 1,015 | $ n/a | $ n/a | $ n/a | $ n/a |

(1) Amount excludes contractual sublease income of $6.6 million, which consist of $1.6 million to be received in less than 1 year, $3.8 million to be received in 1 through 3 years, and $1.2 million to be received in 3 to 5 years.

(2) Amount reflects total gross purchase commitments under our manufacturing agreement with a third party contract manufacturer. Of this amount, we have accrued $4.2 million for estimated purchase commitments that we do not expect to consume in normal operations.

*Share Repurchase Program.* In August 2004, our board of directors approved a share repurchase program for up to $100.0 million of our common stock. The purchases may be made, from time to time, in the open market and will be funded from available working capital. The number of shares to be purchased and the timing of purchases will be based on the level of our cash balances, general business and market conditions, and other factors, including alternative investment opportunities. As of January 27, 2007, we have repurchased 47.3 million shares and $52.7 million remains available for future repurchases under this program.

**Critical Accounting Policies**

Our discussion and analysis of financial condition and results of operations is based upon our Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these Condensed Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We evaluate, on an on-going basis, our estimates and judgments, including those related to sales returns, bad debts, excess inventory and purchase commitments, investments, warranty obligations, restructuring costs, lease losses, income taxes, and contingencies and litigation. We base our estimates on historical experience and assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The methods, estimates, and judgments we use in applying our most critical accounting policies have a significant impact on the results that we report in our Condensed Consolidated Financial Statements. The SEC considers an entity's most critical accounting policies to be those policies that are both most important to the portrayal of a company's financial condition and results of operations, and those that require management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about matters that are inherently uncertain at the time of estimation. We believe the following critical accounting policies, among others, require significant judgments and estimates used in the preparation of our Condensed Consolidated Financial Statements:

- Revenue recognition, and allowances for sales returns, sales programs, and doubtful accounts;
- Stock-based compensation;
- Warranty reserves;
- Inventory valuation and purchase commitment liabilities;
- Restructuring charges and lease loss liabilities;
- Goodwill and intangible assets;
- Litigation costs; and
- Accounting for income taxes.

*Revenue recognition, and allowances for sales returns, sales programs, and doubtful accounts*. Product revenue is generally recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collection is probable. However, for newly introduced products, many of our large OEM customers require a product qualification period during which our products are tested and approved by the OEM customer for sale to their customers. Revenue recognition, and related cost, is deferred for shipments to new OEM customers and for shipments of newly introduced products to existing OEM customers until satisfactory evidence of completion of the product qualification has been received from the OEM customer. In addition, revenue from sales to our master reseller customers is recognized in the same period in which the product is sold by the master reseller (sell-through).

We reduce revenue for estimated sales returns, sales programs, and other allowances at the time of shipment. Sales returns, sales programs, and other allowances are estimated based on historical experience, current trends, and our expectations regarding future experience. Reductions to revenue associated with sales returns, sales programs, and other allowances include consideration of historical sales levels, the timing and magnitude of historical sales returns, claims under sales programs, and other allowances, and a projection of this experience into the future. In addition, we maintain allowances for doubtful accounts, which are also accounted for as a reduction in revenue, for estimated losses resulting from the inability of our customers to make required payments. We analyze accounts receivable, historical collection patterns, customer concentrations, customer creditworthiness, current economic trends, changes in customer payment terms and practices, and customer communication when evaluating the adequacy of the allowance for doubtful accounts. If actual sales returns, sales programs, and other allowances exceed our estimate, or if the financial condition of our customers was to deteriorate, resulting in an impairment of their ability to make payments, additional allowances and charges may be required.

Service revenue consists of training and maintenance arrangements, including post-contract customer support ("PCS") and other professional services. PCS services are offered under renewable, annual fee-based contracts or as part of multiple element arrangements and typically include upgrades and enhancements to our software operating system software, and telephone support. Service revenue, including revenue allocated to PCS elements, is deferred and recognized ratably over the contractual period. Service contracts are typically one to three years in length. Professional services are offered under fee based contracts or as part of multiple element arrangements. Professional service revenue is recognized as delivery of the underlying service occurs. Training revenue is recognized upon completion of the training.

Our multiple-element product offerings include computer hardware and software products, and support services. We also sell certain software products and support services separately. Our software products, including those that are embedded in our hardware products and are essential to the functionality of our hardware products and are, therefore, accounted for in accordance with Statement of Position 97-2, "Software Revenue Recognition" ("SOP 97-2"), as amended. We allocate revenue to each element in a multiple element arrangement based upon vendor-specific objective evidence ("VSOE") of the fair value of the element or, if VSOE is not available for the delivered elements, by application of the residual method. In the application of the residual method, we allocate revenue to the undelivered elements based on VSOE for those elements and allocate the residual revenue to the delivered elements. VSOE of the fair value for an element is based upon the price charged when the element is sold separately. Revenue allocated to each element is then recognized when the basic revenue recognition criteria are met for each element. Changes in the allocation of revenue to each element in a multiple element arrangement may affect the timing of revenue recognition.

*Stock-Based Compensation.* Effective October 30, 2005 we began recording compensation expense associated with stock-based awards and other forms of equity compensation in accordance with SFAS 123R. We adopted the modified prospective transition method provided for under SFAS 123R. Under this transition method, compensation cost associated with stock-based awards recognized for fiscal year 2007 and fiscal year 2006 now includes 1) quarterly amortization related to the remaining unvested portion of stock-based awards granted prior to October 30, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123; and 2) quarterly amortization related to stock-based awards granted subsequent to October 30, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. In addition, we record expense over the offering period and vesting term in connection with 1) shares issued under our employee stock purchase plan and 2) stock options and restricted stock awards. The compensation expense for stock-based awards includes an estimate for forfeitures and is recognized over the expected term of the award under a graded vesting method.

Prior to October 30, 2005, we accounted for stock-based awards using the intrinsic value method of accounting in accordance with APB 25, whereby the difference between the exercise price and the fair market value on the date of grant is recognized as compensation expense. Under the intrinsic value method of accounting, no compensation expense was recognized in our Condensed Consolidated Statements of Income when the exercise price of our employee stock option grant equals the market price of the underlying common stock on the date of grant, and the measurement date of the option grant is certain. The measurement date is certain when the date of grant is fixed and determinable. Prior to October 30, 2005 when the measurement date was not certain, we recorded stock-based compensation expense using variable accounting under APB 25. Effective October 30 2005, for awards where the measurement date is not certain, we record stock-based compensation expense under SFAS 123R. Under SFAS 123R, we remeasure the intrinsic value of the options at the end of each reporting period until the options are exercised, cancelled or expire unexercised.

*Warranty reserves.* We provide warranties on our products ranging from one to three years. Estimated future warranty costs are accrued at the time of shipment and charged to cost of revenues based upon historical experience, current trends and our expectations regarding future experience. If actual warranty costs exceed our estimate, additional charges may be required.

*Inventory valuation and purchase commitment liabilities.* We write down inventory and record purchase commitment liabilities for estimated excess and obsolete inventory equal to the difference between the cost of inventory and the estimated fair value based upon forecast of future product demand, product transition cycles, and market conditions. Although we strive to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant impact on the value of our inventory and commitments, and our reported results. If actual market conditions are less favorable than those projected, additional inventory write-downs, purchase commitment liabilities, and charges against earnings might be required.

*Restructuring charges and lease loss liabilities.* We monitor and regularly evaluate our organizational structure and associated operating expenses. Depending on events and circumstances, we may decide to take additional actions to reduce future operating costs as our business requirements evolve. In determining restructuring charges, we analyze our future operating requirements, including the required headcount by business functions and facility space requirements. Our restructuring costs, and any resulting accruals, involve significant estimates made by management using the best information available at the time the estimates are made, some of which may be provided by third parties. In recording severance accruals, we record a liability when all of the following conditions have been met: employees' rights to receive compensation for future absences is attributable to employees' services already rendered; the obligation relates to rights that vest or accumulate; payment of the compensation is probable; and the amount can be reasonably estimated. In recording facilities lease loss accruals, we make various assumptions, including the time period over which the facilities are expected to be vacant, expected sublease terms, expected sublease rates, anticipated future operating expenses, and expected future use of the facilities. Our estimates involve a number of risks and uncertainties, some of which are beyond our control, including future real estate market conditions and our ability to successfully enter into subleases or lease termination agreements with terms as favorable as those assumed when arriving at our estimates. We regularly evaluate a number of factors to determine the appropriateness and reasonableness of our restructuring and lease loss accruals including the various assumptions noted above. If actual results differ significantly from our estimates, we may be required to adjust our restructuring and lease loss accruals in the future.

*Goodwill and intangible assets.* We account for goodwill in accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* ("SFAS 142"). SFAS 142 requires that goodwill be capitalized at cost and tested annually for impairment. We evaluate goodwill on an annual basis during our second fiscal quarter, or whenever events and changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss is recognized to the extent that the carrying amount exceeds the assets implied fair value. Events which might indicate impairment include, but are not limited to, strategic decisions made in response to economic and competitive conditions, the impact of economic environment on our customer base, material negative changes in relationships with significant customers, and/or a significant decline in our stock price for a sustained period. No goodwill impairment was recorded for the periods presented.

Intangible assets other than goodwill are amortized over their useful lives, unless these lives are determined to be indefinite. Intangible assets are carried at cost less accumulated amortization. Amortization is computed over the estimated useful life of the respective asset. Intangible assets are reviewed for impairment in accordance with Statement of Financial Accounting Standards No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). We perform an impairment tests for long-lived assets on an annual basis or whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Examples of such events or circumstances include significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of acquired assets or the strategy for our business, significant negative industry or economic trends, and/or a significant decline in the Company's stock price for a sustained period. Impairments are recognized based on the difference between the fair value of the asset and its carrying value, and fair value is generally measured based on discounted cash flow analyses. No intangible asset impairment was recorded for the periods presented.

*Litigation costs.* We are subject to the possibility of legal actions arising in the ordinary course of business. We regularly monitor the status of pending legal actions to evaluate both the magnitude and likelihood of any potential loss. We accrue for these potential losses when it is probable that a liability has been incurred and the amount of loss, or possible range of loss, can be reasonably estimated. If actual results differ significantly from our estimates, we may be required to adjust our accruals in the future.

*Accounting for income taxes.* We use the asset and liability method of accounting for income taxes. Under this method, income tax expense is recognized for the amount of taxes payable or refundable for the current year. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts, along with net operating loss carryforwards and credit carryforwards. A valuation allowance is recognized to the extent that it is more likely than not that the tax benefits will not be realized. Income tax contingencies are accounted for in accordance with SFAS No. 5, *"Accounting for Contingencies"* ("SFAS 5").

The determination of our tax provision is subject to judgments and estimates due to operations in multiple tax jurisdictions inside and outside the United States. Sales to our international customers are principally taxed at rates that are lower than the United States statutory rates. The ability to maintain our current effective tax rate is contingent upon existing tax laws in both the United States and in the respective countries in which our international subsidiaries are located. Future changes in domestic or international tax laws could affect the continued realization of the tax benefits we are currently receiving and expect to receive from international sales. In addition, an increase in the percentage of our total revenue from international customers or in the mix of international revenue among particular tax jurisdictions could change our overall effective tax rate. Also, our current effective tax rate assumes that United States income taxes are not provided for undistributed earnings of certain non-United States subsidiaries. These earnings could become subject to United States federal and state income taxes and foreign withholding taxes, as applicable, should they be either deemed or actually remitted from our international subsidiaries to the United States.

The carrying value of our net deferred tax assets is subject to a full valuation allowance with the exception of non-U.S. stock option expense. At some point in the future, the Company may have sufficient United States taxable income to release the valuation allowance. We evaluate the expected realization of our deferred tax assets and assess the need for valuation allowances quarterly.

## Item 3. Quantitative and Qualitative Disclosures About Market Risks

We are exposed to market risk related to changes in interest rates, foreign currency fluctuations, and equity security prices.

### *Interest Rate Risk*

Our exposure to market risk due to changes in the general level of United States interest rates relates primarily to our cash equivalents and short-term and long-term investment portfolios. Our cash, cash equivalents, and short-term and long-term investments are primarily maintained at five major financial institutions in the United States. As of January 27, 2007, we held an immaterial amount of cash flow derivative instruments. The primary objective of our investment activities is the preservation of principal while maximizing investment income and minimizing risk.

The following table presents the hypothetical changes in fair values of our investments as of January 27, 2007 that are sensitive to changes in interest rates (in thousands):

| Issuer | Valuation of Securities Given an Interest Rate Decrease of X Basis Points | | | Fair Value As of January 27, 2007 | Valuation of Securities Given an Interest Rate Increase of X Basis Points | | |
|---|---|---|---|---|---|---|---|
| | (150 BPS) | (100 BPS) | (50 BPS) | | 50 BPS | 100 BPS | 150 BPS |
| U.S. government agencies and municipal obligations | $ 176,477 | $ 174,818 | $ 173,264 | $ 171,775 | $ 170,431 | $ 169,136 | $ 167,913 |
| Corporate bonds and notes | $ 211,812 | $ 211,142 | $ 210,640 | $ 210,077 | $ 209,478 | $ 208,894 | $ 208,314 |
| Total | $ 388,289 | $ 385,960 | $ 383,904 | $ 381,852 | $ 379,909 | $ 378,030 | $ 376,227 |

These instruments are not leveraged and are classified as available-for-sale. The modeling technique used measures the change in fair values arising from selected potential changes in interest rates. Market changes reflect immediate hypothetical parallel shifts in the yield curve of plus or minus 50 basis points (BPS), 100 BPS, and 150 BPS, which are representative of the historical movements in the Federal Funds Rate.

The following table (in thousands) presents our cash equivalents, short-term, restricted short-term, and long-term investments subject to interest rate risk and their related weighted average interest rates as of January 27, 2007. Carrying value approximates fair value.

| | Amount | Weighted Average Interest Rate |
|---|---|---|
| Cash and cash equivalents | $ 249,807 | 4.7% |
| Short-term investments | 319,331 | 4.7% |
| Long-term investments | 62,521 | 5.1% |
| Total | $ 631,659 | 4.7% |

Our common stock is quoted on the Nasdaq National Market under the symbol "BRCD." On January 26, 2007, the last reported sale price of our common stock on the Nasdaq National Market was $8.30 per share.

**Item 4. Controls and Procedures**

(a) *Evaluation of Disclosure Controls and Procedures.* Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this Quarterly Report on Form 10-Q (the "Evaluation Date").

The purpose of this evaluation is to determine if, as of the Evaluation Date, our disclosure controls and procedures were operating effectively such that the information relating to Brocade, required to be disclosed in our Securities and Exchange Commission ("SEC") reports (i) was recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) was accumulated and communicated to our management, including our Chief Executive Officer and Interim Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were operating effectively.

(b) *Changes in Internal Control Over Financial Reporting.*

There were no changes in our internal controls over financial reporting during the first quarter of fiscal 2007 that materially affected or are reasonably likely to materially affect our internal control over financial reporting.

*Limitations on the Effectiveness of Disclosure Controls and Procedures.*

Our management, including our Chief Executive Officer and Chief Financial Officer, do not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors and all fraud. A control system no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within a company are detected. The inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistakes. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and may not be detected.

