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PRESENTATION

Operator

Welcome to the Q1 2014 Ciena Corporation earnings conference call. My name is Richard and I will be your operator for today's call.

(Operator Instructions)

Please note that this conference is being recorded.

I will now turn the call over to Mr. Gregg Lampf, Vice President of Investor Relations. Mr Lampf, you may begin.

Gregg Lampf - *Ciena Corporation - VP of IR*

Thank you, Richard.

Good morning and welcome to Ciena's first-quarter 2014 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 investors section of ciena.com an accompanying investor presentation, including certain highlighted items from this quarter being discussed today, as well as our historical results.

In our prepared remarks today, Gary will discuss management's view on the market, and Jim will offer some color on the results and provide guidance for Q2. We'll then open the call to questions from the sell side analysts, taking one question per person with follow-ups as time allows.

Before we begin, I would like to remind everyone of our analyst day at the New York Stock Exchange on April 3. We hope you can join us live or online.

Before turning the call over to Gary, I'll remind you that, during this call, we will make 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-K filing. Our 10-Q is required to be filed with the SEC by March 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 adjusted 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 Corporation - President & CEO*

Thank you, Gregg. And good morning, everyone.

As you've seen in this morning's press release we reported an excellent first quarter that represents further progress and validation of our network specialist approach.

We continue to see the benefits of the strategic decisions we've made over the past several years, as well as our leading market position. Momentum was strong in the first quarter, despite typical seasonality. Our Q1 performance is highlighted by revenue that grew 18% over the year-ago period, and a very good performance on gross margin, strong adjusted operating margin of 6%, and EPS of $0.13.

With consistent execution and ongoing improvement in operating leverage, we continue to make progress towards achieving our long-term operating targets. In fact, we continue to feel good about conditions and trends in our overall market.

We're seeing further evidence of a shift to more converged and programmable networks that are underpinned by open architectures. The accelerating acceptance of software-defined networking is also influencing the direction of network architectures and decisions.

And all of this represents a great opportunity for Ciena. Capitalizing on its multi-year architectural migration depends upon winning the customer network decisions that are being made today. And that requires the ability to bring the right solutions to market now.

Our OTN architecture is designed specifically to address this shift. And as a result, we continue to take share, as evidenced by our number one position in global packet-optical for 2013, according to the Dell'Oro's most recent market report.

And while the initial deployments of this architectural shift may have started in the core of the network, we are now seeing deployments in the metro, as well. One customer that highlights this shift is AT&T, with whom we've begun deployments of 6,500 in the metro. The converge metro market opportunity overall is beginning now and we see metro as a larger global opportunity than the core of the network.

We have this visibility into customer plans due in part to the increasingly strategic nature of our customer relationships worldwide. Our engagement methodology as part of our network specialist approach is helping us expand our role as a trusted advisor with customers around the world.

As you know, expanding our role in customer networks and our reach across markets is a critical element of our strategy, particularly as we pursue this multi-year opportunity. Our recently announced global partnership with Ericsson should further enhance Ciena's role and reach. It also validates, I believe, our best-of-breed packet-optical technology and our strategic positioning.

Through a packet-optical distribution agreement, a converged IP optical joint development and distribution agreement, and an SDN collaboration framework, this partnership creates the potential to increase our addressable market by significantly expanding the role we play in transforming customer networks, as well as our reach in terms of the number of customers to whom we have access.

Early customer feedback has been very positive and we believe this partnership is a leading example of how the market is evolving; strategic partnerships between players who offer specialized expertise working together across the network in an open ecosystem. It's a model that more customers are choosing and it aligns perfectly with our network specialist approach to architecture and collaborative engagement.

We continue to see this specialist approach as a competitive advantage today and over the long term, as it is deeply embedded across every aspect of our business. In fact, it is a fundamental driver of the market's growing preference for Ciena, a preference that is clearly demonstrated in our differentiated performance.

In summary, our network specialist strategy is working in a changing industry structure. Our opportunity beyond pure optical is expanding and we are executing well to take advantage of that opportunity. As a result, we remain confident in our ability to continue to gain market share, whilst absolutely improving the operating leverage.

I'll now turn the call over to Jim.

Jim Moylan - *Ciena Corporation - CFO*

Thanks, Gary. Good morning, everyone.

I'll cover highlights of our first-quarter performance. As always I'll speak only to non-GAAP results. Please refer to this morning's press release for reconciliations to GAAP numbers.

We continue to believe that the adoption of our approach and our increasing diversification are good measures of our steady progress in expanding our role and reach. In addition to the future benefits of our new partnership with Ericsson, we made good progress in both areas this quarter.

In Q1, we saw a strong rate of adoption for both packet and OTN solutions. For example, our first-quarter packet networking segment revenue was up 13% year over year. And packet switching revenue on 6500 was up 15% compared to last year.

Also, we are addressing increasingly diverse high-bandwidth applications. We shipped 3 times more packet capacity on 6500 than we did a year ago, and 43% more packet capacity overall.

We also continued to add customers for our OTN switching platforms in Q1. Compared to the first quarter of last year, we recognized more than double the revenue on our 5400 switching product.

In terms of our financial performance, we saw continued momentum. Our overall revenue was strong at $534 million, representing an 18% increase over the first quarter of 2013. Orders were up 7% over Q1 of last year, and, as expected, were slightly lower than revenue.

