THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

CIEN - Q2 2016 Ciena Corp Earnings Call

EVENT DATE/TIME: JUNE 02, 2016 / 12:30PM GMT

CORPORATE PARTICIPANTS

Gregg Lampf *Ciena Corporation - VP of IR*

Gary Smith *Ciena Corporation - President and CEO*

Jim Moylan *Ciena Corporation - SVP of Finance and CFO*

Francois Locoh-Donou *Ciena Corporation - SVP and COO*

CONFERENCE CALL PARTICIPANTS

Doug Clark *Goldman Sachs - Analyst*

Rod Hall *JPMorgan - Analyst*

Simon Leopold *Raymond James & Associates - Analyst*

Meta Marshall *Morgan Stanley - Analyst*

Tim Savageaux *Northland Capital Markets - Analyst*

Jeff Kvaal *Nomura Securities - Analyst*

Vijay Bhagavath *Deutsche Bank - Analyst*

Stanley Kovler *Citigroup - Analyst*

Alex Henderson *Needham & Company - Analyst*

Dmitry Netis *William Blair & Co. - Analyst*

Jess Lubert *Wells Fargo Securities - Analyst*

George Notter *Jefferies LLC - Analyst*

Catharine Trebnick *Dougherty & Company - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Ciena Corporation Q2 2016 earnings conference call. (Operator Instructions). As a reminder, today's conference call is being recorded.

I would now like to turn the conference over to Mr. Gregg Lampf, Vice President of Investor Relations. Please go ahead, sir.

Gregg Lampf - *Ciena Corporation - VP of IR*

Thank you, Candace. Good morning and welcome to Ciena's 2016 second-quarter review. With me today is Gary Smith, CEO and President; Jim Moylan, CFO; and Francois Locoh-Donou, COO.

This morning's press release is available on National Business Wire and Ciena.com. We also have posted to the investor section of Ciena.com an accompanying investor presentation including certain highlighted items from the quarter being discussed today. In our prepared remarks today, Gary will discuss management's view on the market and our overall progress and Jim will provide detail on our Q2 results and provide guidance. 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 turning the call over to Gary, I will remind you that during this call we will 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 9 and we expect it to be filed 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 investors section of our website. Gary?

Gary Smith - *Ciena Corporation - President and CEO*

Thanks, Gregg, and good morning to everyone on the call. As you saw in this morning's release, we achieved outstanding second-quarter performance across all key financial operating metrics including adjusted operating margin of 10% and adjusted EPS of $0.34. In addition, order flows in Q2 were especially strong which positions us well for the second half of the year.

I think this financial performance proves out our long-held view of the market as well as our long-term corporate strategy aimed at diversifying the business. Specifically, we've invested heavily in key technologies and geographies to create a broad-based business that is capable of delivering sustainable growth in both revenue and profitability and our Q2 results highlight this changing complexion for that business.

Our growing Packet business is a good example. Having anticipated Ethernet services becoming the fastest growing market for carriers as well as LTE backhaul in preparation for 5G, we are beginning to see our Packet business expand by customer, application and geography. In Q2 we won Packet business from Tier 1 service providers, government agencies, utilities and regional carriers from across North America, EMEA and APAC and we're seeing international diversification beyond packets as well really reflecting the investments we've made to support applications like submarine and investments in key markets such as Brazil and India. And we had a particularly strong quarter in CALA and APAC with both regions experiencing better than 20% year-over-year revenue growth in Q2.

As we been saying for some time and despite the macro volatility that we and others have referenced in recent quarters, fundamental demand drivers remain solidly in play. Those drivers are continuing to shift the industry towards a model of on-demand networking across an open ecosystem. As this shift gains momentum, we're seeing that our technology is now being consumed in many different ways. We view this dynamic as both a competitive advantage and an opportunity for Ciena.

With design principles such as modularity and open APIs of programmability, our OPn architecture differentiates Ciena by allowing us to address the broadest range of consumption models. Whether it's through disaggregated line systems, platforms like Waveserver that change operational paradigms to meet web-scale needs, or fully integrated Packet optical solutions, we believe Ciena is the market-leading enabler of choice when it comes to how different customers can consume network technology.

Another dynamic that we continue to see is network operators absolutely demanding more service agility and automated end-to-end control of their networks. Frankly, they are struggling with monolithic back-office systems, a dependence on vendor controlled legacy OSS systems, and long development cycles that inhabit the creation, customization and most importantly, the monetization of services.