## PART II — OTHER INFORMATION

**Item 1. Legal Proceedings**

From time to time, claims are made against Brocade in the ordinary course of its business, which could result in litigation. Claims and associated litigation are subject to inherent uncertainties and unfavorable outcomes could occur, such as monetary damages, fines, penalties or injunctions prohibiting Brocade from selling one or more products or engaging in other activities. The occurrence of an unfavorable outcome in any specific period could have a material adverse affect on Brocade's results of operations for that period or future periods.

On July 20, 2001, the first of a number of putative class actions for violations of the federal securities laws was filed in the United States District Court for the Southern District of New York against Brocade, certain of its officers and directors, and certain of the underwriters for Brocade's initial public offering of securities. A consolidated amended class action captioned In Re Brocade Communications Systems, Inc. Initial Public Offering Securities Litigation was filed on April 19, 2002. The complaint generally alleges that various underwriters engaged in improper and undisclosed activities related to the allocation of shares in the Brocade's initial public offering and seeks unspecified damages on behalf of a purported class of purchasers of common stock from May 24, 1999 to December 6, 2000. The lawsuit against the Company is being coordinated for pretrial proceedings with a number of other pending litigations challenging underwriter practices in over 300 cases as In Re Initial Public Offering Securities Litigation, 21 MC 92(SAS). In October 2002, the individual defendants were dismissed without prejudice from the action, pursuant to a tolling agreement. On February 19, 2003, the Court issued an Opinion and Order dismissing all of the plaintiffs' claims against Brocade. In June 2004, a stipulation of settlement for the claims against the issuer defendants, including the Brocade, was submitted to the Court for approval. On August 31, 2005, the Court granted preliminary approval of the settlement. On April 24, 2006, the Court held a fairness hearing in connection with the motion for final approval of the settlement. The Court has yet to issue a ruling on the motion for final approval. The settlement remains subject to a number of conditions, including final approval by the Court. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the court's October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceeding. Brocade is not one of the test cases and it is unclear what impact this will have on Brocade's case. On January 5, 2007, plaintiffs filed a petition for rehearing en banc by the Second Circuit.

McDATA Corporation, Mr. John F. McDonnell, the former Chairman of the board of directors of McDATA, Mrs. Dee J. Perry and Mr. Thomas O. McGimpsey, both former officers of McDATA were named as defendants in purported securities class action lawsuits filed in the United States District Court, Southern District of New York. The first of these lawsuits, filed on July 20, 2001, is captioned *Gutner v. McDATA Corporation, Credit Suisse First Boston (CSFB), Merrill Lynch, Pierce Fenner & Smith Incorporated, Bear, Stearns & Co., Inc., FleetBoston Robertson Stephens et al., No. 01 CIV. 6627.* Three other similar suits were filed against McDATA and the individuals. The complaints are identical to numerous other complaints filed against other companies that went public in 1999 and 2000. These lawsuits generally allege, among other things, that the registration statements and prospectus filed with the SEC by such companies were materially false and misleading because they failed to disclose (a) that certain underwriters had allegedly solicited and received excessive and undisclosed commissions from certain investors in exchange for which the underwriters allocated to those investors material portions of shares in connection with the initial public offerings, or IPOs, and (b) that certain of the underwriters had allegedly entered into agreements with customers whereby the underwriters agreed to allocate IPO shares in exchange for which the customers agreed to purchase additional company shares in the aftermarket at pre-determined prices. The complaints allege claims against McDATA, the named individuals, and CSFB, the lead underwriter of McDATA's August 9, 2000 initial public offering, under Sections 11 and 15 of the Securities Act. The complaints also allege claims solely against CSFB and the other underwriter defendants under Section 12(a) (2) of the Securities Act, and claims against the individual defendants under Section 10(b) of the Securities Exchange Act. Although management believes that all of the lawsuits are without legal merit and they intend to defend against them vigorously, there is no assurance that McDATA will prevail. In September 2002, plaintiffs' counsel in the above-mentioned lawsuits offered to individual defendants of many of the public companies being sued, including McDATA, the opportunity to enter into a Reservation of Rights and Tolling Agreement that would dismiss without prejudice and without costs, all claims against such persons if the company itself had entity coverage insurance. This agreement was signed by Mr. John F. McDonnell, the former Chairman of McDATA, Mrs. Dee J. Perry, the former chief financial officer of McDATA, and Mr. Thomas O. McGimpsey, the former General Counsel and Vice President of Business Development of McDATA and the plaintiffs' executive committee. Under the Reservation of Rights and Tolling Agreement, the plaintiffs dismissed the claims against such individuals. On February 19, 2003, the court in the above-mentioned lawsuits entered a ruling on the pending motions to dismiss, which dismissed some, but not all, of the plaintiffs' claims against McDATA. These lawsuits have been consolidated as part of *In Re Initial Public Offering Securities Litigation (SDNY)*. McDATA has considered and agreed to enter into a proposed settlement offer with representatives of the plaintiffs in the consolidated proceeding. On August 31, 2005, the court preliminarily approved the proposed settlement. On April 24, 2006, the Court held a fairness hearing in connection with the motion for final approval of the settlement. The Court has yet to issue a ruling on the motion for final approval. The settlement remains subject to a number of conditions, including final approval by the Court. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the court's October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceeding. McDATA is not one of the test cases and it is unclear what impact this will have on McDATA's case. On January 5, 2007, plaintiffs filed a petition for rehearing en banc by the Second Circuit.

A shareholder class action lawsuit was filed against Inrange and certain of its officers on November 30, 2001, in the United States District Court for the Southern District of New York, seeking recovery of damages caused by Inrange's alleged violation of securities laws, including section 11 of the Securities Act of 1933 and section 10(b) of the Exchange Act of 1934. The complaint, which was also filed against the various underwriters that participated in Inrange's initial public offering (IPO), is identical to hundreds of shareholder class actions pending in this court in connection with other recent IPOs and is generally referred to as *In re Initial Public Offering Securities Litigation.* The complaint alleges, in essence, (a) that the underwriters combined and conspired to increase their respective compensation in connection with the IPO by (i) receiving excessive, undisclosed commissions in exchange for lucrative allocations of IPO shares, and (ii) trading in Inrange's stock after creating artificially high prices for the stock post-IPO through "tie-in" or "laddering" arrangements (whereby recipients of allocations of IPO shares agreed to purchase shares in the aftermarket for more than the public offering price for Inrange shares) and dissemination of misleading market analysis on Inrange's prospects; and (b) that Inrange violated federal securities laws by not disclosing these underwriting arrangements in its prospectus. The defense has been tendered to the carriers of Inrange's director and officer liability insurance, and a request for indemnification has been made to the various underwriters in the IPO. At this point, the insurers have issued a reservation of rights letter and the underwriters have refused indemnification. The court has granted Inrange's motion to dismiss claims under section 10(b) of the Securities Exchange Act of 1934 because of the absence of a pleading of intent to defraud. The court granted plaintiffs leave to replead these claims, but no further amended complaint has been filed. The court denied Inrange's motion to dismiss claims under section 11 of the Securities Act of 1933. The court has also dismissed Inrange's individual officers without prejudice, after they entered into a tolling agreement with the plaintiffs. On July 25, 2003, Inrange's board of directors conditionally approved a proposed partial settlement with the plaintiffs in this matter. The settlement would provide, among other things, a release of Inrange and of the individual defendants for the conduct alleged in the action to be wrongful in the complaint. Inrange would agree to undertake other responsibilities under the partial settlement, including agreeing to assign away, not assert, or release certain potential claims Inrange may have against its underwriters. In June 2004, an agreement of settlement was submitted to the court for preliminary approval. On August 31, 2005, the court preliminarily approved the proposed settlement. On April 24, 2006, the Court held a fairness hearing in connection with the motion for final approval of the settlement. The Court has yet to issue a ruling on the motion for final approval. The settlement remains subject to a number of conditions, including final approval by the court. On December 5, 2006, the Court of Appeals for the Second Circuit reversed the court's October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceeding. Inrange is not one of the test cases and it is unclear what impact this will have on Inrange's case. On January 5, 2007, plaintiffs filed a petition for rehearing en banc by the Second Circuit.

On May 16, 2005, Brocade announced that the SEC and the Department of Justice, or the DOJ, are conducting an investigation regarding Brocade's historical stock option granting processes. Brocade has been cooperating with the SEC and DOJ. During the first quarter of fiscal year 2006, Brocade began active settlement discussions with the Staff of the SEC's Division of Enforcement, or the Staff, regarding its financial restatements related to stock option accounting. As a result of these discussions, for the three months ended January 28, 2006, Brocade recorded a $7.0 million provision for an estimated settlement expense. The $7.0 million estimated settlement expense is based on an offer of settlement that Brocade made to the Staff and which the Staff has noted it intends to recommend to the SEC's Commissioners. The offer of settlement is contingent upon final approval by the SEC's Commissioners.

Beginning on or about May 19, 2005, several securities class action complaints were filed against Brocade and certain of its current and former officers. These actions were filed in the United States District Court for the Northern District of California on behalf of purchasers of Brocade's stock from February 2001 to May 2005. These lawsuits followed Brocade's restatement of certain financial results due to stock-based compensation accounting issues. On January 12, 2006, the Court appointed a lead plaintiff and lead counsel. On April 14, 2006, the lead plaintiff filed a consolidated complaint on behalf of purchasers of Brocade's stock from May 2000 to May 2005. The consolidated complaint alleges, among other things, violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The consolidated complaint generally alleges that Brocade and the individual defendants made false or misleading public statements regarding Brocade's business and operations and seeks unspecified monetary damages and other relief against the defendants. These lawsuits followed Brocade's restatement of certain financial results due to stock-based compensation accounting issues.

Beginning on or about May 24, 2005, several derivative actions were also filed against certain of Brocade's current and former directors and officers. These actions were filed in the United States District Court for the Northern District of California and in the California Superior Court in Santa Clara County. The complaints allege that certain of Brocade's officers and directors breached their fiduciary duties to Brocade by engaging in alleged wrongful conduct including conduct complained of in the securities litigation described above. Brocade is named solely as a nominal defendant against whom the plaintiffs seek no recovery. The derivative actions pending in the District Court for the Northern District of California were consolidated and the Court created a Lead Counsel structure. The derivative plaintiffs filed a consolidated complaint in the District Court for the Northern District of California on October 7, 2005, and Brocade filed a motion to dismiss that action on October 27, 2005. On January 6, 2006, Brocade's motion was granted and the consolidated complaint in the District Court for the Northern District of California was dismissed with leave to amend. The parties to this action subsequently reached a preliminary settlement, which remains subject to approval by the Court.

The derivative actions pending in the Superior Court in Santa Clara County were consolidated. The derivative plaintiffs filed a consolidated complaint in the Superior Court in Santa Clara County on September 19, 2005. Brocade filed a motion to stay that action in deference to the substantially identical consolidated derivative action pending in the District Court for the Northern District of California, and on November 15, 2005, the Court stayed the action. In October 2006, the Court partially lifted the stay and granted plaintiffs leave to file an amended complaint. On November 13, 2006, plaintiffs filed an amended complaint.

No amounts have been recorded in Brocade's Consolidated Financial Statements associated with these matters as the amounts are not probable or reasonably estimable other than the $7.0 million provision for an estimated settlement expense with the SEC as noted above.

**Item 1A. Risk Factors**

***The failure to successfully integrate the business and operations of McDATA Corporation in the expected time frame may adversely affect the combined company's future results.***

Brocade believes that the acquisition of McDATA will result in certain benefits, including certain cost synergies, product innovations, and operational efficiencies. However, Brocade's ability to realize these anticipated benefits depends on successfully combining the businesses of Brocade and McDATA. Challenges of integration include the ability to incorporate acquired products and business technology into its existing product lines, including consolidating technology with duplicative functionality or designed on a different technological architecture and provide for interoperability, and its ability to sell the acquired products through Brocade's existing or acquired sales channels. The combined company may fail to realize the anticipated benefits of the merger on a timely basis, or at all, for a variety of reasons, including the following:

- revenue attrition in excess of anticipated levels;
- failure to successfully execute on our integration plan;
- existing customers may alter or reduce their historical buying patterns;
- failure to successfully manage relationships with original equipment manufacturers, ("OEMs"), end-users, distributors and suppliers;
- failure to successfully develop interoperability between the products of Brocade and McDATA;
- failure to leverage the increased scale of the combined company quickly and effectively;
- failure to successfully integrate and harmonize financial reporting systems;
- the loss of key employees;
- failure to effectively coordinate sales and marketing efforts to communicate the capabilities of the combined company; and
- failure to combine product offerings and product lines quickly and effectively.

The integration of McDATA into Brocade has resulted in and is expected to continue to result in, significant expenses and accounting charges that adversely affect Brocade's operating results and financial condition. Additional costs may include: costs of employee redeployment; relocation and retention, including salary increases or bonuses; accelerated amortization of deferred equity compensation and severance payments; reorganization or closure of facilities; taxes; advisor and professional fees and termination of contracts that provide redundant or conflicting services and cost associated with excess or obsolete inventory. Some of these costs may have to be accounted for as expenses that would decrease Brocade's net income and earnings per share for the periods in which those adjustments are made. Brocade may also experience additional and unforeseen expenses or delays with the integration, which would limit or reduce anticipated synergies. The price of Brocade's common stock could decline to the extent Brocade's financial results are materially affected by the foregoing charges and costs, or if the foregoing charges and costs are larger than anticipated. In addition, Brocade may also experience claims of unlawful termination of employment in connection with the reduction in force as part of the McDATA acquisition. Employment litigation can be costly, may distract management's attention from the day-to-day operation of the business and is inherently unpredictable. If Brocade is not able to successfully integrate McDATA's business and operations, or if there are delays in combining the businesses, the anticipated benefits of the merger may not be realized fully or at all or may take longer to realize than expected.

***General customer uncertainty regarding the acquisition of McDATA Corporation could harm Brocade.***

Uncertainty about the effect of the acquisition of McDATA Corporation on customers, employees, distributors and suppliers may have an adverse effect on Brocade. Customer concerns about changes or delays in the product roadmap of the combined company may negatively affect customer purchasing decisions, such as deferral of purchase decisions or reduced purchases. Customers could be reluctant to purchase the products and services of the combined company due to uncertainty about the direction of their technology, products and services, and willingness to support and service existing products which may be discontinued. This uncertainty may also be used as a competitive advantage by Brocade's competitors to cause customers to purchase a competitor's products in lieu of Brocade's products. As a result, there may be a loss of revenue opportunities and market share for the combined company. If customers delay or defer purchasing decisions, or choose to purchase from a competitor, the revenues of the combined company could materially decline or any anticipated increases in revenue could be lower than expected.

***The gross margins of the combined company's products and services may decline, which would reduce our profitability.***

Because certain product and service offerings acquired in connection with our acquisition of McDATA may have lower gross margins and higher costs than comparable product and service offerings of Brocade prior to the acquisition, the gross margins and profitability of the combined company may be adversely affected. To maintain our recent levels of gross margin, we may need to maintain or increase current shipment volumes, develop and introduce new products, product enhancements and service offerings, and reduce the costs of our products and services. Our ability to make such adjustments may be limited, particularly in the short-term. As a result, we may not be able to decrease our spending to offset any unexpected shortfall in revenues. If this occurs, we could incur losses, and our revenue, gross margins and operating results may be below our expectations and those of investors and stock market analysts.

