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PRESENTATION

Operator

Good day, everyone, and welcome to the Ciena Corporation unaudited fiscal second quarter 2013 conference call. This call is being recorded. At this time, for opening remarks and introductions, I would like to turn the call over to Ciena's Vice President of Investor Relations, Mr. Gregg Lampf. Mr. Lampf, please go ahead.

Gregg Lampf - *Ciena Corp - VP IR*

Thank you, Shannon. Good morning and welcome to Ciena's second quarter 2013 review. With me today is Gary Smith, CEO and President; Jim Moylan, CFO; and Tom Mock, Senior Vice President Corporate Communications. This morning's press release is available on national Business Wire and Ciena.com. We've also posted, to the Investor section of Ciena.com, an accompanying investor presentation including certain highlighted items from this quarter being discussed today as well as our historical results. As was the case with our recent posting of supplemental segment data, we intend to continue to use this site as a vehicle by which to communicate important information to our investors. In our prepared remarks, Gary will discuss Management's view on the quarter and the market and Jim will offer some color on future results and provide guidance for Q3. We'll then open the call to questions from sell-side analysts taking one question per person, with follow ups as time allows.

Before turning the call over to Gary, I'll remind you that during this call we'll be making certain forward-looking statements. Such statements are based on current expectations, forecasts and assumptions regarding the Company that include risks and uncertainties that could cause actual results to differ materially from the statements discussed today. These statements should be viewed in the context of the risk factors detailed in our most recent 10-Q filing. Our 10-Q is required to be filed with the SEC by June 13 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. Today's discussion includes certain adjust, or non-GAAP measures, of Ciena's results of operations. A detailed reconciliation of these non-GAAP measures to our GAAP results is included in today's press release available on Ciena.com.

This call is being recorded and will be available for replay from the investor section of our website. Gary?

Gary Smith - *Ciena Corp - President & CEO*

Thank you, Gregg. Good morning, everyone, and thanks for joining us again today.

This morning we announced strong Q2 results including revenue growth that exceeded expectations. Our performance in the quarter contributed to a very successful first half of 2013 for Ciena, one in which we continued to make good progress towards achieving our long-term financial model. We are outperforming the market as a direct result of our strategy to address a fundamental shift in network architecture that we believe is now fully under way. Over the past several years, we've positioned ourselves to take advantage of the long-term opportunity that that shift represents.

In fact, we've designed the Company specifically to be able to lead this period of architectural change as the network specialist with global scale, a strategy that is working and winning in the marketplace. Just this quarter we announced key projects with major network operators including BT and CenturyLink as we become an increasingly strategic partner with greater penetration across global accounts. We are seeing that market momentum translate into steadily improving financial performance. With the long-term opportunities that this architectural shift creates, we believe will continue to grow faster than the overall market and drive greater operating leverage from our business.

Given that, I'd like to take a moment to address what's driving this fundamental shift. Basically, the architectural changes taking place in the network today are all driven essentially by the end user. Service demands are different today because the behavior of businesses and consumers has fundamentally changed. Therefore, what they need from the network has dramatically changed as well. For example, networks are now being impacted by tremendous growth in cloud computing, mobility, and machine-to-machine applications.

Profound and highly disruptive movements that are only just beginning. According to industry analysts, infrastructure as a service is now the fastest growing cloud service. Mobile data volumes are expected to continue to increase dramatically in the very near term. Machine-to-machine connections are forecast to reach $24 billion over the next several years.

On their own, each of these trends has significant implications on the network. When taken in aggregate, it means networks now require unprecedented levels of convergence, automation, capacity, openness, and software intelligence. As a result, our customers are now beginning to evolve how their networks are architected and managed. Let me be clear. This isn't about a single technology upgrade. While it may begin with the addition of capacity, this is a fundamental re-architecting of the network with multiple elements to it.

All types of services are essentially moving to a converged network architecture that is underpinned by ethernet as the ubiquitous connectivity layer for all types of traffic. This is a major shift that is supported by other architectural changes, including the implementation of OTN to optimize capacity allocation for ethernet flows, packet and optical convergence for much greater efficiency, 100 gig scale and beyond to handle the sheer volume of connections, and software defined networking to make those connections as flexible and as valuable as possible. The importance of that software intelligence continues to grow. With so many different types of connections, networks must be programmable and automated in order to efficiently cope with their volume and variety. Furthermore, networks have to become open so they can respond to requests made directly by applications using the network.

All of this is significant change and it has led our customers to begin multi-year programs to re-architect their networks. In turn, that means multi-year opportunities for Ciena, and we've developed our open architecture to address those opportunities. In fact, the entire Company is designed to take advantage of this architectural shift. It starts with our customer engagement model, which serves as an important differentiator for Ciena. Through close collaboration, consultation and continuity in our team, we've established unparalleled levels of customer intimacy and trust.

As a trusted advisor, we are partnering with our customers, including some of the world's largest and most forward-thinking network operators. We are not just working with the network architects. We are now teaming with our customers' product development organizations, to help them define and create new services. We are working with their marketing teams to help bring those services to market. This engagement model puts us in a position to better understand our customers' business and anticipate future network needs.