Our Blue Planet platform is playing perfectly into this kind of environment leading the industry's transformation to open control and bringing web-scale flexibility and velocity to the telecom world. In fact, we just introduced the Blue Planet DevOps Toolkit and developed a community to provide the software development tools for network operators to use in-house or in collaboration with ecosystem partners really allowing them to take back control of the management and orchestration of both physical and virtual components.

In closing, Ciena's long-term strategy and our ongoing R&D and go-to-market investments continue to be validated by the market with tangible results. And the growing need for greater service agility and an increased appetite for new consumption models both position Ciena for future market momentum. We are confident in our ability to be the industry's leading enabler of choice for a variety of use cases to a wide spectrum of customer segments and our ability to leverage that leadership into continued growth in revenue and earnings per share over time.

With that I'll hand over to Jim.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Thank you, Gary. Good morning, everyone. We have strong and growing relationships with customers all over the globe and we are clearly enjoying momentum in the market as our improving results show. This is due in part to the disciplined investments we've made to build a broad-based business, a business that can address more kinds of customers, applications and geographies.

I'd like to take a moment now to update you on some of the key areas of diversification that are contributing to our progress. That discussion starts with our Packet business, which is expanding across a number of markets. Driven in part by a strong quarter for our 8700 platform which now has 31 customers, Packet Networking revenue in Q2 was up nearly 30% year-over-year and up more than 40% sequentially. We had 15 new Packet wins in the quarter including a number of Tier 1s both in North America and internationally.

We had a particularly strong Packet quarter in India and in the US government market. As Gary mentioned, we are gaining momentum across regions especially CALA and APAC which were up 30% and 60% respectively over Q1.

Regarding EMEA, in our last call we referenced temporary CapEx constraints and some internal execution issues as affecting our performance. Both of those issues are improving and as a result, EMEA revenue was up nearly 20% over Q1. While we have much more work to do, this is very encouraging.

Altogether, international customers contributed 43% of total revenue in the quarter.

Web-scale providers continue to be important for Ciena. As you know, we sell directly to these customers as well as indirectly; that is through service providers that are undertaking projects with Ciena on behalf of their web-scale customers. We have said that we are getting direct revenue from web-scale customers in a range of 5% to 10% of total revenue and Q2 revenue from web-scale customers was in that range, up approximately 25% over Q1. We also are getting indirect contribution from web-scale customers of about 5% to 10% of total revenue, and with recent wins, we believe these percentages will grow over time. Overall, we continue to hold number one share globally in the data center interconnect market.

Customers around the globe are very excited about our Waveserver platform which is purpose built for DCI applications. Waveserver is building momentum and is getting high marks for its superior performance. In fact, I'm pleased to announce that the platform has been selected by two additional top five web-scale customers meaning Waveserver has now been selected by three of the top five web-scale providers. We continue to believe that Waveserver is the performance leader in this nascent market and we are confident that as we evolve the platform over time, it will remain the leading platform in the space.

And finally, we had a strong quarter for our Ericsson partnership showing significantly better revenue than last year.

Turning now to our second-quarter financials, Q2 revenue was $641 million. Q2's adjusted gross margin was 45.1% and operating expense was $223 million. We achieved $66 million in adjusted operating profit in Q2 for an adjusted operating margin of 10%. As Gary mentioned, orders in Q2 were strong coming in significantly higher than revenue. We also generated $61 million in cash from operations.

Our balance sheet continues to strengthen and our leverage ratios continue to improve. In fact, as we went to the capital markets to raise the $250 million in term loan B last quarter, we received a ratings upgrade from both Moody's and Standard & Poor's. We ended the quarter with approximately $1.24 billion in cash and investments.

Finally, Q2's adjusted earnings per share were $0.34. I will now provide guidance for our fiscal third quarter.

We expect Q3 revenue to be in the range of $655 million to $685 million. We expect Q3's adjusted gross margin to be in the mid-40s percentages range and we expect adjusted operating expense in Q3 to be in the range of $225 million with some potential variability due to spending that did not occur in the first half of the year.

I'd also like to provide some commentary on our annual guidance. You'll recall that in March we said that we expected 2016 adjusted operating margin in the range of 10% to 12%. We also indicated that for fiscal 2016 we expected revenue growth in the range of 5% to 8%, adjusted gross margin in the mid-40s percentage range and adjusted OpEx for the final three quarters to average approximately $225 million.

Based on our first-half performance and our expectations for the second half of the year, we continue to expect to achieve those results for the full fiscal year. More specifically, given our strong order flow in Q2 and closer proximity to the end of the fiscal year, we now expect that 2016 revenue growth will be approximately at the midpoint of our guidance range.