As we have discussed before, our customer order flow is typically lighter compared to trend in our first quarter. Overall however, we maintain good visibility into the business. We expect order flow to increase from Q1 and remain strong during 2014.

We're very pleased with Q1's adjusted gross margin. At 43.4%, it was higher than expected, largely as a result of improved mix. Adjusted operating expense in the first quarter was $200 million, coming in lower than expected, primarily as a result of delays in certain R&D projects, which we now expect to occur in Q2. With an adjusted operating profit of $32 million, Q1's adjusted operating margin was 6%.

We ended the quarter with $440 million in cash and investments. We consumed cash in Q1 because we built working capital. This is partly due to a back-end loaded quarter, which resulted in higher accounts receivable, and partly the result of a decision we made to plan for the strong and broad-based order flow we expect during the rest of the year.

We are making a strategic investment to improve the velocity of the business. In response to strong overall customer demand, and our desire to reduce lead times for converged packet-optical products, we made a deliberate decision to increase our levels of finished goods inventory for those products.

We expect to continue to invest in this level of inventory during Q2. While this investment may result in more cash use short term, we do expect it to improve customer service levels and we expect to generate free cash flow for the full fiscal year.

Turning to guidance, for the fiscal second quarter of 2014, absent any significant changes in exchange rates, our guidance is as follows. For fiscal Q2 we expect revenue in the range of $540 million to $570 million.

We expect Q2 adjusted gross margin to be in the low 40%s, lower than Q1. We expect Q2's adjusted operating expense to be in the $210 million range.

As we have discussed in the past, our OpEx spend does include some large project-related expenditures, particularly in R&D. The timing of these projects does lead to some variability in our quarterly OpEx.

And as we stated earlier, some of those Q1 expenditures were deferred to Q2. Therefore we expect OpEx in Q2 will be higher than the average for the year.

That said, we continue to expect that the quarterly average for OpEx during the fiscal year will be approximately $205 million. We continue to expect that OpEx will grow at a rate that is lower than our revenue growth.

With regard to other income and expense in the second quarter, we project an expense of approximately $11 million related to the interest on our convertible notes. We expect our tax obligation for Q2 will continue to be related solely to foreign taxes.

As for share count, we estimate Q2's basic share count at approximately 105 million total shares. Diluted share count will vary depending upon your projections about our profitability.

In closing, Q1 was an outstanding quarter for Ciena and we expect 2014 to be a strong year. We have momentum in the market and we remain confident that we will achieve the low end of our target range of 7% to 10% for adjusted operating margin for the full year.

We are committed to capitalizing on the opportunity before us by expanding our role and reach in the market. And we are committed to continuing to deliver steadily improving financial performance.

That concludes our prepared remarks. Richard, we will now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Tal Liani, Bank of America.

Tal Liani - *BofA Merrill Lynch - Analyst*

Congrats on the good execution. My question is about the comments you made on 2014. You speak about preparations for bigger orders and strong order trend in 2014. Can you give us the nature of these orders? What kind of products are you expecting?

Is it in the high-margin bracket, low margin bracket? What is the nature of it? Are these 100-gig migration projects, or it's more Metro, just to understand the composition? Thanks.

Jim Moylan - *Ciena Corporation - CFO*

Yes, Tal. Thanks. It's really very broad-based. We expect strong orders across the product portfolio, both on the converged packet-optical side and the packet networking side. So, really, it's very broad-based. It's US and International.

We did mention that we've begun Metro deployments with AT&T. And we expect that to continue for the year.

One thing I'd say just as a point that sometimes get asked, we have now over a hundred 100-gig customers and 170 Coherent customers overall. So we continue to make progress and gain customers for our flagship transport products.

Again, just an overall strong order quarter for the year. I would say that the decision that we made about inventory related specifically to converged packet-optical, because over the past several quarters, we have seen higher demand in the quarter than we projected and that we built for.

Tal Liani - *BofA Merrill Lynch - Analyst*

Okay. So, if I ask the same question in a different way, is your visibility or your confidence level into 2014 better than the confidence and visibility you had last year in the same point of time? I'm trying to interpret your comments and your willingness to spend money on inventory. Is this a sign of increased confidence of the trends and some deals that are close to be closed or be signed, et cetera?

Gary Smith - *Ciena Corporation - President & CEO*

Tal, this is Gary. Yes, I would say if you ask the direct question we're more confident now than we were 12 months ago as we come through. I think the answer to that is yes.

We've seen a steadily improving environment and our execution I think we're confident in. So, I think we are in a stronger position now than we were 12 months ago. Hence, I think we're comfortable making this kind of investment in the business.

I would also say that we're confident in our ability to drive the operating leverage from this too. So I think all of those elements come together. I would reiterate what Jim said. It is very broadly based.

I think we are seeing a shift towards the Metro. We mentioned AT&T, we got CenturyLink, there's other customers there, as well. So, I think expanding our role and reach now, I think, is absolutely appropriate.

Tal Liani - *BofA Merrill Lynch - Analyst*

Excellent. Thank you, guys.

Operator

Amitabh Passi, UBS.

Amitabh Passi - *UBS - Analyst*

Jim, just a clarification on the gross margin guidance. Can you give us any help, if we looked at it on a year-over-year basis, do you expect fiscal Q2 gross margin to be higher than last year, in line, slightly lower? Just any help there.

