

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

FORM 10- Q

(Mark One)

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

For the quarterly period ended March 31, 2017

OR

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

For the transition period from _____ to _____

000- 32743

(Commission File Number)

DASAN ZHONE SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

22- 3509099
(I.R.S. Employer
Identification Number)

7195 Oakport Street
Oakland, California
(Address of principal executive offices)

94621
(Zip code)

(510) 777- 7000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S- T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non- accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

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

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No
As of September 20, 2017, there were approximately 16,385,455 shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION**Item 1. Financial Statements**

DASAN ZHONG SOLUTIONS, INC. AND SUBSIDIARIES
Unaudited Condensed Consolidated Balance Sheets
(In thousands, except par value)

	March 31, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	\$ 17,288	\$ 17,893
Restricted cash	6,438	6,650
Short- term investments	250	993
Accounts receivable, net of allowances for sales returns and doubtful accounts of \$1,497 as of March 31, 2017 and \$1,143 as of December 31, 2016:		
Trade receivables	39,998	38,324
Related parties	14,860	13,311
Other receivables:		
Others	12,918	12,068
Related parties	17	171
Inventories	35,913	31,032
Prepaid expenses and other current assets	3,774	4,131
Total current assets	131,456	124,573
Property and equipment, net	6,386	6,288
Goodwill	3,977	3,977
Intangible assets, net	8,150	8,767
Other assets	2,272	1,842
Total assets	\$ 152,241	\$ 145,447
Liabilities, Stockholders' Equity and Non-controlling Interest		
Current liabilities:		
Accounts payable		
Others	30,959	30,681
Related parties	—	430
Short- term debt:		
Others	24,704	17,599
Related parties	1,800	—
Other payables:		
Others	1,159	2,040
Related parties	5,422	6,940
Deferred revenue	2,267	1,901
Accrued and other liabilities	9,977	8,163
Total current liabilities	76,288	67,754
Long- term debt - related parties	5,000	6,800
Deferred revenue	1,877	1,674
Other long- term liabilities	2,560	2,351
Total liabilities	85,725	78,579
Commitments and contingencies (Note 11)		
Stockholders' equity and non- controlling interest:		
Common stock, authorized 36,000 shares, 16,380 shares and 16,375 shares outstanding as of March 31, 2017 and December 31, 2016 at \$0.001 par value	16	16
Additional paid- in capital	89,430	89,174
Other comprehensive income (loss)	55	(2,815)

Accumulated deficit	(23,670)	(19,923)
Total stockholders' equity	65,831	66,452
Non- controlling interest	685	416
Total stockholders' equity and non- controlling interest	66,516	66,868
Total liabilities, stockholders' equity and non- controlling interest	\$ 152,241	\$ 145,447

See accompanying notes to unaudited condensed consolidated financial statements.

DASAN ZHONE SOLUTIONS, INC. AND SUBSIDIARIES
Unaudited Condensed Consolidated Statements of Comprehensive Loss
(In thousands, except per share data)

	Three Months Ended	
	March 31,	
	2017	2016
Net revenue:		
Net revenue	\$ 41,241	\$ 18,033
Net revenue - related parties	10,871	7,307
Total net revenue	<u>52,112</u>	<u>25,340</u>
Cost of revenue:		
Products and services	25,459	14,332
Products and services - related parties	8,708	6,397
Amortization of intangible assets	153	—
Total cost of revenue	<u>34,320</u>	<u>20,729</u>
Gross profit	17,792	4,611
Operating expenses:		
Research and product development	9,229	4,679
Selling, marketing, general and administrative	10,599	4,265
Amortization of intangible assets	493	8
Total operating expenses	<u>20,321</u>	<u>8,952</u>
Operating loss	(2,529)	(4,341)
Interest income	26	48
Interest expense	(274)	(194)
Other income, net	(281)	99
Loss before income taxes	(3,058)	(4,388)
Income tax expense (benefit)	440	(627)
Net loss	(3,498)	(3,761)
Net income attributable to non- controlling interest	249	6
Net loss attributable to DASAN Zhone Solutions, Inc.	<u>\$ (3,747)</u>	<u>\$ (3,767)</u>
Foreign currency translation adjustments	<u>2,890</u>	<u>509</u>
Comprehensive loss	(608)	(3,252)
Comprehensive income attributable to non- controlling interest	269	14
Comprehensive loss attributable to DASAN Zhone Solutions, Inc.	<u>\$ (877)</u>	<u>\$ (3,266)</u>
Basic and diluted net loss per share attributable to DASAN Zhone Solutions, Inc.	<u>\$ (0.23)</u>	<u>\$ (0.40)</u>
Weighted average shares outstanding used to compute basic and diluted net loss per share	16,378	9,493

See accompanying notes to unaudited condensed consolidated financial statements.

DASAN ZHONE SOLUTIONS, INC. AND SUBSIDIARIES
Unaudited Condensed Consolidated Statements of Cash Flows
(In thousands)

	Three Months	
	Ended	
	March 31,	
	2017	2016
Cash flows from operating activities:		
Net loss	\$ (3,498)	\$ (3,761)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,181	268
Stock- based compensation	255	—
Unrealized gain on foreign currency transactions	871	357
Deferred taxes	—	(685)
Changes in operating assets and liabilities		
Accounts receivable	(1,277)	(4,177)
Inventories	(3,704)	(3,064)
Prepaid expenses and other assets	(501)	(8,714)
Accounts payable	6,732	207
Accrued expenses	(739)	11,896
Net cash provided by (used in) operating activities	<u>(680)</u>	<u>(7,673)</u>
Cash flows from investing activities:		
Decrease (increase) in restricted cash	738	(756)
Decrease in short- term and long- term loans to others	—	320
Increase in short- term and long- term loans to others	—	(1,606)
Proceeds from short- term investments	1,040	—
Purchase of short- term investments	(252)	—
Proceeds from disposal of property and equipment and other assets	6	18
Purchase of property and equipment	(404)	(43)
Purchase of intangible asset	(30)	(31)
Net cash provided by (used in) investing activities	<u>1,098</u>	<u>(2,098)</u>
Cash flows from financing activities:		
Repayments of borrowings	(4,356)	—
Proceeds from short- term borrowings	2,570	1,119
Proceeds from long- term borrowings	—	1,800
Government grants received	—	29
Proceeds from issuance of common stock	1	—
Increase (decrease) in other capital	—	(4)
Net cash provided by (used in) financing activities	<u>(1,785)</u>	<u>2,944</u>
Effect of exchange rate changes on cash	<u>762</u>	<u>(87)</u>
Net increase (decrease) in cash and cash equivalents	<u>(605)</u>	<u>(6,914)</u>
Cash and cash equivalents at beginning of period	<u>17,893</u>	<u>9,095</u>
Cash and cash equivalents at end of period	<u>\$ 17,288</u>	<u>\$ 2,181</u>

See accompanying notes to unaudited condensed consolidated financial statements.

Notes to Unaudited Condensed Consolidated Financial Statements

(1) Organization and Summary of Significant Accounting Policies

(a) Description of Business

DASAN Zhone Solutions, Inc. (formerly known as Zhone Technologies, Inc. and referred to, collectively with its subsidiaries, as "DZS" or the "Company") is a global provider of network access solutions and communications equipment for service provider and enterprise networks. The Company provides a wide array of reliable, cost-effective networking technologies, including broadband access, Ethernet switching, mobile backhaul, Passive Optical LAN and software-defined networks, to a diverse customer base that includes more than 1,000 customers in more than 50 countries worldwide.

DZS was incorporated under the laws of the state of Delaware in June 1999. On September 9, 2016, the Company acquired Dasan Network Solutions, Inc. ("DNS") through the merger of a wholly owned subsidiary of the Company with and into DNS, with DNS surviving as a wholly owned subsidiary of the Company (the "Merger"). At the effective time of the Merger, all issued and outstanding shares of capital stock of DNS held by DASAN Networks, Inc. ("DNI") were canceled and converted into the right to receive shares of the Company's common stock in an amount equal to 58% of the issued and outstanding shares of the Company's common stock immediately following the Merger. In connection with the Merger, the Company changed its name from Zhone Technologies, Inc. to DASAN Zhone Solutions, Inc. For periods through September 8, 2016, Zhone Technologies, Inc. is referred to as "Legacy Zhone." The Company's common stock continues to be traded on the Nasdaq Capital Market, and the Company's ticker symbol was changed from "ZHNE" to "DZSI" effective September 12, 2016. The Company is headquartered in Oakland, California.

(b) Going Concern

The accompanying condensed consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States ("U.S. GAAP"), assuming the Company will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. Accordingly, the condensed consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the possible inability of the Company to continue as a going concern.

The Company has incurred significant losses to date and losses from operations may continue. The Company incurred net losses of \$3.5 million and \$15.3 million for the three months ended March 31, 2017 and for the year ended December 31, 2016, respectively. The Company had accumulated deficit of \$23.7 million and working capital of \$55.2 million as of March 31, 2017. As of March 31, 2017, the Company had approximately \$17.3 million in cash and cash equivalents, which included \$8.4 million in cash balances held by the Company's Korean subsidiary, and \$31.5 million in aggregate principal amount of outstanding borrowings under the Company's credit facility with Wells Fargo Bank (the "WFB Facility"), the Company's short-term debt obligations and the Company's loans from DNI. In addition, the Company had \$5.7 million in aggregate borrowing availability under its revolving credit facilities as of March 31, 2017. The Company had \$6.2 million committed as security for letters of credit under these facilities as of March 31, 2017. Due to the amount of short-term debt obligations maturing within the next 12 months and the Company's recurring operating losses, the Company's cash resources may not be sufficient to settle these debt obligations. The Company's ability to continue as a "going concern" is dependent on many factors, including, among other things, its ability to comply with the covenants in its existing debt agreements, its ability to cure any defaults that occur under its debt agreements or to obtain waivers or forbearances with respect to any such defaults, and its ability to pay, retire, amend, replace or refinance its indebtedness as defaults occur or as interest and principal payments come due. Although the process of amending, replacing or refinancing the Company's short-term debt obligations is ongoing and the Company is in active discussions with multiple parties, there is no guarantee that they will result in transactions that are sufficient to provide the Company with the required liquidity to remove the substantial doubt as to its ability to continue as a going concern. If the Company is unable to amend, replace or refinance its short-term debt obligations or raise the capital needed to meet liquidity needs and finance capital expenditures and working capital, the Company may experience material adverse impacts on its business, operating results and financial condition.