With this level of firsthand knowledge, we built our open architecture specifically to enable the shift to the next generation network architecture. This architecture has really guided our strategic investments in what is now the leading portfolio to enable that transition. A portfolio that includes rich software content and network level applications, market leading packet optical convergence and automation, and a dedicated professional services practice to help customers facilitate their network transformation. Our engagement model, our architecture, and our portfolio makes Ciena a truly strategic partner in the you new and evolving industry structure. In fact, 90% of our top 20 customers now buy solutions across our portfolio today, rather than individual products.

One of the reasons why we're able to you address more of our customers' needs is that we are a very different company today in terms of our scope and scale. Let me share with you a few of the contrasts. Entering 2008 we generated revenue of approximately $780 million. Today, having crossed the milestone the of $500 million in single quarterly revenue, we have an annual run rate of over $2 billion. Back then in 2008, Ciena served approximately 300 accounts.

Today, we have more than 1,000 customers worldwide. That base of customers has grown increasingly diverse, both geographically and vertically. Five years ago only 30% of revenue you came from outside the US. Today, over 50% of our sales are in fact international. Back then 12% of our revenues were generated outside the traditional telco space. Now, approximately 25% of sales are to non-telco customers.

As a result of this progress, we are a fundamentally different company today that is broader based and better positioned for today's market. But most importantly, we are now a much more strategic partner, solving customers' long-term business issues, not just their short-term technology challenges. That is supported by the fact that last year we were named a Supplier of the Year at Verizon and have been named a Supplier of the Year at AT&T for two of the last three years. As we continue to expand our influence and our market share, we believe that we are poised to drive sustained, long-term growth and operating leverage.

With that, I'll turn it over to Jim to provide some more detail on our financials for the period. Jim?

Jim Moylan - *Ciena Corp - CFO*

Thank you, Gary. Good morning, everyone. I'll take a few minutes to provide detail on the quarterly results that we published earlier today. I'll be speaking only to non-GAAP results, so please refer to this morning's press release on our website for reconciliations to our GAAP results. At $508 million of revenue, we crossed an important milestone in Q2, with quarterly revenue over $500 million for the first time. In a period of relatively low customer CapEx growth, we have been able to grow and to take market share, in part because of changes in how network operators are allocating their capital expenditures. These changes are driven by the architectural shift away from legacy solutions and toward the essential next gen capabilities that Ciena can provide. These changes are happening regardless of growth trends in overall CapEx. As further evidence, we had another strong orders quarter, and orders were again greater than revenue for the quarter.

Q2 gross margin came in at 42.5%, in line with our guidance. Operating expense in the second quarter was $197 million, higher than Q1. You will recall that last quarter our OpEx came in at $177 million, which was significantly lower than our plan. At that time, we indicated that this was largely due to the timing of certain R&D and real estate activities that moved out of Q1 and that we expected these expenses to move into Q2 or subsequent quarters. Our Q2 OpEx reflects this shift in the timing of those expenses. In addition, Q2 OpEx was impacted by an increase in variable incentive compensation expense. This was the result of our strong financial and operational performance in the quarter and year to date, including order flow and revenues that were higher than plan.

Adjusted operating margin came in at 4%. Our cash in investments ended Q2 at $457 million. During the quarter, we generated $45 million in cash from operations. We paid at maturity the outstanding balance of $216 million on our 2013 convertibles.

I'll now speak to guidance for the fiscal third quarter of 2013. Absent significant changes in exchange rates, our guidance is as follows. We expect Q3 revenue to be in the range of $515 million to $545 million. We expect Q3 gross margin to continue to be in the low 40%s. For operating expense, we expect Q3's adjusted OpEx to be in the mid $190s million range.

We are performing ahead of plan and variable compensation across the Company will be higher in the second half of 2013 than previously expected. As a result, we now believe that our average quarterly OpEx for the remainder of fiscal 2013 will be in the mid $190s million. That said, aside from the incentive compensation component, our underlying OpEx plan for the year remains unchanged. We continue to achieve operating expense efficiencies and we fully expect to be able to drive additional operating leverage from the business going forward.

With regard to other income and expense in the third quarter, we project an expense of approximately $11 million relating to the interest on our convertible notes. We expect our tax obligation for Q3 to continue to be related solely to foreign taxes. As for share count, we estimate Q3's basic share count at approximately 103 million total shares. Diluted share count will vary, depending upon your assumptions about our profitability.

Before we close our prepared remarks, I'd like to emphasize, once again, the changing market dynamics are creating new opportunities and we believe Ciena will be one of the long-term winners. Our ongoing success does not hinge on minor fluctuations in carrier CapEx. Ciena's success depends more upon where customers are choosing to spend their budget as they embark on their long-term programs to implement architectural change. We are confident that we have differentiated and positioned Ciena not just to participate across multiple facets of this process but to lead those changes with our customers. By design, we are already a much different company today than we were five years ago. We believe that the architectural shift will accelerate further change, including a broader role and greater reach for Ciena in the new industry structure. As a result, we would expect to see improvement in gross margin and in operating leverage over time.

That concludes our prepared remarks. Shannon, we'll now open up the line for questions.

QUESTIONS AND ANSWERS

Operator

The question-and-answer session will be conducted electronically.

(Operator Instructions)

Kevin Dennean, Citi.

Kevin Dennean - *Citigroup - Analyst*

Congratulations to you and the team on a great quarter and guidance.

Gary Smith - *Ciena Corp - President & CEO*

Thanks, Kevin.