Jim Moylan - *Ciena Corporation - CFO*

As we've said before, Amitabh, gross margin is a difficult number for us to call because there are so many moving parts, and things move in and out of our quarter in a way that's difficult to project. Finally, when you look inside the margin inside the products, and look at the various elements in there, whether it's cards or chassis, it's just very difficult to project.

We think based on what's going to happen in Q2 and what the backlog looks like that we will be down from Q1. But overall, we feel good about the long-term trend in our margins. If you think back to everything we've said about what's happening in our business, we've said we're going to drive operating leverage.

We think that we will drive operating leverage this year. If we get gross margin improvement, then it will be even better. But we don't necessarily have to have gross margin improvement in order to drive operating leverage this year.

Amitabh Passi - *UBS - Analyst*

Just as a follow-up, I wanted to clarify your commentary around the 100-gig ramp at AT&T in the Metro. Was this the first quarter that you actually started ramping or is this something that's been now going on for a couple quarters?

Gary Smith - *Ciena Corporation - President & CEO*

I think specifically to the Metro, we called out that we are beginning that deployment with AT&T in the Metro. We're actually beginning it with a number of other customers, too, in terms of CenturyLink.

We've not specifically said that it's 100 gig. But of course 6500 is, of course, 100-gig capable. In fact, in certain aspects of the Metro it's 400-gig capable, depending on the distance, even with the current iteration of WaveLogic.

So I think it's really we intended here to highlight there's a number of tier ones now moving out from the core into the Metro deployments. These decisions are being made this year. We're actually seeing real deployments for this kind of converged architecture out of the Metro.

Amitabh Passi - *UBS - Analyst*

Okay. Thank you. I'll jump back in queue.

Operator

Subu Subrahmanyan from The Juda Group.

Subu Subrahmanyan - *The Juda Group - Analyst*

I wanted to ask about the packet portion in the 6500 that you're shipping. You referred to that in the past. I just wanted to get a sense, Gary, of how much over OTN is really the packet functions, ethernet, MPLS in the 6500 today.

Then, Jim, on the operating margin comment, I wanted to clarify. It sounds like you're suggesting that the 7% to 10% to be at the low end of that. Do you still through the year expect that low 40% gross margin? Is that a fair characterization?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Subu, this is Tom. Maybe to start with the packet questions on 6500, we are seeing the packet content in that product line increase. In fact, it's up this quarter over last year.

Historically recently, about 25% of the systems we've been shipping out are packet capable. We're seeing that trend continue and, in fact, increase as we move into the Metro.

Gary mentioned as we move into the Metro that convergence is more important. That, in fact, is true. As you get closer and closer to the end-users, having that capability built into the platforms in the Metro becomes more and more important.

Jim Moylan - *Ciena Corporation - CFO*

Yes. On the operating margin comment, I just want to clarify, our guidance that we gave last quarter and that we have reiterated now, is that the full year will show a number for adjusted operating margin in the low end of our range. We're still confident about that. There's going to be quarterly fluctuation, as there always is, in the numbers in our income statement.

We've always said that the best way of thinking about us is over half years or longer periods of time because there's going to be quarterly fluctuations. But with that said, we've always predicted our business that way, and we've done what we said we were going to do.

Subu Subrahmanyan - *The Juda Group - Analyst*

Thank you.

Operator

Mark Sue, RBC Capital Markets.

Mark Sue - *RBC Capital Markets - Analyst*

I'm still trying to see longer term the impact to the financial model as it relates to the deeper push into the Metro, and also the partnership with Ericsson. These two things are somewhat new versus when the original operating margin targets were provided.

So, when we see the higher revenue days, and we see an uptick in the Metro, and also the time expansion and distribution expansion with Ericsson, should we intuitively think about more R&D spending but less sales and marketing expenses? Just how the mix shift of this $205 million per quarter run rate will change, and the trend maybe, not over the next few quarters but over the longer-term as you get further traction at these two segments.

Jim Moylan - *Ciena Corporation - CFO*

Mark, I'm going to address the OpEx piece of this and then Gary is going to address the longer-term aspects. On the OpEx side, none of the things that we've talked about recently, whether it's the wins on the Metro or the Ericsson partnership, we think have an effect on near-term OpEx in any significant way. There might be inside of our OpEx some movement between projects, but we don't expect that to impact this year's OpEx.

If we look ahead, and think about the fact that possibly the Ericsson partnership will bring us, through customer engagement, some need for additional R&D, then we'll make those decisions as they come. But we're still confident that we're going to grow OpEx at a slower rate than we're going to grow our revenue. I think we're going to grow our revenue at a very nice pace, faster than whatever the market grows at.

Gary Smith - *Ciena Corporation - President & CEO*

Mark, I think you've got to separate the two things out, obviously -- the Metro and the Ericsson elements. I think on the Metro side this is something we've been planning for many years. We've, in fact, been investing in the whole 6500 concept is really a converged platform for all of the traditional segments into a converged architecture out into the Metro.

So that's clearly not new to us. We've been spending and investing in that area for a number of years and been engaged with a number of customers.

So I would say we also internally have been viewing that Metro shipments would start at the beginning of 2014. The reason we're calling it out is that we actually are comforted that, that's on track. So, that's completely within our plans, completely within our financial model.