The Company has continued its focus on cost control and operating efficiency along with restrictions on discretionary spending, however in order to meet the Company's liquidity needs and finance its capital expenditures and working capital needs for its business, the Company may be required to sell assets, issue debt or

equity securities, purchase credit insurance or borrow on potentially unfavorable terms. In addition, the Company may be required to reduce the scope of its planned product development, reduce sales and marketing efforts and reduce its operations in low margin regions, including reductions in headcount. Based on the Company's current plans and business conditions, the Company believes that its focused operating expense discipline along with its existing cash, cash equivalents and available credit facilities will be sufficient to satisfy its anticipated cash requirements for at least the next 12 months, however the factors discussed above raise substantial doubt about the Company's ability to continue as a going concern. The accompanying condensed consolidated financial statements do not include any adjustments that may result from the outcome of the uncertainties set forth above.

(c) Risks and Uncertainties

As result of the Merger, DNI owned approximately 58% of the outstanding shares of the Company's common stock as of March 31, 2017. Thereafter, for so long as DNI and its affiliates hold shares of the Company's common stock representing at least a majority of the votes, DNI will be able to freely nominate and elect all the members of the Company's board of directors. The directors elected by DNI will have the authority to make decisions affecting the Company's capital structure, including the issuance of additional capital stock or options, the incurrence of additional indebtedness, the implementation of stock repurchase programs, and the declaration of dividends. The interests of DNI may not coincide with the interests of the Company's other stockholders or with holders of the Company's indebtedness. DNI's ability to control all matters submitted to the Company's stockholders for approval limits the ability of other stockholders to influence corporate matters and, as a result, the Company may take actions that the Company's other stockholders or holders of our indebtedness do not view as beneficial. See Note 2, Note 9 and Note 11 to the consolidated financial statements for additional information.

As discussed above in Note 1(b), there is also substantial doubt about the Company's ability to continue as a going concern. The accompanying unaudited consolidated financial statements do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

(d) Correction of Errors

In this Quarterly Report on Form 10-Q, certain prior quarter financial information has been revised due to correction of certain errors. The Company identified errors related to the timing of revenue recognition in the consolidated financial statements for the quarter ended March 31, 2016.

Correction of this error resulted in a decrease in total net revenue of \$0.5 million, an increase in net loss of \$0.3 million and an increase in basic and diluted net loss per share attributable to DZSI of \$0.03 for the quarter ended March 31, 2016. The prior quarter financial information has also been revised for the classification of certain related party revenue, related party cost of revenue, and related royalty fees. This correction resulted in the Company reclassifying revenues of \$4.8 million to related party revenues and costs of \$4.0 million to related party cost of revenue for the quarter ended March 31, 2016. Finally, an understatement of the cash flows used in investing activities of \$1.1 million was corrected in the statement of cashflows for the three months ended March 31, 2016. The overall impact of these errors on the Company's condensed consolidated financial position and results of operations is not material and as such, previously filed quarterly financial information contained in our proxy statement filed with the SEC on August 8, 2016 affected by the errors has not been amended.

(e) Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

The condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that, in the opinion of management, are necessary for a fair presentation of the results for the interim periods presented. All intercompany transactions and balances have been eliminated in consolidation. The results of operations for the current interim period are not necessarily indicative of results to be expected for the current year or any other period. These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements of the Company and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016 filed with the Securities and Exchange Commission.

As discussed more fully in Note 2, the Merger is treated as a reverse acquisition for accounting purposes, with DNS as the acquirer of the Company. As such, the consolidated financial results of the Company for the three months ended March 31, 2017 are compared to the financial results for DNS and its consolidated subsidiaries for

the three months ended March 31, 2016. The balance sheet of the Company reflects the fair value of the assets and liabilities of Legacy Zhone as of the effective date of the Merger. Those assets include the fair value of acquired intangible assets and goodwill. Due to the foregoing, the Company's financial results for the three months ended March 31, 2017 are not comparable to its financial results for the three months ended March 31, 2016. Except as otherwise specifically noted herein, all references to the "Company" refer to (i) DNS and its consolidated subsidiaries for periods through September 8, 2016 and (ii) the Company and its consolidated subsidiaries for periods on or after September 9, 2016.

(f) Reverse Stock Split

On February 28, 2017, the Company filed a Certificate of Amendment with the Delaware Secretary of State to amend the Company's Restated Certificate of Incorporation, which amendment effected a one- for- five reverse stock split of the Company's common stock and reduced the authorized shares of the Company's common stock from 180 million to 36 million. As a result of the reverse stock split, the number of shares of the Company's common stock then issued and outstanding was reduced from approximately 81.9 million to approximately 16.4 million. References to shares of the Company's common stock, stock options (and associated exercise price) and restricted stock units in this Quarterly Report on Form 10-Q are provided on a post- reverse stock split basis.

(g) Concentration of Risk

The Company's customers include competitive and incumbent local exchange carriers, competitive access providers, Internet service providers, wireless carriers and resellers serving these markets. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. Allowances are maintained for potential doubtful accounts. For the three months ended March 31, 2017, two customers represented 12% (related party) and 11% of net revenue, respectively. For the three months ended March 31, 2016, three customers represented 26% (a related-party) , 14% and 11% of net revenue, respectively.

As of March 31, 2017, two customers represented 18% and 16% (related party) of net accounts receivable, respectively. As of December 31, 2016, two customers represented 12% (related party) and 10% of net accounts receivable, respectively.

As of March 31, 2017 and December 31, 2016, receivables from customers in countries other than the United States represented 85% and 87%, respectively, of net accounts receivable.

(2) Merger

On September 9, 2016, the Company acquired DNS through the Merger of a wholly owned subsidiary of the Company with and into DNS, with DNS surviving as a wholly owned subsidiary of the Company. The Merger combines leading technology platforms with a broadened customer base.

At the effective time of the Merger, all issued and outstanding shares of capital stock of DNS held by DNI were canceled and converted into the right to receive shares of the Company's common stock in an amount equal to 58% of the issued and outstanding shares of the Company's common stock immediately following the Merger. Accordingly, at the effective time of the Merger, the Company issued 9,493,016 shares (post reverse stock split) of the Company's common stock to DNI as consideration in the Merger, of which 949,302 shares (post reverse stock split) are being held in escrow as security for claims for indemnifiable losses in accordance with the merger agreement relating to the Merger. As a result, immediately following the effective time of the Merger, DNI held 58% of the outstanding shares of the Company's common stock and the holders of the Company's common stock immediately prior to the Merger retained, in the aggregate, 42% of the outstanding shares of the Company's common stock.

As described in Note 1(d), the Company accounted for the Merger as a reverse acquisition under the acquisition method of accounting in accordance with ASC 805, "Business Combination." Consequently, for the purpose of the purchase price allocation, DNS' assets and liabilities have been retained at their carrying values and Legacy Zhone's assets acquired, and liabilities assumed, by DNS (as the accounting acquirer in the Merger) have been recorded at their fair value measured as of September 9, 2016.

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The total purchase consideration in the Merger is based on the number of shares of Legacy Zhone common stock and Legacy Zhone stock options vested and outstanding immediately prior to the closing of the Merger, and was determined based on the closing price of \$5.95 per share (post reverse stock split) of the Company's common stock on the September 9, 2016. The estimated total purchase consideration is calculated as follows (in thousands):

	Estimated	
	Fair	
	Shares	Value
Shares of Legacy Zhone stock as of September 8, 2016	6,874	\$ 40,902
Legacy Zhone stock options	198	540
Total Purchase Consideration		<u>\$ 41,442</u>

The following table summarizes the allocation of the fair value consideration transferred for the acquisition date (in thousands):

Cash and cash equivalents	\$ 7,013
Accounts receivable	18,510
Inventory	16,456
Prepaid expenses and other current assets	2,191
Property and equipment	4,339
Other assets	125
Identifiable intangible assets	10,479
Goodwill	3,284
Accounts payable	(11,021)
Accrued and other liabilities	(7,089)
Other long-term liabilities	<u>(2,845)</u>
Total Indicated Fair Value of Assets	<u>\$ 41,442</u>

The goodwill was primarily attributed to people, geographic diversification and complementary products. The goodwill arising from the Merger is not tax deductible.

The Company considered the deferred tax liabilities caused by the Merger to be a source of income to support recoverability of acquired deferred tax assets, before considering the recoverability of the acquirer's existing deferred tax assets. Accordingly, the valuation allowance on the acquiree's deferred tax assets was reduced by the deferred tax liabilities caused by the Merger and accounted for as part of the purchase price allocation.

The following table presents the fair values of the acquired intangible assets at the effective date of the Merger (in thousands, except years):

	Useful	
	life	
	(in	Fair
	Years)	Value
Developed technology	5	\$ 3,060
Customer relationships	10	5,240
Backlog	1	<u>2,179</u>
		<u>\$ 10,479</u>

The following unaudited pro forma condensed combined financial information for the three months ended March 31, 2016 gives effect to the Merger as if it had occurred at the beginning of 2015. The unaudited pro forma condensed combined financial information has been included for comparative purposes only and is not necessarily indicative of what the combined Company's financial position or results of operations might have been had the Merger been completed as of the date indicated.

	Three Months Ended March 31, 2016
(in thousands)	
Pro forma total net revenue	\$ 46,083
Pro forma net loss	(8,532)

(3) Fair Value Measurement

The Company utilizes a fair value hierarchy that is intended to increase consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value that are either observable or unobservable. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon their own market assumptions. The fair value hierarchy consists of the following three levels:

- Level 1 – Inputs are quoted prices in active markets for identical assets or liabilities.
- Level 2 – Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market- corroborated inputs which are derived principally from or corroborated by observable market data.
- Level 3 – Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

The following financial instruments are not measured at fair value on the Company's consolidated balance sheet as of March 31, 2017 and December 31, 2016, but require disclosure of their fair values: cash and cash equivalents, short- term investments, accounts receivable, accounts payable and debt. The carrying values of financial instruments such as cash and cash equivalents, short- term investments, accounts receivable and accounts payable approximate their fair values based on their short- term nature. The carrying value of the Company's debt approximates their fair values based on the current rates available to the Company for debt of similar terms and maturities.

(4) Inventories

Inventories as of March 31, 2017 and December 31, 2016 were as follows (in thousands):

	March 31, 2017	December 31, 2016
Raw materials	\$ 15,896	\$ 13,547
Work in process	4,339	3,705
Finished goods	15,678	13,780
Total inventories	<u>\$ 35,913</u>	<u>\$ 31,032</u>

Inventories provided as collateral for borrowings from Export- Import Bank of Korea amounted to \$19.6 million as of March 31, 2017.

(5) Property and Equipment

Property and equipment as of March 31, 2017 and December 31, 2016 were as follows (in thousands):

	March 31, 2017	December 31, 2016
Furniture and fixtures	\$ 21,919	\$ 20,040
Machinery and equipment	4,981	4,530
Leasehold improvements	3,406	3,573
Computers and software	425	411
Other	1,008	922
	<u>31,739</u>	<u>29,476</u>
Less accumulated depreciation and amortization	(25,111)	(22,922)
Less government grants	(242)	(266)
Total property and equipment, net	<u>\$ 6,386</u>	<u>\$ 6,288</u>

Depreciation and amortization expense associated with property and equipment for the three months ended March 31, 2017 and 2016 was \$0.5 million and \$0.3 million, respectively.