Kevin Dennean - *Citigroup - Analyst*

I have one quick housekeeping clarification and then really a longer term question. On the housekeeping clarification, Jim, you and the team have done a good job on keeping a lid on OpEx. You've told us for a while now OpEx would have to drift higher with sales. Can you talk a little bit about specifically what portions of R&D -- of OpEx should move higher in concert with sales? Are we going to see a relatively tight lid kept on R&D and it's mostly sales and marketing, which should understandably move higher with sales or should we think about the entire OpEx pie maybe having to grow a bit here?

Jim Moylan - *Ciena Corp - CFO*

I think the element of OpEx which will most closely correlate with sales -- with revenue is the sales and marketing line, as we said, because we'll have to continue to put feet on the street as we expand our reach and our role, for that matter. We do intend to hold as tight a lid on the rest of OpEx as we can. I think there could be some movement in the other elements because, if no other reason, because we have inflation. I do believe that we will continue to increase our operating leverage as we move you through time.

Kevin Dennean - *Citigroup - Analyst*

Great. Thanks. Gary, a quick question for you. You talked a lot about how the cycle's not just a capacity buy but a cycle driven by architectural shifts. Can you give us a sense for where you think your customers are on this shift, and particularly in the US? Verizon and AT&T, do you think we're still in the early innings of their deployments of 100 gig and OTN and Converged Packet-Optical? Lastly on Europe, how are you feeling about Europe, given some of the increased chatter on the regulatory front?

Gary Smith - *Ciena Corp - President & CEO*

Thanks, Kevin. I describe it as these overall shift is one of the multi year and it's a multi year opportunity for us. I think, in terms of US sporting parlance, what innings are we in from a baseball point of view, I still think we're in the first or second innings here. I think it varies, carrier by carrier, but I think the US are into that first from an overall architectural shift of stopping spending money on legacy and really directing to the new world architectures. But, I think we're also seeing that in certain other forward-thinking carriers around the world as well. Specifically to Europe, we would actually describe it as stabilized over the last few quarters and we're actually seeing opportunity in Europe. I think, really, that's more of an artifact of not the economy but really I think the industry structure, which is coming to our favor. We are seeing opportunities that we've not seen before in Europe, largely as a result of the industry structure.

Kevin Dennean - *Citigroup - Analyst*

Terrific. Thank you very much.

Operator

Mark Sue, RBC Capital Markets.

Mark Sue - *RBC Capital Markets - Analyst*

Gentlemen, if I could parse the near-term revenue strength and also the outlook, what component of that is really related to just recognizing the strength of the bookings that we saw over the last 12 months? Or, are we adding and refilling the funnel as well? Maybe if you could give us a sense of how your backlog is growing and how you feel about your overall run rates going forward? It does seem that a lot of the opportunity are still in the early days.

Jim Moylan - *Ciena Corp - CFO*

Yes, with respect to the latter point, Mark, definitely we're in the early days. As we think about our order book, as I said, we had a very strong orders quarter. Our backlog grew. We said last quarter and earlier in the year that it looked to us as though this might be the year in which the North

American service providers started to build out their architectural change and we've certainly seen that in our results. As you saw, we had nice growth in our US business and we had two 10% customers. So, that part of the situation is sort of unfolding as we expected. We still have a very strong backlog and we expect our backlog to continue to build.

Mark Sue - *RBC Capital Markets - Analyst*

That's helpful. Then, recognizing that Ciena's quite different from where it was five years ago, you have assembled some assets. You have expanded your product portfolio. What is its influence on gross margins going forward? I understand directionally you want to improve that, such as the scale, the mix, are those things conducive now for steady improvements in gross margins? Maybe if you could share with us your targets and the working efforts to get your margins higher on the gross margin side?

Jim Moylan - *Ciena Corp - CFO*

Yes, let me start the answer and I think Gary has some thoughts as well. One thing I'd I say, as we've talked about our results over the past year or so, really, is we've been an attacker in a number of markets and as an attacker we have had some upfront costs. We helped customers with their switching costs. We had early discounts and we had lab gear, et cetera. All of those things influenced our margin going forward, in addition to a continued very competitive environment for these new builds. I won't say that all of that is behind us, because we continue to attack where we see opportunities and so we'll continue to see some of that. I would just say, though, that we are seeing an increase in some of those accounts in the build outs, the cards and things that follow the initial roll outs and that's helping. Over the long term, as we've said before, the key to our margins is a change in the mix.

Gary Smith - *Ciena Corp - President & CEO*

Yes, Mark, I think if you look at it from a long-term point of you view, as Jim was saying, I think we've now got this critical mass around an established base of these major carriers and their new builds. I think you've seen an improvement in the last few quarters in the gross margins. We were below 40% for a couple of quarters last year and I think we're unlikely to see that again. Generally, we see in the low to -- low 40%s for now, but our aspiration, clearly, the next milestone for us is to get to a sustainable mid-40%s gross margin. Which we believe the product mix that we're now expanding, particularly with OTN, the tight packet convergence and the increasing amount of software and applications that we're putting into the marketplace, should all be positive factors to our overall gross margin that should get us to that sustained mid 40%s over time.

Mark Sue - *RBC Capital Markets - Analyst*

Thanks. That's helpful. Thank you. Good luck, gentlemen.