Brocade may also elect to exit certain historical business lines of McDATA that do not provide operating margins in line with Brocade's long-term operating model or are otherwise not deemed by Brocade to be strategic on a long-term basis. In such cases, the combined company may experience revenue shortfalls or may disrupt existing customer relationships. In addition, Brocade may not be able to exit selected business lines on a timely basis, which would reduce the Company's overall operating margins or cause customer uncertainty, thereby reducing revenues with respect to such business lines.

***Integrating Brocade and McDATA following the merger may divert management's attention away from the combined company's operations.***

Successful integration of Brocade's and McDATA's operations, products and personnel has placed, and will continue to place, a significant burden on Brocade's management and internal resources. Brocade may also experience difficulty in effectively integrating the different cultures and practices of McDATA, as well as in assimilating McDATA's broad and geographically dispersed personnel. Further, the difficulties of integrating McDATA could disrupt the combined company's ongoing business, and distract its management focus from other opportunities and challenges. The diversion of management attention and any difficulties encountered in the transition and integration process could harm the combined company's business, financial condition and operating results.

***Failure to manage expansion effectively could seriously harm our business, financial condition and prospects.***

We continue to increase the scope of our operations domestically and internationally, particularly as a result of our acquisition of McDATA which significantly increased the size of our operations, and as a result of our expanded product and service offerings. Our ability to successfully implement our business plan, develop and offer products, and manage expansion in a rapidly evolving market requires a comprehensive and effective planning and management process. Moreover, our growth in business and relationships with customers and other third parties has placed, and will continue to place, a significant strain on management systems, resources, intercompany communications and coordination. As we grow, our failure to maintain and to continue to improve upon our operational, managerial and financial controls, reporting systems, processes and procedures, and/or our failure to continue to expand, train, and manage our work force worldwide, could seriously harm our business and financial results.

***Brocade's future revenue growth depends on its ability to introduce new products and services on a timely basis and achieve market acceptance of these new products and services.***

The market for storage networks and data management is characterized by rapidly changing technology and accelerating product introduction cycles. Brocade's future success depends largely upon its ability to address the rapidly changing needs of its customers by developing and supplying high-quality, cost-effective products, product enhancements and services on a timely basis, and by keeping pace with technological developments and emerging industry standards. This risk will become more pronounced as the storage network and data management markets becomes more competitive and as demand for new and improved technologies increases.

Brocade has introduced a significant number of new products in recent history, including products across its SAN product family, which accounts for a substantial portion of Brocade's revenues. Brocade has also launched a number of File Area Network solutions as well as new service and support offerings. For example, as of the third quarter of fiscal year 2006, approximately 68% of our products based on revenue had been in the market less than six quarters. New offerings in fiscal year 2006 include the Brocade 4900 64-port switch, and the enhanced Brocade 48000 director, which now supports up to 384 ports in a single chassis as well as the addition of iSCSI capabilities.

Brocade must achieve widespread market acceptance of Brocade's new products and service offerings in order to realize the benefits of Brocade's investments. The rate of market adoption is also critical. The success of Brocade's product and service offerings depends on numerous factors, including its ability to:

- properly define the new products and services;
- timely develop and introduce the new products and services;
- differentiate Brocade's new products and services from its competitors' technology and product offerings; and
- address the complexities of interoperability of Brocade's products with its OEM partners' server and storage products and its competitors' products.

Various factors impacting market acceptance are outside of Brocade's control, including the availability and price of competing products, and alternative technologies; product qualification requirements by Brocade's OEM partners, which can cause delays in the market acceptance; and the ability of its OEM partners to successfully distribute, support and provide training for its products. If Brocade is not able to successfully develop and market new and enhanced products and services, its business and results of operations will be harmed.

***Brocade is currently expanding its product and service offerings to include software applications and professional and support services, and Brocade's operating results will suffer if these initiatives are not successful.***

Brocade has made a series of investments, and plans to continue to invest, in offerings focused on new markets that are adjacent or parallel to Brocade's traditional market, including new and emerging markets. For instance, Brocade has recently made a series of introductions in the emerging File Area Network (FAN) market with several enhancements to existing products in its family of file management software solutions which includes Brocade StorageX, Brocade Wide Area File Services, or WAFS, and Brocade File Lifecycle Manager, or FLM. In addition, Brocade has added multiple new professional service offerings to its solution portfolio.

Part of Brocade's growth strategy is to derive competitive advantage and drive incremental revenue growth through such investments. As a result, Brocade believes these new markets could substantially increase its total available market opportunities. However, Brocade cannot be certain that it has accurately identified and estimated these market opportunities. Moreover, Brocade cannot assure you that its new strategic offerings will achieve market acceptance, or that Brocade will benefit fully from the substantial investments it has made and plans to continue to make in them. Brocade may also have only limited experience in these new markets given that such markets are adjacent or parallel to Brocade's core market. As a result, Brocade may not be able to successfully penetrate or realize anticipated revenue from these new potential market opportunities. Brocade also faces greater challenges in accurately forecasting its revenue and margins with respect to these other product market opportunities.

Developing new offerings also requires significant, upfront, investments that may not result in revenue for an extended period of time, if at all. Particularly as Brocade seeks to diversify its product and service offerings, Brocade expects to incur significant costs and expenses for product development, sales, marketing and customer services, most of which are fixed in the short-term or incurred in advance of receipt of corresponding revenue. In addition, these investments have caused, and will likely continue to result in, higher operating expenses and if they are not successful, Brocade's operating income and operating margin will deteriorate. These new offerings may also involve cost and revenue structures that are different from those experienced in Brocade's historical business, which would impact Brocade's operating results.

Because these new offerings may address different market needs than those it has historically addressed, Brocade may face a number of additional challenges, such as:

- developing new customer relationships both with new and existing customers;
- expanding Brocade's relationships with its existing OEM partners and end-users;
- managing different sales cycles;
- hiring qualified personnel with appropriate skill sets on a timely basis; and
- establishing effective distribution channels and alternative routes to market.

Brocade's new product and service offerings also may contain some features that are currently offered by Brocade's OEM partners, which could cause conflicts with partners on whom Brocade relies to bring its current products to customers and thus negatively impact Brocade's relationship with such partners.

***Increased market competition may lead to reduced sales, margins, profits and market share.***

The storage network and data management markets continue to be very competitive as new products, services and technologies are introduced by existing competitors and as new competitors enter the market. Increased competition in the past has resulted in greater pricing pressure, and reduced sales, margins, profits and market share. For example, Brocade expects to experience increased competition in future periods as other companies gain market acceptance with recently released 4 Gbit products that are intended to compete with Brocade's 4 Gbit products. Moreover, new competitive products could be based on existing technologies or new technologies that may or may not be compatible with Brocade's storage network technology. Competitive products include, but are not limited to, non-Fibre Channel based emerging products utilizing Gigabit Ethernet, 10 Gigabit Ethernet, InfiniBand, and Internet Small Computer System Interface ("iSCSI").

Currently, Brocade believes that it principally faces competition from providers of Fibre Channel switching products for interconnecting servers and storage. These principle competitors include Cisco Systems and QLogic Corporation. In addition, Brocade's OEM partners, who also have relationships with some of Brocade's current competitors, could become new competitors by developing and introducing products that compete with Brocade's product offerings, by choosing to sell Brocade's competitors' products instead of Brocade's products, or by offering preferred pricing or promotions on Brocade's competitors' products. Competitive pressure will likely intensify as Brocade's industry experiences further consolidation in connection with mergers by Brocade, its competitors and its OEM partners.

Some of Brocade's competitors have longer operating histories and significantly greater human, financial and capital resources than Brocade does. Brocade's competitors could adopt more aggressive pricing policies than Brocade. Brocade believes that competition based on price may become more aggressive than it has traditionally experienced. Brocade's competitors could also devote greater resources to the development, promotion, and sale of their products than Brocade may be able to support and, as a result, be able to respond more quickly to changes in customer or market requirements. Brocade's failure to successfully compete in the market would harm Brocade's business and financial results.

Brocade's competitors may also put pressure on Brocade's distribution model of selling products to customers through OEM solution providers by focusing a large number of sales personnel on end-user customers or by entering into strategic partnerships. For example, one of Brocade's competitors has formed a strategic partnership with a provider of network storage systems, which includes an agreement whereby Brocade's competitor resells the storage systems of its partner in exchange for sales by the partner of Brocade's competitor's products. Such strategic partnerships, if successful, may influence Brocade to change Brocade's traditional distribution model.

***Brocade depends on OEM partners for a majority of Brocade's revenues, and the loss of any of these OEM partners or a decrease in their purchases could significantly reduce Brocade's revenues and negatively affect Brocade's financial results.***

Brocade depends on recurring purchases from a limited number of large OEM partners for the majority of its revenue. As a result, these large OEM partners have a significant influence on Brocade's quarterly and annual financial results. Brocade's agreements with its OEM partners are typically cancelable, non-exclusive, have no minimum purchase requirements and have no specific timing requirements for purchases. For fiscal year 2006, three customers each represented ten percent or more of Brocade's total revenues for a combined total of 73 percent. Brocade anticipates that its revenues and operating results will continue to depend on sales to a relatively small number of OEM partners. The loss of any one significant OEM partner, or a decrease in the level of sales to any one significant OEM partner, or unsuccessful quarterly negotiation on key terms, conditions or timing of purchase orders placed during a quarter, would likely cause serious harm to Brocade's business and financial results.

In addition, some of Brocade's OEM partners purchase Brocade's products for their inventories in anticipation of customer demand. These OEM partners make decisions to purchase inventory based on a variety of factors, including their product qualification cycles and their expectations of end customer demand, which may be affected by seasonality and their internal supply management objectives. Others require that Brocade maintain inventories of Brocade's products in hubs adjacent to their manufacturing facilities and purchase Brocade's products only as necessary to fulfill immediate customer demand. If more of Brocade's OEM partners transition to a hub model, form partnerships, alliances or agreements with other companies that divert business away from Brocade; or otherwise change their business practices, their ordering patterns may become less predictable. Consequently, changes in ordering patterns may affect both the timing and volatility of Brocade's reported revenues. The timing of sales to Brocade's OEM partners, and consequently the timing and volatility of Brocade's reported revenues, may be further affected by the product introduction schedules of Brocade's OEM partners.

Brocade's OEM partners evaluate and qualify Brocade's products for a limited time period before they begin to market and sell them. Assisting Brocade's OEM partners through the evaluation process requires significant sales, marketing and engineering management efforts on Brocade's part, particularly if Brocade's products are being qualified with multiple distribution partners at the same time. In addition, once Brocade's products have been qualified, its customer agreements have no minimum purchase commitments. Brocade may not be able to effectively maintain or expand its distribution channels, manage distribution relationships successfully, or market its products through distribution partners. Brocade must continually assess, anticipate and respond to the needs of its distribution partners and their customers, and ensure that its products integrate with their solutions. Brocade's failure to successfully manage its distribution relationships or the failure of its distribution partners to sell Brocade's products could reduce Brocade's revenues significantly. In addition, Brocade's ability to respond to the needs of its distribution partners in the future may depend on third parties producing complementary products and applications for Brocade's products. If Brocade fails to respond successfully to the needs of these groups, its business and financial results could be harmed.

***The prices of Brocade's products have declined in the past, and Brocade expects the price of Brocade's products to continue to decline, which could reduce Brocade's revenues, gross margins and profitability.***

The average selling price for Brocade's products, including products of McDATA acquired in connection with our acquisition of McDATA, has declined in the past, and Brocade expects it to continue to decline in the future as a result of changes in product mix, competitive pricing pressure, increased sales discounts, new product introductions by Brocade or Brocade's competitors, the entrance of new competitors or other factors. For example, in 2005, Brocade introduced and began shipping a number of new products that expand and extend the breadth of Brocade's product offerings. Several of these new products have lower revenue per port and lower gross margin than Brocade's traditional products. If Brocade is unable to offset any negative impact that changes in product mix, competitive pricing pressures, increased sales discounts, enhanced marketing programs, new product introductions by Brocade or Brocade's competitors, or other factors may have on it by increasing the volume of products shipped or reducing product manufacturing cost, Brocade's total revenues and gross margins will be negatively impacted.

In addition, to maintain Brocade's gross margins Brocade must maintain or increase the number of products shipped, develop and introduce new products and product enhancements, and continue to reduce the manufacturing cost of Brocade's products. While Brocade has successfully reduced the cost of manufacturing Brocade's products in the past, Brocade may not be able to continue to reduce cost of production at historical rates. Moreover, most of Brocade's expenses are fixed in the short-term or incurred in advance of receipt of corresponding revenue. As a result, Brocade may not be able to decrease its spending quickly enough or in sufficient amounts to offset any unexpected shortfall in revenues. If this occurs, Brocade could incur losses, Brocade's operating results and gross margins could be below its expectations and the expectations of investors and stock market analysts, and its stock price could be negatively affected.

***Brocade is dependent on sole source and limited source suppliers for certain key components.***

Brocade purchases certain key components used in the manufacture of its products from single or limited sources. Brocade purchases specific ASICs from a single source, and Brocade purchases microprocessors, certain connectors, small form-factor pluggable transceivers, or SFP's, logic chips, power supplies and programmable logic devices from limited sources. Brocade also licenses certain third-party software that is incorporated into Brocade's operating system software and other software products. If Brocade is unable to obtain these and other components when required or Brocade experiences significant component defects, Brocade may not be able to deliver Brocade's products to Brocade's customers in a timely manner. As a result, Brocade's business and financial results could be harmed.

In addition, the loss of any of Brocade's major third party contract manufacturers, including third party manufacturers used by McDATA prior to our acquisition of McDATA, could significantly impact Brocade's ability to produce its products for an indefinite period of time. Qualifying a new contract manufacturer and commencing volume production is a lengthy and expensive process. If Brocade is required to change its contract manufacturer or if its contract manufacturer experiences delays, disruptions, capacity constraints, component parts shortages or quality control problems in its manufacturing operations, shipment of Brocade's products to Brocade's customers could be delayed resulting in loss of revenues and Brocade's competitive position and relationship with customers could be harmed.

***The failure to successfully consolidate our third party contract manufacturing could adversely affect our business.***

We currently use three third party contract manufacturers for a substantial part of our business and have only limited overlap of our products among the contract manufacturers. Particularly as a result of our acquisition of McDATA, we may seek to consolidate product manufacturing to fewer third party contract manufacturers. To the extent we elect to change or reduce contract manufacturers, we will be subject to a number of risks, including potential production problems due to delays related to the acquisition of product components, and administrative or logistical obstacles during the transition, which may result in loss of revenue and harm our customer relationships. In addition, the third party contract manufacturers would likely be located overseas, which would expose us to additional risks, including unexpected changes in regulatory requirements and tariffs, and potentially adverse tax consequences, all of which could harm our business. If we do not successfully transition our manufacturing to overseas markets, or if we are not successful in the implementation of this overseas manufacturing, our ability to manufacture and sell our products could be substantially impaired.