In closing, as the need for on-demand networking drives change across the industry, customers continue to tell us that Ciena is highly differentiated in its approach to both engagement and technology resulting in an overall better experience and more valuable outcomes for them and their end-users. We compete in a market where customers increasingly require more choice and different consumption models for network solutions and we believe that Ciena is uniquely suited to provide the widest range of choice to customers. Our ability to deliver greater value to network operators positions us for sustainable, long-term growth and continuous gains in profitability.

Candace, we will now open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Doug Clark, Goldman Sachs.

Doug Clark - *Goldman Sachs - Analyst*

Great. Thanks for taking my question. My first one is on the data point that you gave on the web-scale direct sales growing 25% sequentially. I'm wondering if that's driven by revenues from Waveserver or expansion of customers or perhaps a combination of both?

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Yes, it's not Waveserver, Doug; not yet. Waveserver is just entering the revenue phase of its life. We expect that it will grow but it's basically our standard 6500 platforms that we're selling to them now.

Doug Clark - *Goldman Sachs - Analyst*

Okay, and then as a follow-up, we've been getting questions on the submarine market and you mentioned it briefly in your remarks. Can you talk a little bit about the activity going on there as well as the involvement by web-scale companies, for example, Facebook and Microsoft just announced their own submarine cable network. Could you talk a little bit about that topically?

Gary Smith - *Ciena Corporation - President and CEO*

Yes, hey, Doug; it's Gary. What we've seen in the last two to three years of the submarine market is -- we've been doing a lot of over builds on existing capacity because we're able to extend the life of these cables and that's really been our entry point into the market. What we're now seeing is the demand is so great that people are actually putting new cables out there and you've seen some of the announcements both [Consortia] and also directly with the web-scale guys as well. And this, I think, provides a great opportunity for Ciena to help really drive that capacity. So we see quite a vibrant market in the submarine space over the next two to three years and we think we are incredibly well-positioned for it.

Doug Clark - *Goldman Sachs - Analyst*

Excellent. That's helpful. And a quick follow-up to that. Can you help quantify or at least level set us in terms of how large your submarine exposure is?

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

The market overall is between $500 million and $700 million. We have roughly 30% of the market, 25% to 30%.

Doug Clark - *Goldman Sachs - Analyst*

Got it. Thanks a lot.

Operator

Rod Hall, JPMorgan.

Rod Hall - *JPMorgan - Analyst*

Yes, good morning, guys. Thanks for taking my question. I guess a good set of numbers here. A couple of questions I've got. First of all, could you guys just give us an update on Verizon timing? And I guess I'd also like to know if you are including in your revenue growth for the full year any material revenues for them or are you thinking most of that revenue pushes into late this year, early next? So that was the first question.

And then secondly, back to Waveserver, could you talk about when you expect material revenue there? Are you expecting that later this year? Just give us some idea for how you expect revenue there to spin up? Thank you.

Gary Smith - *Ciena Corporation - President and CEO*

Hey, Rod, let me take the Verizon one first. I would say I think the next gen metros which you refer is on track. The split looks like the split that we expected. It's a mix of large and smaller metros. I think our expectation -- they've pretty much been on track I think for a while in terms of the schedule of the project. So -- and I think -- we've taken some revenues, I would say pretty small, we'll take some more during the second half as that begins to ramp, but I think you're probably looking at 2017 and 2018 for the majority of revenues associated with it. But it's pretty much on track and as they'd previously indicated.

Rod Hall - *JPMorgan - Analyst*

So, Gary, no impact from the strike? Could you just clarify that one?

Gary Smith - *Ciena Corporation - President and CEO*

I think -- too early to tell from that but I think we've baked some of that into obviously our expectations for the second half.

Rod Hall - *JPMorgan - Analyst*

Okay.

Gary Smith - *Ciena Corporation - President and CEO*

And I think in terms of the planning, I think that was also previously baked in.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

On the Waveserver question, the exciting thing to us is that we have more than 30 engagements around the world with Waveserver. We have a total of five customers which are, one, three of which are web-scale type customers, and just a lot of excitement around it. In terms of revenue, we've said in the past that we think it's in the low tens of millions this year and should start ramping next year.

Gregg Lampf - *Ciena Corporation - VP of IR*

Thank you, Rod.

Rod Hall - *JPMorgan - Analyst*

Great. Thanks a lot, guys.

Operator

Simon Leopold, Raymond James.