Operator

Tal Liani, Bank of America-Merrill Lynch.

Eric Ghernati - *BofA Merrill Lynch - Analyst*

Hi. This is Eric Ghernati for Tal. Congratulations as well. Gary, just a question, since your backlog is building and your order book is clearly strengthening, specifically in the US, just curious to share your thoughts with us as far as directionally going into the back half of the year? How do you think your revenue and your order prospects with your tier one service provider customers in the US look like directionally? Also, like what you're seeing going to the back half as far as European customers go? Thank you.

Gary Smith - *Ciena Corp - President & CEO*

I'd, obviously, expect it to have a stronger second half than first half, given the guidance we've given for Q3. We expect that both from a revenue point of view. I'd also expect that from an order point of view as well. I expect us to continue in the second half to build backlog. We're seeing a number of wins in the marketplace that have yet to translate to full order flows, so we're encouraged by that. To your point, whilst we're talking, and Jim mentioned, it's pleasing to see the North American carriers really now beginning to execute on a lot of their next generation plans, we're also seeing that from certain carriers around the globe as well. Both within some of the emerging markets, Brazil, Russia, India, Middle East, we're seeing good opportunities for growth there as well and with similar kind of network architecture shift. Our coverage as a company is much more extensive than it was, so we're really designed around making sure we exploit those opportunities internationally as well.

Eric Ghernati - *BofA Merrill Lynch - Analyst*

Just one follow up. Clearly, 100 gig becoming more and more important going into next year. The competition is clearly going after the opportunity as well. How do you see the competitive landscape as far as like design win share and position at tier one, both in the tier one customers, both in US and abroad? Thank you.

Gary Smith - *Ciena Corp - President & CEO*

I'd describe 100 gig as one of the essential components for this next generation architecture, along with OTN, converged packets and very tightly aligned software architectures as well. I think it's one of the key components. We're clearly have market leadership in that space in terms of revenues and tier one wins and overall capacity that we're now deploying on a global basis. We're seeing a strong uptick in 100 gig. We expect to see that continue and also spread into other areas of the architecture. We've got WaveLogic 3, which is our third generation platform. Many of our competitors are struggling to get their, frankly, their first generation fully operational in the marketplace. We've got a lot of features and functionality and in fact software intelligence that is part of WaveLogic 3. So, increasingly more smart photonics there that we're able to leverage. We feel very positive from a competitive position around 100 gig, particularly when you encompass it with the complete solutions you're putting together around OTN, controlled playing, converged packets and then the software architecture approach that we have.

Jim Moylan - *Ciena Corp - CFO*

Yes this is an architectural shift. You have to have all the elements that Gary just described really to be a winner here. Just having 100 gig solution is not enough.

Tom Mock - *Ciena Corp - SVP Corporate Communications*

One thing I would also add to that, too, is that we're now seeing 100G across all domains in the network and one of the ways you can get to those other domains in the network is to have the bigger architectural components that Jim and Gary talked about. That's really what let us move from the Core into the Metro and also into the ultra long haul in under sea markets.

Eric Ghernati - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Ehud Gelblum, Morgan Stanley.

Ehud Gelblum - *Morgan Stanley - Analyst*

Couple of things. First of all, one on the diversity of the customer mix. Gary, it really sounds as though in your order flow you're seeing a much more diverse set of customers, TNV's obviously in North America are doing very well for you, grew to almost one-third of revenues. When you back out the growth that you're seeing from them, which is almost about 23% year over year, is what I calculated, it looks like your other carriers, sales to other carriers were pretty much flat on a year-over-year basis. So I'm wondering in the order backlog are you seeing bigger growth? Can you give us some sense of the composition of that order backlog, just to see some of those deals that you're talking about? Or are these still prospective things and the order backlog looks very similar to your regular revenue right now? Then, I have a follow up. Thanks.

Gary Smith - *Ciena Corp - President & CEO*

Without getting to sort of granularity of that from a disclosure point of view, I think we're seeing good diversity around the customer base, with much broader base of customers right now. The other point that I would make is that even within the large customers that we have, we have much greater diversity in terms of the engagement with them, meaning depending on how you want to talk about it, multiple domains, multiple platforms, multiple different parts of the customer we're now engaged with. The nice thing about that, it gives us much more balance and breadth as a business, as those deployments ebb and flow, depending upon the particular part of the architecture that they're transitioning. Even within the large customers, we've spread out considerably to where we are and as I mentioned in my comments, we're now truly a strategic vendor, too. I include things like professional services in that as well and consulting.

To your point around the strength of North America, I'd reiterate that you haven't seen all of the strength of the international piece. We've got a lot of large international projects, I think it's fair to say, in backlog and also being deployed and also in terms of opportunities. So, we do expect the overall balance of our business to continue to be about 50% in international over time, which, again, gives us much more breadth as a business.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay. Great. A follow-up to either you or Jim. With the new way of reporting, I was looking to try to get some granularity or just some detail on the Converged Packet-Optical piece. Can you give us a sense as to how 5400, 5300 did? How CoreDirector did? On the 6500 last quarter, I think you said the 40 and 100G together were 60% of revenues? Can you give us an update on that number? Did it climb? Is it now up to 80%, 85%? Whatever clarity you can give between CoreDirector, 5400 and 6500 in detail would be great, just to understand how each one grew?

