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Q1 2023 Ciena Corp Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the Ciena's Fiscal First Quarter 2023 Financial Results Conference Call. (Operator Instructions) Please note this event is being recorded. I would now like to turn the conference over to Gregg Lampf, Vice President of Investor Relations. Please go ahead.

Gregg M. Lampf ***Ciena Corporation - VP of IR***

Thank you, Jason. Good morning, and welcome to Ciena's 2023 Fiscal First Quarter Results Conference Call. On the call today is Gary Smith, President and CEO; and Jim Moylan, CFO. Scott McFeely, our Senior Vice President of Global Products and Services, is also with us for Q&A. As OFC begins today, our team today is taking calls from different locations. We ask for your patience during Q&A as we coordinate our responses please. In addition to this call and the press release, we have posted to the Investors section of our website an accompanying investor presentation that reflects this discussion as well as certain highlighted items from the quarter. Our comments today speak to our recent performance, our views on current market dynamics and drivers of our business as well as a discussion of our financial outlook.

Today's discussion includes certain adjusted or non-GAAP measures of Ciena's results of operations. A reconciliation of these non-GAAP measures to our GAAP results is included in today's press release. Before turning the call over to Gary, I'll remind you that during this call, we'll be making certain forward-

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looking statements. Such statements, including our quarterly and annual guidance and our long-term financial outlook, discussion of market opportunities and strategy, commentary about our impacts of supply chain results on our business and end results are based on current expectations, forecasts and assumptions regarding the company and its markets which include risks and uncertainties that could cause actual results to differ materially from the statements discussed today.

Assumptions relating to our outlook, which mentioned on this call are included in the investor presentation that will be posted shortly after, are an important part of such forward-looking statements, and we encourage you to consider them. Our forward-looking statements should also be viewed in the context of the risk factors detailed in our most recent 10-K filing and in our upcoming 10-Q filing which is required to be filed with the SEC by March 9, and we expect to file by that date. Ciena assumes no obligation to update the information discussed in this conference call, whether as a result of new information, future events or otherwise. As always, we will allow for as much Q&A as possible today, though we ask that you limit yourselves to 1 question and 1 follow-up, please. As a reminder, we'll be hosting investor meetings with the sell side at OFC tomorrow and Wednesday. And we look forward to seeing many of you there.

With that, I'll turn the call over to Gary.

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
Thanks, Gregg, and good morning, everyone. Today, we reported outstanding fiscal first quarter results including higher-than-expected quarterly revenue of $1.06 billion and adjusted gross margin of 43.7%. And in fact, Q1 was our largest revenue quarter ever, up 25% year-over-year. We also reported very strong profitability metrics, with quarterly adjusted operating margin of 12.6% and an adjusted EPS of $0.64. These results are a strong demonstration of our market leadership and continued demand for our market-leading technology across our complete portfolio. While supply chain has not completely recovered, and there is still some volatility in component deliveries, we are encouraged by the component availability in Q1 and our related strong shipment performance. This is both, I think, a proof point of our mitigation efforts and a positive indicator of our expectation for continued gradual improvements in the supply environment as we move through the year.

We are very pleased with this progress as we continue to work hard to fulfill our customers' network capacity needs. With this strong momentum, we remain confident in our ability to grow faster than the market in both, the short and long term and of course, take market share. This confidence is underpinned by 3 fundamental beliefs. First, the positive overall demand environment and the strength of our customer relationships. Second, the market-leading strength of our portfolio to best service customer demand. And lastly, the visibility, particularly provided by our backlog. And with respect to demand, we remain positive about the fundamental drivers, including 5G, cloud, AI and automation and continue to believe that they are very durable over the long term. Indeed, these drivers require network operators to increase capacity, reduce latency and optimize power consumption while also intelligently converging technologies.

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These are critical elements across the core metro and increasingly edge network segments. And our customers know that they must continue investing in key parts of their networks to address these areas of their business in order to remain competitive. And there are clear signs, including our Q1 order book that point to be happening. Service these demand dynamics, we continue to leverage the strength of our business model and our investment capacity to remain at the forefront of innovation across our portfolio. And our leading technology and strategic focus on addressable market expansions are closely aligned with our customers' investment priorities. And in fact, you probably saw, we just announced the sixth generation of our WaveLogic technology, which will once again set a new standard in coherent optics, where we have led the market for generations of this technology.

WaveLogic 6 will be the first to support up to 1.6 terabits single-carrier wavelengths, 800 gig across the longest links and footprint optimized 800-gig pluggables that yet again, will have the lowest energy consumption. Our newest generation modem technology will be supported across a range of our optical and routing and switching platforms and will also be made available for use in third-party solutions. These breakthrough innovations in WaveLogic 6 are made possible through our unique expertise in coherent DSP and high-bandwidth electro optics, leveraging state-of-the-art 3-nanometer silicon technology. And in metro and edge, we continue to invest in market expansion and further solidify our role as the disruptive challenger in this space with a very compelling value proposition. These investments are positioning us to both, pursue new opportunities and leverage our position with current customers to address use cases deeper in the network.