Simon Leopold - *Raymond James & Associates - Analyst*

Great. Thank you. I have a question that you may not want to answer or maybe can't, so I reserve the right for another one if you punt. But I wanted to talk about margin trends towards 2017 at least if you could express a level of bias. And what I'm trying to think about are crosscurrents where we think you've got increasing software business that's margin favorable yet some new projects such as a Verizon initiative that typically in the early phases can be margin unfavorable. So if you could help us understand cross currents longer-term.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Well, you mentioned that you wanted us to express bias, Simon. I want you to know that we have no biases here. And of course we're not going to respond on 2017. What I would say is that we've made great progress on gross margin over the last really year, year and a half, maybe, and we are now in the mid-40s. We do feel good about where margins are today and we think that we are in that mid-40s range. There is going to be some volatility in our margins depending upon what's hitting the margin at any given quarter, but we feel good about where they are.

Simon Leopold - *Raymond James & Associates - Analyst*

So maybe if you could give us sort of a shorter-term perspective then. In the context of the guidance you've given, what are your expectations for the Software mix going out to the balance of the year? How should we see that trend given that that has a lot of leverage on your margin?

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

We're not expecting a big growth in Software this year. Now if you look at our data around Software, we have shown a nice growth rate in Software and Software-Related Services, and most of those Software-Related Services are subscription of software and maintenance kinds of things. So the trends are good, but we're not expecting a lot of Software revenue in the second half this year.

Simon Leopold - *Raymond James & Associates - Analyst*

Okay, and one last one. Quick clarification. You mentioned EMEA starting to improve which we're encouraged by. Was the source of that, the big three customers that you've historically benefited from or something different? And then I'll yield the floor. Thank you.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

It was broadly based. Yes, we got a little from those customers, but it was a little more broadly based and as we say, we are encouraged by the fact that with our lowered expectations, we are now sort of on plan to what we thought we would do when we talked about it end of last quarter.

Simon Leopold - *Raymond James & Associates - Analyst*

Great. Thank you.

Operator

Meta Marshall, Morgan Stanley.

Meta Marshall - *Morgan Stanley - Analyst*

Great. I just wanted to get an update on whether the growth rates you had given for the long haul metro and DCI market stand given what you've seen in the service provider spend market over the last quarter? And then just a question on how Cyan performed to expectations and are they performing to your expectations for the year? Thanks.

Gary Smith - *Ciena Corporation - President and CEO*

In terms of the -- Meta, in terms of the growth rate for DCI and metro, it's about what we thought. As we look at the overall market, we think it's in the mid-single digit if you blend all of those. Some are obviously much higher than others and that's what we're seeing in the mix. So really our view of the market as we look at for the rest of 2016 really hasn't changed as we look at the blended the balance of growth.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Yes, we said that we believe that we are growing and taking market share in every region except for EMEA and we still believe that to be the case.

On the Cyan question, I assume, Meta, that you're talking about the hardware side of Cyan, the Z-Series. On the Z-Series, it's been doing very well. We had a total of about $25 million in revenue from Cyan this year, both products and services.

Gregg Lampf - *Ciena Corporation - VP of IR*

This quarter.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

This quarter. Excuse me. Thank you, Gregg. So it's pretty much performing as to expectation. And then on the Software side, great traction. Again, not a lot of revenue this year, but we've proven to ourselves that there is a market and that we have a really, really good product because we're winning.

Gregg Lampf - *Ciena Corporation - VP of IR*

Thanks Meta.

Meta Marshall - *Morgan Stanley - Analyst*

Great, thanks.

Operator

Tim Savageaux, Northland Capital markets.

Tim Savageaux - *Northland Capital Markets - Analyst*

Hi, good morning. A question on business mix geographically as the year progresses or what's implied in your outlook. Obviously you saw more than a fair bit of international strength here in the quarter. I wonder if you expect any changes in that as the year progresses for US customers to maybe step up a bit? And sort of in context of that if you might be able to address trends you see in the US market. You've already focused on web-scale, maybe talk about trends in your traditional Tier 1 customer base as well as cable where we've at least seen a fair bit of strength it would seem of late.

Gary Smith - *Ciena Corporation - President and CEO*

Yes, Tim, I think the dynamics that we see playing out for the rest of the year -- listen, I think APAC is going to continue to be strong. I would highlight India specifically as being a standout geography, and also CALA. But I do think -- which I think is to the point of your question that we will see North American growth strengthen in the second half and we think that we can probably see double digits organically growing. If you take out AT&T from the North American picture, we can see double-digit growth in North America in the second half.

And I think to your point that that's a blend of cable, web-scale environment, utilities, some of even the large enterprise data center pieces as well. So on the order flow that we saw in Q2 was I think was reflective of that and that gives us visibility and some confidence around that North America market in the second half as well.