Jim Moylan - *Ciena Corp - CFO*

We disclosed our Converged Packet-Optical the 6500 was $244 million, $243 million. So, the remainder, of course, is a combination of mainly CoreDirector and 5430. That's the progress. We do expect the standalone switching business to be up in this year and in the second half over the first half. We're continuing to add 5400 customers. We added two new customers in the quarter. So, there's some detail. I would say this, that we continue to show growth and interest in the idea of embedding and integrating switching in our 6500 platform and that's all about convergence. I do think that these categories will become a bit more blurred as we move through time, but again, on a standalone basis, we think our switching business, standalone switching, will be up in 2013 and in the second half as compared to the first half.

Operator

Kent Schofield, Goldman Sachs.

Kent Schofield - *Goldman Sachs - Analyst*

To follow up on the gross margin side of things, you disclose you have your top two customers at 31%. You have 25% or so outside of the telco domain, and then that leaves a good piece besides that. I was wondering if you could talk about, besides just product mix, how we should think about gross margins across those three buckets?

Jim Moylan - *Ciena Corp - CFO*

That's the kind of detail, Kent, that I don't -- we're not going to provide. I'd say this, that generally speaking, our margin structure, as we said before, is a function mainly of mix, so that where we're selling more of our higher software content products are more software, we get higher returns, just because these are stickier products which are more embedded into the customer's operating systems. The other thing I'd say is that much of the margin differential depends upon where we are in the relationship cycle. If we're attacking in an area where we are not incumbent, then we're going to see lower margins. But that's what the intent of gaining margin over time as we sell broader product mixes and as we turn into cards as compared to initial comment. Those are the general things that we see across our margin structure.

Kent Schofield - *Goldman Sachs - Analyst*

Okay. Understood. Maybe just then a follow-up on the cash flow side of things. It was up nicely, Q on Q, but down year on year. Looks like in part due to accounts receivable. How should we think about that throughout the rest of the year? Should we expect some improvement on that side of things?

Jim Moylan - *Ciena Corp - CFO*

Yes, you should. We do intend to drive cash for the full year. We had a good quarter in both inventory and in our collections for the quarter. I think we'll continue to do that for the rest of this year. As our profitability increases through time, we intend to be a very consistent provider of cash to the balance sheet.

Kent Schofield - *Goldman Sachs - Analyst*

Thank you.

Operator

Scott Thomson, FBR Capital Markets.

Scott Thompson - *FBR Capital Markets & Co. - Analyst*

Could you expand a little bit on the impact of the converged? There's $11 million in interest expense. There's some share, at least in the diluted line, some share give and take. Can you comment a little bit more on that and what to expect, what happened this quarter and what to expect over the next couple?

Jim Moylan - *Ciena Corp - CFO*

Sure. We paid off $216 million of the convertibles, which came due in May of this year. We still have on our balance sheet $1.2 billion of convertibles. They mature at different periods, starting in 2015 and extending to 2020. Of the $1.2 billion, about $700 million convert at around $20 per share. It would be our hope that much of that set of debt will convert into equity over time. As we talked about a couple of quarters ago, we did take the opportunity to extend out the maturity of the 2015 -- half of the 2015 note out to 2020. If you look at what we have over the next several years, we have essentially one maturity of $187 million. It converts at around $20 a share. We're very comfortable with our balance sheet situation as we sit here today.

Scott Thompson - *FBR Capital Markets & Co. - Analyst*

Okay. One quick follow-up to that on the architectural shift that you guys are talking about. You talked to the low-end guys at some of the carriers and you hear them talking or chattering a little bit about this. You talk to the high-end execs and you hear them chattering about it. You don't hear much at the mid levels. Can you comment a little on maybe why that is and if this changes are being driven down from the top down, or is it a full change across all levels of these organizations?

Gary Smith - *Ciena Corp - President & CEO*

Scott, I mean, I think the drivers to it are multifold. It's driven by economics. It's driven by fundamental competitive things that are going on, driven by businesses and consumers and changes to the end users. So, it's economics. It's the operations of these networks are changing dramatically. I would say that it's certainly well known and expressed and being driven by the senior executives of the major carriers. Our experience is, it's also well understood and embraced through all levels of the organization and frankly these organizations are going through dramatic change as a result of this and they are very complex, large enterprises and it takes a while to affect that change. I think we're finally seeing the real tangible results of some of that, again, at the early stages. Scott, it does impact everybody within these major operators.

Scott Thompson - *FBR Capital Markets & Co. - Analyst*

So sounds like the change is happening, just a little fuzzy on exactly in which areas and what timing but it's also in move.

Gary Smith - *Ciena Corp - President & CEO*

It's definitely moving and I think -- so if you ask me a single question around why are we growing faster than the market and very simply why are our revenues up, I'd say this change is beginning to happen now. It's taken longer than I think we would have all anticipated, but Ciena is specifically designed to exploit this and I think the reason that we're growing faster than the market is absolutely the fact that you're now seeing this change happen.

Tom Mock - *Ciena Corp - SVP Corporate Communications*

Couple of data points you might use there, Scott. You heard AT&T talk about their Velocity IT program, which is a multi-year shift in how they connect to their customers. You're also seeing very rapid growth in ethernet business services, which is another symptom of how the network is changing.

Scott Thompson - *FBR Capital Markets & Co. - Analyst*

Okay. Thank you guys.