And since we last spoke to you in December, we closed the acquisition of Tibit Communications, which further strengthens our solution in broadband access. Benefiting now from our vertical integration and a modern open architectural approach, we believe we are very well positioned to attack this rapidly growing market that is the focus of private and public investment across multiple regions. These portfolio investments will be supported by similar efforts on software and services designed to enable customers to realize additional benefits of network automation, and execute on their network transformation strategies.

And lastly, let me pick up on this point of we have a very strong visibility given our backlog. As a reminder, going into 2020, we had accumulated a multitude of new design wins and WaveLogic 5 Extreme was only just beginning initial commercial deployments at that time. Now given the dynamics of COVID and supply chain conditions, those wins only started to translate into orders during the last several quarters. As a result of these wins and industry dynamics during this period, our backlog grew from $1.2 billion at the end of fiscal 2020 to $4.2 billion as we entered fiscal 2023. With that, it is clear that in recent periods, our backlog has far exceeded historical levels.

In Q1, our backlog came down slightly, because we significantly outperformed our revenue expectations. And of course, this is good news on a variety of fronts. First and most importantly, it means that we are delivering more product to our customers. Second, it's an indicator that the supply chain challenges are improving. And lastly, our market share gains are becoming evident as we convert this backlog to revenue. And while we expect ebbs and flows with orders given the supply chain dynamics, as we move

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through FY'23, orders for the year are off to a pretty good start. And even with these expected fluctuations, we expect to finish the year with backlog that is higher than our historical levels, albeit down from the extraordinary level we had at the beginning of the year.

Moving to additional highlights from the quarter that I think speak to our efforts to meet customer demand. In optical, WaveLogic 5 Extreme continues to be the world's most widely deployed 800 gig coherent technology, including 13 new customers in Q1, bringing our total customer count to 214. And Q1 was our biggest modem shipment quarter ever overall, including for WaveLogic 5e, for which we've now surpassed 60,000 modems shipped to date. It was also, of course, our strongest WaveLogic 5e modem production quarter ever as well.

In Routing and Switching, with a focus on next-gen metro and edge, we continue to press down our efforts and to expand our addressable market and gain market share. Overall, quarterly revenue for our Routing and Switching segment increased 39% year-over-year. And Q1 was, of course, also a record shipment quarter for these platforms. And within this portfolio, we secured new wins in Q1 for our broadband access solution, which includes the recently acquired technology from both, Benu Networks and Tibit Communications.

Shifting to customer segments and regions in the quarter, non-telco revenue was 40% of total sales in Q1. This reflects a strong performance with web-scale, which included a 10% customer in the quarter. Direct web-scale was 24% of total revenue in the quarter and increased 47% year-over-year. We remain very positive about the year with this group of customers. In fact, in FY '23, we expect record revenue in web-scale and growth well above the corporate average.

As we continue to focus on driving growth outside the U.S., Q1 revenue in the APAC region was up 41% year-over-year. This was largely driven by revenue growth in India, which was up 150% year-over-year in Q1 to $64 million, reflecting the strong demand environment in that market. And finally, we are placing an intense focus on customer experience. Specifically, the combination of our investment in inventory over the last 12 months and a ramp-up of our service team's readiness to deploy for our customers as fast as possible as we ship product.

In summary, we have great momentum in the market today, supported by robust fundamental demand drivers, a market-leading set of technologies and platforms and strong visibility with our backlog. And with that, we are confident that we will deliver outsized year-over-year revenue growth in FY '23 and that we remain on track to achieve the 3-year revenue CAGR outlook we previously provided.

With that, I will now turn over to Jim to speak more on those items as well as to provide additional detail on the Q1 financial results. Jim?

James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
Thanks, Gary. Good morning, everyone, and an especially good very early morning to those on the West Coast at OFC. As Gary mentioned, we had a tremendous performance in Q1 that demonstrates our

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strong position as the market leader. Total revenue was $1.06 billion, higher than expected. We shipped more product than expected due to improvements in vendor component deliveries, particularly toward the end of the quarter. Adjusted gross margin was strong at 43.7%, reflecting a favorable product mix and specifically, a high volume of modems. Modems carry higher gross margins than average, and they made up a significant percentage of the late quarter shipments. Q1 adjusted operating expense was $329 million, reflecting our investments in TAM expansion, and it included OpEx from the acquisitions of Benu and Tibit.

With respect to profitability measures, in Q1, we delivered strong results, including adjusted operating margin of 12.6%, adjusted net income of $95.6 million and adjusted EPS of $0.64 per share. In addition, we used cash from operations in the quarter, primarily related to increases in inventory and accounts receivable. Our inventory levels reflect our continued investment in components and other raw materials to manage the impact of supply chain volatility on our customers. As supply conditions gradually improve, we expect inventory levels to come down as we move through fiscal 2023 but to remain elevated relative to historical levels. We do believe that inventory will be lower in Q4 of this year than in Q4 of 2022.