The Company receives grants from the government mainly to support capital expenditures. Such grants are deferred and are generally refundable to the extent the Company does not utilize the funds for qualifying expenditures. Once earned, the Company records the grants as a contra amount to the assets and amortizes such amount over the useful lives of the related assets as a reduction to depreciation expense.

(6) Goodwill and Intangible Assets

Goodwill as of March 31, 2017 and December 31, 2016 was as follows (in thousands):

	March 31, 2017	December 31, 2016
Beginning balance	\$ 3,977	\$ 693
Addition from the Merger	—	3,284
Less: accumulated impairment	—	—
Ending balance	<u>\$ 3,977</u>	<u>\$ 3,977</u>

The Company did not recognize impairment loss on goodwill during the three months ended March 31, 2017 and 2016. Intangible assets as of March 31, 2017 and December 31, 2016 were as follows (in thousands):

	March 31, 2017	December 31, 2016
Developed technology	\$ 3,060	\$ 3,060
Customer relationships	5,240	5,240
Backlog	2,179	2,179
Other	146	105
Less accumulated amortization	<u>(2,475)</u>	<u>(1,817)</u>
Intangible assets, net	\$ 8,150	\$ 8,767

Amortization expense associated with intangible assets for the three months ended March 31, 2017 and 2016 was \$0.7 million and \$2 thousand, respectively.

(7) Debt

Wells Fargo Bank Facility

As of March 31, 2017, the Company had a \$25.0 million credit facility with Wells Fargo Bank (the "WFB Facility"). Under the WFB Facility, the Company has the option of borrowing funds at agreed upon interest rates. The amount that the Company is able to borrow under the WFB Facility varies based on eligible accounts receivable and inventory, as defined in the agreement, as long as the aggregate amount outstanding does not exceed \$25.0 million less the amount committed as security for letters of credit. To maintain availability of funds under the WFB Facility, the Company pays a commitment fee on the unused portion. The commitment fee is 0.25% per annum and is recorded as interest expense.

As of March 31, 2017, the Company had \$0.2 million in outstanding borrowings under its WFB Facility, and \$3.6 million was committed as security for letters of credit. The Company had \$5.7 million of borrowing availability under the WFB Facility as of March 31, 2017. The amounts borrowed under the WFB Facility bear interest, payable monthly, at a floating rate equal to the three-month LIBOR plus a margin based on the Company's average excess availability (as calculated under the WFB Facility). The interest rate on the WFB Facility was 3.65% at March 31, 2017. The maturity date under the WFB Facility is March 31, 2019.

The Company's obligations under the WFB Facility are secured by substantially all of its personal property assets and those of its subsidiaries that guarantee the WFB Facility, including their intellectual property. The WFB Facility contains certain financial covenants, and customary affirmative covenants and negative covenants. If the Company defaults under the WFB Facility due to a covenant breach or otherwise, WFB may be entitled to, among other things, require the immediate repayment of all outstanding amounts and sell the Company's assets to satisfy the obligations under the WFB Facility. On July 3, 2017, the Company executed an agreement with WFB to extend the due date for delivery for the Company's audited financial statements for the year ended December 31, 2016 to September 27, 2017. As of March 31, 2017, the Company was in compliance with the covenants under the WFB Facility.

Bank and Trade Facilities - Foreign Operations

Certain of the Company's foreign subsidiaries have entered into various financing arrangements with foreign banks and other lending institutions consisting primarily of revolving lines of credit, trade facilities, term loans and export development loans. These facilities are renewed on an annual basis and are generally secured by a security interest in certain assets of the applicable foreign subsidiaries. Payments under such facilities are made in accordance with the given lender's amortization schedules.

As of March 31, 2017 and December 31, 2016, the Company had an aggregate outstanding balance of \$24.5 million and \$17.6 million, respectively, under such financing arrangements, and the interest rates per annum applicable to outstanding borrowings under these financing arrangements were as listed in the tables below.

		<u>As of March 31, 2017</u>	
		<u>Interest rate (%)</u>	<u>Amount</u>
Industrial Bank of Korea	Credit facility	2.16 - 2.8	\$ 5,863
Shinhan Bank	General loan	4.69	2,867
Shinhan Bank	Trade finance	3.47 - 3.59	2,400
NongHyup Bank	Credit facility	2.16 - 2.94	3,673
KEB Hana Bank	Comprehensive credit loan	2.97	2,577*
The Export- Import Bank of Korea	Export development loan	3.1	7,168
			<u>\$ 24,548</u>

* As of June 30, 2017, this balance owed to KEB Hana Bank had been fully repaid.

		<u>As of December 31, 2016</u>	
		<u>Interest rate (%)</u>	<u>Amount</u>
Industrial Bank of Korea	Credit facility	2.16 - 2.76	\$ 1,106
Shinhan Bank	General loan	4.08	3,310
Shinhan Bank	Trade finance	3.28 - 3.44	1,752
NongHyup Bank	Credit facility	1.92 - 2.66	482
KEB Hana Bank	Comprehensive credit loan	2.79	3,501
The Export- Import Bank of Korea	Export development loan	3.10	7,448
			<u>\$ 17,599</u>

As of March 31, 2017, the Company had \$9.5 million in outstanding borrowings and \$2.4 million committed as security for letters of credit under the Company's \$12.0 million credit facility with certain foreign banks.

(8) Non- Controlling Interests

Non- controlling interests for the three months ended March 31, 2017 and 2016 were as follows (in thousands):

	<u>Three Months Ended March 31,</u>	
	<u>2017</u>	<u>2016</u>
Beginning non- controlling interests	\$ 416	\$ 138
Acquisition of additional interest in a subsidiary	—	277
Net income attributable to non- controlling interests	249	6
Foreign currency translation adjustments (OCI)	20	8
Ending non- controlling interests	<u>\$ 685</u>	<u>\$ 429</u>

(9) Related- Party Transactions

Related- Party Debt

In connection with the Merger, on September 9, 2016, the Company entered into a loan agreement with DNI for a \$5.0 million unsecured subordinated term loan facility. Under the loan agreement, the Company was permitted to request drawdowns of one or more term loans in an aggregate principal amount not to exceed \$5.0 million. As of March 31, 2017, \$5.0 million in term loans was outstanding under the facility. Such term loans mature in September 2021 and are pre- payable at any time by the Company without premium or penalty. The interest rate as of March 31, 2017 under this facility was 4.6% per annum.

In addition, the Company borrowed \$1.8 million from DNI for capital investment in February 2016, which amount was outstanding as of March 31, 2017. This loan matured in March 2017 with an option of renewal by mutual agreement, and bore interest at a rate of 6.9% per annum, payable annually. Effective February 27, 2017, the Company amended the terms of this loan to extend the repayment date from March 2017 to March 2018, and to reduce the interest rate from 6.9% to 4.6% per annum.

On June 23, 2017, the Company borrowed \$3.5 million from Solueta, an affiliate of DNI, which amount was outstanding as of June 30, 2017. This loan matures in November 2017 and bears interest at a rate of 4.6% per annum, payable monthly.

Other Related- Party Transactions

Sales and Purchases to and from Related Parties

Sales and purchases, cost of revenue, research and product development, selling, marketing, general and administrative and other expenses to and from related parties for the three months ended March 31, 2017 and 2016 were as follows (in thousands):

Counterparty	DNI Ownership Interest	Three Months Ended March 31, 2017					
		Sales	Cost of revenue	Manufacturing (Cost of revenue)	Research and product development	Selling, marketing, general and administrative	Other Expenses
(As Revised)							
DNI (Parent Company)	N/A	\$ 4,151	\$ 3,321	\$ —	\$ —	\$ 874	\$ 63
CHASAN Networks Co., Ltd.	100%	—	—	195	27	—	—
DASAN FRANCE	100%	394	387	—	—	—	—
DASAN INDIA Private Limited	100%	6,287	4,783	—	—	—	—
D- Mobile	100%	11	13	—	—	102	—
Fine Solution	100%	—	—	—	—	3	—
HANDYSOFT, Inc.	17.64%	20	9	—	—	—	—
J- Mobile Corporation	68.56%	8	—	—	—	132	—
Tomato Soft (Xi'an) Ltd.	100%	—	—	—	171	—	—
		<u>\$ 10,871</u>	<u>\$ 8,513</u>	<u>\$ 195</u>	<u>\$ 198</u>	<u>\$ 1,111</u>	<u>\$ 63</u>

Three Months Ended March 31, 2016								
Counterparty	DNI Ownership Interest	Sales	Cost of revenue	Manufacturing (Cost of revenue)	Research and product development	Selling, marketing, general and administrative		Other Expenses
DNI (Parent Company)	N/A	\$ 6,708	\$ 5,719	\$ —	\$ —	\$ —	\$ 1,760	\$ 116
CHASAN Networks Co., Ltd.	100%	—	—	198	28	—	—	—
DASAN FRANCE	100%	—	—	—	—	—	—	—
DMC, Inc.	100%	1	1	—	—	—	—	—
D- Mobile	100%	543	432	—	—	—	94	—
HANDYSOFT, Inc.	17.64%	52	47	—	—	—	—	—
J- Mobile Corporation	68.56%	3	—	—	—	—	634	—
PANDA Media, Inc.	90%	—	—	—	—	—	2	—
Tomato Soft (Xi'an) Ltd.	100%	—	—	—	176	—	—	—
		<u>\$ 7,307</u>	<u>\$ 6,199</u>	<u>\$ 198</u>	<u>\$ 204</u>	<u>\$ —</u>	<u>\$ 2,490</u>	<u>\$ 116</u>

The Company has entered into certain sales agreements with DNI and certain of its subsidiaries. Sales and cost of revenue to DNI, DASAN France, DASAN INDIA Private Limited, and D- Mobile represent finished goods produced by the Company that are sold to these related parties who sell the Company's products in Korea, France, India and Taiwan, respectively.

The Company has entered into an agreement with CHASAN Networks Co., Ltd. to provide manufacturing and research and development services for the Company. Under the agreement with CHASAN Networks., Ltd., the Company is charged a cost plus 7% fee for the manufacturing and development of certain deliverables.

The Company has entered into an agreement with Tomato Soft (Xi'an) Ltd. to provide research and development services for the Company. Under the agreement with Tomato Soft (Xi'an) Ltd., the Company is charged an expected annual fee of \$0.8 million for the development of certain deliverables.