***Brocade's business is subject to cyclical fluctuations and uneven sales patterns, which makes predicting results of operations difficult.***

Many of Brocade's OEM partners experience uneven sales patterns in their businesses due to the cyclical nature of information technology spending. For example, some of Brocade's partners close a disproportionate percentage of their sales transactions in the last month, weeks and days of each fiscal quarter, and other partners experience spikes in sales during the fourth calendar quarter of each year. Because the majority of Brocade's sales are derived from a small number of OEM partners, when they experience seasonality, Brocade typically experiences similar seasonality. Historically, Brocade's first and fourth fiscal quarters are seasonally stronger quarters than its second and third fiscal quarters. In addition, Brocade has experienced quarters where uneven sales patterns of Brocade's OEM partners have resulted in a significant portion of Brocade's revenue occurring in the last month of Brocade's fiscal quarter. This exposes Brocade to additional inventory risk as it has to order products in anticipation of expected future orders and additional sales risk if Brocade is unable to fulfill unanticipated demand. Brocade is not able to predict the degree to which the seasonality and uneven sales patterns of Brocade's OEM partners or other customers will affect Brocade's business in the future particularly as Brocade release new products.

***Brocade has been named as a party to several class action and derivative action lawsuits arising from Brocade's internal reviews and related restatements of Brocade's financial statements during 2005, and Brocade may be named in additional litigation, all of which could require significant management time and attention and result in significant legal expenses as well as result in an unfavorable outcome which could have a material adverse effect on Brocade's business, financial condition, results of operations and cash flows.***

Brocade is subject to a number of lawsuits arising from Brocade's internal reviews and the related restatements of Brocade's financial statements in 2005, some purportedly filed on behalf of a class of Brocade's stockholders, against Brocade and certain of its executive officers claiming violations of securities laws and others purportedly filed on behalf of Brocade against certain of Brocade's executive officers and board members, and Brocade may become the subject of additional private or government actions. The expense of defending such litigation may be significant. The amount of time to resolve these lawsuits is unpredictable and defending Brocade may divert management's attention from the day-to-day operations of Brocade's business, which could adversely affect Brocade's business, results of operations and cash flows. In addition, an unfavorable outcome in such litigation, such as a court judgment against the Company resulting in monetary damages or penalties, could have a material adverse effect on Brocade's business, results of operations and cash flows.

***As a result of Brocade's internal reviews and related restatements, Brocade is subject to investigations by the SEC and Department of Justice, or DOJ, which may not be resolved favorably and have required, and will continue to require, a significant amount of management time and attention and accounting resources and legal expense, which could adversely affect Brocade's business, results of operations and cash flows.***

The SEC and the DOJ are currently conducting investigations of Brocade. The period of time necessary to resolve the SEC and DOJ investigations is uncertain, and these matters could require significant management and financial resources which could otherwise be devoted to the operation of Brocade's business. If Brocade is subject to an adverse finding resulting from the SEC and DOJ investigation, Brocade could be required to pay damages or penalties or have other remedies imposed upon Brocade. During the three months ended January 28, 2006 Brocade began active settlement discussions with the Staff of the SEC's Division of Enforcement, or the Staff. As a result of these discussions, for the three months ended January 28, 2006 Brocade recorded $7.0 million provision for an estimated settlement expense. The $7.0 million estimated settlement expense is based on an offer of settlement that Brocade made to the Staff and for which the Staff has stated it intends to recommend to the SEC's Commissioners. The offer of settlement is contingent upon final approval by the SEC's Commissioners. The restatements of Brocade's financial results in 2005, the ongoing SEC and DOJ investigations and any negative outcome that may occur from these investigations could impact Brocade's relationships with customers and Brocade's ability to generate revenue. In addition, considerable legal and accounting expenses related to these matters have been incurred to date and significant expenditures are expected to continue to be incurred in the future. The SEC and DOJ investigations could adversely affect Brocade's business, results of operations, financial position and cash flows.

In July 2006, the United States Attorney's Office for the Northern District of California, the SEC, and the Federal Bureau of Investigation announced the filing of civil and, in some cases criminal, charges against certain former executive officers of Brocade. While those actions are targeted against former executive officers and not Brocade, those actions may nevertheless have an adverse impact on Brocade. In addition to the risks noted above, Brocade has certain indemnification obligations to such former officers in connection with such actions, which may result in significant expense to Brocade.

***Brocade's quarterly and annual revenues and operating results may fluctuate in future periods due to a number of factors, which could adversely affect the trading price of Brocade's stock.***

Brocade's quarterly and annual revenues and operating results may vary significantly in the future due to a number of factors, any of which may cause Brocade's stock price to fluctuate. Factors that may affect the predictability of Brocade's annual and quarterly results include, but are not limited to, the following:

- announcements, introductions, and transitions of new products by Brocade and its competitors or its OEM partners;
- the timing of customer orders, product qualifications, and product introductions of Brocade's OEM partners;
- seasonal fluctuations;
- long and complex sales cycles;
- changes, disruptions or downturns in general economic conditions, particularly in the information technology industry;
- declines in average selling prices for Brocade's products as a result of competitive pricing pressures or new product introductions by Brocade or its competitors;
- the emergence of new competitors and new technologies in the storage network and data management markets;
- deferrals of customer orders in anticipation of new products, services, or product enhancements introduced by Brocade or its competitors;
- Brocade's ability to timely produce products that comply with new environmental restrictions or related requirements of its OEM customers;
- Brocade's ability to obtain sufficient supplies of sole- or limited-sourced components, including ASICs, microprocessors, certain connectors, certain logic chips, and programmable logic devices;
- increases in prices of components used in the manufacture of Brocade's products;
- Brocade's ability to attain and maintain production volumes and quality levels;
- variations in the mix of Brocade's products sold and the mix of distribution channels and geographies through which they are sold;
- pending or threatened litigation;
- stock-based compensation expense that is affected by Brocade's stock price;
- new legislation and regulatory developments; and
- other risk factors detailed in this section entitled "Risks Related to Brocade's Business."

Accordingly, the results of any prior periods should not be relied upon as an indication of future performance. Brocade cannot assure you that in some future quarter Brocade's revenues or operating results will not be below Brocade's projections or the expectations of stock market analysts or investors, which could cause Brocade's stock price to decline.

***The failure to accurately forecast demand for Brocade's products or the failure to successfully manage the production of Brocade's products could negatively affect the supply of key components for Brocade's products and Brocade's ability to manufacture and sell Brocade's products.***

Brocade provides product forecasts to its contract manufacturer and places purchase orders with it in advance of the scheduled delivery of products to Brocade's customers. Moreover, in preparing sales and demand forecasts, Brocade relies largely on input from its OEM partners. Therefore, if Brocade or its OEM partners are unable to accurately forecast demand, or if Brocade fails to effectively communicate with its distribution partners about end-user demand or other time-sensitive information, sales and demand forecasts may not reflect the most accurate, up-to-date information. If these forecasts are inaccurate, Brocade may be unable to obtain adequate manufacturing capacity from its contract manufacturer to meet customers' delivery requirements, or Brocade may accumulate excess inventories. Furthermore, Brocade may not be able to identify forecast discrepancies until late in its fiscal quarter. Consequently, Brocade may not be able to make adjustments to its business model. If Brocade is unable to obtain adequate manufacturing capacity from its contract manufacturer, if Brocade accumulates excess inventories, or if Brocade is unable to make necessary adjustments to Brocade's business model, revenue may be delayed or even lost to Brocade's competitors, and Brocade's business and financial results may be harmed.

In addition, although the purchase orders placed with Brocade's contract manufacturer are cancelable, in certain circumstances Brocade could be required to purchase certain unused material not returnable, usable by, or sold to other customers if Brocade cancels any of Brocade's orders. This purchase commitment exposure is particularly high in periods of new product introductions and product transitions. If Brocade is required to purchase unused material from Brocade's contract manufacturer, Brocade would incur unanticipated expenses and Brocade's business and financial results could be negatively affected.

***Brocade may not realize the anticipated benefits of past or future mergers and strategic investments, and integration of acquired companies or technologies may negatively impact Brocade's business.***

Brocade has in the past, and may in the future, acquire or make strategic investments in additional companies, products or technologies. Other examples include the acquisition of Silverback Systems, Inc. in January 2007 and NuView, Inc. in March 2006. Brocade may not realize the anticipated benefits of these or any other mergers or strategic investments, which involve numerous risks, including:

- problems integrating the purchased operations, technologies, personnel or products over geographically disparate locations;
- assumption of debt and contingent liabilities;
- unanticipated costs, litigation and other contingent liabilities;
- diversion of management's attention from Brocade's daily operations and business;
- adverse effects on existing business relationships with suppliers and customers;
- risks associated with entering into markets in which Brocade have limited, or no prior experience;
- failure to successfully manage additional remote locations, including the additional infrastructure and resources necessary to support and integrate such locations;
- incurrence of significant exit charges if products acquired in business combinations are unsuccessful;
- incurrence of merger-related costs or amortization costs for acquired intangible assets that could impact Brocade's operating results;
- potential write-down of goodwill and/or acquired intangible assets, which are subject to impairment testing on a regular basis, and could significantly impact Brocade's operating results;
- inability to retain key customers, distributors, vendors and other business partners of the acquired business;
- dilution of the percentage of Brocade's stockholders to the extent equity is used as consideration or option plans are assumed; and
- potential loss of Brocade's key employees or the key employees of an acquired organization.

If Brocade is not able to successfully integrate businesses, products, technologies or personnel that Brocade acquires, or to realize expected benefits of Brocade's mergers or strategic investments, Brocade's business and financial results may be adversely affected.

***If Brocade loses key personnel or is unable to hire additional qualified personnel, Brocade's business may be harmed.***

Brocade's success depends to a significant degree upon the continued contributions of key management, engineering, sales and other personnel, many of whom would be difficult to replace. Brocade believes its future success will also depend, in large part, upon Brocade's ability to attract and retain highly skilled managerial, engineering, sales and other personnel, and on the ability of management to operate effectively, both individually and as a group, in geographically disparate locations. Brocade has experienced difficulty in hiring qualified personnel in areas such as application specific integrated circuits, software, system and test, sales, marketing, service, key management and customer support. In addition, Brocade's past reductions in force could potentially make attracting and retaining qualified employees more difficult in the future. Brocade's ability to hire qualified personnel may also be negatively impacted by Brocade's internal reviews and financial statement restatements in 2005, related investigations by the SEC and DOJ, and Brocade's stock price. The loss of the services of any of Brocade's key employees, the inability to attract or retain qualified personnel in the future, or delays in hiring required personnel, particularly engineers and sales personnel, could delay the development and introduction of, and negatively affect Brocade's ability to sell its products.

In addition, companies in the computer storage and server industry whose employees accept positions with competitors may claim that their competitors have engaged in unfair hiring practices or that there will be inappropriate disclosure of confidential or proprietary information. Brocade may be subject to such claims in the future as Brocade seeks to hire additional qualified personnel. Such claims could result in material litigation. As a result, Brocade could incur substantial costs in defending against these claims, regardless of their merits, and be subject to additional restrictions if any such litigation is resolved against Brocade.

***Brocade is subject to environmental regulations that could have a material adverse effect on Brocade's business.***

Brocade is subject to various environmental and other regulations governing product safety, materials usage, packaging and other environmental impacts in the various countries where Brocade's products are sold. For example, many of Brocade's products are subject to laws and regulations that restrict the use of mercury, hexavalent chromium, cadmium and other substances, and require producers of electrical and electronic equipment to assume responsibility for collecting, treating, recycling and disposing of Brocade's products when they have reached the end of their useful life. For example, in Europe substance restrictions apply to products sold, and certain of Brocade's OEM partners require compliance with these or more stringent requirements. In some cases Brocade redesigned Brocade's products to comply with these substance restrictions as well as related requirements imposed by Brocade's OEM customers. In addition, recycling, labeling, financing and related requirements apply to products Brocade sells in Europe. China has also enacted similar legislation with a compliance deadline of March 1, 2007. Brocade is also coordinating with Brocade's suppliers to provide Brocade with compliant materials, parts and components. Despite Brocade's efforts to ensure that Brocade's products comply with new and emerging requirements, Brocade cannot provide absolute assurance that its products will, in all cases comply with such requirements. If Brocade's products do not comply with the substance restrictions in Europe or China or other applicable environmental laws, Brocade could become subject to fines, civil or criminal sanctions, and contract damage claims. In addition, Brocade could be prohibited from shipping non-compliant products into one or more jurisdictions, and required to recall and replace any non-compliant products already shipped, which would disrupt Brocade's ability to ship products and result in reduced revenue, increased obsolete or excess inventories and harm to Brocade's business and customer relationships. Brocade's suppliers may also fail to provide it with compliant materials, parts and components despite Brocade's requirement to them to provide compliant materials, parts and components, which could impact Brocade's ability to timely produce compliant products and, accordingly could disrupt Brocade's business. In addition, various other countries and states in the United States have issued, or are in the process of issuing, other environmental regulations that may impose additional restrictions or obligations and require further changes to Brocade's products.

***Brocade's revenues will be affected by changes in domestic and international information technology spending and overall demand for storage area network solutions.***

In the past, unfavorable or uncertain economic conditions and reduced global information technology spending rates have adversely affected Brocade's operating results. Brocade is unable to predict changes in general economic conditions and when information technology spending rates will be affected. If there are future reductions in either domestic or international information technology spending rates, or if information technology spending rates do not improve, Brocade's revenues, operating results and financial condition may be adversely affected.

Even if information technology spending rates increase, Brocade cannot be certain that the market for storage network and data management solutions will be positively impacted. Brocade's storage networking products are sold as part of storage systems and subsystems. As a result, the demand for Brocade's storage networking products has historically been affected by changes in storage requirements associated with growth related to new applications and an increase in transaction levels. Although in the past Brocade has experienced historical growth in Brocade's business as enterprise-class customers have adopted storage area network technology, demand for storage network products in the enterprise-class sector could be adversely affected if the overall economy weakens or experiences greater uncertainty, or if larger businesses were to decide to limit new equipment purchases. If information technology spending levels are restricted, and new products improve Brocade's customers' ability to utilize their existing storage infrastructure, the demand for storage network products may decline. If this occurs, Brocade's business and financial results will be harmed.

***Brocade's failure to successfully manage the transition between its new products and its older products may adversely affect Brocade's financial results.***

As Brocade introduces new or enhanced products, Brocade must successfully manage the transition from older products to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories and provide sufficient supplies of new products to meet customer demands. For example, Brocade's introduction of 4 Gigabit per second, or Gbit, technology solutions that replaced many of Brocade's 2 Gbit products contributed to a quarterly drop in revenue in the third quarter of fiscal year 2005 and write-downs of $3.4 million and $1.8 million for excess and obsolete inventory during the third and fourth quarters of fiscal year 2005, respectively. When Brocade introduces new or enhanced products, Brocade faces numerous risks relating to product transitions, including the inability to accurately forecast demand, and manage different sales and support requirements due to the type or complexity of the new products.

***Brocade's future operating expenses may be adversely affected by changes in Brocade's stock price.***

A portion of Brocade's outstanding stock options are subject to variable accounting. Under variable accounting, Brocade is required to remeasure the value of the options, and the corresponding compensation expense, at the end of each reporting period until the option is exercised, cancelled or expires unexercised. As a result, the stock-based compensation expense Brocade recognizes in any given period can vary substantially due to changes in the market value of Brocade's common stock. Volatility associated with stock price movements has resulted in compensation benefits when Brocade's stock price has declined and compensation expense when Brocade's stock price has increased. For example, the market value of Brocade's common stock at the end of the third and fourth quarters of fiscal year 2005 and the first quarter of 2006 was $4.48, $3.60 and $4.62 per share, respectively. Accordingly, Brocade recorded compensation expense (benefit) in the fourth quarter of fiscal year 2005 and the first quarter of fiscal year 2006 of approximately $(0.2) million and $0.3 million, respectively. Brocade is unable to predict the future market value of Brocade's common stock and therefore is unable to predict the compensation expense or benefit that Brocade will record in future periods.