Tim Savageaux - *Northland Capital Markets - Analyst*

Great. And if I could just follow-up real briefly on that, with regard to the strength you mentioned in CALA and APAC in addition to the commentary around Ericsson, should we be connecting dots in terms of our relationship between those two trends right there on the one hand? And on the other, do you feel like you're taking share in those regions, perhaps in a more aggressive fashion than the rest of the world?

Gary Smith - *Ciena Corporation - President and CEO*

I would say, the relationship certainly has had a good contribution to it. I would think given the size of the numbers that we're seeing there it really is us taking share. And I think -- you look at somewhere like India, we been invested in the India market now for almost 10 years and we're really beginning to see the benefits of that. We also are pleased to announce that we've just been awarded the defense project in India, which will start to roll out during 2017. It's the largest network of its type and that's really based on carrier Ethernet transport delivery to all of the various armed forces in India and we've just been selected for that project.

So I think that's an example of the direct activity that has taken a long time to come to fruition but we're really beginning to see those markets move now.

Gregg Lampf - *Ciena Corporation - VP of IR*

(inaudible)

Tim Savageaux - *Northland Capital Markets - Analyst*

Yes, nice quarter, guys.

Gary Smith - *Ciena Corporation - President and CEO*

Thank you.

Gregg Lampf - *Ciena Corporation - VP of IR*

Thank you.

Operator

Jeff Kvaal, Nomura.

Jeff Kvaal - *Nomura Securities - Analyst*

Yes, a couple as well. I think number one is, could you talk perhaps, Jim, about the spending that didn't occur in the first half of the year? It seems as though you were more or less on plan with your OpEx so far, so what's happening there?

And then bigger picture, if orders are better -- and it seems as though you've given us a lot of reasons to think why orders are better, then why only reiterate the midpoint of your guidance for the full year? Why wouldn't you take that up? Shouldn't -- or maybe to signal a new an incremental level of conservatism in the full-year guidance? Thanks.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Okay, Jeff, on the OpEx question, remember when we started the year, we said that we were going to do $225 million a quarter and that's what we thought. We actually did quite a bit lower than that in Q1 and slightly lower than that in Q2. Some of that was because of just management of OpEx and making sure we weren't spending any more money than we had to. But some of it, particularly in areas like real estate and IT and to some extent in R&D, we are project-based and our spending is not necessarily going to occur in the period that we project and some of it's going to move out in the year.

So we're trying to give ourselves just a little bit of room. When we said the $225 million with some potential variability due to spending that did not occur earlier in the year in case we run a little hotter than $225 million in Q3.

Gary Smith - *Ciena Corporation - President and CEO*

In terms of the growth for the year, I would say that we expected good order flows in Q2, and now that we've got that and we've secured some of those deals that we thought we were going to get, I think that gives us greater confidence and visibility as we look into that guidance. Obviously, it's always a risk-adjusted, balanced perspective on it. I mean, generally speaking, we're reasonably accurate on where we think we're going to come out. There is a lot of moving parts to it but I think we've got greater confidence and visibility which is why we reaffirmed that number.

Gregg Lampf - *Ciena Corporation - VP of IR*

Thanks, Jeff.

Operator

Vijay Bhagavath, Deutsche Bank.

Vijay Bhagavath - *Deutsche Bank - Analyst*

Yes, thanks. Hi, Gary, Jim. A quick question for you on visibility in the emerging market opportunities. Roughly how many quarters do you think of order visibility you have in projects in India and also in LatAm in particular? And then Europe, Gary, would you view Europe as challenging or performing better than your internal sales targets heading into the back half? Thanks.

Gary Smith - *Ciena Corporation - President and CEO*

Okay, let me take the project base. We have pretty good visibility into the projects and they tend to be more large project-based with longer cycles to them. Sometimes takes longer for revenue but it does give us visibility into it. I think you look at some of the buildouts that are going out on some of these key markets now, I think they are one to two years to three years; they are pretty large build outs. You're seeing that in India as well publicized around the 4G buildouts that are going on there and also in CALA. So we have pretty good visibility to them.

Regards to EMEA, I think that market has been challenged from a CapEx point of view for -- it's well documented for a little while. Also, the competitive dynamics there, frankly, in the closing period of Alcatel's existence and also with Huawei have been very, very competitive in Europe. And also I think as we've said, we think we can do better to be aligned around some of the opportunities for us in EMEA than we have been.

As Jim said, I'm encouraged by the profile that we're seeing in Europe; it's early days. I continue to think that we can expand in Europe and grow that business and I think we're on a reasonable trajectory over the next 18 months or so to do that, but we've got a lot more work to do.