Prior to the Merger, as DNS was then a wholly owned subsidiary of DNI, DNI had sales agreements with certain customers on DNS' behalf. Since the Merger, due to these prior sales agreements, the Company has entered into an agreement with DNI in which DNI acts as a sales channel to these customers. Selling, marketing, general and administrative expense includes a fee of 3% of total sales to DNI for sales to these customers.

The Company shares office space with DNI and certain of DNI's subsidiaries. Prior to the Merger, DNS, then a wholly owned subsidiary of DNI, shared human resources, treasury and other administrative support with DNI. As such, the Company entered into certain service sharing agreements with DNI and certain of its subsidiaries for the shared office space and shared administrative services. Expenses related to rent and administrative services are allocated to the Company based on square footage occupied and headcount, respectively.

Other income from J- Mobile Corporation represents interest income earned on a loan receivable from J- Mobile Corporation. The loan receivable was issued for the amount of \$0.5 million and earned an interest rate of 6.9% per annum. The loan receivable was scheduled to mature on July 1, 2020, but was fully paid off on September 3, 2016.

Other expenses to related parties represent expenses to DNI for its payment guarantees relating to the Company's borrowings. The Company pays DNI a guarantee fee which is calculated as 0.9% of the guaranteed amount.

Balances of Receivables and Payables with Related Parties

Balances of receivables and payables arising from sales and purchases of goods and services with related parties as of March 31, 2017 and December 31, 2016 were as follows (in thousands):

		<u>As of March 31, 2017</u>					
		Deposits					
<u>Counterparty</u>	<u>DNI Ownership Interest</u>	<u>Account receivables</u>	<u>Other receivables</u>	<u>for lease*</u>	<u>Accounts payable</u>	<u>Other payables</u>	<u>Loans</u>
DNI (Parent Company)	N/A	\$ 4,610	\$ —	\$ 747	\$ 5,220	\$ 6,800	\$ 6,800
ABLE	61.99%	57	—	—	—	—	—
CHASAN Networks Co., Ltd.	100%	—	—	—	66	—	—
DASAN France	100%	408	4	—	—	—	—
DASAN INDIA Private Limited	100%	8,883	—	—	—	—	—
D- Mobile	100%	895	13	—	—	—	—
HANDYSOFT, Inc.	17.64%	7	—	—	—	—	—
J- Mobile Corporation	68.56%	—	—	—	42	—	—
Solueta	27.21%	—	—	—	18	—	—
Tomato Soft Ltd.	100%	—	—	—	16	—	—
Tomato Soft (Xi'an) Ltd.	100%	—	—	—	60	—	—
		<u>\$ 14,860</u>	<u>\$ 17</u>	<u>\$ 747</u>	<u>\$ 5,422</u>	<u>\$ 6,800</u>	<u>\$ 6,800</u>

		<u>As of December 31, 2016</u>					
		Deposits					
<u>Counterparty</u>	<u>DNI Ownership Interest</u>	<u>Account receivables</u>	<u>Other receivables</u>	<u>for lease*</u>	<u>Accounts payable</u>	<u>Other payables</u>	<u>Loans</u>
DNI (Parent Company)	N/A	\$ 6,679	\$ 171	\$ 690	\$ 360	\$ 6,861	\$ 6,800
ABLE	61.99%	53	—	9	—	—	—
DASAN France	100%	23	—	—	—	—	—
DASAN INDIA Private Limited	100%	2,606	—	—	—	—	—
D- Mobile	100%	3,943	—	—	—	—	—
HANDYSOFT, Inc.	17.64%	2	—	—	—	—	—
J- Mobile Corporation	68.56%	5	—	—	—	—	—
Tomato Soft Ltd.	100%	—	—	—	—	16	—
Tomato Soft (Xi'an) Ltd.	100%	—	—	—	70	63	—
		<u>\$ 13,311</u>	<u>\$ 171</u>	<u>\$ 699</u>	<u>\$ 430</u>	<u>\$ 6,940</u>	<u>\$ 6,800</u>

* Included in other assets related to deposits for lease in the condensed consolidated balance sheet as of March 31, 2017 and the consolidated balance sheet as of December 31, 2016.

(10) Net Loss Per Share Attributable to DASAN Zhong Solutions, Inc.

Basic net loss per share attributable to DASAN Zhong Solutions, Inc. is computed by dividing the net loss attributable to DASAN Zhong Solutions, Inc. for the period by the weighted average number of shares of common stock outstanding during the period. The calculation of diluted net loss per share attributable to DASAN Zhong Solutions, Inc. gives effect to common stock equivalents; however, potential common equivalent shares are excluded if their effect is antidilutive. Potential common equivalent shares are composed of incremental shares of common equivalent shares issuable upon the exercise of stock options and the vesting of restricted stock units.

Basic net loss per share is the same as diluted net loss per share for the three months ended March 31, 2016 because DNS did not issue the potentially dilutive common stock. Basic net loss per share is the same as diluted net loss per share for the three months ended March 31, 2017 because the effects of stock options and unvested restricted stock units would have been anti-dilutive.

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The following table is a reconciliation of the numerator and denominator in the basic and diluted net loss per share calculation (in thousands, except per share data):

	Three Months Ended March 31,	
	2017	2016
		(As Revised)
Net loss attributable to DASAN Zhone Solutions, Inc.	<u>\$ (3,747)</u>	<u>\$ (3,767)</u>
Weighted average number of shares outstanding:		
Basic	16,378	9,493
Effect of dilutive securities:		
Stock options, restricted stock units and share awards	—	—
Diluted	<u>16,378</u>	<u>9,493</u>
Net loss per share attributable to DASAN Zhone Solutions, Inc.:		
Basic	<u>\$ (0.23)</u>	<u>\$ (0.40)</u>
Diluted	<u>\$ (0.23)</u>	<u>\$ (0.40)</u>

(11) Commitments and Contingencies**Operating Leases**

The Company has entered into operating leases for certain office space and equipment, some of which contain renewal options and escalation clauses. Estimated future lease payments under all non-cancellable operating leases with terms in excess of one year, including taxes and service fees, are as follows (in thousands):

Operating Leases	
Year ending December 31:	
2017 (remainder of the year)	\$ 2,669
2018	2,923
2019	2,335
2020	2,192
2021	2,178
Thereafter	8,287
Total minimum lease payments	<u>\$ 20,584</u>

Warranties

The Company accrues for warranty costs based on historical trends for the expected material and labor costs to provide warranty services. Warranty periods are generally two to five years from the date of shipment. The following table reconciles changes in the Company's accrued warranties and related costs for the three months ended March 31, 2017 and 2016 (in thousands):

	Three Months Ended March 31,	
	2017	2016
Beginning balance	\$ 878	\$ 441
Charged to cost of revenue	100	95
Claims and settlements	(212)	(95)
Foreign exchange impact	20	7
Ending balance	<u>\$ 786</u>	<u>\$ 448</u>

Performance Bonds

In the normal course of operations, from time to time, the Company arranges for the issuance of various types of surety bonds, such as bid and performance bonds, which are agreements under which the surety company guarantees that the Company will perform in accordance with contractual or legal obligations. As of March 31, 2017, the Company had \$0.4 million of surety bonds guaranteed by third parties.

Purchase Commitments

The Company has agreements with various contract manufacturers which include non- cancellable inventory purchase commitments. The Company's inventory purchase commitments typically allow for cancellation of orders 30 days in advance of the required inventory availability date as set by the Company at time of order. The amount of non- cancellable purchase commitments outstanding, net of reserve, was \$7.4 million as of March 31, 2017.

On July 16, 2017, the Company reached an agreement with a supplier to cancel a purchase arrangement for certain inventory which was committed to through 2020. Under the settlement, the Company is no longer required to fulfill its commitment to purchase \$4.3 million in inventory. In connection with the settlement, the Company also entered into a technical support services arrangement with the supplier through April 30, 2021.

Payment Guarantees Provided by Third Parties

The following table sets forth third parties that have provided payment guarantees of the Company's indebtedness and other obligations as of March 31, 2017 (in thousands):

Guarantor	Amount Guaranteed	Description of Obligations Guaranteed
DNI	\$ 3,441	Borrowings from Shinhan Bank
DNI	2,150	Purchasing card from Shinhan Bank
DNI	3,120	Borrowings from KEB Hana Bank
DNI	11,626	Credit facility and purchasing card from Industrial Bank of Korea
DNI	6,000	Credit facility from NongHyup Bank
DNI	1,075	Purchasing card from NongHyup Bank
Industrial Bank of Korea	6,958	Credit facility
NongHyup Bank	4,978	Credit facility
Shinhan Bank	178	Purchasing card
KEB Hana Bank	30	Performance bonds
State Bank of India	39	Performance bonds
Seoul Guarantee Insurance Co.	340	Performance payment guarantee
	\$ 39,935	

Royalties

The Company has certain royalty commitments associated with the shipment and licensing of certain products. Royalty expense is generally based on a dollar amount per unit shipped or a percentage of the underlying revenue and is recorded in cost of revenue.

Legal Proceedings

The Company is subject to various legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, the Company records an accrual for legal contingencies that it has determined to be probable to the extent the amount of the loss can be reasonably estimated. The Company does not expect that the ultimate costs to resolve these matters will have a material adverse effect on its consolidated financial position or results of operations. However, litigation is subject to inherent uncertainties, and unfavorable rulings could occur. If an unfavorable ruling were to occur, there exists the possibility of a material adverse impact on the results of operations of the period in which the ruling occurs, or future periods.

(12) Enterprise- Wide Information

The Company is a global provider of network access solutions and communications equipment for service provider and enterprise networks. There are no segment managers who are held accountable for operations, operating results and plans for levels or components below the Company unit level. Accordingly, the Company is considered to be in a single reporting segment and operating unit structure. The Company's chief operating decision makers are the Company's Co- Chief Executive Officers, who review financial information presented on a consolidated basis accompanied by disaggregated information about revenues by geographic region for purposes of making operating decisions and assessing financial performance. The Company attributes revenue from customers to individual countries based on location shipped. The following summarizes required disclosures about geographic concentrations and revenue by products and services (in thousands):

	Three Months Ended March 31,	
	2017	2016
	(As Revised)	
Revenue by geography:		
United States	\$ 12,147	\$ 2,352
Canada	1,192	—
Total North America	<u>13,339</u>	<u>2,352</u>
Latin America	4,870	414
Europe, Middle East, Africa	5,503	1,127
Korea	16,315	16,354
Other Asia Pacific	12,085	5,093
Total International	<u>38,773</u>	<u>22,988</u>
Total	<u>\$ 52,112</u>	<u>\$ 25,340</u>

	Three Months Ended March 31,	
	2017	2016
	(As Revised)	
Revenue by products and services:		
Products	\$ 49,725	\$ 24,485
Services	2,387	855
Total	<u>\$ 52,112</u>	<u>\$ 25,340</u>

The Company's property and equipment, net of accumulated depreciation, were located in the following geographical areas as of March 31, 2017 and December 31, 2016 (in thousands):

	March 31, 2017	December 31, 2016
	United States	\$ 3,943
Korea	1,676	1,455
Japan and Vietnam	767	739
	<u>\$ 6,386</u>	<u>\$ 6,288</u>

(13) Income Taxes

Income tax expense (benefit) for the three months ended March 31, 2017 and 2016, was \$0.4 million and - \$0.6 million, respectively on pre- tax losses of \$3.1 million and \$4.4 million, respectively. As of March 31, 2017, the income tax rate

varied from the United States statutory income tax rate primarily due to valuation allowances in the United States and taxable income generated by the Company's wholly-owned foreign subsidiaries.