***Providing telecommunications services to our customers subjects us to new risks, such as additional governmental regulation, which may impede our business.***

As part of our acquisition of McDATA, we now offer certain telecommunication services. Our provision of telecommunications and bandwidth to our customers subjects us to various risks. The telecommunications industry is heavily regulated by state and federal governments, and changes in these regulations could make it difficult for us to compete. In addition, the regulatory framework under which we operate and new regulatory requirements or new interpretations of existing regulatory requirements could require substantial time and resources for compliance, which could make it difficult for us to operate our business. Such regulation could also impede our ability to enter into change-of-control transactions. In addition, telecommunications networks and circuits can fail which would make it difficult for us to attract and retain clients. In addition, we may experience difficulty in obtaining or developing circuits to provide to our clients.

***Brocade's business is subject to increasingly complex corporate governance, public disclosure, accounting, and tax requirements that have increased both its costs and the risk of noncompliance.***

Brocade is subject to rules and regulations of federal and state government as well as the stock exchange on which Brocade's common stock is listed. These entities, including the Public Company Accounting Oversight Board, ("PCAOB"), the SEC, the Internal Revenue Service and Nasdaq, have issued a significant number of new and increasingly complex requirements and regulations over the course of the last several years and continue to develop additional regulations and requirements in response to laws enacted by Congress, most notably the Sarbanes-Oxley Act of 2002. Brocade's efforts to comply with these requirements have resulted in, and are likely to continue to result in, increased expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

Brocade is subject to periodic audits or other reviews by such governmental agencies. For example, in November 2005, Brocade was notified by the Internal Revenue Service that Brocade's domestic federal income tax return for the year ended October 25, 2003 was subject to audit. Additionally, in May 2006, the Franchise Tax Board notified Brocade that its California income tax returns for the years ended October 25, 2003 and October 30, 2004 are subject to audit. The SEC also periodically reviews Brocade's public company filings. Any such examination or review frequently requires management's time and diversion of internal resources and, in the event of an unfavorable outcome, may result in additional liabilities or adjustments to Brocade's historical financial results.

***Brocade has extensive international operations, which subjects it to additional business risks.***

A significant portion of Brocade's sales occur in international jurisdictions and Brocade's contract manufacturer has significant operations in China. Brocade also plans to continue to expand its international operations and sales activities. Expansion of international operations will involve inherent risks that Brocade may not be able to control, including:

- supporting multiple languages;
- recruiting sales and technical support personnel with the skills to design, manufacture, sell, and support Brocade's products;
- increased complexity and costs of managing international operations;
- increased exposure to foreign currency exchange rate fluctuations;
- commercial laws and business practices that favor local competition;
- multiple, potentially conflicting, and changing governmental laws, regulations and practices, including differing export, import, tax, labor, anti-bribery and employment laws;
- longer sales cycles and manufacturing lead times;
- difficulties in collecting accounts receivable;
- reduced or limited protection of intellectual property rights;
- managing a development team in geographically disparate locations, including China and India; and
- more complicated logistics and distribution arrangements.

In addition, international political instability may halt or hinder Brocade's ability to do business and may increase Brocade's costs. Various events, including the occurrence or threat of terrorist attacks, increased national security measures in the United States and other countries, and military action and armed conflicts, can suddenly increase international tensions. In addition, concerns about other international crises, such as potential pandemics, may have an adverse effect on the world economy and could adversely affect Brocade's business operations or the operations of Brocade's OEM partners, contract manufacturer and suppliers.

To date, no material amount of Brocade's international revenues and costs of revenues have been denominated in foreign currencies. As a result, an increase in the value of the United States dollar relative to foreign currencies could make Brocade's products more expensive and, thus, not competitively priced in foreign markets. Additionally, a decrease in the value of the United States dollar relative to foreign currencies could increase Brocade's operating costs in foreign locations. In the future, a larger portion of Brocade's international revenues may be denominated in foreign currencies, which will subject Brocade to additional risks associated with fluctuations in those foreign currencies. Brocade currently does not have hedging program in place to offset its foreign currency risk.

***Undetected software or hardware errors could increase Brocade's costs, reduce Brocade's revenues and delay market acceptance of Brocade's products.***

Networking products frequently contain undetected software or hardware errors, or bugs, when first introduced or as new versions are released. Brocade's products are becoming increasingly complex and, particularly as Brocade continues to expand Brocade's product portfolio to include software-centric products, including software licensed from third parties, errors may be found from time to time in Brocade's products. Some types of errors also may not be detected until the product is installed in a heavy production or user environment. In addition, Brocade's products are often combined with other products, including software, from other vendors. As a result, when problems occur, it may be difficult to identify the source of the problem. These problems may cause Brocade to incur significant warranty and repair costs, divert the attention of engineering personnel from product development efforts and cause significant customer relations problems. Moreover, the occurrence of hardware and software errors, whether caused by another vendor's storage network and data management products or Brocade's, could delay market acceptance of Brocade's new products.

***Brocade relies on licenses from third parties and the loss or inability to obtain any such license could harm Brocade's business.***

Many of Brocade's products are designed to include software or other intellectual property licensed from third parties. While it may be necessary in the future to seek or renew licenses relating to various aspects of Brocade's products, Brocade believes that, based upon past experience and standard industry practice, such licenses generally could be obtained on commercially reasonable terms. Nonetheless, there can be no assurance that the necessary licenses would be available on acceptable terms, if at all. Brocade's inability to obtain certain licenses or other rights on favorable terms could have a material adverse effect on Brocade's business, operating results and financial condition. In addition, if Brocade fails to carefully manage the use of "open source" software in Brocade's products, Brocade may be required to license key portions of Brocade's products on a royalty free basis or expose key parts of source code.

***Third-parties may bring infringement claims against Brocade, which could be time-consuming and expensive to defend.***

In recent years, there has been significant litigation in the United States involving patents and other intellectual property rights. Brocade has in the past been involved in intellectual property-related disputes, including lawsuits with Vixel Corporation, Raytheon Company and McDATA, and Brocade may be involved in such disputes in the future, to protect

Brocade's intellectual property or as a result of an alleged infringement of the intellectual property of others. Brocade also may be subject to indemnification obligations with respect to infringement of third party intellectual property rights pursuant to Brocade's agreements with OEM partners or customers. These claims and any resulting lawsuit could subject Brocade to significant liability for damages and invalidation of proprietary rights. Any such lawsuits, even if ultimately resolved in Brocade's favor, would likely be time-consuming and expensive to resolve and would divert management's time and attention. Any potential intellectual property dispute also could force Brocade to do one or more of the following:

- stop selling, incorporating or using products or services that use the challenged intellectual property;
- obtain from the owner of the infringed intellectual property a license to the relevant intellectual property, which may require Brocade to pay royalty or license fees, or to license Brocade's intellectual property to such owner, and which may not be available on commercially reasonable terms or at all; and
- redesign those products or services that use technology that is the subject of an infringement claim.

If Brocade is forced to take any of the foregoing actions, Brocade's business and results of operations could be materially harmed.

***Business interruptions could adversely affect Brocade's business.***

Brocade's operations and the operations of its suppliers, contract manufacturer and customers are vulnerable to interruption by fire, earthquake, hurricanes, power loss, telecommunications failure and other events beyond Brocade's control. For example, a substantial portion of Brocade's facilities, including its corporate headquarters, is located near major earthquake faults. In the event of a major earthquake, Brocade could experience business interruptions, destruction of facilities and loss of life. Brocade does not carry earthquake insurance and has not set aside funds or reserves to cover such potential earthquake-related losses. In addition, Brocade's contract manufacturer has a major facility located in an area that is subject to hurricanes. In the event that a material business interruption occurs that affects Brocade or its suppliers, contract manufacturer or customers, shipments could be delayed and Brocade's business and financial results could be harmed.

***Provisions in Brocade's charter documents, customer agreements, and Delaware law could prevent or delay a change in control of Brocade, which could hinder stockholders' ability to receive a premium for Brocade's stock.***

Provisions of Brocade's certificate of incorporation and bylaws may discourage, delay or prevent a merger or merger that a stockholder may consider favorable. These provisions include:

- authorizing the issuance of preferred stock without stockholder approval;
- providing for a classified board of directors with staggered, three-year terms;
- prohibiting cumulative voting in the election of directors;
- limiting the persons who may call special meetings of stockholders;
- prohibiting stockholder actions by written consent; and
- requiring super-majority voting to effect amendments to the foregoing provisions of Brocade's certificate of incorporation and bylaws.

Certain provisions of Delaware law also may discourage, delay, or prevent someone from acquiring or merging with Brocade, and Brocade's agreements with certain of Brocade's customers require that Brocade give prior notice of a change of control and grant certain manufacturing rights following a change of control. Brocade's various anti-takeover provisions could prevent or delay a change in control of Brocade, which could hinder stockholders' ability to receive a premium for Brocade's stock.

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

The following table summarizes stock repurchase activity for the three months ended January 27, 2007 (in thousands excluding per share data):

| | Total Number of Shares Purchased (1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Program | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program (2) |
|---|---|---|---|---|
| October 29, 2006 — November 25, 2006 | — | — | — | $52,737 |
| November 26, 2006 — December 23, 2006 | — | — | — | $52,737 |
| December 24, 2006 — January 27, 2007 | — | — | — | $52,737 |
| Total | — | — | — | $52,737 |

(1) The total number of shares repurchased include those shares of Brocade common stock that employees deliver back to Brocade to satisfy tax-withholding obligations at the settlement of restricted stock exercises, and upon the termination of an employee, the forfeiture of either restricted shares or unvested common stock as a result of early exercises. As of January 27, 2007, approximately 2.3 million shares are subject to repurchase by Brocade.

(2) In August 2004, our board of directors approved a share repurchase program for up to $100.0 million of our common stock. The purchases may be made, from time to time, in the open market and will be funded from available working capital. The number of shares to be purchased and the timing of purchases will be based on the level of our cash balances, general business and market conditions, and other factors, including alternative investment opportunities. As of January 27, 2007, we have purchased 7.9 million shares at an average price of $5.93 per share, and under this program $52.7 million remains available for future repurchases.

**Item 4. Submission of Matters to a Vote of Security Holders.**

A special meeting of Brocade's stockholders was held on January 25, 2007 in San Jose, California to consider and vote upon a proposal for the issuance of shares of Brocade common stock in connection with the merger contemplated by the Agreement and Plan of Reorganization, dated as of August 7, 2006, as amended, by and among Brocade, Worldcup Merger Corporation, a wholly-owned subsidiary of Brocade, and McDATA Corporation.

The proposal was approved and the results of the voting are as follows:

| Votes For | Votes Against | Abstain |
|---|---|---|
| 186,022,259 | 2,630,976 | 196,337 |

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**Item 6. Exhibits**

| Exhibit Number | Description of Document |
|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 from Brocade's Annual Report on Form 10-K for the fiscal year ended October 27, 2001) |
| 3.2 | Amended and Restated Bylaws of the Registrant amended as of January 29, 2007 (incorporated by reference to Exhibit 3.1 from Brocade's Form 8-K filed on February 2, 2007) |
| 3.3 | Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of Brocade Communications Systems, Inc. (incorporated by reference to Exhibit 4.1 from Brocade's Registration Statement on Form 8-A filed on February 11, 2002) |
| 3.4 | Certificate of Elimination of Series A Participating Preferred Stock of Brocade (incorporated by reference to Exhibit 3.1 from Brocade's Form 8-K filed on February 16, 2007) |
| 4.1 | Form of Brocade's Common Stock certificate (incorporated by reference to Exhibit 4.1 from Brocade's Registration Statement on Form S-1 (Reg. No. 333-74711), as amended) |
| 4.2 | Preferred Stock Rights Agreement dated as of February 7, 2002 between Brocade and Wells Fargo Bank MN, N.A. (incorporated by reference to Exhibit 4.1 from Brocade's Registration Statement on Form 8-A filed on February 11, 2002) |
| 4.3 | Form of Convertible Debenture (incorporated by reference to Exhibit 4.3 from Brocade's Quarterly Report on Form 10-Q for the fiscal quarter ended January 26, 2002) |
| 4.4 | Amendment No. 1 dated August 7, 2006 to the Preferred Stock Rights Agreement dated as of February 7, 2002 between Brocade and Wells Fargo Bank MN, N.A. (incorporated by reference to Exhibit 99.3 from Brocade's Current Report on Form 8-K filed August 8, 2006) |
| 4.5 | Amendment No. 2 to Preferred Stock Rights Agreement between Brocade Communications Systems, Inc. and Wells Fargo Bank, N.A., dated as of January 23, 2007 (incorporated by reference to Exhibit 4.3 to Brocade's Form 8-A/A filed January 24, 2007) |
| 10.1*/** | Senior Leadership Plan as amended and restated as of November 17, 2006 |
| 10.2*/** | Amended and Restated 1999 Stock Plan as amended and restated on November 17, 2006 and related forms of agreements |
| 10.3** | Amendment #28 dated January 2, 2007 to Statement of Work No. 1 between International Business Machines Corporation and Brocade dated August 12, 2005 |
| 31.1** | Rule 13a-14(a)/15d-14(a) Certification by the Chief Executive Officer. |
| 31.2** | Rule 13a-14(a)/15d-14(a) Certification by the Chief Financial Officer. |
| 32.1** | Certification by the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

* Indicates management contract or compensatory plan required to be filed as an exhibit pursuant to Item 14(c) of Form 10-K.

** Filed herewith

**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.

BROCADE COMMUNICATIONS SYSTEMS, INC.

Date: March 7, 2007

By: /s/ Richard Deranleau
Richard Deranleau
Chief Financial Officer

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** Filed herewith

Exhibit 10.1

# BROCADE SENIOR LEADERSHIP PLAN

Revised: November 17, 2006

## PURPOSE

The Brocade Senior Leadership Plan is designed to link incentive compensation with Company performance.

## PERFORMANCE PERIOD AND PAYOUT PERIOD

Performance against Company and individual objectives is measured annually (according to the Company's fiscal year) (Plan Period), but will be reviewed semi-annually. Payout of earned cash bonuses, if any, occurs on an annual basis.

## ELIGIBILITY

Regular full-time and part-time Vice President (VP) level employees are eligible to participate in the Senior Leadership Plan Program. To the extent a VP is eligible to and participates in the Company's Sales Incentive Plan, then that VP shall not be eligible to participate in this Senior Leadership Plan.

Participants must be regular (full-time or part-time) employees at the end of the fiscal year to be eligible to receive a Senior Leadership Plan Payout.

## PARTICIPANT PERFORMANCE

As each Plan Period begins, participants must complete a CEO or VP Performance Contract. Performance contracts should be tied to company and departmental goals as outlined by the board of directors (i.e., company priorities and initiatives). All goals must be tied to overall company objectives and have defined measurements.

Before Performance Contracts for Executive VPs are final, they are to be reviewed and approved by Finance, Human Resources, and the Chief Executive Officer (CEO). Performance Contracts for Functional VPs are reviewed and approved by the applicable Executive VP. The CEO's Performance Contract shall be reviewed by the Chair or a designated member of the Compensation Committee or the Compensation Committee.