And finally, adjusted EBITDA in Q1 was $155.1 million. Benefiting from our successful term loan transaction in Q1, we ended the quarter with approximately $1.2 billion in cash and investments. And just as a reminder, during Q1, we acquired the new and Tibit for an aggregate price of approximately $292 million. With our strong balance sheet, we intend to return capital to stockholders, including our continued expectation for the repurchase of approximately $250 million in shares during this fiscal year.

Turning now to guidance. I want to be clear that the updated outlook I'm about to provide reflects the same set of key assumptions that we discussed last quarter and which are also in our earnings presentation, including those related to supply chain conditions. This latter point is particularly important in a still uncertain supply chain environment. We believe that gradually improving supply conditions of the type we saw in Q1 will begin to allow for greater deployments of our accumulated design wins as well as for new business from customers pursuing best-in-class technology across our portfolio. Accordingly, in Q2, we expect to deliver revenue in a range of $1.035 billion to $1.115 billion. Adjusted gross margin in the low 40% range and adjusted operating expense in Q2 of roughly $335 million.

With respect to the fiscal year, we expect to achieve strong share gains as already reflected in our significant revenue overperformance in Q1 and our expectations for Q2. Therefore, we now expect to achieve fiscal year FY'23 revenue growth in a range of 20% to 22%, up from 16% to 18%. For adjusted gross margin, we continue to believe that our gross margin for fiscal '23 will be in a range of 42% to 44%. This reflects our expectation for a greater proportion of line systems in our product mix over the next few quarters. And for adjusted operating expense, we expect to average approximately $335 million -- $330 million per quarter for fiscal year 2023. This reflects our intent to continue investing strategically in our future, primarily targeting opportunities for TAM expansion in next-gen metro and edge. This latter area is very rapidly growing, and we see potential to gain share with our best-in-class offerings.

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It's clear from the quarterly results we reported today, as well as our outlook for Q2 and fiscal year 2023 that we are performing extremely well. We have never felt better about our position in our business. The combination of robust demand drivers are market-leading technologies and platforms and expanding addressable market and strong visibility with our sizable backlog gives us high confidence in market share gains over the next few years.

Jason, we will now take questions from the sell-side analysts.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from George Notter from Jefferies.

George Charles Notter ***Jefferies LLC, Research Division - MD & Equity Research Analyst***

I guess I wanted to ask a bit about backlog. You said it was down slightly. Could you just give us a precise number? I think you said it was $4.2 billion last quarter, but just was curious on the update. And then also wondering if you're seeing any cancellations on that backlog, any more detail you could give us there? And then just also product lead times. Obviously, lead times have been extended in a lot of areas of the business. I'm just curious what the update is there.

Gary B. Smith ***Ciena Corporation - CEO, President & Director***

Let me take that, George. We don't normally give sort of precise sort of backlog, but given the environment to it, I would say this, if we were to finish at the midpoint of our guide, then we would basically have replenished all of our backlog. So we ate through some of our backlog principally, because our revenue was $100 million over our expectation for the quarter. So we still have an incredibly healthy backlog, but we expect to come down during the year. We do not think this level of backlog is sustainable or frankly, desirable. Customers want equipment, they don't want it sitting on our backlog. And that really bleeds into the second part of the question on the sort of cancellation. We're not seeing any change in update to that. It's a very small and minor and just normal run-of-the-mill type cancellations. So we're very confident about the integrity of the backlog.

What was the third question, George?

George Charles Notter ***Jefferies LLC, Research Division - MD & Equity Research Analyst***

I guess it was just about product lead times. I know they've been extended for some time now. I'm just wondering if you're able to make a dent on this.

Scott Alexander McFeely ***Ciena Corporation - SVP of Global Products & Services***

Yes, George, it's Scott, product lead times have improved as we've just shipped more products and have sort of built a bigger ship going forward. They will continue to improve throughout the year, although I

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don't think we will get them back to historical levels in this fiscal year. And I'm not sure what the new norm will be, but they will be significantly improved as we go throughout the year.

Operator

Our next question comes from Tal Liani from Bank of America.

Tal Liani ***BofA Securities, Research Division - MD, Head of Technology Supersector & Senior Analyst***

I have a follow-up on the previous question, and I have another question on cloud. So the first one is, when I look at the results of all the companies in the space and I'm [general networking,] let's say, it's all the same, meaning very strong revenues, margins are going up because of higher revenues, but the backlog is coming down. And the question is -- and I'm asking on the other side. I mean, George asked you about the backlog, I'll ask about the environment. The question is, how much -- you sound very confident as well as [Cisco] sounded confident, how much of this strength is really a backlog flush and historical orders with the risk that this will end when the backlog going down to normal levels? And how much of it is basically a strong environment that really needs a strong network -- underlying network. So if you can talk about the environment, the orders, the kind of projects and customers, et cetera. So that's first question. And I'll ask both questions together because they are linked.