The total amount of unrecognized tax benefits, including interest and penalties, at March 31, 2017 was not material. The amount of tax benefits that would impact the effective income tax rate, if recognized, is not expected to be material. There were no significant changes to unrecognized tax benefits during the quarters ended March 31, 2017 and 2016. The Company does not anticipate any significant changes with respect to unrecognized tax benefits within the next 12 months.

The Company or one of its subsidiaries files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. The open tax years for the major jurisdictions are as follows:

- Federal 2013 -
2016
- California and Canada 2012 -
2016
- Brazil 2011 -
2016
- Germany 2012 -
2016
- Japan 2011 -
2016
- Korea 2015 -
2016
- United Kingdom 2014 -
2016
- Vietnam 2016

However, due to the fact the Company had net operating losses and credits carried forward in most jurisdictions, certain items attributable to closed years are still subject to adjustment by the relevant taxing authority through an adjustment to tax attributes carried forward to open years.

The Company estimates that its foreign income will generally be subject to taxation in the United States on a current basis and that its foreign subsidiaries and representative offices will therefore not have any material untaxed earnings subject to deferred taxes. In addition, to the extent the Company is deemed to have sufficient connection to a particular taxing jurisdiction to enable that jurisdiction to tax the Company but the Company has not filed an income tax return in that jurisdiction for the year(s) at issue, the jurisdiction would typically be able to assert a tax liability for such years without limitation on the number of years it may examine.

The Company is not currently under examination for income taxes in any material jurisdiction.

(14) Subsequent Events

Management Transition

On June 27, 2017, the Company and the former Chief Technology Officer of the Company, entered into an agreement setting for the terms pursuant to which the former Chief Technology Officer ceased to be an officer and employee of the Company effective July 11, 2017. Under the terms of this agreement, the former Chief Technology Officer: (a) received a severance payment equivalent to two months and two weeks of his base salary; (b) received an acceleration of unvested stock options to purchase 5,000 shares then held by the former Chief Technology Officer and an extension of exercise period with respect to such options until December 31, 2017; (c) has until October 9, 2017 to exercise his remaining vested options; and (d) received COBRA benefits for up to one month.

On September 11, 2017, the Company announced management transition changes in connection with the first anniversary of the Merger and the progress successfully attained in the integration of the businesses of Legacy Zhone and DNS. The Legacy Zhone senior management team of James Norrod and Kirk Misaka had been serving as the Company's Co- Chief Executive Officer and Chief Financial Officer, respectively, since the completion of the DNS acquisition under one- year employment agreements to ensure a smooth transition and integration of the businesses of legacy Zhone and DNS. Given the successful integration over the past year, the Company agreed with Messrs. Norrod and Misaka that they would step down from their management roles effective as of September 11, 2017. On September 11, 2017, Mr. Norrod also agreed to step down as a member of the Board of Directors of the Company. In connection with their resignations from their management roles, Messrs. Norrod and Misaka entered into release agreements with the Company. Pursuant to his release agreement, Mr. Norrod is entitled to receive a lump sum cash payment of \$300,000, continued health benefits at Company expense for a period of six months following his termination of employment and an extension of the period of time to exercise his vested stock options through September 11, 2018. Pursuant to his release agreement, Mr. Misaka is entitled to receive a lump sum cash payment of \$232,500 and an

extension of the period of time to exercise his vested stock options through September 11, 2018. Mr. Misaka has agreed to remain in the employ of the Company as its Corporate Treasurer and Secretary for a transitional period to assist with the transition of his responsibilities, with the same base salary as was in effect prior to the management transition, and continued vesting of his outstanding stock options during the term of his employment, although his continued employment will no longer be governed by the terms of his employment agreement, which was terminated effective September 11, 2017. As part of this management transition, effective September 11, 2017, the Board of Directors of the Company appointed Il Yung Kim to serve as President, Chief Executive Officer and Acting Chief Financial Officer of the Company.

Patent Infringement Injunction Relating to Supplier

In July 2017, a supplier of the Company lost a patent infringement case relating to certain components that are used in Company products. As a result of this injunction, the Company will no longer sell or ship these products to Germany.

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

As used in this report, unless the context suggests otherwise, the terms "we", "us", or "our" refer to (i) Dasan Network Solutions, Inc. (DNS) and its consolidated subsidiaries for periods through September 8, 2016 and (ii) DASAN Zhone Solutions, Inc. and its consolidated subsidiaries (collectively, DZS) for periods on or after September 9, 2016, the effective date of the Merger (as defined below). In connection with the Merger, Zhone Technologies, Inc. changed its name to DASAN Zhone Solutions, Inc. For periods through September 8, 2016, Zhone Technologies, Inc. is referred to as "Legacy Zhone."

Forward- Looking Statements

This report, including "Management’s Discussion and Analysis of Financial Condition and Results of Operations," 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 and the Securities Exchange Act of 1934. 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. We use words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "goal," "intend," "may," "plan," "project," "seek," "should," "target," "will," "would," variations of such words, and similar expressions to identify forward- looking statements. In addition, statements that refer to projections of earnings, revenue, costs or other financial items; anticipated growth and trends in our business or key markets; cost synergies, growth opportunities and other financial and operating benefits of the Merger; future growth and revenues from our products; our ability to refinance or repay our existing indebtedness prior to the applicable maturity date; future economic conditions and performance; anticipated performance of products or services; plans, objectives and strategies for future operations; and other characterizations of future events or circumstances, are forward- looking statements. 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 under the heading "Risk Factors" in Part II, Item 1A, elsewhere in this report and our other filings with the Securities and Exchange Commission (the SEC). Therefore, actual results may differ materially and adversely from those expressed in any forward- looking statements. Factors that might cause such a difference include, but are not limited to, our ability to realize the anticipated cost savings, synergies and other benefits of the Merger and any integration risks relating to the Merger, the ability to generate sufficient revenue to achieve or sustain profitability, the ability to raise additional capital to fund existing and future operations or to refinance or repay our existing indebtedness, defects or other performance problems in our products, any economic slowdown in the telecommunications industry that restricts the ability of our customers to purchase our products, commercial acceptance of our products, intense competition in the communications equipment market from large equipment companies as well as private companies with products that address the same networks needs as our products, higher than anticipated expenses that we may incur, any failure to comply with the periodic filing and other requirements of The Nasdaq Stock Market for continued listing, material weaknesses or other deficiencies in our internal control over financial reporting, the initiation of any civil litigation, regulatory proceedings, government enforcement actions or other adverse effects relating to the Audit Committee investigation or errors in the consolidated financial statements of Legacy Zhone and other factors identified elsewhere in this report and in our most recent reports on Forms 10- K, 10- Q and 8- K. We undertake no obligation to revise or update any forward- looking statements for any reason.

OVERVIEW

We are a global provider of network access solutions and communications equipment for service provider and enterprise networks. We research, develop, test, sell, manufacture and support communications equipment in five major areas: broadband access, Ethernet switching, mobile backhaul, passive optical LAN (POLAN) and software defined networks (SDN).

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As discussed under "Liquidity and Capital Resources" below, the maturing of short- term debt obligations and our recurring losses from operations raise substantial doubt on whether we will be able to continue as a going concern.

As of March 31, 2017, the total outstanding principal amount of our debt obligations was \$31.5 million, consisting of the following:

- \$24.7 million in short- term debt obligations;
- \$1.8 million in short- term debt obligations to related parties; and
- \$5.0 million in long- term debt obligations to related parties.

Our ability to continue as a "going concern" is dependent on many factors, including, among other things, our ability to comply with the covenants in our existing debt agreements, our ability to cure any defaults that occur under our debt agreements or to obtain waivers or forbearances with respect to any such defaults, and our ability to pay, retire, amend, replace or refinance our indebtedness as defaults occur or as interest and principal payments come due.

Going forward, our key financial objectives include the following:

- Increasing revenue while continuing to carefully control costs;
- Continued investments in strategic research and product development activities that will provide the maximum potential return on investment; and
- Minimizing consumption of our cash and cash equivalents.

Merger

On September 9, 2016, we acquired DNS through the merger of a wholly owned subsidiary of Zhone Technologies, Inc. with and into DNS, with DNS surviving as our wholly owned subsidiary (the Merger). In connection with the Merger, Zhone Technologies, Inc. changed its name to DASAN Zhone Solutions, Inc. Our common stock continues to be traded on the Nasdaq Capital Market, and our ticker symbol was changed from "ZHNE" to "DZSI" effective September 12, 2016.

At the effective time of the Merger, all issued and outstanding shares of capital stock of DNS held by its sole shareholder, DASAN Networks, Inc. (DNI), were canceled and converted into the right to receive shares of our common stock in an amount equal to 58% of the issued and outstanding shares of our common stock immediately following the Merger. Accordingly, at the effective time of the Merger, we issued 9,493,016 shares (post reverse stock split) of our common stock to DNI as consideration in the Merger, of which 949,302 shares (post reverse stock split) are being held in escrow as security for claims for indemnifiable losses in accordance with the merger agreement relating to the Merger. As a result, immediately following the effective time of the Merger, DNI held 58% of the outstanding shares of our common stock and the holders of our common stock immediately prior to the Merger retained, in the aggregate, 42% of the outstanding shares of our common stock. See Note 2 to the unaudited condensed consolidated financial statements set forth in Part I, Item 1 of this report for additional information regarding the Merger.

ITEMS AFFECTING COMPARABILITY OF OUR FINANCIAL RESULTS

As discussed in Note 1(e) to the unaudited condensed consolidated financial statements set forth in Part I, Item 1 of this report, the Merger has been accounted for as a reverse acquisition under which DNS was considered the accounting acquirer of Legacy Zhone. As such, our financial results for the three months ended March 31, 2017 presented in this report are compared to the financial results of DNS and its consolidated subsidiaries for the three months ended March 31, 2016. Our balance sheet includes the fair value of the assets and liabilities of Legacy Zhone as of the effective date of the Merger. Those assets include the fair value of acquired intangible assets and goodwill. Due to the foregoing, our financial results for the three months ended March 31, 2017 are not comparable to our financial results for the three months ended March 31, 2016.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

There have been no material changes to our critical accounting policies and estimates from the information provided in Part II, "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates" included in our Annual Report on Form 10- K for the year ended December 31, 2016.