I would say on the Ericsson side, very early days. As we've said, we don't expect a large impact financially during 2014. We do obviously see it as being incrementally accretive to us as we go forward over the long term.

Very encouraged by what we've seen so far. I think it's also very consistent with our view of expanding our role and reach over the long term.

Mark Sue - *RBC Capital Markets - Analyst*

Gary, if I could follow-up, one of the other things that we used to talk about was your architecture approach. Are you starting to see that more in terms of larger deal sizes, customers purchasing your equipment and software across a range of products? Just maybe revisit that thought of larger deals with your architectural approach.

Gary Smith - *Ciena Corporation - President & CEO*

Yes. I think what we are seeing that. I think we're seeing it manifested in two ways. One, we're seeing larger deals. There's some particularly large International ones that we've secured over the course of the last 18 months, which I think talks to our architectural vision.

I think what we're also seeing is that's manifesting itself in multiple engagements within large tier ones. So, that architecture is being adopted across a wide array of the network. So that's also consistent with us having broader and deeper engagements with many of our tier one customers.

I think the Metro is an illustration of that. As you get into the Metro, you're actually getting closer to the service delivery. Therefore you've got lots more opportunity to engage across a broad array of services with the customers.

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Mark, one metric that we've been sharing with people over the last few quarters that demonstrates that is if you look at the number of customers in our top 20 that are multi-product customers in any given quarter, it's typically running 16 to 18 out of 20.

Mark Sue - *RBC Capital Markets - Analyst*

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

Operator

Ehud Gelblum, Citi.

Ehud Gelblum - *Morgan Stanley - Analyst*

Couple questions. First of all, Jim, on the build-up in inventory, I just want to go back to that for a quick second. Was that caused by a particular customer that perhaps gave you an opportunity to win a deal because you could differentiate on the time to deployment, and so you said -- sure, I'll build up the inventory, so you can do that. It allowed you to beat out another customer?

Was that maybe from a couple customers saying that? Or was that just a general thought that you guys had that you wanted to speed that up, the velocity of that, so add inventory? Then I've got a more in-depth question.

Jim Moylan - *Ciena Corporation - CFO*

Definitely broad-based. We've seen over the past several quarters that our ability to project 6500 demand has been less than great. We've expanded every quarter in terms of the need for customers as compared to our design build. As a consequence, we think that we want to try to improve customer service overall.

This is important in particularly some elements of the market like the enterprise segment where lead times are very important. So it's broad-based. It's not driven by anyone customer. We think it's going to help both our customers and the velocity of our business once we get this fully implemented.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay. That's helpful. I assume that it stays at that level? You obviously won't have to build it. It won't take up new cash. But that working capital will stay roughly at that level as we go forward, right?

Jim Moylan - *Ciena Corporation - CFO*

We always know that working capital as a percent of revenue is going to have to stay within a range. So, as our revenue grows, our working capital will grow. I think that the one thing I do feel confident about is not just our ability to drive operating leverage but for the full year we're going to drive free cash flow.

Ehud Gelblum - *Morgan Stanley - Analyst*

Right. Okay. Things seem to be clicking now at AT&T. They have been for some time but as the Metro starts going I'm assuming the long haul gets going at some point in the future, too. Your other large North American customer was sub 10% for the second straight quarter after being pretty big for a number of quarters in the past.

How should we think about that opportunity as they digest what you sold to them in the past, and take on another vendor? Is that something that we should see them pop back up again next quarter or the quarter after that? Or not until we get until the end of the year and into 2015?

Gary Smith - *Ciena Corporation - President & CEO*

I think if you look at the North American landscape, you've got four or five very large tier one players. In fact, you've got Verizon, you've got CenturyLink, you've got Sprint, you've got Comcast. Many of them at any point come into the 10% range or fluctuate through that.

We're actually selling multiple things into -- back to the earlier point we're making -- we're in multiple parts of their network. Specifically, I would disclose that Verizon was our largest 100-gig customer for the quarter, and was extremely close to 10% for the quarter. It's going to fluctuate, but we're very confident in our position in these tier one accounts, both in terms of our embedded base and in terms of the opportunity going forward.

Ehud Gelblum - *Morgan Stanley - Analyst*

That's actually very helpful. I appreciate it. Last comment, can you give us a similar update on Vodafone and how that build is going, the pace of that, and how we should see it lay out?

Gary Smith - *Ciena Corporation - President & CEO*

Without getting too specific, it's a new relationship for us that we were awarded late last year. We're continuing the rollout. It's going well.

I think there's a larger opportunity, as well under Project Spring, which is well publicized. I think Ciena's in a good position to help, I think, execute with Vodafone over the next few years on a more global basis.

Ehud Gelblum - *Morgan Stanley - Analyst*

Appreciate it.

Operator

Brian Modoff, Deutsche Bank.

Brian Modoff - *Deutsche Bank - Analyst*

Coming along the lines of, we were talking about an LTE, Mobile World Congress, Deutsche Telekom was demonstrating 480 megs per customer type data rates on two-carrier aggregation. Talking to that other customer that was almost 10% of your revenues, they talk about having fiber deep into their network and out to almost every base station. How do you see the impact of LTE builds globally on your businesses through this year and into next year, particularly as they start to accelerate?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Brian, it's Tom. From the perspective of LTE, anything that tends to increase the amount of traffic on our network is a good thing for us. That certainly will push a lot of the cell towers that aren't fiber today to be fiber. As they get fibered, they get fibered with ethernet. So I think broadly that plays to our strengths.