The second question is about cloud. Another thing that we have seen with Arista, for example, is that cloud is strong. And for you, if you don't mind to repeat the numbers, but I think cloud was up 47%. And the question is how much risk is there in the concentration of maybe 1 big customer, 1 big quarter, with their budgets coming down, what's the risk here that cloud will slow down throughout the year?

Gary B. Smith ***Ciena Corporation - CEO, President & Director***

Okay. Let me take the first part of those multiple questions, Tal. I would say, first of all, one has to step back from the environment that we're seeing, which is the sort of whipsaw around the whole COVID piece, then enormous pent-up demand, then supply chain issues, et cetera. So you're seeing a very turbulent set of dynamics over the last few -- couple of years, and we're still living through it this year. If you sort of look through that dynamic and when we get to some kind of new normal, let's sort of assume that's '24. Then I think you can look back on this and say that the consistent market demand has been strong, mid-single digits, which I think it is consistently and historically been. And I think all of the dynamics and signals that we see are consistent with that. The desire for bandwidth in all its various forms, closer to the end user consumer continues unabated. But that has typically translated into an optical market growth of the mid-single digits.

If you look at Ciena over that period, and again, similar to historical norms, we are a few percentage points above that. And if you look at our CAGR for the next 3 years, which we gave basically last quarter, it's in the 10% to 12% range. So clearly, we're going to be taking a lot of share, mainly because of the wins that we secured in '19 and '20 and '21 now coming into revenue. So I think, yes, we've got outsized revenue this year. There's no doubt about that, and that will obviously normalize at some point, but we will continue to grow faster than the market. And the overall demand, Tal, continues to be strong from that perspective.

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Moving on to web-scale. Obviously, we have relationships with all of the major web scalers. It's not just 1 single 1 that we did have a 10% this quarter, but it's across the board. And we're going to be up significantly for the year, as I said, 47% for the year. We expect growth this year to continue to be above our corporate average. So you can see it's pretty strong. And we're continuing to see good activity with these guys as well.

James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
Just to add on to that a little bit, Tal. We've been through a period over the last 3 or 4 years with the web-scalers [of] tremendous growth across just about every metric in their businesses. And I think it's sort of natural that they are looking at their business in the wake of what's going on in the world, and we've seen a lot of noise out there in the market about what they're doing with their people and what they're doing with their CapEx. But if you look through all of that, underlying business remains strong. Their cloud businesses are strong. So we don't see any impact on their demand. There's turbulence and pushouts and things like that, but we don't see any significant change in the fundamental nature of their business. They're growing.

Operator
Our next question comes from Samik Chatterjee from JPMorgan.

Samik Chatterjee ***JPMorgan Chase & Co, Research Division - Analyst***
So I had a couple, and maybe just to start with one of the questions we're getting this morning. I think, Gregg, you mentioned -- sorry, Gary, you mentioned that overall, you would have replenished the backlog if you had hit the midpoint of the guide for 1Q. I think last quarter, you had said you building backlog with the assumption that you hit the midpoint. So I think one of the questions coming up is that even within the robust order number, were there pockets of weakness that sort of led to a modest sort of slightly below on the order numbers that you had expected? And I have a follow-up, please.

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
I would not describe it as that. It's a very, very strong Q1 for us. If you think about it, that kind of number is very strong. And I would caution folks that I understand people are fixated on orders in the backlog. The backlog cannot and should not maintain the levels that it is. So the order flows, whilst they're good will not match shipments. We expect that during the year. So we expect very simply to end the quarter -- end the year with less backlog than we went into it. And that is a good result for our customers and a good result for us. So I think we actually had a very strong Q1 orders. But I would caution particularly on just taking order metrics on a quarterly basis right now. We're going to see some ebbs and flows during the year. There's no doubt about that. I mean, last year, we had 25% order growth last year. And if you look at the end of, I think it was Q3 in FY '22, if you look at the trailing 12 months, it was up 60%. That is not sustainable. And whilst it's wonderful, and it's a great demonstration of all the wins that we've had, we've got to take them to revenue in this next phase of the business. And we still believe we're going to have a very good '24 and go in with a strong backlog. But it's not going to be a linear line from an order point of view, that's for sure. Second part of your question, Samik.

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Samik Chatterjee ***JPMorgan Chase & Co, Research Division - Analyst***
Yes. I understand we are happy on small numbers here. But maybe switching gears here to WaveLogic 6, you just mentioned that the WaveLogic 5 orders had really started to sort of come in more in the recent quarters. So how do you think about the likelihood that with the release of WaveLogic 6, so quick in succession that customers start push out sort of their move to WaveLogic 5 and wait out till the WaveLogic 6 is in the market, just given that it's so sort of following on the heels of the WaveLogic 5 orders starting to pick up?