RESULTS OF OPERATIONS

We list in the table below the historical condensed consolidated statement of comprehensive loss data as a percentage of net revenue for the periods indicated.

	Three Months Ended	
	March 31,	
	<u>2017</u>	<u>2016</u>
Net revenue:		
Net revenue	79 %	71 %
Net revenue - related parties	21 %	29 %
Total net revenue	100 %	100 %
Cost of revenue:		
Products and services	49 %	57 %
Products and services - related parties	16 %	24 %
Amortization of intangible assets	0 %	0 %
Total cost of revenue	66 %	82 %
Gross profit	34 %	18 %
Operating expenses:		
Research and product development	18 %	18 %
Selling, marketing, general and administrative	20 %	17 %
Amortization of intangible assets	1 %	0 %
Total operating expenses	39 %	35 %
Operating loss	(5)%	(17)%
Interest income	0 %	0 %
Interest expense	(1)%	(1)%
Other income, net	(1)%	0 %
Loss before income taxes	(6)%	(17)%
Income tax provision (benefit)	1 %	(2)%
Net loss	(7)%	(15)%
Net income attributable to non- controlling interest	0 %	0 %
Net loss attributable to DASAN Zhong Solutions, Inc.	(7)%	(15)%
Foreign currency translation adjustments	6 %	2 %
Comprehensive loss	(1)%	(13)%
Comprehensive income attributable to non- controlling interest	0 %	0 %
Comprehensive loss attributable to DASAN Zhong Solutions, Inc.	(1)%	(13)%

Net Revenue

Information about our net revenue for products and services for the three months ended March 31, 2017 and 2016 is summarized below (in millions):

Three Months Ended			
March 31,			
2017	2016	Decrease	% change
(As Revised)			
Products	\$ 49.7	\$ 24.5	\$ 25.2 103%
Services	2.4	0.8	1.6 200%
Total	\$ 52.1	\$ 25.3	\$ 26.8 106%

Information about our net revenue for North America and international markets for the three months ended March 31, 2017 and 2016 is summarized below (in millions):

Three Months Ended				
March 31,				
Increase				
2017	2016	(Decrease)	% change	
(As Revised)				
Revenue by geography:				
United States	\$ 12.1	\$ 2.4	\$ 9.7	404 %
Canada	1.2	—	1.2	100 %
Total North America	13.3	2.4	10.9	454 %
Latin America	4.9	0.4	4.5	1,125 %
Europe, Middle East, Africa	5.5	1.1	4.4	400 %
Korea	16.3	16.4	(0.1)	(1)%
Asia Pacific	12.1	5.1	7.0	137 %
Total International	38.8	23.0	15.8	69 %
Total	\$ 52.1	\$ 25.3	\$ 26.8	106 %

For the three months ended March 31, 2017, net revenue increased 106% or \$26.8 million to \$52.1 million from \$25.3 million for the same period last year. For the three months ended March 31, 2017, product revenue increased 103% or \$25.2 million to \$49.7 million compared to the same period last year. The increase in product revenue for the three months ended March 31, 2017 was primarily related to the consummation of the Merger in September 2016 (which resulted in the inclusion of product revenue related to the Legacy Zhone business for the current year quarter). Service revenue represents revenue from maintenance and other services associated with product shipments. For the three months ended March 31, 2017, service revenue increased 200% or \$1.6 million to \$2.4 million compared to the same period last year. The increase in service revenue for the three months ended March 31, 2017 was primarily related to the consummation of the Merger in September 2016 (which resulted in the inclusion of service revenue related to the Legacy Zhone business for the current year quarter), as well as an increase in sales of maintenance services. International net revenue increased 69% or \$15.8 million to \$38.8 million for the three months ended March 31, 2017 from \$23.0 million for the same period last year, and represented 74% of total net revenue compared with 91% during the same period of 2016. The increase in international net revenue for the three months ended March 31, 2017 was primarily related to the consummation of the Merger in September 2016 (which resulted in the inclusion of international net revenue related to the Legacy Zhone business for the current year quarter). The year-over-year decrease in international net revenue as a percentage of total net revenue reflects the inclusion of net revenue related to the Legacy Zhone business in North America in the current year period.

For the three months ended March 31, 2017, two customers represented 12% and 11% of net revenue, respectively. For the three months ended March 31, 2016, three customers represented 26% (a related-party), 14% and 11% of net revenue, respectively. We anticipate that our results of operations in any given period may depend to a large extent on sales to a small

number of large accounts. As a result, our revenue for any quarter may be subject to significant volatility based upon changes in orders from one or a small number of key customers.

Cost of Revenue and Gross Margin

Total cost of revenue increased 66% or \$13.6 million to \$34.3 million for the three months ended March 31, 2017, compared to \$20.7 million for the three months ended March 31, 2016. The increase in total cost of revenue for the three months ended March 31, 2017 was primarily due to the consummation of the Merger in September 2016 (which resulted in the inclusion of cost of revenue related to the Legacy Zhone business for the current year quarter) as well as increased sales. Gross margin slightly increased due to improved manufacturing efficiencies and product mix for the three months ended March 31, 2017, compared to the three months ended March 31, 2016.

We expect that in the future our cost of revenue as a percentage of net revenue will vary depending on the mix and average selling prices of products sold. In addition, continued competitive and economic pressures could cause us to reduce our prices, adjust the carrying values of our inventory, or record inventory charges relating to discontinued products and excess or obsolete inventory.

Research and Product Development Expenses

Research and product development expenses increased 97% or \$4.6 million to \$9.2 million for the three months ended March 31, 2017 compared to \$4.7 million for the three months ended March 31, 2016. The increase in research and product development expenses for the three months ended March 31, 2017 was primarily due to the consummation of the Merger in September 2016 (which resulted in the inclusion of research and product development expenses related to the Legacy Zhone business for the current year period). We intend to continue to invest in research and product development to attain our strategic product development objectives while seeking to manage the associated costs through expense controls.

Selling, Marketing, General and Administrative Expenses

Selling, marketing, general and administrative expenses increased 149% or \$6.3 million to \$10.6 million for the three months ended March 31, 2017 compared to \$4.3 million for the three months ended March 31, 2016. The increase in selling, marketing, general and administrative expenses was primarily due to the consummation of the Merger in September 2016 (which resulted in the inclusion of selling, marketing, general and administrative expenses related to Legacy Zhone business for the current year quarter), offset by higher commission expenses during the three months ended March 31, 2016.

Income Tax Provision

During the three months ended March 31, 2017 and 2016, no material provision or benefit for income taxes was recorded, due to our recurring operating losses and the significant uncertainty regarding the realization of our net deferred tax assets, against which we have continued to record a full valuation allowance.

OTHER PERFORMANCE MEASURES

In managing our business and assessing our financial performance, we supplement the information provided by our GAAP results with adjusted earnings before stock- based compensation, interest, taxes, and depreciation, or Adjusted EBITDA, a non- GAAP financial measure. We define Adjusted EBITDA as net income (loss) plus (i) interest expense, (ii) provision (benefit) for taxes, (iii) depreciation and amortization, (iv) stock- based compensation, and (v) material non- recurring transactions or events, such as Merger transaction costs or a gain (loss) on sale of assets or impairment of fixed assets. We believe that the presentation of Adjusted EBITDA enhances the usefulness of our financial information by presenting a measure that management uses internally to monitor and evaluate our operating performance and to evaluate the effectiveness of our business strategies. We believe Adjusted EBITDA also assists investors and analysts in comparing our performance across reporting periods on a consistent basis because it excludes the impact of items that we do not believe reflect our core operating performance.

Adjusted EBITDA has limitations as an analytical tool. Some of these limitations are:

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual requirements;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debts;

- although depreciation and amortization are non- cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- non- cash compensation is and will remain a key element of our overall long- term incentive compensation package, although we exclude it as an expense when evaluating our ongoing operating performance for a particular period; and
- other companies in our industry may calculate Adjusted EBITDA and similar measures differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, Adjusted EBITDA should not be considered in isolation or as a substitute for net income (loss) or any other performance measures calculated in accordance with GAAP or as a measure of liquidity. Management understands these limitations and compensates for these limitations by relying primarily on our GAAP results and using Adjusted EBITDA only supplementally.

Set forth below is a reconciliation of net loss to Adjusted EBITDA, which we consider to be the most directly comparable GAAP financial measure to Adjusted EBITDA (in thousands):

	Three Months Ended March 31,	
	2017	2016
Net loss	\$ (3,498)	\$ (3,761)
Add:		
Interest expense, net	248	146
Income tax provision (benefit)	440	(627)
Depreciation and amortization	1,181	268
Stock- based compensation	255	—
Adjusted EBITDA	<u>\$ (1,374)</u>	<u>\$ (3,974)</u>

LIQUIDITY AND CAPITAL RESOURCES

Our operations are financed through a combination of our existing cash, cash equivalents, available credit facilities, and sales of equity and debt instruments, based on our operating requirements and market conditions.

As of March 31, 2017, our cash and cash equivalents were \$17.3 million compared to \$17.9 million at December 31, 2016. Our cash and cash equivalents as of March 31, 2017 included \$8.4 million in cash balances held by our Korean subsidiary. The \$0.6 million decrease in cash and cash equivalents was attributable to net cash used in operating and financing activities of \$0.7 million and \$1.8 million, respectively, partially offset by the effect of exchange rate changes on cash of \$0.8 million and net cash provided by investing activities of \$1.1 million.

Ability to Continue as a Going Concern

The accompanying condensed consolidated financial statements have been prepared in conformity with GAAP, assuming we will continue as a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. Accordingly, the condensed consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result from the possible inability of DZS to continue as a going concern.

We have incurred significant losses to date and our losses from operations may continue. We incurred net losses of \$3.5 million and \$15.3 million for the three months ended March 31, 2017 and the year ended December 31, 2016, respectively. We had accumulated deficit of \$23.7 million and working capital of \$55.2 million as of March 31, 2017. As of March 31, 2017, we had approximately \$17.3 million in cash and cash equivalents, which included \$8.4 million in cash balances held by our Korean subsidiary, and \$31.5 million in aggregate principal amount of outstanding borrowings under our credit facility with Wells Fargo Bank, our short- term debt obligations and our loans from DNI. In addition, we had \$5.7 million in aggregate borrowing availability under our credit facilities as of March 31, 2017. We had \$6.0 million committed as security for letters of credit under these facilities as of March 31, 2017. Due to the amount of short- term debt obligations maturing within the next 12 months and our recurring operating losses, our cash resources may not be sufficient to settle these short- term debt obligations. Our ability to continue as a "going concern" is dependent on many factors, including, among other things, our ability to comply with the covenants in our existing debt agreements, our ability to cure any defaults that occur under our debt agreements or to obtain waivers or forbearances with respect to any such defaults, and our ability to pay, retire, amend, replace or refinance our

indebtedness as defaults occur or as interest and principal payments come due. Although the process of amending, replacing or refinancing our short-term debt obligations is ongoing and we are in active discussions with multiple parties, there is no guarantee that they will result in transactions that are sufficient to provide us with the required liquidity to remove the substantial doubt as to our ability to continue as a going concern. If we are unable to amend, replace, refinance our short-term debt obligations or raise the capital needed to meet liquidity needs and finance capital expenditures and working capital, we may experience material adverse impacts on our business, operating results and financial condition.