Operator

Paul Silverstein, Cowen & Company.

Paul Silverstein - *Credit Suisse - Analyst*

Can you hear me?

Gary Smith - *Ciena Corp - President & CEO*

We can hear you, Paul.

Paul Silverstein - *Credit Suisse - Analyst*

I'm going to apologize if these questions were already asked. I've been off and on all morning. I do apologize. One, did you all give the percentage of revenue that was 40/100 gig? I know you told us the switching, but did you give us the 40/100 piece as a percentage of total transport or percentage of total revenue?

Jim Moylan - *Ciena Corp - CFO*

About 70% of our WDM revenue is coherent and that's 40 and 100 gig, Paul. By the way, welcome back, Paul. It's good to hear your voice.

Paul Silverstein - *Credit Suisse - Analyst*

You're very kind. I appreciate that, Jim. It's good to be back. Secondly, and again I apologize if this came up before. Going back to a question that was asked earlier on the depth and breadth of the strength that you're seeing both in the quarter and looking ahead, I know there's some concerns in the Street about Verizon in particular, and I appreciate that there's only so much you want to say about any one customer. The checks might suggest that -- I think Verizon stated publicly in terms of using you for 100 gig long haul or 100 gig metro, OT switching and some other stuff. I don't even think the metro's started yet. If we look bigger picture, I don't think there's been much 100 gig metro to date. The question that I have for you is can you give us any insight as to how much of that particular build, and more generically looking across your customer base, how much 100 gig metro has been done to date?

Jim Moylan - *Ciena Corp - CFO*

Sometimes it's hard for us to tell exactly where the equipment's been going in. One of the things we've been working on 6500 is to try to make a platform that can be used in a variety of different applications. We're seeing deployment of 6500 subsea, ultra long haul, long haul and metro. With respect to Verizon in particular, I can't comment on them specifically, but we did talk about 6500 going into the metro network of CenturyLink. You are starting to see 100G make its way into metro networks in the US and globally.

Paul Silverstein - *Credit Suisse - Analyst*

Tom, would it be fair to say it's still very -- that metro -- those metro deployments of 100 gig are fairly early? They can't be that far into them.

Tom Mock - *Ciena Corp - SVP Corporate Communications*

Definitely, Paul. The first deployments, as always, are in the core of the network because that's where the traffic cross section is greatest and it usually works its way out into the metro. We are in the very early days of that.

Paul Silverstein - *Credit Suisse - Analyst*

One last question, if I may. On the Metro piece, is it fair to say that -- again, I recognize it's early, but the Metro should be two to perhaps five times as large as a general proposition as the long haul build outs?

Tom Mock - *Ciena Corp - SVP Corporate Communications*

Metro, generally is, as a market, a bigger market than the core of the network. If you talk to industry analysts, they'll give you a number that's probably toward the lower end of your range rather than the upper end of your range. One of the things that is happening as part of this architectural shift is how people think about the network is in fact changing. They're isn't as much of a hard line between metro and core as there used to be. In fact, what you're really seeing now is a division in the network where people are connecting to essentially content and then content centers are being connected together and that content centers being connected together is a combination of both the metro and the long haul networks. The lines are, in some senses, blurring a bit there. The numbers, if you use the low end of your range, are roughly correct relative to current view on this relative size of the market.

Paul Silverstein - *Credit Suisse - Analyst*

I appreciate it. I'll pass it on. Thanks, guys.

Operator

Simon Leopold, Raymond James.

Simon Leopold - *Raymond James & Associates - Analyst*

I wanted to see if we could touch a little bit on some of the other segments, particularly the CESD business and services, get a little bit more color around the quarter and the trending there? Noting that the PFD business looks real good in this quarter and just wondering should we think about this as a new normal? What's your thought on lumpiness? Then, software and services were just a bit light this quarter in an otherwise good quarter. I would typically think it would move more consistently with the rest of the products, so some color there would be helpful? And just a clarification, you mentioned earlier on the call, 25% of the customer base being non telco. I'd like to try to understand the composition of that 25%, cable, government, web 2.0, how to think about that, because it was a bigger number than I would have guessed?

Gary Smith - *Ciena Corp - President & CEO*

Okay. A lot of questions there, Simon. Let me run through them. First of all, on the Packet Networking, I think it really -- the main driver there is now the ethernet business services. Up until this point, I think it's better to characterize it as predominantly one as backhaul. We're now seeing finally as ethernet business services. It's the fastest growing part of the enterprise data services market. We expect the percentage of revenue coming from this business, ethernet services to increase. Our position is pretty strong in the marketplace, certainly even with wireless backhaul. I think we support about 50% of the fiber fed US towers for backhaul, actually, which we've been able to deploy over the last couple of years. The bet that we placed, which was significant, on the converged ethernet and packet networking space is beginning to pay off. I think we're at the early stages of this shift over from essentially TDM services into the enterprise, into ethernet. That is largely what's in the uptick. I would think that it is, given the nature of that, absolutely sustainable and I would expect to continue to grow this segment of the business.

Tom Mock - *Ciena Corp - SVP Corporate Communications*

One other thing I'd also point out, Simon, is that there are components of ethernet that show up across our portfolio. For example, one of the things we've been working to do now is also get ethernet interfaces and also ethernet switching and integration capability into our transport products.