A couple of things we've done in the last year or so to make our products more friendly to a global LTE market I think will also be helpful to us. We've added some features in our carrier ethernet products, basically to make them fit more easily into a back-haul network outside the United States.

Brian Modoff - *Deutsche Bank - Analyst*

Then if I can have a follow-on, can you talk a little about the impact of the upgrade you did in terms of your chip module? You talked about last quarter it was a more modest impact on your margins. [wait watch] and [free chip]. How do you see that impacting your margins or helping your margins as you move through the year? Thanks.

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

One thing I would say right now, the lion's share of what we're shipping out in terms of Coherent today is WaveLogic 3. We recognize that as the industry evolves we need to continue innovation.

That's one of the reasons we're on our third generation and beginning work on our fourth generation, and those sorts of things. The way I would go with that is to say that most of what we're shipping in terms of Coherent today is WaveLogic 3.

Brian Modoff - *Deutsche Bank - Analyst*

Good.

Operator

Paul Silverstein, Cowen and Company.

Paul Silverstein - *Cowen and Company - Analyst*

I'm going to apologize. I took a RedEye, so if you've already said this, I do apologize for wasting your and others' time. First off, did you give an update on the new wins for 100G, 40-plus-100 and optical switching?

Jim Moylan - *Ciena Corporation - CFO*

We didn't give that but I can tell you we have 21 new 100-gig customers. We now have a total of 119 100-gig customers. We have 170 total Coherent customers. Continue to gain share and to bring customers to our Coherent products.

Paul Silverstein - *Cowen and Company - Analyst*

Jim, the optical switching count, did that increase at all this quarter, new ones?

Jim Moylan - *Ciena Corporation - CFO*

It did. The number of --.

Gary Smith - *Ciena Corporation - President & CEO*

I think we added three new customers, switching customers, during the quarter.

Paul Silverstein - *Cowen and Company - Analyst*

Gary, that's up to 42 total? Is that correct?

Gary Smith - *Ciena Corporation - President & CEO*

I think, it's more -- if you look at the 5400 now, we have almost as many 5400 customers as we had core director customers. I think we're close to --.

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Closer to around 40.

Gary Smith - *Ciena Corporation - President & CEO*

Yes, around 40 customers.

Paul Silverstein - *Cowen and Company - Analyst*

All right. That 21 100 gig, that's a big step up. I don't remember you all having a number that high in terms of new 100-gig customers.

That helps me, but that sounds like a big step up from previous quarters. Are tier ones a healthy piece of the 21 or are these now getting down to the small customers?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

It's a pretty broad-based mix. I will also point out that a lot of the 100G customers that we're saying that are coming online at 100G were prior 10G and 40G customers.

Paul Silverstein - *Cowen and Company - Analyst*

All right. I've got three quick questions. First of all, has it proven true since you started shipping 100 gig that if you had a 40-gig customer, almost always that 40-gig customer, as soon as they upgrade to 100 gig, they upgrade with you? Or have there been a lot of instances where that 40-gig customer turned to one of your competitors -- Huawei, OU, whoever -- for 100 gig?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

I think it's been pretty unusual that we'd have a customer who was a current installed base customer for 6500 at 40 or 10 that wouldn't go to 100 on our equipment.

Jim Moylan - *Ciena Corporation - CFO*

I was just going to say that this is going to be an evolution. Certainly 100 gig has been an important product and great for us and great for our customers. But some customers in certain parts of their network are going to stay at 40 gig.

Some even are going to stay at 10 gig. It just depends on the customer itself. But, as Tom said, losing a customer on an installed base is quite unusual for us.

Paul Silverstein - *Cowen and Company - Analyst*

So, to the extent you've got another 50 additional customers, that it looks like from the counts you gave that are 40 gig that haven't gone to 100 yet, if they go to 100, they will likely go with you. That would be the read?

Jim Moylan - *Ciena Corporation - CFO*

I think it's likely. They are all sorts of things in the daily discussions with customers that could change. But, yes, I think it's likely.

Paul Silverstein - *Cowen and Company - Analyst*

All right. Let me ask one last question. If I looked at your total customer base other than AT&T and Verizon, and if I've done the math right, it sounds like all those other customers in the aggregate grew by 16% year over year following, I think it was 17% or 18% growth in the previous quarter. So, two straight quarters of high teens growth.

I know everyone tends to focus on Verizon exactly where that 100-gig build-out is with Verizon. Given their size, I get it. But if you look at your non-AT&T and Verizon customer base, the two quarters you just put out, is that extraordinary or consistent with the wins you've announced the last several quarters, the new Vodafone relationship?

I don't mean to lead the witness here, but I'm trying to understand to what extent you have visibility about that type of growth from that 75% of revenue that comes from other than AT&T and Verizon?

Gary Smith - *Ciena Corporation - President & CEO*

Paul, I think you highlighted a good element here around -- we've tried to build a broader balanced business. There are a lot of other customers, large tier one customers, both in North America and around the globe, that are now significant customers for Ciena.

They might not feature over 10% because we're growing so fast. But our customer base is increasing significantly over the last two to three years.

We have very large tier one players internationally. They are very meaningful to our revenue stream. Also in North America, as well. I think the last couple of quarters highlight that.