Vijay Bhagavath - *Deutsche Bank - Analyst*

A quick follow-on for Jim. That $225 million OpEx number, Jim, would that be the new norm for the next few quarters or if the OpEx number could trend down, what could help in getting the OpEx number down? Would it be project-based or would it just be overall cost reductions? Thanks.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Well, as I said, we gave $225 million per quarter at the beginning of the year and we've done better than that. We think we're in that range now. So we're not going to be trending down OpEx as we move through the rest of this year.

Operator

Stanley Kovler, Citi.

Stanley Kovler - *Citigroup - Analyst*

Thanks a lot. Just two housekeeping questions and then a follow-up. So I wanted to just ask about foreign exchange impact especially given the strength internationally, how that factored into the results and what we should expect for the balance of the year as far as that impact? And also the tax outlook for the balance of the year.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Yes, on FX, remember we had a long exposition about the effects of FX early on and although some of the currencies have strengthened against the dollar slightly, we don't see a lot of change in FX as we sit here today from the description that we gave at the end of the first quarter. The Canadian dollar has strengthened a little bit; that is affecting our OpEx. But not a new story, significantly new story with respect to FX for the year.

On tax, as we've said, our tax line is really just driven by profitability in non-US countries. We do expect it to be slightly higher in the second half than it's been in the first half, but it still going to be a relatively small number.

Stanley Kovler - *Citigroup - Analyst*

Got it. That's helpful. Thank you. And then I just wanted to follow-up on the linearity in the quarter, especially in North America and the AT&T business. If you can help us understand how it tracked throughout the quarter and the finish and then whether with your largest customer we should be thinking about year-over-year to be flat or declining in the trends there, especially non-Verizon metro 100 G deployments and how those are tracking for the balance of the year? Thanks a lot.

Gary Smith - *Ciena Corporation - President and CEO*

Okay, Stanley, why don't I take the AT&T first? I think we're delighted with the progress that we're seeing in AT&T. We're continuing to diversify our role as a strategic supplier and I think their approach to the architecture is giving us a real opportunity to add a lot more value across a much broader range of engagements with them. We expect the profile of the account to evolve to reflect this as they go towards next-generation architecture and more software orientation. So I think we expect from a revenue point of view that it is going to be -- that we don't think it will grow this year. I think we've talked about that so you know very clearly. But I think we continue to expand our market share within the account and manifest our relationship in different ways, primarily with next gen and software.

So as a percentage of our overall revenue, I think -- the rest of the business grows, it will decrease and I think that's a positive element around the diversification of our business.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Just to clarify the question, you said linearity of revenue from AT&T in the US. Were you talking about through the year or inside of a quarter? What were you asking there, Stan?

Stanley Kovler - *Citigroup - Analyst*

Related to that part of the question, it was what happened in the quarter?

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Inside the quarter? Okay. Well, as we've said, our business generally is back-end loaded. We do have a fair amount of activity in the latter part of the quarter. For larger customers, it is probably a little more linear. We tend to have a little more steady quarters from larger customers, but still we're just going to always have a third month of the quarter, which is going to be heavier than either of the first two. That's just the way our business works. We'd love it to be very linear; it's just not going to be.

Gregg Lampf - *Ciena Corporation - VP of IR*

Thanks, Stan.

Operator

Alex Henderson, Needham.

Alex Henderson - *Needham & Company - Analyst*

Yes. Thank you very much. Can you hear me?

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Yes.

Alex Henderson - *Needham & Company - Analyst*

Great. I was hoping you could talk a little bit about the competitive environment particularly given the transition at ALU to Nokia. I know ALU has been particularly aggressive in the marketplace going into the transition period but has there been any changes recently and do you anticipate any changes? Are you hearing any difference in their behavior in terms of bidding contracts that might alter the trajectory of their price aggression going forward?

Gary Smith - *Ciena Corporation - President and CEO*

I would say, Alex, at this stage I think it's too early to tell. This thing takes a while for it to filter through into the front-end engagements, but we're not particularly seeing much change frankly.

Alex Henderson - *Needham & Company - Analyst*

And then the second question if I could. The metro buildouts, you talked about the timeline for your revenue recognition, but is there a difference in the rate at which you are doing installations? I would assume that the installation process is fairly lengthy exercise and that some of that installation process has already been fairly aggressively engaged as we start rolling out metros here in the May timeframe and going into the back half. So can you talk about the difference between rate of inflation and rate of revenue recognition over the course of the year in metro?