Scott Alexander McFeely ***Ciena Corporation - SVP of Global Products & Services***
Samik. So first of all, just a point of clarification. The WaveLogic 5 orders were a big part of that order growth that we saw in the last 18 months. So it's really a microcosm of the whole order dynamic that Gary said. So what we are doing now is we are in an accelerated way, converting those to revenue, and to converting them to shipments to our customers. So just I thought I heard you say something a little bit different, so just a point of clarification there. I think about WaveLogic 6, the timing as we said, is first half of '24. Obviously, we'll start to see design wins against that earlier than that, I suspect. But I will point out that it takes several cycles for next generation of technology to actually overtake the previous generation of technologies in terms of shipments or revenues. For example, this past quarter is the first quarter where WaveLogic 5 was the biggest number of units that we shipped across all of our generation of technology, and it's been available for a couple of years.

Operator
Our next question comes from Paul Silverstein from Cowen.

Paul Jonas Silverstein ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***
Gary, apologies for returning to the issue, but we seem to be a slow bunch. So I'll add to it. Relative to investor concerns about CapEx from both, carriers and web-scale, what do you -- from your comments, it doesn't sound like you're seeing any weakness. It sounds like the strength is pretty broad-based if I understood your comments correctly. What's driving that, what's the disconnect between these? And I'm mindful that CapEx trends in the individual companies' revenue are far from one of the same. What -- can you give us any incremental insight and what's driving your strength relative to the outlook for this year, those cutbacks that a lot of your customers have been talking about?

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
Well, I think first of all, you're dealing with a lot of pent-up demand, orders that have been placed because of extended lead times. And carriers -- I mean, let me be really clear, carriers and web-scale want the equipment. There's no doubt about that. They want the equipment. Now I would say, for the first time in the web-scale sort of area, we're seeing them manage to their budgets. So even though they want all the equipment, they can't take all of the equipment in the year. And we are seeing that, and that is built into our guide. Even with the massive uptick that we're seeing in web-scale, that is built into our guide. So they are scheduling stuff out into '24 which is great, because it gives us backlog and visibility there. We know they want the equipment to complete the networks that they're driving. So

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that actually is sort of a positive dynamic, but they are -- the web-scale, particularly are managing to their budgets. And we are seeing that, we have seen that for the last few quarters.

On the carrier side of things, again, they've got pent-up demand, and they are, as usual, managing to their budgets and CapEx. But I would say that the priority for them is actually in this space and is on capacity to build out their networks. Particularly when you think about it, the last 2 to 3 years, first of all, they did not during the sort of COVID period, they were operationally conservative, and really the growth in the market was pretty flat. Then they had pent-up demand, then we couldn't ship it to them in time.

And so it is a priority for them right now to roll out these networks. So obviously, they're not immune to all of the economic uncertainty out there. But given the particular demand dynamics around capacity in their networks, we've got good visibility to that and not just in the backlog, but in the activity that we're seeing with them. So that's how I would characterize the 2 groups. We are not seeing any push out on the carrier side from a budget point of view. We're not seeing it.

Paul Jonas Silverstein ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***
All right. As a follow-up, the numbers clearly indicate that ZR, at least at present, is not having an adverse impact. And I'm mindful that you guys indicate that you've got the lowest power solution in the market, which obviously is a critical factor. You've now announced WaveLogic 6 on 3 nanometer. I don't think anyone else has announced 3 nanometer, which presumably would -- I recognize it's not necessarily ZR, but presumably that will continue your trajectory in terms of power efficiency. But let me let you respond. Any update on where your activity is at on your participation, if any, relative to that opportunity?

Scott Alexander McFeely ***Ciena Corporation - SVP of Global Products & Services***
Paul, I don't think our perspective has changed much since the last time we chatted. I firmly believe we've got the best pluggable product in the marketplace, both from -- you mentioned power and -- but also [reach.] And there's starting to be some external references to validate that. We still think that market in terms of the ZR market for campus DCI is still very much in front of us. There's been some early movements. I don't think they've moved into the network as fast as people had expected. But as that sort of inventory position and those customers bleeds off, we think there will be opportunity in front of us.

Paul Jonas Silverstein ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***
All right. Jim, can you just clarify something? Any meaningful contribution from Tibit [revenue] in the quarter?

James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
No, it was not, Paul. They were a little bit later in the quarter, and there was no meaningful revenue contribution at this stage.

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Operator
Our next question comes from Tim Long from Barclays.

Timothy Patrick Long ***Barclays Bank PLC, Research Division - MD and Senior Technology Hardware & Networking Analyst***
Yes, 2, if I could, as well. First, I wanted to touch on Routing and Switching, which seem to reflect a little bit higher in the quarter. Can you talk a little bit about kind of growth in use cases or sales or what it takes to keep that business scaling? And then secondly, a little bit higher level, looking at kind of the service businesses as a whole continue to lag product. Most companies in the peer group have seemed to match revenue there. So could you talk a little bit about why we've seen service underperformance in a pretty weak gross margin accordingly this quarter?

Scott Alexander McFeely ***Ciena Corporation - SVP of Global Products & Services***
Let me take the second 1 first, the Services piece. So it really has more to do with the project mix and timing of sort of product revenue delivery versus sort of [installation] projects. I don't think there's a sustainable difference in the performance of the services business relative to our equipment business here. It's really just timing and project based, particularly on the installation based services. And that has both, the revenue ratio that you pointed out but also has a margin implication, because we carry a bit of fixed cost on the services piece and the revenue timing is not -- is off a bit, and you see it as a bit of a headwind from a margin perspective in the short term. So that's the Services dynamic.