Paul Silverstein - *Cowen and Company - Analyst*

All right. Gregg, I apologize, one last question. With respect to your Metro platform, are there synergies -- I assume there are synergies, basically from a control plane. It's not other synergies with a long haul in the optical switching, et cetera. Are there meaningful synergies for a customer that's using one or more of your platform, other platforms, that would lead them to upgrade with you, lead them to use you for Metro?

Gary Smith - *Ciena Corporation - President & CEO*

The answer to your question is yes. It's all part of the converged architecture where you've got a single platform that can do multi functions, what was classically called long-haul OTN, et cetera. It's part of our open architecture.

So, you've got a single platform that can have multi functions and support multiple services. The economics of that are very compelling. So therefore, any footprint we've got on 6500 in any major carrier is an opportunity for multiple different kinds of sales.

Paul Silverstein - *Cowen and Company - Analyst*

Thank you.

Operator

Simon Leopold, Raymond James.

Simon Leopold - *Raymond James & Associates - Analyst*

I have two genuinely quick clarifications and then a question. On the clarification side, if you could just talk a little bit about the increase in DSOs and a little bit more color in terms of the switch CoreDirector 5400 contribution in the quarter.

Then what I was hoping we could really drill down a little bit more on would be the international trends. This quarter you had a steep sequential drop but we know there's lumpiness. You've had, I think, a good progression of international.

I'd like you to speak more to international as an opportunity, and the color you can give in terms of international regions, international opportunities. The bottom line is I'm trying to get a sense of how does international grow relative to domestic in 2014. Thank you.

Jim Moylan - *Ciena Corporation - CFO*

On the first point, Simon, I spoke to the fact that we had a back-end loaded quarter. What that means is that we ship a lot of stuff in the last month of the quarter. Given our typical acceptance terms, even in North America in payment terms, if you ship in the last month of the quarter, it's very difficult to collect in the last month of the quarter, or before the end of the quarter.

So, as a consequence we ended up with pretty high DSOs, much higher than we expect to see going forward. So I think it is -- hopefully that's an anomaly.

By the way, we always have back-end loaded quarters. I don't mean to imply that we don't and we won't. It was a particularly back-end loaded quarter and that resulted in high DSOs. Expect it to go down as we move through the year.

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

In answer to your question, Simon, around switching, we're still seeing our switching business grow. In fact, if we look at this quarter in 2014 versus this quarter in 2013 we're up about 74%.

Simon Leopold - *Raymond James & Associates - Analyst*

Was that 17%, Tom?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

7-4.

Simon Leopold - *Raymond James & Associates - Analyst*

Okay, big difference. Thank you.

Gary Smith - *Ciena Corporation - President & CEO*

On the international question, Simon, again we're seeing broad-based opportunity. Regionally, I'd characterize it as Europe, steady with a more positive outlook. I think that's specific to us around some of the wins that we've had there.

I would say Latin America, Brazil, I would also say India, looked very good markets for us, for 2014. We've already secured a number of key customers there that we're rolling out during the course of this year.

In terms of North America versus international I think we see growth in both, frankly, during the course of 2014. That's part of our strategy around expanding our role and our reach building a broader-based business.

I think it's also consistent with the architectural shift that we're seeing as these carriers make these kinds of decisions to move to these next-generation networks. It's opening up, particularly internationally, opportunities for Ciena that were not there before.

Jim Moylan - *Ciena Corporation - CFO*

Just one comment I'd make about the international versus the US business, too. We've alluded to this in the past. But they are quite different in terms of the time to revenue cycle.

In North America, as a general comment, what we do is we ship and we recognize revenue. Outside of North America we tend to be involved in broader network deployments where we're actually doing the installation ourselves. So we have to wait until we get to final network completion, acceptance and light up before we get to revenue.

As a consequence, that means it just takes longer to get to revenue, generally speaking, outside of North America than it does in North America. You can see that in our inventory levels in our deferred cost of sales. You can see that, that's high and that's mostly, in fact almost entirely, international.

Simon Leopold - *Raymond James & Associates - Analyst*

Thanks. That's very helpful.

Operator

Kent Schofield, Goldman Sachs.

Kent Schofield - *Goldman Sachs - Analyst*

I would assume it's safe to say you have more visibility into your OpEx than you do your revenues. But there obviously is some variability especially around the R&D projects like we saw this last quarter.

Can you talk a little bit about your R&D project pipeline and what that means to meeting your operating margin target? Then I do wonder a little bit if there's some of what you discussed on the international side of things, if that has an impact?

Jim Moylan - *Ciena Corporation - CFO*

Yes. I'll address that, Kent. We've said before that we're going to average about $205 million this quarter, and we believe that to be true. I'd say that if you look at our annual operating plan, our OpEx tends to come in very close on an annual basis to what we project at the beginning of the year. Another case where we said what we're going to do for the year and we've done that and we expect to continue to do so.

So, on an annual basis, OpEx is well planned and planned out at the beginning of the year. There are times when, as a result of great performance, that we exceed incentive compensation targets, and so we get some variability for the year as a result of that. But, again, as we've said, we have very good forecast-ability of operating expense on an annual basis.

It's just that within R&D, and in some cases other parts of our operating expense, it is project based. The timing of the execution of those projects, or completion of those projects, is sometimes difficult to get to.