We have continued our focus on cost control and operating efficiency along with restrictions on discretionary spending. In order to meet our liquidity needs and finance our capital expenditures and working capital needs for our business, we may be required to sell assets, issue debt or equity securities, purchase credit insurance or borrow on potentially unfavorable terms. In addition, we may be required to reduce the scope of our planned product development, reduce sales and marketing efforts and reduce our operations in low margin regions, including reductions in headcount. Based on our current plans and business conditions, we believe that our focused operating expense discipline along with our existing cash, cash equivalents and available credit facilities will be sufficient to satisfy our anticipated cash requirements for at least the next 12 months, however the factors discussed above raise substantial doubt about our ability to continue as a going concern.

Operating Activities

Net cash provided by operating activities for the three months ended March 31, 2017 consisted of a net loss of \$3.5 million, adjusted for non-cash charges totaling \$2.3 million and an increase in net operating assets totaling \$0.5 million. The most significant components of the changes in net operating assets were an increase in accounts receivable of \$1.3 million and an increase in inventory of \$3.7 million offset by a decrease in accounts payable of \$6.7 million. The increase in accounts receivable was primarily the result of the timing of receivables collections during the current year period. The increase in inventory was due to slower utilization of inventory in the current year period. The decrease in accounts payable was mainly due to reclassification of certain balances to short-term debt.

Net cash used in operating activities for the three months ended March 31, 2016 consisted of a net loss of \$3.8 million, adjusted for non-cash charges totaling \$0.1 million and a decrease in net operating assets totaling \$3.9 million. The most significant components of the changes in net operating assets were an increase in accrued expenses of \$11.9 million offset by an increase in prepaid expenses and other current assets of \$8.7 million.

Investing Activities

Net cash provided by investing activities for the three months ended March 31, 2017 consisted of a decrease in restricted cash of \$0.7 million and proceeds from short-term investments of \$1.0 million, offset by purchases of property and equipment of \$0.4 million.

Net cash used in investing activities for the three months ended March 31, 2016 consisted of an increase in short-term and long-term loans to others of \$1.6 million and an increase in restricted cash of \$0.8 million, offset by a decrease in short-term and long-term loans of \$0.3 million.

Financing Activities

Net cash used in financing activities for the three months ended March 31, 2017 consisted of cash used in repayments of borrowings of \$4.4 million, offset by proceeds from short-term borrowings of \$2.6 million.

Net cash provided by financing activities for the three months ended March 31, 2016 consisted of proceeds from short-term borrowings and proceeds from long-term borrowings of \$1.1 million and \$1.8 million, respectively.

Cash Management

Our primary source of liquidity comes from our cash and cash equivalents which totaled \$17.3 million at March 31, 2017, as well as our credit facilities, under which we had aggregate borrowing availability of \$5.8 million as of March 31, 2017, and under which \$3.6 million was committed as security for letters of credit as of March 31, 2017. Our cash and cash equivalents as of March 31, 2017 included \$8.4 million in cash balances held by our Korean subsidiary.

WFB Facility

As of March 31, 2017, we had a \$25.0 million credit facility (the "WFB Facility") with Wells Fargo Bank ("WFB"). Under the WFB Facility, we have the option of borrowing funds at agreed upon interest rates. The amount that we are able to borrow under the WFB Facility varies based on eligible accounts receivable and inventory, as defined in the WFB Facility, as long as

the aggregate amount outstanding does not exceed \$25.0 million less the amount committed as security for letters of credit. To maintain availability of funds under the WFB Facility, we pay a commitment fee on the unused portion. The commitment fee is 0.25% per annum and is recorded as interest expense.

As of March 31, 2017, we had \$0.2 million in outstanding borrowings under the WFB Facility, and \$3.6 million was committed as security for letters of credit. We had \$5.7 million of borrowing availability under the WFB Facility as of March 31, 2017. The amounts borrowed under the WFB Facility bear interest, payable monthly, at a floating rate equal to the three-month LIBOR plus a margin based on our average excess availability (as calculated under the WFB Facility). The interest rate on the WFB Facility was 0.0365% at March 31, 2017. The maturity date under the WFB Facility is March 31, 2019.

Our obligations under the WFB Facility are secured by substantially all of our personal property assets and those of our subsidiaries that guarantee the WFB Facility, including our intellectual property. The WFB Facility contains certain financial covenants, and customary affirmative covenants and negative covenants. If we default under the WFB Facility due to a covenant breach or otherwise, WFB may be entitled to, among other things, require the immediate repayment of all outstanding amounts and sell our assets to satisfy the obligations under the WFB Facility. In the past we have violated the covenants in our former credit facility and received waivers for these violations. On July 3, 2017, we executed an agreement with WFB to extend the due date for delivery for our audited financial statements for the year ended December 31, 2016 to September 27, 2017. As of March 31, 2017, we were in compliance with the covenants under the WFB Facility. We make no assurances that we will be in compliance with these covenants in the future.

Bank and Trade Facilities - Foreign Operations

Certain of our foreign subsidiaries have entered into various financing arrangements with foreign banks and other lending institutions consisting primarily of revolving lines of credit, trade facilities, term loans and export development loans. These facilities are renewed on an annual basis and are generally secured by a security interest in certain assets of the applicable foreign subsidiaries. Payments under such facilities are made in accordance with the given lender's amortization schedules. As of March 31, 2017 and December 31, 2016, we had an aggregate outstanding balance of \$24.5 million and \$17.6 million, respectively, under such financing arrangements, and the interest rate per annum applicable to outstanding borrowings under these financing arrangements as of March 31, 2017 and December 31, 2016 ranged from 2.16% to 4.69% and 1.92% to 4.08%, respectively.

Related- Party Debt

In connection with the Merger, on September 9, 2016, we entered into a loan agreement with DNI for a \$5.0 million unsecured subordinated term loan facility. Under the loan agreement, we were permitted to request drawdowns of one or more term loans in an aggregate principal amount not to exceed \$5.0 million. As of March 31, 2017, \$5.0 million in term loans was outstanding under the facility. Such term loans mature in September 2021 and are pre-payable at any time by us without premium or penalty. The interest rate as of March 31, 2017 under this facility was 4.6% per annum. In addition, we borrowed \$1.8 million from DNI for capital investment in February 2016, which amount was outstanding as of March 31, 2017. This loan matured in March 2017 with an option of renewal by mutual agreement, and bore interest at a rate of 6.9% per annum, payable annually. Effective February 27, 2017, we amended the terms of this loan to extend the repayment date from March 2017 to March 2018 and to reduce the interest rate from 6.9% to 4.6% per annum.

On June 23, 2017, we borrowed \$3.5 million from Solueta, an affiliate of DNI, which amount was outstanding as of June 30, 2017. This loan matures in November 2017 and bears interest at a rate of 4.6% per annum, payable monthly.

Future Requirements and Funding Sources

Our fixed commitments for cash expenditures consist primarily of payments under operating leases, inventory purchase commitments, and payments of principal and interest for debt obligations.

From time to time, we may provide or commit to extend credit or credit support to our customers. This financing may include extending the terms for product payments to customers. Any extension of financing to our customers will limit the capital that we have available for other uses.

Our accounts receivable, while not considered a primary source of liquidity, represent a concentration of credit risk because a significant portion of the accounts receivable balance at any point in time typically consists of a relatively small number of customer account balances. As of March 31, 2017, two customers accounted for 18% and 16% of net accounts receivables, respectively, and receivables from customers in countries other than the United States represented 85% of net accounts

receivable. We do not currently have any material commitments for capital expenditures, or any other material commitments aside from operating leases for our facilities, inventory purchase commitments and debt.

As discussed above in "Ability to Continue as a Going Concern", there is substantial doubt about our ability to continue as a going concern. The accompanying condensed consolidated financial statements do not include any adjustments that might be necessary if we are unable to continue as a going concern.

Contractual Commitments and Off- Balance Sheet Arrangements

At March 31, 2017, our future contractual commitments by fiscal year were as follows (in thousands):

	<u>Total</u>	<u>Payments due by period</u>					<u>Thereafter</u>
		<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	
Operating leases	\$ 20,584	\$ 2,669	\$ 2,923	\$ 2,335	\$ 2,192	\$ 2,178	\$ 8,287
Purchase commitments	10,215	6,329	1,398	1,383	1,106	—	—
WFB Facility	155	155	—	—	—	—	—
Short- term debt	24,548	24,548	—	—	—	—	—
Related- party debt	6,800	—	1,800	—	—	5,000	—
Total future contractual commitments	<u>\$ 62,302</u>	<u>\$ 33,701</u>	<u>\$ 6,121</u>	<u>\$ 3,718</u>	<u>\$ 3,298</u>	<u>\$ 7,178</u>	<u>\$ 8,287</u>

Operating Leases

The operating lease amounts shown above represent primarily off- balance sheet arrangements. For operating lease commitments, a liability is generally not recorded on our balance sheet unless the facility represents an excess facility for which an estimate of the facility exit costs has been recorded on our balance sheet, net of estimated sublease income. For operating leases that include contractual commitments for operating expenses and maintenance, estimates of such amounts are included based on current rates. Payments made under operating leases will be treated as rent expense for the facilities currently being utilized.

Purchase Commitments

The purchase commitments shown above represent non- cancellable inventory purchase commitments as of March 31, 2017. On July 16, 2017, we reached an agreement with a supplier to cancel a purchase arrangement for certain inventory which was committed to through 2020. Under the settlement, we are no longer required to fulfill our commitment to purchase \$4.3 million in inventory. In connection with the settlement, we also entered into a technical support services arrangement with the supplier through April 30, 2021.

WFB Facility

Obligations under our WFB Facility have been recorded as a liability on our balance sheet and comprise the \$0.2 million in outstanding borrowings under the WFB Facility as of March 31, 2017. The amount shown above represents the scheduled principal repayment under the WFB Facility, but not the associated interest payments which may vary based on changes in market interest rates. At March 31, 2017, the interest rate on the WFB Facility was 0.0365%. See above under "Cash Management - WFB Facility" for further information about the WFB Facility.