On the Routing and Switching piece, you're absolutely right. Good quarter in Routing and switching. There's been a few in a row, so we're pretty excited about the momentum there. In many of the use cases, we are challengers that are building, I'll say, to next-generation architectures. So we think that the future is still very much in front of us in terms of getting at that expanded TAM that we talked about. And just to remind you, the key use cases that we've been focused on include wireless transport; next-generation residential broadband with XGS-PON; enterprise edge in both, the physical and sort of virtual capability; and then a converged metro core, benefiting both, from our IP capabilities but also our optical strengths there. So we're pretty excited about being the challenger in that space and the continued opportunities in front of us.

Operator
Our next question comes from Simon Leopold from Raymond James.

Simon Matthew Leopold ***Raymond James & Associates, Inc., Research Division - Research Analyst***
I'm going to ask sort of the 2 combined, because I think they're related, but I wanted to see if you could talk a little bit about your expectations for India. I picked up the comment from Gary on the quarter at $64 million. I think last year, you were about 2% of revenues. Just want to get a better sense of the sustainability and outlook for India. And the related question is, more broadly, your thoughts and updates on being able to displace Huawei, not just India but outside China, globally, how you see your position to win share from Huawei versus your competitors?

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Gary B. Smith ***Ciena Corporation - CEO, President & Director***
Simon, let me take the India one. Yes, I think we're beginning to see what we sort of generally anticipated in the industry, which is a strong build-out in India. You saw that in our results. I would expect India to have not just a good year, but probably a good 3 years for us, quite frankly. There's a whole investment cycle there, driven primarily by sort of the 5G build-out. But just generally, the investment there is the fastest-growing internet market in the world, and we have #1 market share and are well positioned there. So we're very positive about India. It's going to be a strong cycle.

And Huawei -- and actually to pick up on Huawei in India and then broaden out the question that you had, Simon. A lot of those decisions have already been made. I think I would characterize India as moving very quickly, relative to other parts of the world on the displacement of Huawei. And we've certainly benefited from that. We've had wins that we're now rolling out, which is direct replacement. I think Europe is the other sort of market area, particularly where they are changing out Huawei. But that is a multiyear process in Europe. And I think we're winning our fair share of that in Europe. And that will continue over the next few years as they replace their infrastructure. Their initial focus was not building with them in the wireless space. The kind of transport stuff is they kind of get into it when they get to it. And they are beginning to get to it, and that will continue.

Other parts of the world are less sort of responsive generally speaking. You look at Africa, you look at Latin America, there's not as much movement to replace Huawei as you see in the geopolitical stuff in -- particularly in Europe and in certain other countries in Asia, too. So that's sort of holding course and speed, I would describe it like that. Simon.

James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
I would add that Huawei has a pretty significant market share in the [pond] area. And that's one of the reasons why it's interesting to us, because we believe that they will have the same resistance in the pond area as they're having in the core of the networks.

Simon Matthew Leopold ***Raymond James & Associates, Inc., Research Division - Research Analyst***
Just to clarify the India comments. I think the prior peak, I think 2018 was about 9% of revenue. So a smaller revenue base. Just wondering, is this business likely to be material enough to not maybe consistently, but at least get close to 10% of revenue? Or is this sort of $64 million-ish a sustainable level? How do we think about that?

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
I think it's possible to grow in absolute percentage terms as a part of our revenue. Now everything else is growing as well and you look at sort of the uptick in switching and routing. And well, you look at the uptick, particularly in web scale, et cetera. So would it touch 10% again? That's probably a little high, but it can certainly be a major contributor to us. There's no doubt about that.

Operator
The next question comes from Meta Marshall from Morgan Stanley.

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Meta A. Marshall ***Morgan Stanley, Research Division - VP***
Great. A couple of questions for me. Just maybe starting on gross margins. Just as you think about the year and supply chain, seemingly releasing a little bit sooner than expected, understanding you're leaving kind of gross margins about the same for the year. But just is there anything that we should think of differently as more new deployments, less supply chain overhead, just anything they consider there? And then second, just given the topical nature of it right now, just wondering how you guys see the AI opportunity for DCI and whether it's relatively small, because it's mostly in data center traffic or whether you think that, that could be kind of an additional growth driver for you guys.

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
Thank you, Meta. Jim, why don't you take the first part of that, (inaudible) the gross margin question?