At the end of each Plan Period, actual performance against the plan's financial metric goals is determined by Finance and provided to the plan participants. Performance against goals is then assessed by the Participant and then reviewed and assessed by the VP's manager, in order to determine each participant's bonus payout for the period. The Compensation Committee reviews and approves all Section 16 Officers' performance and bonus payouts annually. The CEO reviews and approves all other VP cash bonus payouts. The Compensation Committee shall review and approve the CEO's bonus payouts.

COMPANY PERFORMANCE & SENIOR LEADERSHIP PLAN FUNDING

Each Plan Period, Brocade will set a revenue and non-GAAP operating income target for the Company to achieve during the Plan Period (Target Revenue and OI).

At the end of each Plan Period, Brocade will fund the Senior Leadership Plan based on the actual performance achieved by Brocade during the Plan Period (Actual Revenue and OI) relative to the Target Revenue and OI (Actual Contribution).

The Actual Revenue and OI will be communicated following the end of each Plan Period.

PARTICIPANT INCENTIVE TARGET

A Participant's Incentive Target is determined by the Participant's pay grade at the end of the 12-month Plan Period, unless otherwise indicated in writing by Brocade.

| Participant Pay Grade | Annual Incentive Target |
|---|---|
| CEO | 100% |
| CEO Direct Reports and Select VPs | 50% |
| Other VPs | 40% |

SENIOR LEADERSHIP PLAN PAYOUTS

On an annual basis, the Compensation Committee reviews and approves Section 16 Officers' performance and cash bonus payouts. The CEO reviews and approves all other VP cash bonuses. Program payouts are made within eight (8) weeks following the conclusion of the 12-month Plan Period. Payouts will be pro-rated for Participants who are hired or transferred into the Senior Leadership Plan during any Plan Period.

Except as otherwise agreed upon by the Company and the Participant, for each Participant, the cash bonus payout is calculated based on the following formula (less applicable taxes and deductions):

*Bonus Payout* = (Actual Funding) x (Individual VP Goal Points Earned for the year) x (Annual Incentive Target) x (Annual Salary)

| Participant | Revenue | Non-GAAP Operating Income | Individual Goals | Total |
|---|---|---|---|---|
| CEO | 37.5% | 37.5% | 25% | 100% |
| VPs | 50% | 40% | 10% | 100% |

Bonuses will be calculated using the salary as of the last day of the Plan Period.

Departmental budgets are communicated at the beginning of each fiscal year and may be updated quarterly throughout the year by the CEO and CFO. Adherence to the individual's departmental budget is a gate for the individual to qualify for the Senior Leadership Plan bonus. Failure to adhere to the agreed upon budget disqualifies the individual from a bonus payout.

ADMINISTRATIVE PROCEDURES

*Compensation Committee Approval*

The Compensation Committee reserves the right to decrease or eliminate bonus otherwise indicated.

*New Hires and Promotions*

Participants new to the company or who are promoted into the Senior Leadership Plan must complete a VP Performance Contract within 60 days of beginning in the new position.

*Grade/Salary Factor*

Payout will be based on the Participant's salary and pay grade on the last day of the Plan Period. Bonuses will be pro-rated if Participant received a cash bonus on another bonus program.

*Terminations*: Anyone who is not on the payroll as of the end of the fiscal year is not eligible to receive a cash bonus payout.

*Leaves of Absences, Disability or Death*: In the event of the Participant death, disability time off, or leave of absence, Payouts will be made on a pro-rated basis, based on the number of days the Participant was actively working at Brocade. If the Participant is on a legally protected leave of absence (e.g. Family Medical Leave or Military Leave), the Participant's eligibility for participation in Plan may be extended beyond the time above, in accordance with the laws governing the legally protected leave. In the event of death, any cash bonus payments will be paid to the Participant's primary beneficiary as designated in the Participant's Brocade life insurance plan documentation, if any.

*Performance Improvement Plan/Disciplinary Situations (Development Needed):* If a Participant, at anytime prior to the cash bonus payout 12-month Plan Period, is subject to a performance improvement plan, discipline or demotion, Brocade may, in its sole discretion, reduce or eliminate the Cash Payment that the Participant would otherwise have been eligible to receive. If, at the time prior to the Payout for a 12-month Plan Period, it is determined that a Participant may be subject to corrective action, discipline or demotion, then Brocade may withhold the entire Cash Bonus Payout, or a portion thereof, until after a final decision on such corrective action has been made. If a Participant is given a performance rating of Development Needed, the Participant will not be eligible to receive a Payout. Only the VP of Human Resources or CEO may approve exceptions to this policy.

*Other Provisions*: Participation in the Senior Leadership Plan does not constitute an agreement (express or implied) between the Participant and Brocade that the Participant will be employed by Brocade for any specific period of time, nor is there any agreement for continuing or long - term employment. Terms and conditions regarding the Senior Leadership Plan and any participation therein, including but not limited to Senior Leadership Plan eligibility, Senior Leadership Plan funding, and performance and payout criteria and determinations, are subject to change by Brocade at any time in its sole discretion. Brocade and its Board of Directors retain the absolute right to interpret, revise, modify or terminate the Senior Leadership Plan at any time in its sole discretion.

**ADDENDUM TO BROCADE SENIOR LEADERSHIP PLAN**
**(DATED OCTOBER 21, 2005)**

Notwithstanding any terms to the contrary in the Brocade Senior Leadership Plan, the following terms shall apply to the Bonus Payout under the Senior Leadership Plan for fiscal 2006 and 2007:

| | 2006 | 2007 |
|---|---|---|
| **Executive Officers and Certain Other Officers** | | |
| Cash Bonus Premium[1] | Up to 1.0x of 2006 Bonus Target | Up to 0.5x of 2007 Bonus Target |
| Restricted Stock[2] | 1.5x of 2005 Base Salary | N/A |
| **Other Officers** | | |
| Cash Bonus Premium[1] | Up to 0.35x of 2006 Bonus Target | Up to 0.35x of 2007 Bonus Target |

1 In addition to normal bonus and subject to achievement of revenue and operating margin/profit targets determined by the Board of Directors and other Company and departmental financial, strategic and operational metrics.

2 The number of shares of restricted stock to be issued is multiplied by such employee’s 2005 base salary, divided by then fair market value on the date of grant. The grants will be subject to 2-year cliff vesting. These grants will be in lieu of any 2006 focal option grants for such employees.

Exhibit 10.2

**BROCADE COMMUNICATIONS SYSTEMS, INC.**
**1999 STOCK PLAN**
**(as amended and restated on November 17, 2006)**

1. Purposes of the Plan. The purposes of this 1999 Stock Plan are:

- to attract and retain the best available personnel for positions of substantial responsibility,
- to provide additional incentive to Employees, Directors and Consultants, and
- to promote the success of the Company's business.

Options granted under the Plan may be Incentive Stock Options or Nonstatutory Stock Options, as determined by the Administrator at the time of grant. Stock Purchase Rights and Restricted Stock Units may also be granted under the Plan.

2. Definitions. As used herein, the following definitions shall apply:

(a) "Administrator" means the Board or any of its Committees as shall be administering the Plan, in accordance with Section 4 of the Plan.

(b) "Applicable Laws" means the requirements relating to the administration of equity-based award plans under U. S. state corporate laws, U.S. federal and state securities laws, the Code, any stock exchange or quotation system on which the Common Stock is listed or quoted and the applicable laws of any foreign country or jurisdiction where Awards are, or will be, granted under the Plan.

(c) "Award" means, individually or collectively, a grant under the Plan of Options, Stock Purchase Rights or Restricted Stock Units and other stock or cash awards as the Administrator may determine.

(d) "Award Agreement" means the written or electronic agreement setting forth the terms and provisions applicable to each Award granted under the Plan, including an Option Agreement. The Award Agreement is subject to the terms and conditions of the Plan.

(e) "Board" means the Board of Directors of the Company.

(f) "Code" means the Internal Revenue Code of 1986, as amended.

(g) "Committee" means a committee of Directors appointed by the Board in accordance with Section 4 of the Plan.

(h) "Common Stock" means the common stock of the Company.

(i) "Company" means Brocade Communications Systems, Inc., a Delaware corporation.

(j) "Consultant" means any person, including an advisor, engaged by the Company or a Parent or Subsidiary to render services to such entity.

(k) "Director" means a member of the Board.

(l) "Disability" means total and permanent disability as defined in Section 22(e)(3) of the Code.

(m) "Employee" means any individual, including Officers and Directors, employed by the Company or any Parent or Subsidiary of the Company. For purposes of the Plan, the employment relationship shall be treated as continuing intact while the individual (i) is on any bona fide leave of absence approved by the Company or (ii) transfers between locations of the Company or between the Company, its Parent, any Subsidiary, or any successor. Neither service as a Director nor payment of a director's fee by the Company shall be sufficient to constitute "employment" by the Company.

(n) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(o) "Fair Market Value" means, as of any date, the value of Common Stock determined as follows:

(i) If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market or The Nasdaq SmallCap Market of The Nasdaq Stock Market, its Fair Market Value shall be the closing sales price for such stock (or the closing bid, if no sales were reported) as quoted on such exchange or system for the last market trading day on the date of such determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, the Fair Market Value of a Share of Common Stock shall be the mean between the high bid and low asked prices for the Common Stock on the last market trading day prior to the day of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable; or

(iii) In the absence of an established market for the Common Stock, the Fair Market Value shall be determined in good faith by the Administrator.

(p) "Incentive Stock Option" means an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code and the regulations promulgated thereunder.

(q) "Nonstatutory Stock Option" means an Option not intended to qualify as an Incentive Stock Option.

(r) "Notice of Grant" means a written or electronic notice evidencing certain terms and conditions of an individual Award grant. The Notice of Grant is part of the Award Agreement.

(s) "Officer" means a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

(t) "Option" means a stock option granted pursuant to the Plan.

(u) "Option Agreement" means an agreement between the Company and a Participant evidencing the terms and conditions of an individual Option grant. The Option Agreement is subject to the terms and conditions of the Plan.

(v) "Option Exchange Program" means a program whereby outstanding Options are surrendered in exchange for Options with a lower exercise price.

(w) "Optioned Stock" means the Common Stock subject to an Award.

(x) "Optionee" means the holder of an outstanding Option or Stock Purchase Right granted under the Plan.

(y) "Parent" means a "parent corporation," whether now or hereafter existing, as defined in Section 424(e) of the Code.

(z) "Participant" means the holder of an outstanding Award, including an Optionee.

(aa) "Plan" means this 1999 Stock Plan.

(bb) "Restricted Stock" means shares of Common Stock acquired pursuant to a grant of Stock Purchase Rights under Section 11 of the Plan.

(cc) "Restricted Stock Purchase Agreement" means a written agreement between the Company and the Participant evidencing the terms and restrictions applying to stock purchased under a Stock Purchase Right. The Restricted Stock Purchase Agreement is subject to the terms and conditions of the Plan and the Notice of Grant.

(dd) "Restricted Stock Unit" means a bookkeeping entry representing an amount equal to the Fair Market Value of one Share, granted pursuant to Section 12. Each Restricted Stock Unit represents an unfunded and unsecured obligation of the Company.

(ee) "Rule 16b-3" means Rule 16b-3 of the Exchange Act or any successor to Rule 16b-3, as in effect when discretion is being exercised with respect to the Plan.

(ff) "Section 16(b)" means Section 16(b) of the Exchange Act.

(gg) "Service Provider" means an Employee, Director or Consultant.

(hh) “Share” means a share of the Common Stock, as adjusted in accordance with Section 14 of the Plan.

(ii) “Stock Purchase Right” means the right to purchase Common Stock pursuant to Section 11 of the Plan, as evidenced by a Notice of Grant.

(jj) “Subsidiary” means a “subsidiary corporation”, whether now or hereafter existing, as defined in Section 424(f) of the Code.

3. Stock Subject to the Plan. Subject to the provisions of Section 14 of the Plan, the maximum aggregate number of Shares which may be optioned and sold under the Plan is 7,607,000 Shares [60,856,000 Shares as adjusted for three 2:1 stock splits effective on or prior to 12/21/00], plus an annual increase to be added on the first day of the Company’s fiscal year beginning in 2000 equal to the lesser of (i) 5,000,000 shares [40,000,000 shares as adjusted for three 2:1 stock splits effective on or prior to 12/21/00], (ii) 5% of the outstanding shares on such date or (iii) a lesser amount determined by the Board. The Shares may be authorized, but unissued, or reacquired Common Stock.

If an Award expires or becomes unexercisable without having been exercised in full, or is surrendered pursuant to an Option Exchange Program, the unpurchased Shares (or for Awards other than Options, the forfeited or repurchased Shares), which were subject thereto shall become available for future grant or sale under the Plan (unless the Plan has terminated); provided, however, that Shares that have actually been issued under the Plan upon exercise of an Award, shall not be returned to the Plan and shall not become available for future distribution under the Plan, except that if Shares of Restricted Stock or Shares acquired pursuant to Restricted Stock Units are repurchased by the Company at their original purchase price or are forfeited to the Company, such Shares shall become available for future grant under the Plan.

4. Administration of the Plan.

(a) Procedure.

(i) Multiple Administrative Bodies. The Plan may be administered by different Committees with respect to different groups of Service Providers.

(ii) Section 162(m). To the extent that the Administrator determines it to be desirable to qualify Awards granted hereunder as “performance-based compensation” within the meaning of Section 162(m) of the Code, the Plan shall be administered by a Committee of two or more “outside directors” within the meaning of Section 162(m) of the Code.

(iii) Rule 16b-3. To the extent desirable to qualify transactions hereunder as exempt under Rule 16b-3, the transactions contemplated hereunder shall be structured to satisfy the requirements for exemption under Rule 16b-3.

(iv) Other Administration. Other than as provided above, the Plan shall be administered by (A) the Board or (B) a Committee, which committee shall be constituted to satisfy Applicable Laws.

(b) Powers of the Administrator. Subject to the provisions of the Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the Administrator shall have the authority, in its discretion:

(i) to determine the Fair Market Value;

(ii) to select the Service Providers to whom Awards may be granted hereunder;

(iii) to determine the number of shares of Common Stock to be covered by each Award granted hereunder;

(iv) to approve forms of agreement for use under the Plan;

(v) to determine the terms and conditions, not inconsistent with the terms of the Plan, of any Award granted hereunder. Such terms and conditions include, but are not limited to, the exercise price, the time or times when Awards may be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions, and any restriction or limitation regarding any Award or the shares of Common Stock relating thereto, based in each case on such factors as the Administrator, in its sole discretion, shall determine;

(vi) to reduce the exercise price of any Award to the then current Fair Market Value if the Fair Market Value of the Common Stock covered by such Award shall have declined since the date the Award was granted;

(vii) to institute an Option Exchange Program;

(viii) to construe and interpret the terms of the Plan and Awards granted pursuant to the Plan;

(ix) to prescribe, amend and rescind rules and regulations relating to the Plan, including rules and regulations relating to sub-plans established for the purpose of qualifying for preferred tax treatment under foreign tax laws;

(x) to modify or amend each Award (subject to Section 16(c) of the Plan), including the discretionary authority to extend the post-termination exercisability period of Awards longer than is otherwise provided for in the Plan;

(xi) to allow Participants to satisfy withholding tax obligations by electing to have the Company withhold from the Shares to be issued upon exercise of an Award that number of Shares having a Fair Market Value equal to the amount required to be withheld. The Fair Market Value of the Shares to be withheld shall be determined on the date that the amount of tax to be withheld is to be determined. All elections by a Participant to have Shares withheld for this purpose shall be made in such form and under such conditions as the Administrator may deem necessary or advisable;

(xii) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Administrator;

(xiii) to make all other determinations deemed necessary or advisable for administering the Plan.