Overall, on an annual basis, we do a pretty good job of projecting. Everything that we've said about being confident in our ability to get operating leverage takes that into account.

Kent Schofield - *Goldman Sachs - Analyst*

Thank you. I think you've been clear that it's the Ericsson opportunity is a longer-term opportunity. But when do you think it's fair for us to start peppering you guys with questions as far as traction there? Is it 2015?

Do we have to go out into 2016? How should we think about when we should start to see some traction?

Gary Smith - *Ciena Corporation - President & CEO*

Kent, I think we'll provide commentary as we get to maybe towards the second half of this year. But I would think we'd begin to see some financial impact as we get through 2015.

Kent Schofield - *Goldman Sachs - Analyst*

Okay. Thank you.

Operator

Michael Genovese, MKM Partners.

Michael Genovese - *MKM Partners - Analyst*

Two questions. First is on the Ericsson guidance. I just want to get more color on why we're putting off expectations for revenues from that deal until fiscal 2015, given that when we ask Ericsson about it, they say they're super excited and their sales force is out there right now pitching the product and trying to get deals done.

Gary Smith - *Ciena Corporation - President & CEO*

I'm very glad to hear that. Thank you, Mike. I think we're excited about it, too. We see excellent opportunities for it. It expands our role and our reach.

I think the initial take, as I said, is the customer feedback has been very positive, too. Just from our experience, these things take time to secure, and customer adoption cycles are not immediate. Therefore, by the time it shows up into our revenue, there's a lag there.

Particularly, as Jim just highlighted, when you look at international business, even though it expands our reach it does take time for those revenues to show up into our recognized financials. So that's why we're being a little more cautious around that. But you should not interpret that as lack of excitement on our part at all. I think it's just the reality of the agreement.

Michael Genovese - *MKM Partners - Analyst*

Great. Then the second question is about just if we could talk about the risks to CapEx this year. Clearly you're doing great with AT&T, and congratulations on the 6500 deal there.

Given that they're the most aggressive in terms of transforming their network for NFV and SDN, if you could talk about that as a risk factor. Also potential carrier M&A globally this year, just your views there. Thanks.

Gary Smith - *Ciena Corporation - President & CEO*

I think this CapEx gets a lot of focus, and obviously I can understand that. But I think the predominant issue for us, it's not about the absolute CapEx or the total aggregate growth. It's around what they spend it on. I think what we're increasingly seeing is the spend towards this next-generation architecture as the architectural shift gains momentum.

So it's not an absolute terms how much any of these carriers spend. It's what they spend it on. I think we saw it last year. I think we're seeing increasing momentum this year.

They are spending less on legacy and more on the new stuff. That's good for us because that's where we've got our investments. That's how we've structured the Company.

Specifically around software-driven networks, NFV, et cetera, that's all an opportunity for Ciena. That's absolutely consistent with our open architecture which we launched about 18 months ago. We've been diligently driving our R&D to deliver on some of those items that are pertinent to us over the last 18 months.

So we're very well-positioned for that. Frankly the faster that shifts, the better for Ciena.

Operator

Rod Hall, JPMorgan.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Just a couple. I wanted to go back to the AT&T comment and just see if you guys could talk a little bit more about the structural nature of that deal. Are we talking about a structural decision similar to what we've heard from Verizon where they're going to roll 100 gig in all their metro areas? Or is it something more piecemeal than that? Can you just give us some idea on that?

Then also just how that project progresses over time. It sounds like it's pretty early stage, so I guess that runs for quite a while.

Then also related to that, if you guys could talk about -- maybe not really related to that -- but could you talk about the inventory build relative to specific deals versus just a strategic decision? Are there some deals that are driving that inventory decision or is it really just a broad-based strategic decision?

Then the last thing I wanted to see -- Jim, could you just update us on the order backlog? I know it was about $1 billion exiting Q4. Could you give us any color update on what the backlog looks like now? Thanks, guys.

Gary Smith - *Ciena Corporation - President & CEO*

Rod, I'll take the first one. I don't want to get too specific around individual customers. We called out a couple today really to illustrate this trend towards the Metro. I wouldn't like to say too more than that.

It's very aligned with our architectural vision and what's happening in terms of the shift that's going on across the board. I think more and more metro adoption, people like CenturyLink, et cetera, I think it's just testament to that architecture becoming a reality.

Jim Moylan - *Ciena Corporation - CFO*

Yes. On the inventory question, this question came up a bit earlier. It is certainly a strategic decision based around a broad-based belief that we're going to have strong order flow on the converged packet-optical products this year.

As I said, the demand for 6500 has continued to grow faster than we have projected. As a result, we haven't always every quarter been able to meet customer demand for that product. This decision that we've taken is an attempt to get to where we're serving customers better, improve lead times, increase and improve our customer service levels.

On the backlog, the backlog did go down a bit in the first quarter. We did say that orders were less than revenue, pretty much as we expected. We do think that will have strong order flow for the rest of the year, so I don't derive any discomfort about the fact that it did decrease a little bit in Q1.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Can you quantify it at all, Jim?

Jim Moylan - *Ciena Corporation - CFO*

No.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Okay. Thanks a lot.

Operator

Dmitry Netis, William Blair.

Dmitry Netis - *William Blair & Company - Analyst*

I hate to beat a dead horse to death on the AT&T opportunity but just a clarification there. I know you didn't qualify whether it's 40G or 100G.