James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
Well, thanks, Gary. As we've always said, Meta, the most important element of our gross margin historically and for the future is mix. And we have won a lot of deployments and new projects with customers all over the world, including the web scalers, which calls for our new reconfigurable line system. We expect that this year, we will deliver a much higher proportion of what we call RLS, reconfigurable line system, to a bunch of customers and those deployments will have a dilutive effect on our gross margin. It hasn't happened to a great extent so far, but it will happen. And so we think it's going to impact our gross margin to the downside over the next couple of quarters. On the other side, we do think that exception costs which we said last year cost us probably 300 or 400 basis points to our gross margin will begin to come down. And these are the costs that we pay to brokers for components on the broker market as well as higher logistics costs. So it's the combination of a mix shift and these exception costs, which is influencing our margin right now. We did say in Q1, we had a higher percentage of modems, which are higher than average gross margin. We do think that, that percentage of modems will come down a bit as we go through the year and start to deliver RLS. Now for the future, we think that all of these things will tend to average themselves out, and we do think over the next few years, we'll get back to the mid-40s gross margin that we enjoyed back pre-COVID. Gary on AI?

Scott Alexander McFeely ***Ciena Corporation - SVP of Global Products & Services***
Yes, Meta, on your AI question, you're right, the community of interest right now is largely in the back end of the data center. But as you look at sort of those data center architecture is becoming more distributed due to the requirement of having to get more and more power to service the applications and you look at the traffic that AI is going to generate, that's going to have a bleeder effect on the [WAN] side traffic which is a good thing for those of us that are in the bandwidth business, and it will be both, in the web-scale direct networks as well as the service providers that service those web-scales.

The second thing I'd say, there's a lot of interesting dynamics going on in the architectures as people look forward into the future of this AI world inside the data center. And those architectures are starting to yield conversations around where does the coherent technology play [in] those architectures of the future. And you would have saw on our WaveLogic 6 announcement, starting to talk about industry has

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kind of phrased coherent light and the capability being in that generation of technology for us to take advantage and participate in those architectures. So that's a new, [new] space for us. So not necessarily in a timeline of our of our 3-year revenue guidance. But just beyond that horizon, we start to see those opportunities.

Operator
The next question comes from David Vogt from UBS.

David Vogt ***UBS Investment Bank, Research Division - Analyst***
Great. And I apologize if I'm going to belabor the point about backlog and orders. And so maybe, Gary, just for the comments on the call. It certainly sounds like based on the backlog draw that maybe book-to-bill was less than 0.9 in the quarter. Is that correct? And if we extrapolate that trend going forward for the full year, does that mean backlog comes down in the mid-teens based on sort of your expectations?

And then maybe if I roll that forward, is my second question into the 3-year model. Can you kind of square your comments about share gains in optical, if the optical industry is growing sort of mid-single digits? Because if I just take the midpoint of your guide, I would assume that in the back half of your 3-year plan, '24 and '25, Ciena revenue would only be growing around 6%. So I just would love to get some clarity on that.

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
Okay. Sure, David. First of all, on the backlog, no, that isn't the right assumption. It was more than 0.9 for Q1, it was about that. Backlog for the year end, as we've said, I think everybody needs to get their head around the fact that we're not going to have 25% order growth year-on-year and the specific dynamics that have built up to that. And we expect to go into '24 with a bigger backlog than we would normally take into any fiscal year. So that backlog is still going to be very strong. The focus right now is to ship the backlog that we have and to reduce our lead times. If you look at the -- we gave a 3-year guide, a CAGR over that. We only gave it last quarter. So we're 36 months out into that. And I don't know as many companies that give that specificity. So we're very confident around a 10% to 12% growth in that CAGR.

Obviously, we're having an outsized year this year as we shipped the backlog. But if you look through all of that and the dynamics around various quarters and even various years, that's very strong, 10% to 12% in a market that's growing at about 5%. And that has typically been what Ciena has done for the last decade or so. And given the leading technology that we have, given the investment profile and scale of the customers that we have, that, we think, is a very, very strong performance. And so I think -- I don't know many companies of our size in our space that are talking about a midpoint of the range of 21% for the year.

James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
And just to be clear, our future has not changed. We still feel great about our position in the market and our ability to grow. We did give a range, David. And so to jump quickly to a mathematical equation, there is probably not the right idea in this time of turbulence and change. We feel great about our ability to

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grow faster than market.

Operator
Next question comes from Amit Daryanani from Evercore ISI.

Amit Jawaharlaz Daryanani ***Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst***
I guess, Gary, maybe towards end of what you were talking about on the backlog dynamic, is that the way to think about where do you think your backlog exits this year? And I think historically, you've talked about if memory serves me a backlog number in a normalized range should be in the $750 million to maybe $1 billion range. How long does it take you to get to that normalized backlog? Is it a '24 process or much beyond that as well?

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
Amit, the honest answer to that is I honestly don't know what the new normal is going to look like. And I think the dynamics of this are largely driven, resulting not necessarily by demand. Demand has been very consistent and is very solid. It's by the ability of lead times to meet that demand. And so lead times in this space, even in very large infrastructure projects, were 10 to 12 weeks. I'm not sure they will return to that level for that kind of product. For the access and the edge and the rest of it, absolutely, 2 weeks or whatever the dynamics should be around that. But I'm not sure of what the new normal will look like for that and when that new normal absolutely kicks in, because you've still got volatility around the supply chain. It's getting better, there's no doubt about it, that's great.