(c) Effect of Administrator's Decision. The Administrator's decisions, determinations and interpretations shall be final and binding on all Participants and any other holders of Awards.

5. Eligibility. Nonstatutory Stock Options, Stock Purchase Rights and Restricted Stock Units may be granted to Service Providers. Incentive Stock Options may be granted only to Employees.

6. Limitations.

(a) Each Option shall be designated in the Award Agreement as either an Incentive Stock Option or a Nonstatutory Stock Option. However, notwithstanding such designation, to the extent that the aggregate Fair Market Value of the Shares with respect to which Incentive Stock Options are exercisable for the first time by the Participant during any calendar year (under all plans of the Company and any Parent or Subsidiary) exceeds $100,000, such Options shall be treated as Nonstatutory Stock Options. For purposes of this Section 6(a), Incentive Stock Options shall be taken into account in the order in which they were granted. The Fair Market Value of the Shares shall be determined as of the time the Option with respect to such Shares is granted.

(b) Neither the Plan nor any Award shall confer upon a Participant any right with respect to continuing the Participant's relationship as a Service Provider with the Company, nor shall they interfere in any way with the Participant's right or the Company's right to terminate such relationship at any time, with or without cause.

(c) The following limitations shall apply to grants of Options:

(i) No Service Provider shall be granted, in any fiscal year of the Company, Options to purchase more than 1.5 million Shares.

(ii) In connection with his or her initial service, a Service Provider may be granted Options to purchase up to an additional 1.5 million Shares which shall not count against the limit set forth in subsection (i) above.

(iii) The foregoing limitations shall be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 14.

(iv) If an Option is cancelled in the same fiscal year of the Company in which it was granted (other than in connection with a transaction described in Section 14), the cancelled Option will be counted against the limits set forth in subsections (i) and (ii) above. For this purpose, if the exercise price of an Option is reduced, the transaction will be treated as a cancellation of the Option and the grant of a new Option.

7. Term of Plan. Subject to Section 20 of the Plan, the Plan shall become effective upon its adoption by the Board. It shall continue in effect for a term of ten (10) years unless terminated earlier under Section 16 of the Plan.

8. Term of Option. The term of each Option shall be stated in the Award Agreement. In the case of an Incentive Stock Option, the term shall be ten (10) years from the date of grant or such shorter term as may be provided in the Award Agreement. Moreover, in the case of an Incentive Stock Option granted to a Participant who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Incentive Stock Option shall be five (5) years from the date of grant or such shorter term as may be provided in the Award Agreement.

9. Option Exercise Price and Consideration.

(a) Exercise Price. The per share exercise price for the Shares to be issued pursuant to exercise of an Option shall be determined by the Administrator, subject to the following:

(i) In the case of an Incentive Stock Option

(A) granted to an Employee who, at the time the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price shall be no less than 110% of the Fair Market Value per Share on the date of grant.

(B) granted to any Employee other than an Employee described in paragraph (A) immediately above, the per Share exercise price shall be no less than 100% of the Fair Market Value per Share on the date of grant.

(ii) In the case of a Nonstatutory Stock Option, the per Share exercise price shall be determined by the Administrator. In the case of a Nonstatutory Stock Option intended to qualify as “performance-based compensation” within the meaning of Section 162(m) of the Code, the per Share exercise price shall be no less than 100% of the Fair Market Value per Share on the date of grant.

(iii) Notwithstanding the foregoing, Options may be granted with a per Share exercise price of less than 100% of the Fair Market Value per Share on the date of grant pursuant to a merger or other corporate transaction.

(b) Waiting Period and Exercise Dates. At the time an Option is granted, the Administrator shall fix the period within which the Option may be exercised and shall determine any conditions which must be satisfied before the Option may be exercised.

(c) Form of Consideration. The Administrator shall determine the acceptable form of consideration for exercising an Option, including the method of payment. In the case of an Incentive Stock Option, the Administrator shall determine the acceptable form of consideration at the time of grant. Such consideration may consist entirely of:

(i) cash;

(ii) check;

(iii) other Shares which (A) in the case of Shares acquired upon exercise of an option, have been owned by the Participant for more than six months on the date of surrender, and (B) have a Fair Market Value on the date of surrender equal to the aggregate exercise price of the Shares as to which said Option shall be exercised;

(iv) consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan;

(v) a reduction in the amount of any Company liability to the Participant, including any liability attributable to the Participant's participation in any Company-sponsored deferred compensation program or arrangement;

(vi) any combination of the foregoing methods of payment; or

(vii) such other consideration and method of payment for the issuance of Shares to the extent permitted by Applicable Laws.

10. Exercise of Option.

(a) Procedure for Exercise; Rights as a Shareholder. Any Option granted hereunder shall be exercisable according to the terms of the Plan and at such times and under such conditions as determined by the Administrator and set forth in the Award Agreement. Unless the Administrator provides otherwise, vesting of Options granted hereunder shall be tolled during any unpaid leave of absence. An Option may not be exercised for a fraction of a Share.

An Option shall be deemed exercised when the Company receives: (i) written or electronic notice of exercise (in accordance with the Award Agreement) from the person entitled to exercise the Option, and (ii) full payment for the Shares with respect to which the Option is exercised. Full payment may consist of any consideration and method of payment authorized by the Administrator and permitted by the Award Agreement and the Plan. Shares issued upon exercise of an Option shall be issued in the name of the Participant or, if requested by the Participant, in the name of the Participant and his or her spouse. Until the Shares are issued (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company), no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock, notwithstanding the exercise of the Option. The Company shall issue (or cause to be issued) such Shares promptly after the Option is exercised. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Shares are issued, except as provided in Section 14 of the Plan.

Exercising an Option in any manner shall decrease the number of Shares thereafter available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised.

(b) Termination of Relationship as a Service Provider. If a Participant ceases to be a Service Provider, other than upon the Participant's death or Disability, the Participant may exercise his or her Option within such period of time as is specified in the Award Agreement to the extent that the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). In the absence of a specified time in the Award Agreement, the Option shall remain exercisable for three (3) months following the Participant's termination. If, on the date of termination, the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination, the Participant does not exercise his or her Option within the time specified by the Administrator, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(c) Disability of Participant. If a Participant ceases to be a Service Provider as a result of the Participant's Disability, the Participant may exercise his or her Option within such period of time as is specified in the Award Agreement to the extent the Option is vested on the date of termination (but in no event later than the expiration of the term of such Option as set forth in the Award Agreement). In the absence of a specified time in the Award Agreement, the Option shall remain exercisable for twelve (12) months following the Participant's termination. If, on the date of termination, the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall revert to the Plan. If, after termination, the Participant does not exercise his or her Option within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(d) Death of Participant. If a Participant dies while a Service Provider, the Option may be exercised within such period of time as is specified in the Award Agreement (but in no event later than the expiration of the term of such Option as set forth in the Notice of Grant), by the Participant's estate or by a person who acquires the right to exercise the Option by bequest or inheritance, but only to the extent that the Option is vested on the date of death. In the absence of a specified time in the Award Agreement, the Option shall remain exercisable for twelve (12) months following the Participant's termination. If, at the time of death, the Participant is not vested as to his or her entire Option, the Shares covered by the unvested portion of the Option shall immediately revert to the Plan. The Option may be exercised by the executor or administrator of the Participant's estate or, if none, by the person(s) entitled to exercise the Option under the Participant's will or the laws of descent or distribution. If the Option is not so exercised within the time specified herein, the Option shall terminate, and the Shares covered by such Option shall revert to the Plan.

(e) Buyout Provisions. The Administrator may at any time offer to buy out for a payment in cash or Shares an Option previously granted based on such terms and conditions as the Administrator shall establish and communicate to the Participant at the time that such offer is made.

11. Stock Purchase Rights.

(a) Rights to Purchase. Stock Purchase Rights may be issued either alone, in addition to, or in tandem with other awards granted under the Plan and/or cash awards made outside of the Plan. After the Administrator determines that it will offer Stock Purchase Rights under the Plan, it shall advise the offeree in writing or electronically, by means of a Notice of Grant, of the terms, conditions and restrictions related to the offer, including the number of Shares that the offeree shall be entitled to purchase, the price to be paid, and the time within which the offeree must accept such offer. The offer shall be accepted by execution of a Restricted Stock Purchase Agreement in the form determined by the Administrator.

(b) Repurchase Option. Unless the Administrator determines otherwise, the Restricted Stock Purchase Agreement shall grant the Company a repurchase option exercisable upon the voluntary or involuntary termination of the purchaser's service with the Company for any reason (including death or Disability). The purchase price for Shares repurchased pursuant to the Restricted Stock Purchase Agreement shall be the original price paid by the purchaser and may be paid by cancellation of any indebtedness of the purchaser to the Company. The repurchase option shall lapse at a rate determined by the Administrator.

(c) Other Provisions. The Restricted Stock Purchase Agreement shall contain such other terms, provisions and conditions not inconsistent with the Plan as may be determined by the Administrator in its sole discretion.

(d) Rights as a Shareholder. Once the Stock Purchase Right is exercised, the purchaser shall have the rights equivalent to those of a shareholder, and shall be a shareholder when his or her purchase is entered upon the records of the duly authorized transfer agent of the Company. No adjustment will be made for a dividend or other right for which the record date is prior to the date the Stock Purchase Right is exercised, except as provided in Section 14 of the Plan.

12. Restricted Stock Units.

(a) Grant. Restricted Stock Units may be granted at any time and from time to time as determined by the Administrator. Each Restricted Stock Unit grant will be evidenced by an Award Agreement that will specify such other terms and conditions as the Administrator, in its sole discretion, will determine, including all terms, conditions, and restrictions related to the grant, the number of Restricted Stock Units and the form of payout, which, subject to Section 12(d), may be left to the discretion of the Administrator.

(b) Vesting Criteria and Other Terms. The Administrator will set vesting criteria (which may include performance objectives based upon the achievement of Company-wide, departmental or individual goals, Company performance relative to selected other companies, or any other basis determined by the Administrator) in its discretion, which, depending on the extent to which the criteria are met, will determine the number of Restricted Stock Units that will be paid out to the Participant. After the grant of Restricted Stock Units, the Administrator, in its sole discretion, may reduce or waive any restrictions for such Restricted Stock Units. Each Award of Restricted Stock Units will be evidenced by an Award Agreement that will specify the vesting criteria, and such other terms and conditions as the Administrator, in its sole discretion, will determine.

(c) Earning Restricted Stock Units. Upon meeting the applicable vesting criteria (including without limitation, achievement of any applicable performance objectives), the Participant will be entitled to receive a payout as specified in the Award Agreement. Notwithstanding the foregoing, at any time after the grant of Restricted Stock Units, the Administrator, in its sole discretion, may reduce or waive any vesting criteria that must be met to receive a payout.

(d) Form and Timing of Payment. Payment of earned Restricted Stock Units will be made as soon as practicable after the date(s) set forth in the Award Agreement. The Restricted Stock Units will be paid in Shares.

(e) Cancellation. On the date set forth in the Award Agreement, all unearned Restricted Stock Units will be forfeited to the Company.

13. Non-Transferability of Awards. Unless determined otherwise by the Administrator, an Award may not be sold, pledged, assigned, hypothecated, transferred, or disposed of in any manner other than by will or by the laws of descent or distribution and may be exercised, during the lifetime of the Participant, only by the Participant. If the Administrator makes an Award transferable, such Award shall contain such additional terms and conditions as the Administrator deems appropriate.

14. Adjustments Upon Changes in Capitalization, Dissolution, Merger or Asset Sale.

(a) Changes in Capitalization. Subject to any required action by the shareholders of the Company, the number of shares of Common Stock covered by each outstanding Award, and the number of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation or expiration of an Award, as well as the price per share of Common Stock covered by each such outstanding Award, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares of Common Stock subject to an Award.

(b) Dissolution or Liquidation. In the event of the proposed dissolution or liquidation of the Company, the Administrator shall notify each Participant as soon as practicable prior to the effective date of such proposed transaction. The Administrator in its discretion may provide for a Participant to have the right to exercise his or her Option until ten (10) days prior to such transaction as to all of the Optioned Stock covered thereby, including Shares as to which the Option would not otherwise be exercisable. In addition, the Administrator may provide that any Company repurchase option applicable to any Shares purchased upon exercise of an Award shall lapse as to all such Shares or, with respect to Restricted Stock Units, all Shares shall vest, provided the proposed dissolution or liquidation takes place at the time and in the manner contemplated. To the extent it has not been previously exercised, an Award will terminate immediately prior to the consummation of such proposed action.

(c) Merger or Asset Sale. In the event of a merger of the Company with or into another corporation, or the sale of substantially all of the assets of the Company, each outstanding Award shall be assumed or an equivalent option or right substituted by the successor corporation or a Parent or Subsidiary of the successor corporation. In the event that the successor corporation refuses to assume or substitute for the Award, the Participant shall fully vest in and have the right to exercise the Award as to all of the Optioned Stock, including Shares as to which it would not otherwise be vested or exercisable, all restrictions on Restricted Stock shall lapse, and all outstanding Restricted Stock Units shall fully vest. If an Award becomes fully vested and exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Administrator shall notify the Participant in writing or electronically that the Award shall be fully vested and exercisable for a period of fifteen

(15) days from the date of such notice, and the Award shall terminate upon the expiration of such period. For the purposes of this paragraph, the Award shall be considered assumed if, following the merger or sale of assets, the Award confers the right to purchase or receive, for each Share subject to the Award immediately prior to the merger or sale of assets, the consideration (whether stock, cash, or other securities or property) received in the merger or sale of assets by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the merger or sale of assets is not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of the Award, for each Share of Optioned Stock subject to the Award, to be solely common stock of the successor corporation or its Parent equal in fair market value to the per share consideration received by holders of Common Stock in the merger or sale of assets.

15. Date of Grant. The date of grant of an Award shall be, for all purposes, the date on which the Administrator makes the determination granting such Award, or such other later date as is determined by the Administrator. Notice of the determination shall be provided to each Participant within a reasonable time after the date of such grant.

16. Amendment and Termination of the Plan.

(a) Amendment and Termination. The Board may at any time amend, alter, suspend or terminate the Plan.

(b) Shareholder Approval. The Company shall obtain shareholder approval of any Plan amendment to the extent necessary and desirable to comply with Applicable Laws.

(c) Effect of Amendment or Termination. No amendment, alteration, suspension or termination of the Plan shall impair the rights of any Participant, unless mutually agreed otherwise between the Participant and the Administrator, which agreement must be in writing and signed by the Participant and the Company. Termination of the Plan shall not affect the Administrator’s ability to exercise the powers granted to it hereunder with respect to Awards granted under the Plan prior to the date of such termination.