Francois Locoh-Donou - *Ciena Corporation - SVP and COO*

Hi, Alex; it's Francois. So on the metro, I think your question initially was specifically about Verizon. I think as we said, it's going to ramp in the second half of the year. We don't expect a lot of revenues this year, but we will take some revenues.

In terms of the delta between the time we install the systems and the time we take revenue, that shouldn't be -- there shouldn't be a long lag or a long time difference there. It will be pretty straightforward in this case. Remember, we're also doing deployments in other Tier 1s in the metro in the US with AT&T and [Centrelink] and that's already on the way and that's the time between install and revenue there is also pretty straightforward.

Alex Henderson - *Needham & Company - Analyst*

Okay, great. Thank you.

Operator

Dmitry Netis, William Blair.

Dmitry Netis - *William Blair & Co. - Analyst*

Hi. Thanks for taking my questions. I have a couple. One, I wanted to follow-up on the time question asked earlier. I don't think you guys touched on that. But what are you baking into the full year 2016? Is it -- I think the last guide was the 30s number for the next couple of quarters, so should that -- is that what we should be expecting here? How did Cyan do in the current quarter?

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

Yes, we think that around $30 million per quarter is the right kind of range for now. It was a little lower in Q2. It was around $25 million in total, products and services, and so it's on plan.

What I would say is that over time, some of those customers are going to transition to 6500 and so the delineation between Cyan revenue and 6500 revenue is going to get increasingly blurred. But overall, we're very, very happy with both sides of that deal, both hardware and software.

Dmitry Netis - *William Blair & Co. - Analyst*

Okay, and I guess on the Software piece, if I may, the Blue Planet, I looked at the total Software contribution this quarter. You had a nice -- I mean relative to the overall revenues, probably minuscule but it was nice sequentially up about $5 million or so. So there is some traction there. I was just wondering if it is coming from Blue Planet or something else? I know you have some Software-Related Services there. So if you could kind of separate the two and give us a little bit of sense of where Blue Planet sits and how it's doing and what your expectations may be for the rest of the year? And then maybe next year, can we expect Blue Planet to maybe do $25 million or more? How should we be thinking about that one?

Francois Locoh-Donou - *Ciena Corporation - SVP and COO*

Yes, so a couple of -- let me start with your first question around current quarter. Yes, we did see an uptick on Software and Software-Related Services quarter-on-quarter and year-on-year and the contributions come from three areas. One is, yes, we are starting to see some contribution from Blue Planet in the revenue line there. But we're also seeing increasing contribution from our Software Subscription services, which as you know is a more predictable stream of revenues on Software, and generally our network management systems are doing well. As Gary mentioned earlier, the consumption models are evolving and that's allowing us to sell more of this [off box] software.

So there's really three contributions giving us this uptick on Software. I don't think at this stage we are ready to comment on Blue Planet for next year. That being said, we are seeing traction with Blue Planet across the board. I would say the pipeline has significantly increased from the time of the acquisition of Cyan. We're seeing a number of applications for Blue Planet orchestrating resources in the data center and we're also seeing applications for solving key pain points in wide area networks for carriers operating multivendor networks. And really this ability that we bring to the table to manage resources both in the data center and in the wide area network is pretty unique in the market and that's why we're seeing the traction that we're seeing across the board.

Dmitry Netis - *William Blair & Co. - Analyst*

Okay. Helpful.

Operator

Jess Lubert, Wells Fargo.

Jess Lubert - *Wells Fargo Securities - Analyst*

Hi, guys. I have a question on the Packet Networking business. It's a fairly strong quarter. You highlighted a number of longer-term drivers, running business Ethernet services in 5G. So I was hoping you could comment on how you'd expect this business to progress during the second half of the year? And to what extent should we expect the Packet Networking business to grow faster than the transport segment from both a near and longer-term perspective?

And just following up on that perhaps you can touch upon to what degree the 8700 is opening new opportunities for driving some of the incremental optimism here?

Francois Locoh-Donou - *Ciena Corporation - SVP and COO*

Very good. So on Packet Networking, so first of all, yes, it is growing faster than the transport segment. It has grown so far in the first half of the year faster than the transport segment, and we expect it to be to have even a stronger half -- stronger second half on Packets than we did in the first half. So overall for the year, we do expect it to grow and to grow faster. It's growing higher than double-digit from the numbers, as you will see.