So it's very difficult to predict exactly when we'll get back to some kind of new normal and indeed, even, Amit, what that new normal might look like. But it will be better lead times than we're seeing right now. There's no doubt about it. And that will reflect in carrying a lower backlog into the business. And that's the same for sort of everybody in this space. It's a little bit different for us in that we had enormous amounts of backlog because of the new wins that we had in the sort of '19 to '21 timeframe that have now translated into orders and backlog. So that's what gives us fantastic visibility over the next 12 months or so.

Amit Jawaharlaz Daryanani ***Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst***
Got it. And then if you could maybe spend a minute talking about -- I think about the 20%, 22% growth rate. You talked a fair bit about APAC and India doing fairly well. How do you think EMEA stacks up for the year from that growth perspective, you sort of think about it? And then I think (inaudible) quote is a little bit weaker there versus the rest of the geos. So maybe just touch on what are you seeing in EMEA for the year? That would be helpful.

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
Jim, do you want to take that?

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James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
We believe that all of our regions are going to grow pretty meaningfully this year. EMEA is going to grow. I'm not sure that it's quite at this company average, but it will grow very significantly in this year. India is probably going to grow above average, web-scale, well above average.

Operator
Next question comes from Jim Suva from Citigroup.

James Dickey Suva ***Citigroup Inc., Research Division - MD & Research Analyst***
Congratulations. My question is a little bit on gross margins. You'd mentioned that -- I think you said lower -- I'm sorry, around low 40% range. I want to make sure that I understood it correctly, you're not saying 40%. You're just kind of saying lower part of 40%, because I believe your range for the full year is 42% to 44%. But with this long backlog and lead times, should you have kind of more visibility in pricing power? So is it just less modem shippings that you're going to be experiencing in the next quarter? Or why would the margins potentially come in lower? Or maybe I just misheard that.

James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
It is low range -- low 40s, not below 40%. Now look, there's a range in gross margin, and mix can change. But our expectation is low 40 percentages. So what is that? 41%, 42%, 43%, I don't know. But it's some number like that. And it is absolutely related to a mix change toward line systems and a way for modems, and there's nothing sinister about that. It just has to do with the flow of our deliveries and the fact that, as we said, we won a lot of new projects, a lot of new deployments and they start with line systems. So that's it precisely, and that's why we think it will be low 40s in Q2. We believe that we will average 42% to 44% for the year. I do want to say, though, again, that our expectation is to return to the mid-40s and maybe even beyond that, we'll see but with -- as our business mix changes more. But we've had a lot of change. We've had a lot of exception costs, and we've had this mix shift between modems and line systems, which should equalize over time and get us back to the mid-40s.

Operator
The next question comes from Fahad Najam from Loop Capital.

Fahad Najam ***Loop Capital Markets LLC, Research Division - MD***
I apologize if I'm going to ask you to repeat on the backlog, I hate to revisit it, but it's too early here in the West Coast. So could you remind us what portion of your $4.2 billion in backlog was longer duration, meaning beyond the next 12 months? And then I have [a real] question that I wanted to ask you.

Gary B. Smith ***Ciena Corporation - CEO, President & Director***
Fahad, I can't hear you very well, but I think the question was what percentage going in of the $4.2 billion was outside of FY '23, I don't think we broke that down.

James E. Moylan ***Ciena Corporation - Senior VP of Finance & CFO***
I would say that a lot of it would be taken by customers if we could deliver it to them. A very significant

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percentage of it would be taken, but lead times, component availability, et cetera, are sort of disturbing the situation as we know.

Fahad Najam ***Loop Capital Markets LLC, Research Division - MD***
Got it. Now to my question. On your WaveLogic 6 product announcements, you also announced the WaveLogic 6 nano, the 800-gig ZR, which seems to suggest that if you -- I guess the timeline wasn't announced, but I'm assuming it's first half of '24. And if that's the case, it sounds like you guys are preempting the existing market leaders in the 400 [gig ZR] pluggable market by kind of accelerating the cadence. How big of an opportunity do you see for Ciena in '24, maybe '25 really from ZR, how big of a catalyst could that be to your business, especially in client?

Scott Alexander McFeely ***Ciena Corporation - SVP of Global Products & Services***
Yes, I wouldn't look at it as trying to disrupt necessarily the natural flow of 400 gig ZR. It is the next step that customers that are interested [in 400 gig ZR], expect to take. And there's a whole ecosystem around moving to these generations, including the entire switch fabric has to get upgraded. So we are doing it, because there are some efficiencies of doing it in parallel with our WaveLogic 6 Extreme. And we want to be ready for that market. But I wouldn't necessarily think it was driven by trying to disrupt the 400-gig ZR market. We just think it's the natural evolution for our customers that play in that space.

Gregg M. Lampf ***Ciena Corporation - VP of IR***
And thank you, everyone, for joining us today. Especially, again, as Jim said, those of us on the West Coast at OFC, we're looking forward to meeting with a lot of you in the next couple of days and we'll see you then. Thank you very much.

Operator
Conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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