Jim Moylan - *Ciena Corp - CFO*

And just as a general statement, you have to -- I don't think you should look at any single quarter and compare that to any other single quarter and draw a big conclusion, Simon, as we've talked about in the past. We do have big projects and things can move through our various segments as a result of big projects being recognized in revenue that don't necessarily reflect long-term or short-term trends. But having said all that, the Packet Networking is up significantly. It's up 100% year over year and we do think that that will continue to trend upward from where it's been the last few quarters. Now, on the software and services side, I'd say a couple of things about that. Services, also, is a situation where we can have pretty large deployments in any given quarter as we build out a given project. So, you can see movements up and down in services. However, I think over time you're going to see the trend in services grow because we are certainly moving into areas where our services, particularly our network transformation solutions services, are very attractive to customers and as a valued advisor to our customers we can win there.

On software, a couple of things about that. The amount that we report in our software line is fairly small today. Because it's so small, it can show movements up and down. We do intend to grow that over time. But I'd just make one other statement about that. That number is only a small piece of what we measure as the software content in our products. When we look internally at software content, software is a much higher percentage of our overall revenue. It's just that the way that we have to segment, we end up with a pretty small number in our software. Having said all that, our NMS software is up year over year and we are beginning to bring applications to market, which I think will increase our software line on a standalone basis.

Gary Smith - *Ciena Corp - President & CEO*

Simon, on the --

Simon Leopold - *Raymond James & Associates - Analyst*

And the clarification on the -- sorry, Gary -- the 25% non-telco?

Gary Smith - *Ciena Corp - President & CEO*

Why don't I take that. As you're going down that path, the mix, exactly right, it's cable operated, governments, research and education, some very large research and education networks around the globe, clearly a big requirement to move very, very large amounts of capacity around. The enterprise space is a lot of very high-end enterprises who want carrier class interconnectivity, largely between their data centers. We're increasingly seeing opportunities in that space and also the content delivery network folks as well. So, all of that together is about 25%.

Simon Leopold - *Raymond James & Associates - Analyst*

And what's in that is -- are any particular group like cable or government material? Does any, let's say is government 5%, cable 15%?

Gary Smith - *Ciena Corp - President & CEO*

I would say the largest part of that is probably the enterprise and data center connectivity segment, given what's going on there. We are seeing good opportunities in the cable operator space, particularly with some of the consolidation that's going on in there, obviously some of those customers are quite large. US government, clearly a bit challenging right now, but we are well positioned for some of their future networks as well. Research and education continues to be strong.

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Simon Leopold - *Raymond James & Associates - Analyst*

Great. Thank you.

Operator

Brian Modoff, Deutsche Bank.

Brian Modoff - *Deutsche Bank - Analyst*

A couple questions. Back to the software and services piece then, what you were saying earlier about you think that it becomes more significant as a part of the business. Do you see it growing then as a percent of revenue over time? How does that you affect your margins? Then, looking at the mix of Converged Packet-Optical and Packet Networking, how do you see that mix moving forward? In other words, when do you start to see 400 gig coming into play? Can you talk a little about how you're going to migrate from 40 to 100 to 400 from the standpoint of technology changes? You're keeping the same clock rate, so what are you going to be doing to increase the speeds?

Jim Moylan - *Ciena Corp - CFO*

It's actually hard to make a guess as to the general percent of software and services as a percent of revenue. Let me tell you the things that we're doing. As I said, we are bringing applications software to market and so I believe that the standalone software number in our results will increase as a percent of revenue. Understand, that's a pretty small number today. We are doing a number of things. We're spending a lot of money in developing software and I believe that over time that that will increase, that standalone software as a percent of revenue.

With respect to services, we're rolling out this NTS service that we've talked about, which is Network Transformation Solutions. It's all about acting as a consultant with our customers as a trusted advisor and helping them both modernize and monetize their networks. I would think that services is going to continue to grow. It may grow as a percent of revenue, if we are successful on the NTS side. I will say that if we're successful on NTS, that will probably pull through some equipment. As I say, hard to say. If you're looking at our income statement through the prism of percent of revenue, it's just difficult to project. We think we're strongly positioned in all of those places.

Tom Mock - *Ciena Corp - SVP Corporate Communications*

Brian, as to your question on the migration to 400G and beyond, probably a good way to look at the different things that you can do to get to higher capacity, first thing you can do, and you've seen this with our WaveLogic 3, is you can increase the modulation format. That lets you get more information in a given channel. The other thing you can start to do is pack those channels in more closely together and strap them together. If you look at the announcement we just recently made about what we're doing at British Telecom with the 800G trial, what we've done there is upped the modulation format so we can get 200 gigs in a channel and then we strap a number of those channels together to get additional information down the line. The idea of higher modulation formats is one way we do that.

When we start putting some of these channels together to create what are called super channels, you're going to need to also start thinking about how you make your network gridless, There are a number of things we've been showing our customers here recently the to show them how that can happen in a cost effective way. Lastly, as we do that, we need to be mindful of the fact that all of this needs to exist on the same fiber channels, if you will, as current traffic. So, it needs be able to co-exist with 40 and 100G on the same routes. One of the things we've done in some of the trials we've done with customers as well as some of the demonstrations we're doing at Vectors event up in Canada right now with our major customers is to show them how you can put all those technologies together on the same fiber.