Short- term Debt

Obligations under our short- term credit facilities was \$24.5 million as of March 31, 2017. The amount shown above represents scheduled principal repayments under these facilities, but not the associated interest payments which may vary based on changes in market interest rates. At March 31, 2017, the interest rate per annum applicable to outstanding borrowings under the trade facilities of our foreign subsidiaries ranged from 2.16% to 4.69%. The amount shown above excludes \$1.8 million in short- term debt obligations to related parties, which is included in the table as related-party debt (as discussed further below).

See above under "Cash Management - Bank and Trade Facilities - Foreign Operations" for further information about these facilities.

Related- Party Debt

As of March 31, 2017, we had borrowed an aggregate of \$6.8 million from DNI, of which \$5.0 million and \$1.8 million mature in September 2021 and March 2018, respectively, and the interest rate per annum applicable to these borrowings was 4.6%. The amounts listed in the table above reflect the amendment in February 2017 to the DNS capital investment loan, which among other matters extended the repayment date of the loan from March 2017 to March 2018. The table does not include the \$3.5 million borrowed from Solueta, an affiliate of DNI, in June 2017. See above under "Cash Management" for further information about our related- party debt.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Concentration of Credit Risk

Financial instruments which potentially subject us to concentrations of credit risk consist primarily of cash and cash equivalents, and accounts receivable. Cash and cash equivalents consist principally of demand deposit and money market accounts. Cash and cash equivalents are principally held with various domestic financial institutions with high credit standing. We perform ongoing credit evaluations of our customers and generally do not require collateral. Allowances are maintained for potential doubtful accounts.

We anticipate that our results of operations in any given period may depend to a large extent on sales to a small number of large accounts. As a result, our revenue for any quarter may be subject to significant volatility based upon changes in orders from one or a small number of key customers. For the three months ended March 31, 2017, two customers represented 12% and 11% of net revenue, respectively. For the three months ended March 31, 2016, three customers represented 26% (a related- party), 14% and 11% of net revenue, respectively.

As of March 31, 2017, two customers represented 18% and 16% of net accounts receivable, respectively. As of December 31, 2016, two customers represented 13% (a related- party) and 10% of net accounts receivable.

As of March 31, 2017, and December 31, 2016, receivables from customers in countries other than the United States represented 85% and 87%, respectively, of net accounts receivable.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our variable rate outstanding debt. As of March 31, 2017, our outstanding debt balance was \$31.5 million, which comprised of \$0.2 million in principal amount of borrowings under our WFB Facility, \$24.5 million in aggregate principal amount of borrowings under our short- term credit facilities and \$6.8 million in loans from DNI (which bear interest at a fixed rate).

Amounts borrowed under the WFB Facility bear interest, payable monthly, at a floating rate equal to the three- month LIBOR plus a margin based on our average excess availability (as calculated under the WFB Facility). As of March 31, 2017, the interest rate on the WFB Facility was 0.0365%. Amounts borrowed under our short- term credit facilities bear interest ranging from 2.16% to 4.69% as of March 31, 2017. Assuming the outstanding balance on our variable rate debt remains constant over a year, a 2% increase in the interest rate would decrease pre- tax income and cash flow by approximately \$0.5 million.

Foreign Currency Risk

We transact business in various foreign countries, and a significant portion of our assets is located in Korea. We have sales operations throughout Europe, Asia, the Middle East and Latin America. We are exposed to foreign currency exchange rate risk associated with foreign currency denominated assets and liabilities, primarily intercompany receivables and payables. Accordingly, our operating results are exposed to changes in exchange rates between the U.S. dollar and those currencies. During the three months ended March 31, 2017 and 2016, we did not hedge any of our foreign currency exposure.

We have performed a sensitivity analysis as of March 31, 2017 using a modeling technique that measures the impact on the balance sheet arising from a hypothetical 10% adverse movement in the levels of foreign currency exchange rates relative to the U.S. dollar, with all other variables held constant. The sensitivity analysis indicated that a hypothetical 10% adverse movement in foreign currency exchange rates would result in a foreign exchange loss of \$2.4 million at March 31, 2017. This sensitivity analysis assumes a parallel adverse shift in foreign currency exchange rates, which do not always move in the same direction. Actual results may differ materially.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance of achieving the objective that information required to be disclosed in our reports filed or submitted pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Co- Chief Executive Officers and Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosures. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management applies its judgment in evaluating the cost- benefit relationship of possible controls and procedures.

As required by SEC Rule 13a- 15(b), we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2017, the end of the period covered by this report. The evaluation was done under the supervision and with the participation of management, including our Co- Chief Executive Officers and our Chief Financial Officer. Based upon this evaluation, our Co- Chief Executive Officers and Chief Financial Officer concluded that, because of the material weaknesses in our internal control over financial reporting that existed as of December 31, 2016, as described below, our disclosure controls and procedures were not effective as of March 31, 2017.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis. The material weaknesses that management previously identified in connection with its evaluation of our internal control over financial reporting as of December 31, 2016 were as follows: we did not maintain an effective control environment as there was an insufficient complement of personnel with appropriate accounting knowledge, experience and competence, resulting in incorrect application of generally accepted accounting principles. This material weakness contributed to the following material weaknesses. We did not maintain effective controls over our financial close process. Also, we did not design and maintain effective controls over the review of supporting information to determine the completeness and accuracy of the accounting for complex transactions, specifically related to the business combination that occurred on September 9, 2016, which resulted in an incorrect application of generally accepted accounting principles that resulted in material misstatements and a restatement of our unaudited condensed consolidated financial statements for the three and nine months period ended September 30, 2016. Additionally, these material weaknesses could result in a misstatement in the financial statements that would result in a material misstatement in the annual or interim consolidated financial statements that would not be prevented or detected.

In light of the material weakness described above, and based on the criteria set forth in Internal Control —Integrated Framework (2013) issued by the Committee Sponsoring Organizations of the Treadway Commission (COSO), our management concluded that our internal control over financial reporting was not effective as of December 31, 2016.

As of the date of this report, we are re- assessing the design of our controls and modifying processes related to the accounting for significant and unusual transactions as well as enhancing monitoring and oversight controls in the application of applicable accounting guidance related to such transactions. In connection therewith, we anticipate that we will hire additional accounting personnel with relevant skills, training and experience, and conduct further training of accounting and finance personnel.

Changes in Internal Control over Financial Reporting

Except as described above, there were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Merger- related integration activities may lead us to modify certain internal controls in future periods.

Inherent Limitations on Effectiveness of Controls

Our management, including our Co- Chief Executive Officers and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. 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. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision- making can be faulty and that breakdowns can occur because of simple error or mistake. 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. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are subject to various legal proceedings, claims and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect that the ultimate costs to resolve these matters will have a material adverse effect on our consolidated financial position or results of operations. However, litigation is subject to inherent uncertainties, and unfavorable rulings could occur. If an unfavorable ruling were to occur, there exists the possibility of a material adverse impact on the results of operations of the period in which the ruling occurs, or future periods.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A, Risk Factors" in our Annual Report on Form 10- K for the year ended December 31, 2016, which could materially affect our business, financial condition or future results. There have been no material changes to the risk factors described in the "Risk Factors" section in our Annual Report on Form 10- K for the year ended December 31, 2016. The risks described in our Annual Report on Form 10- K are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 6. Exhibits

The Exhibit Index on page 34 is incorporated herein by reference as the list of exhibits required as part of this report.

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.

DASAN ZHONG SOLUTIONS, INC.

Date: September 27, 2017 By: _____ /s/ IL YUNG KIM
Name: **Il Yung Kim**
Title: **President, Chief Executive Officer and Acting Chief Financial Officer**

EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
3.1	Restated Certificate of Incorporation of DASAN Zhone Solutions, Inc., as amended through February 28, 2017 (incorporated by reference to Exhibit 3.1 of registrant's Annual Report on Form 10- K for the year ended December 31, 2016 and filed on September 27, 2017)
10.1#	DASAN Zhone Solutions, Inc. 2017 Incentive Award Plan (incorporated by reference to Exhibit 10.1 of registrant's Current Report on Form 8- K dated January 4, 2017 and filed on January 10, 2017)
10.1.1#	Form of Stock Option Agreement for the DASAN Zhone Solutions, Inc. 2017 Incentive Award Plan (incorporated by reference to Exhibit 10.2 of registrant's Current Report on Form 8- K dated January 4, 2017 and filed on January 10, 2017)
10.1.2#	Form of Restricted Stock Unit Award Agreement for the DASAN Zhone Solutions, Inc. 2017 Incentive Award Plan (incorporated by reference to Exhibit 10.1.2 of registrant's Annual Report on Form 10- K for the year ended December 31, 2016 and filed on September 27, 2017) Consent Memorandum, dated as of May 5, 2017, by and among DASAN Zhone Solutions, Inc., ZTI Merger Subsidiary III, Inc., Premisys Communications, Inc., Zhone Technologies International, Inc., Paradyne Networks, Inc., Paradyne Corporation, Dasan Network Solutions, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.1 of registrant's Current Report on Form 8- K dated May 9, 2017)
10.2	Letter agreement, dated July 3, 2017, by and among DASAN Zhone Solutions, Inc., ZTI Merger Subsidiary III, Inc., Premisys Communications, Inc., Zhone Technologies International, Inc., Paradyne Networks, Inc., Paradyne Corporation, Dasan Network Solutions, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 10.1 of registrant's Current Report on Form 8- K dated July 3, 2017)
10.3	
31.1	Certification of Chief Executive Officer and Acting Chief Financial Officer Pursuant to Rule 13a- 14(a)/15d- 14(a)
32.1	Section 1350 Certification of Chief Executive Officer and Acting Chief Financial Officer
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Extension Labels Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

Management contract or compensatory plan or arrangement in which one or more executive officers or directors participates.

**CERTIFICATION OF CO- CHIEF EXECUTIVE OFFICER
PURSUANT TO
RULE 13a- 14(a)/15d- 14(a)**

I, Il Yung Kim, certify that:

1. I have reviewed this Quarterly Report on Form 10- Q of DASAN Zhone Solutions, 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: September 27, 2017

/s/ IL YUNG KIM

Il Yung Kim

President, Chief Executive Officer, Acting Chief Financial Officer and
Director

SECTION 1350 CERTIFICATION

Pursuant to 18 U.S.C. Section 1350, James Norrod and Il Yung Kim, Co- Chief Executive Officers of DASAN Zhone Solutions, Inc. (the “Company”), and Kirk Misaka, Chief Financial Officer of the Company, each hereby certify that, to their knowledge:

1. The Company’s Quarterly Report on Form 10- Q for the quarter ended September 30, 2016 (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: September 27, 2017

/s/ IL YUNG KIM

Il Yung Kim

President, Chief Executive Officer, Acting Chief Financial Officer and
Director