17. Conditions Upon Issuance of Shares.

(a) Legal Compliance. Shares shall not be issued pursuant to the exercise of an Award unless the exercise of such Award and the issuance and delivery of such Shares shall comply with Applicable Laws and shall be further subject to the approval of counsel for the Company with respect to such compliance.

(b) Investment Representations. As a condition to the exercise of an Award, the Company may require the person exercising such Award to represent and warrant at the time of any such exercise that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required.

18. Inability to Obtain Authority. The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

19. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

20. Shareholder Approval. The Plan shall be subject to approval by the shareholders of the Company within twelve (12) months after the date the Plan is adopted. Such shareholder approval shall be obtained in the manner and to the degree required under Applicable Laws.

**Notice of Grant of Stock Options**
**and Option Agreement**

**Brocade Communications Systems, Inc.**
**ID:** 77-0409517
1745 Technology Drive
San Jose, CA 95110

**Name:**
**Address:**

**Option Number:**
**Plan:** **1999**
**ID:**

Effective [DATE], you have been granted a(n) Non-Qualified Stock Option to buy [SHARES] shares of Brocade Communications Systems, Inc. (the Company) stock at $[PRICE] per share.

The total option price of the shares granted is $[PRICE].

Shares in each period will become fully vested on the date shown.

| Shares | Vest Type | Full Vest | Expiration |
|---|---|---|---|

By your signature and the Company's signature below, you and the Company agree that these options are granted under and governed by the terms and conditions of the Company's Stock Option Plan as amended and the Option Agreement, all of which are attached and made a part of this document.

Brocade Communications Systems, Inc. Date

[EMPLOYEE NAME] Date

**BROCADE COMMUNICATIONS SYSTEMS, INC.**
**1999 STOCK OPTION PLAN**
**STOCK OPTION AGREEMENT**

**Termination Period:**

This Option may be exercised for three months after Optionee ceases to be a Service Provider. Upon the death or Disability of the Optionee, this Option may be exercised for one year after Optionee ceases to be a Service Provider. In no event shall this Option be exercised later than the Term/Expiration Date as provided above.

## I. AGREEMENT

A. Grant of Option.

The Plan Administrator of the Company hereby grants to the Optionee named in the Notice of Grant attached as Part I of this Agreement (the "Optionee") an option (the "Option") to purchase the number of Shares, as set forth in the Notice of Grant, at the exercise price per share set forth in the Notice of Grant (the "Exercise Price"), subject to the terms and conditions of the Plan, which is incorporated herein by reference. Subject to Section 15(c) of the Plan, in the event of a conflict between the terms and conditions of the Plan and the terms and conditions of this Option Agreement, the terms and conditions of the Plan shall prevail.

If designated in the Notice of Grant as an Incentive Stock Option ("ISO"), this Option is intended to qualify as an Incentive Stock Option under Section 422 of the Code. However, if this Option is intended to be an Incentive Stock Option, to the extent that it exceeds the $100,000 rule of Code Section 422(d) it shall be treated as a Nonstatutory Stock Option ("NSO").

B. Exercise of Option.

(a) Right to Exercise. This Option is exercisable during its term in accordance with the Vesting Schedule set out in the Notice of Grant and the applicable provisions of the Plan and this Option Agreement.

(b) Method of Exercise. This Option is exercisable by delivery of an exercise notice, in the form attached as Exhibit A (the "Exercise Notice"), which shall state the election to exercise the Option, the number of Shares in respect of which the Option is being exercised (the "Exercised Shares"), and such other representations and agreements as may be required by the Company pursuant to the provisions of the Plan. The Exercise Notice shall be completed by the Optionee and delivered to Elizabeth Moore, Stock Administrator, of the Company. The Exercise Notice shall be accompanied by payment of the aggregate Exercise Price as to all Exercised Shares. This Option shall be deemed to be exercised upon receipt by the Company of such fully executed Exercise Notice accompanied by such aggregate Exercise Price.

No Shares shall be issued pursuant to the exercise of this Option unless such issuance and exercise complies with Applicable Laws. Assuming such compliance, for income tax purposes the Exercised Shares shall be considered transferred to the Optionee on the date the Option is exercised with respect to such Exercised Shares.

C. Method of Payment.

Payment of the aggregate Exercise Price shall be by any of the following, or a combination thereof, at the election of the Optionee:

1. cash; or

2. check; or

3. consideration received by the Company under a cashless exercise program implemented by the Company in connection with the Plan; or

4. surrender of other Shares which (i) in the case of Shares acquired upon exercise of an option, have been owned by the Optionee for more than six (6) months on the date of surrender, **and** (ii) have a Fair Market Value on the date of surrender equal to the aggregate Exercise Price of the Exercised Shares; or

5. with the Administrator's consent, delivery of Optionee's promissory note (the "Note") in the form attached hereto as Exhibit C, in the amount of the aggregate Exercise Price of the Exercised Shares together with the execution and delivery by the Optionee of the Security Agreement attached hereto as Exhibit B. The Note shall bear interest at the "applicable federal rate" prescribed under the Code and its regulations at time of purchase, and shall be secured by a pledge of the Shares purchased by the Note pursuant to the Security Agreement.

D. Non-Transferability of Option.

This Option may not be transferred in any manner otherwise than by will or by the laws of descent or distribution and may be exercised during the lifetime of Optionee only by the Optionee. The terms of the Plan and this Option Agreement shall be binding upon the executors, administrators, heirs, successors and assigns of the Optionee.

E. Term of Option.

This Option may be exercised only within the term set out in the Notice of Grant, and may be exercised during such term only in accordance with the Plan and the terms of this Option Agreement.

F. Tax Consequences.

Some of the federal tax consequences relating to this Option, as of the date of this Option, are set forth below. THIS SUMMARY IS NECESSARILY INCOMPLETE, AND THE TAX LAWS AND REGULATIONS ARE SUBJECT TO CHANGE. THE OPTIONEE SHOULD CONSULT A TAX ADVISER BEFORE EXERCISING THIS OPTION OR DISPOSING OF THE SHARES.

G. Exercising the Option.

1. Nonstatutory Stock Option. The Optionee may incur regular federal income tax liability upon exercise of a NSO. The Optionee will be treated as having received compensation income (taxable at ordinary income tax rates) equal to the excess, if any, of the Fair Market Value of the Exercised Shares on the date of exercise over their aggregate Exercise Price. If the Optionee is an Employee or a former Employee, the Company will be required to withhold from his or her compensation or collect from Optionee and pay to the applicable taxing authorities an amount in cash equal to a percentage of this compensation income at the time of exercise, and may refuse to honor the exercise and refuse to deliver Shares if such withholding amounts are not delivered at the time of exercise.

2. Incentive Stock Option. If this Option qualifies as an ISO, the Optionee will have no regular federal income tax liability upon its exercise, although the excess, if any, of the Fair Market Value of the Exercised Shares on the date of exercise over their aggregate Exercise Price will be treated as an adjustment to alternative minimum taxable income for federal tax purposes and may subject the Optionee to alternative minimum tax in the year of exercise. In the event that the Optionee ceases to be an Employee but remains a Service Provider, any Incentive Stock Option of the Optionee that remains unexercised shall cease to qualify as an Incentive Stock Option and will be treated for tax purposes as a Nonstatutory Stock Option on the date three (3) months and one (1) day following such change of status.

3. Disposition of Shares.

(a) NSO. If the Optionee holds NSO Shares for at least one year, any gain realized on disposition of the Shares will be treated as long-term capital gain for federal income tax purposes.

(b) ISO. If the Optionee holds ISO Shares for at least one year after exercise and two years after the grant date, any gain realized on disposition of the Shares will be treated as long-term capital gain for federal income tax purposes. If the Optionee disposes of ISO Shares within one year after exercise or two years after the grant date, any gain realized on such disposition will be treated as compensation income (taxable at ordinary income rates) to the extent of the excess, if any, of the lesser of (A) the difference between the Fair Market Value of the Shares acquired on the date of exercise and the aggregate Exercise Price, or (B) the difference between the sale price of such Shares and the aggregate Exercise Price. Any additional gain will be taxed as capital gain, short-term or long-term depending on the period that the ISO Shares were held.

(c) Notice of Disqualifying Disposition of ISO Shares. If the Optionee sells or otherwise disposes of any of the Shares acquired pursuant to an ISO on or before the later of (i) two years after the grant date, or (ii) one year after the exercise date, the Optionee shall immediately notify the Company in writing of such disposition. The Optionee agrees that he or she may be subject to income tax withholding by the Company on the compensation income recognized from such early disposition of ISO Shares by payment in cash or out of the current earnings paid to the Optionee.

H. Entire Agreement; Governing Law.

The Plan is incorporated herein by reference. The Plan and this Option Agreement constitute the entire agreement of the parties with respect to the subject matter hereof and supersede in their entirety all prior undertakings and agreements of the Company and Optionee with respect to the subject matter hereof, and may not be modified adversely to the Optionee's interest except by means of a writing signed by the Company and Optionee. This agreement is governed by the internal substantive laws, but not the choice of law rules, of Delaware.

I. NO GUARANTEE OF CONTINUED SERVICE.

OPTIONEE ACKNOWLEDGES AND AGREES THAT THE VESTING OF SHARES PURSUANT TO THE VESTING SCHEDULE HEREOF IS EARNED ONLY BY CONTINUING AS A SERVICE PROVIDER AT THE WILL OF THE COMPANY (AND NOT THROUGH THE ACT OF BEING HIRED, BEING GRANTED AN OPTION OR PURCHASING SHARES HEREUNDER). OPTIONEE FURTHER ACKNOWLEDGES AND AGREES THAT THIS AGREEMENT, THE TRANSACTIONS CONTEMPLATED HEREUNDER AND THE VESTING SCHEDULE SET FORTH HEREIN DO NOT CONSTITUTE AN EXPRESS OR IMPLIED PROMISE OF CONTINUED ENGAGEMENT AS A SERVICE PROVIDER FOR THE VESTING PERIOD, FOR ANY PERIOD, OR AT ALL, AND SHALL NOT INTERFERE WITH OPTIONEE'S RIGHT OR THE COMPANY'S RIGHT TO TERMINATE OPTIONEE'S RELATIONSHIP AS A SERVICE PROVIDER AT ANY TIME, WITH OR WITHOUT CAUSE.

By your signature and the signature of the Company's representative, you and the Company agree that this Option is granted under and governed by the terms and conditions of the Plan and this Option Agreement. Optionee has reviewed the Plan and this Option Agreement in their entirety, has had an opportunity to obtain the advice of counsel prior to executing this Option Agreement and fully understands all provisions of the Plan and Option Agreement. Optionee hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Administrator upon any questions relating to the Plan and Option Agreement. Optionee further agrees to notify the Company upon any change in the residence address indicated on page one.

RESTRICTED STOCK UNITS AND PERFORMANCE-BASED RESTRICTED STOCK UNITS

Pursuant to the 1999 Stock Plan (as amended), the Company may grant restricted stock units and performance-based restricted stock units from time to time. Each of the restricted stock units and performance-based restricted stock units represent a contingent right to receive one share of the Company's common stock. The vesting of the restricted stock units and performance-based restricted stock units shall be determined by the Company's Compensation Committee (or Board of Directors or duly authorized subcommittee). The restricted stock units issued in November 2006 vest on the two-year anniversary of the date of grant, assuming continued employment. The performance-based restricted stock units issued in November 2006 vest on the three-year anniversary of the date of grant, and are subject to continued employment and the Company's performance compared to certain peer companies based on the following criteria at the end of the three-year performance period: revenue growth, operating income growth, free cash flow growth and stock price performance. The performance-based restricted stock units also have a maximum payout of 200% if the Company exceeds certain performance targets.

Each of the restricted stock units and performance-based restricted stock units for Michael Klayko, the Company's Chief Executive Officer, is subject to acceleration of all of the then unvested portion of such award upon termination of employment by the Company without cause, or by such officer for good reason, within 12 months following a change of control. Each of the stock units and performance-based restricted stock units for Richard Deranleau (Chief Financial Officer), Don Jaworski (Vice President, Product Development), Tejinder Grewal (Vice President, Corporate Development) and Tyler Wall (General Counsel and Vice President) is subject to acceleration of 50% of the then unvested portion of such award upon termination of employment by the Company without cause, or by such officer for good reason, within 12 months following a change of control. The above acceleration of vesting is also subject to receipt by the Company of a general release of claims from each such officer.

**Exhibit 10.3**

3030 Cornwallis Road
RTP, NC 27709

January 2, 2007 [sic]

Mr. Michael Harrison
Brocade Communications Systems, Inc.
1745 Technology Drive
San Jose, CA 95110

Subject: Amendment 28 to SOW#1 of the IBM/Brocade Goods Agreement ROC-P-68

This letter (the "Amendment") serves as Amendment Number 28 to SOW#1, including all amendments thereto ("SOW#1") of the Goods Agreement ROC-P-68 (the "Agreement"), which the parties hereto do mutually agree to amend as follows

1. The third sentence in the first paragraph of the Goods Agreement, and Section 1. of Amendment #24, is modified as follows:

"The Term of this SOW #1 shall be extended from 12/31/06 to 12/31/07.

The effective date of this Amendment shall be the date on the top of this Amendment (the "Effective Date").

The parties acknowledge that they have read this Amendment, understand it, and agree to be bound by its terms and conditions. All capitalized terms not defined herein shall have the meaning set forth in the Goods Agreement or the SOW #1. All other terms and conditions of the Goods Agreement and SOW#1 that are unaffected by the revisions set forth in this Amendment shall remain in full force and effect. Further, the parties agree that this Amendment and the Goods Agreement and SOW#1 are the complete and exclusive statement of the agreement between the parties, superseding all proposals or other prior agreement, oral or written, and all other communications between the parties relating to this subject.

**Accepted and Agreed To:**
**International Business Machines Corporation**

By: /s/Patrick T. Gaynor 01/04/07
Authorized Signature Date

Patrick T. Gaynor
Type or Print Name

Manager, Storage Procurement
Title & Organization

**Accepted and Agreed To:**
**Brocade Communications Systems, Inc.**

By:/s/ Jill Cameron 01/19/07
Authorized Signature Date

Jill Cameron
Type or Print Name

Director, WW Sales Operations
Title & Organization

**EXHIBIT 31.1**

CERTIFICATION

I, Michael Klayko, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended January 27, 2007 of Brocade Communications Systems, 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(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 7, 2007

/s/ Michael Klayko

Michael Klayko
Chief Executive Officer
(Principal Executive Officer)

**EXHIBIT 31.2**

CERTIFICATION

I, Richard Deranleau, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the quarter ended January 27, 2007 of Brocade Communications Systems, 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(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 7, 2007

/s/ Richard Deranleau

Richard Deranleau
Chief Financial Officer
(Principal Accounting Officer)

**EXHIBIT 32.1**

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

I, Michael Klayko, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Brocade Communications Systems, Inc. on Form 10-Q for the fiscal quarter ended January 27, 2007 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Brocade Communications Systems, Inc.

By: /s/ Michael Klayko
Michael Klayko
Chief Executive Officer

I, Richard Deranleau, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Brocade Communications Systems, Inc. on Form 10-Q for the fiscal quarter ended January 27, 2007 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Quarterly Report on Form 10-Q fairly presents in all material respects the financial condition and results of operations of Brocade Communications Systems, Inc.

By: /s/ Richard Deranleau
Richard Deranleau
Chief Financial Officer