Brian Modoff - *Deutsche Bank - Analyst*

Thank you.

Operator

Amitabh Passi, UBS.

Amitabh Passi - *UBS - Analyst*

I just had a couple of questions. My first question was, just wanted to get a sense of order momentum through the quarter? I apologize if you commented on that. I was just curious, the order bookings trend and as the quarter progressed, any insight you can give both North American, internationally? Perhaps just a bigger picture question, given these architectural shifts with increased Packet-Optical convergence, are you seeing increased competitive pressure from companies such as Cisco and Alcatel-Lucent, both of whom have very strong IT and optical assets?

Jim Moylan - *Ciena Corp - CFO*

Let me speak to the backlog. It's up. I'd say that most elements of our business do have some piece of back-end loading. We generally tend to get stronger third month of the quarter results in a number of different elements of our financial statements. I would say, though, that when we looked at the last quarter, we started off strong and we just continued strong. It was a good quarter. We felt very good about our order progression and we have every reason to expect that we're going to continue to show that kind of order flow.

Gary Smith - *Ciena Corp - President & CEO*

In terms of the converged packet landscape, that's clearly something where we placed heavy bets for the Company and the design point for all our architecture is really built around and that in architecture, really is the driver of that. I would say that, generally speaking, this whole move towards disaggregation with things like SDN, software, et cetera, plays very much to our open architecture, meaning, A, it is open, which our architecture is, and B, you're really looking at the development of a lot of the packet technologies across a converged portfolio. Clearly, we can leverage our worldwide leadership and control playing technology, then becomes critical. The real optical intelligence that we're able to bring to bear on the actual traffic flows with increasing amounts of software, OTN, packaging of ethernet traffic. We actually think we have a real competitive advantage as that architecture gets more and more adopted. Clearly, this pulls us into competition with some larger players, particularly in the packet space, but we think there are distinct advantages around the tool kit that we have in our solution approach coming up as opposed to layer three coming down. We've seen that in a number of wins over the last year or so.

Gregg Lampf - *Ciena Corp - VP IR*

We'll take one more question.

Operator

Rod Hall, JPMorgan.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Just a couple of quick questions. One, international grew pretty strongly. I just wonder if you guys can give us any more color on what drove that? Then secondly, you are indicating that higher OpEx and some optimism around order growth through the end of the year. I think you guys had said 9% to 11% as a target revenue growth rate, you said you'd grow faster than the market. It feels like you're pacing ahead of that number and

-- or at least at the top end of that 9% to 11% range and Metro hasn't even started yet, which we all, I think, agree is a pretty big chunk of revenue. Just wondering, how you're sitting with that 9% to 11% target growth rate at this stage, especially you look into next year? Thanks.

Gary Smith - *Ciena Corp - President & CEO*

Okay, Rod, why don't I take the first part of that. Internationally, we're actually seeing good opportunities and good momentum. A lot of the markets, there'd probably -- would resonate with folks, the big buildout that's going on in Brazil and India and Russia, we're well positioned there. The Middle East as well in certain countries is moving pretty aggressively. We're also seeing opportunities, as I said, in Europe, as well, that with a little unexpected to us, but I think is more really around the evolving industry structure as this architectural shift gains momentum.

Jim Moylan - *Ciena Corp - CFO*

With respect to the growth rate, Rod, what we said is that if you look at what the industry analysts are saying, the growth rate for revenue in our space is expected to be in the mid to high-single digits for the year. We expect, in the context of whatever the growth rate of the industry is, to gain market share. I don't think we've intentionally said anything about 10% growth, but you can sort of get there by inference. So, what I'd say is, that as you can see, we delivered a very strong revenue quarter this quarter. We have guided to pretty good results in Q3. We expect a good Q4. I think our trend line on growth is in good shape and without commenting upon 10% or whatever, we feel good about our revenue trend. It's driven by the fact that our orders have been strong this year and we expect them to remain strong.

Gary Smith - *Ciena Corp - President & CEO*

Rod, the other thing I'd add is a lot of this sort of traditional industry analysis is really looking at this through the optical prism of growth. I think, given the amount of convergence and the changes that are going on, I'd encourage us to think about a -- looking in that through a different broader prism around Converged Packet-Optical. I think as this evolves over the next couple of years, I think you'll see a broader market that Ciena addresses.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Gary, can you just -- can you maybe say a little -- on international I was wondering is it mostly long haul business you're seeing there at this stage or is it long haul -- ?

Gary Smith - *Ciena Corp - President & CEO*

No, it really goes back to this overall sort of shift. We're seeing -- clearly, capacity is a fundamental part of this. But, we're also seeing, certainly in some of the countries that I just talked to, in many cases they want to leap frog to this next generation architecture. They're very focused on things like Packet-Optical, OTN deployments. They're looking at the intelligence of the software on the optical side. I think it's not just driven by 100 gig and pure capacity as we've been saying, even those international markets. I think we're seeing overall on a global basis the shift happen. I would say that probably the North American carriers are probably leading some of this right now, but we are seeing the same kind of architectural shift apparent outside of North America.

Gregg Lampf - *Ciena Corp - VP IR*

Thanks, Rod. Thanks everyone for joining. We appreciate you joining us this morning. We look forward to speaking with you soon and talking with you next quarter.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day.