Gary Smith - *Ciena Corporation - President & CEO*

Yes. We have not deliberately -- that's up for the customer themselves to talk about. I'd say that 6500 is obviously 100-gig ready. In fact, 400-gig ready in keeping with our overall architecture. But it wouldn't be appropriate for me to go into any more detail on that, frankly.

Dmitry Netis - *William Blair & Company - Analyst*

Okay. Then are there other vendors involved in this metro deployment, or was it just exclusive to you?

Gary Smith - *Ciena Corporation - President & CEO*

Again, I think it wouldn't be appropriate for me to comment on. I think the point that we're trying to highlight there, and I think we called out CenturyLink and a couple of others about a quarter or so ago, is really this shift towards the Metro opportunity, generally across the globe we see as a larger opportunity than just the core of the network.

I think that's what's driving a multi-year opportunity for us across multiple carriers as we get this architectural shift from multiple networks down to a single multi-service architecture. That's really what we're highlighting.

Dmitry Netis - *William Blair & Company - Analyst*

Okay. I appreciate that. Could I just ask about the 100G long-haul with AT&T and the timing of that? I know that --.

Gary Smith - *Ciena Corporation - President & CEO*

Dmitry, honestly, I think it's inappropriate for me to talk about. Honestly. Sorry.

Dmitry Netis - *William Blair & Company - Analyst*

Understood. Let me just ask a couple more quick ones here. On the packet networking, I appreciate it was up 13% year over year, but it did go down 16% quarter over quarter. Was this related to a specific project? Some color you can provide what really we should be expecting out of this.

THOMSON REUTERS

Gary Smith - *Ciena Corporation - President & CEO*

Dmitry, I wouldn't read too much into that. I think you are going to see some ebbs and flows. It's not always going to be linear in each area here.

I think also this quarter is a challenging one for deployments because most carriers don't like to deploy in December or in January. They take -- and a lot of that packet stuff is really out at the edge of the network.

So there's not that many deployments. I think it's more attributable to that. In fact, I think it's probably going to be up in Q2.

Dmitry Netis - *William Blair & Company - Analyst*

Then last one -- thank you, Gary -- last one for Jim real quick. On the other income loss, I think you had this additional $6 million loss on that line. I think that contributes to roughly $0.05 dilution in earnings. Could you explain where that's coming from?

I think you guided for $11 million interest expense going forward. So does that imply we shouldn't be seeing that additional $6 million interest expense potentially that you saw?

Jim Moylan - *Ciena Corporation - CFO*

The other income and expense amount in Q1 was related to FX. In particular to Brazil where the Brazilian real did diminish against the dollar pretty significantly for the year. It's a balance sheet translation effect. It really results in the fact that we now have assets, in some cases, sitting out in foreign currencies.

As we expand our role and our reach around the globe I think you're going to see potentially some FX effects. We are getting more active in hedging these risks. So hopefully we'll control them going forward. But that's what it is.

Operator

Mark McKechnie, Evercore Partners.

Mark McKechnie - *Evercore Partners - Analyst*

The question I have is probably for Gary and Tom. On the Metro, can you confirm, I've always looked at it as around 3 times the size of the long-haul opportunity. So maybe develop that a bit. The margin profile for that, I think we're looking for better packet content there.

Then, I'm sorry, the two other ones would be quick ones. DSOs up. There's a lot of guys ask questions there. Would you expect the April quarter -- all quarters are a bit back-end loaded, I know, for you -- but April quarter a little less so?

Then finally, Jim, if you could talk about the R&D project that we had the uptick, that got pushed to spend into April. Thanks.

Jim Moylan - *Ciena Corporation - CFO*

Okay. Mark, thanks. On the DSOs, I would predict that over the year that's going to come down. The first quarter was particularly back-end loaded, more so than we've seen.

As I say and as I've said, we've always had some back-end loading to the quarter. It's just the way our business works. But first quarter was particularly back-end loaded. So I expect that to improve as we move through the year.

The R&D -- without getting into the specific projects, we spend almost $400 million a year or so on R&D. There are a lot of projects inside there, some of which are quite large and they consist of prototypes. We have third-party services that are involved in these things.

Our ongoing employee expense is very predictable and we know where it's going to be. But with respect to third-party services, with respect to prototypes, things move around. We feel good about adherence to our roadmap for the year.

So nothing that's happened in Q1 gives us any cut pause for concern about our roadmap progress. It's just that a couple things that expected to get done weren't finished. That's it.

Gary Smith - *Ciena Corporation - President & CEO*

Mark, why don't I take the Metro question? I think in broad terms, it's difficult to scope out in terms of absolute sizing but I think directionally, 2 to 3 times is not unreasonable, the opportunity in the metro versus the core.

I also would concur in a margin expansion opportunity over time, as well, I think, particularly as you put more functionality in there, clearly more packet capability, more OTN, more switching capability. Also I think there's an opportunity for some NFV type capability as you get to the edge of the network, as well. So, that is part of our opportunity from a financial model point of view to drive leverage over time and to improve our gross margins over the long term.

Gregg Lampf - *Ciena Corporation - VP of IR*

Thanks, everybody. We're going to conclude the call now. Appreciate your time. Again, we'll look forward to seeing everyone in New York at the New York Stock Exchange for our investor day on April 3. Thanks again.

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.