If you look at the trends and the reasons for that, there are a couple of important ones. One, and Gary touched on it in his remarks. Overall, the Ethernet services market for carriers delivering services to the enterprise is one of the fastest-growing segments of the enterprise market for services and we are very well positioned with the relationship we have with carriers really helping them sell these new services. And our carriers and our technology and increasingly the help that Blue Planet brings to evolving these services is an accelerating factor on the Ethernet business.

The other factor that you'll see is both carriers and utilities moving to Ethernet as a ubiquitous layer of connectivity to the edge of the network, and we're seeing that in migrations from part of the world in emerging markets -- we talked about that -- are still migrating from 2G to 3G or going straight from 2G to 4G so we're seeing significant opportunities in the mobile backhaul space and that's part of what's helping our diversification and our growth in our international business.

And then we're also seeing utilities migrate from legacy systems to Ethernet-based connectivity and that's an accelerating factor as well. So overall, our Packet Networking business is growing rapidly and we expect that to continue for the foreseeable future.

Jess Lubert - *Wells Fargo Securities - Analyst*

Can you touch upon to what degree the Packet Networking strength you're expecting is more dependent on some of these international opportunities or would you expect it to be fairly balanced both domestically and internationally going forward?

Francois Locoh-Donou - *Ciena Corporation - SVP and COO*

We would expect it to be fairly balanced in terms of the growth rate. But as you know, the Packet Networking business originally was -- had a high concentration in North America and what you are seeing now flow through in the numbers is higher contribution from international customers.

Jess Lubert - *Wells Fargo Securities - Analyst*

Thanks, guys.

Operator

George Notter, Jefferies.

George Notter - *Jefferies LLC - Analyst*

Hey, thank you very much. I guess I was curious about the progress you're making on 16QAM. I think in the past you guys have given us a number of customers you have there. I would just be curious on where you are with customer count and then just generally traction in the marketplace with that capability? Thanks.

Francois Locoh-Donou - *Ciena Corporation - SVP and COO*

So, George, we're making a lot of progress. We have over 30 customers now that are deploying 200 gig systems from us and we're really quite unique in this capability still in the marketplace in terms of the competitive environment. That number is growing rapidly, as we have roughly about 200 customers now that deploy 100 gig and a lot of these customers are starting to adopt 200 gig and 16QAM technology. We're seeing that -- initial applications for that are in the metro, but that's starting to move to more metro regional applications. And as it migrates to metro regional, then we're seeing more customers adopt that.

All of that, George, is driven by -- we see a lot of need for increasing capacity effectively across the globe and a lot of our customers don't have a lot of fiber and so spectral efficiency is very important for them and our 16QAM technology is really leading the market with spectral efficiency.

George Notter - *Jefferies LLC - Analyst*

Just as a follow-up there, I'd be curious about how that impacts your financial model.

Francois Locoh-Donou - *Ciena Corporation - SVP and COO*

Can you expand a bit, George, on the question? What part of the financial model?

Gary Smith - *Ciena Corporation - President and CEO*

Gross margins?

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

He's asking gross margins which we don't see a huge difference in gross margin. It is kind of a unique product right now, so we might get a bit of a premium in some markets. But it's not right now moving the needle in terms of our gross margin picture.

George Notter - *Jefferies LLC - Analyst*

Got it. Thank you.

Operator

Catharine Trebnick, Dougherty.

Catharine Trebnick - *Dougherty & Company - Analyst*

Thank you. Thanks for taking my question. Last quarter you talked about some FX impact in Brazil and this quarter you noticed -- you did say the CALA was up. Are there other regions in the CALA region and what would be some of the use cases that you are seeing in Latin America? Could you give us more color on that? Thank you.

Jim Moylan - *Ciena Corporation - SVP of Finance and CFO*

On the FX side, the biggest effect from FX has been in -- from Brazil. We've had an effect in Argentina, although that has tended to be in our other income line. The Brazilian effect is the biggest effect in terms of revenue. And as far as use cases, you're talking about product use cases or applications use cases, Catharine?

Catharine Trebnick - *Dougherty & Company - Analyst*

Product use cases and some application. I'm trying to think outside Brazil, you have Mexico, other regions that look like AT&T is building out, etc. I'm just trying to figure out which other regions besides Brazil is there more subsea opportunity in that area, is it carrier Ethernet? Is it more 100 gig, etc.? Thanks.

Francois Locoh-Donou - *Ciena Corporation - SVP and COO*

Hey, Catharine; it's Francois here. Yes, so the use case are actually buried in CALA. We do indeed have subsea opportunities. They are both on private cable and on Consortia cables. We're seeing more traffic from the US to CALA and back driven by the web-scale players. So that's a growing application for us.

We're also seeing growing application in the Packet Networking space in CALA, which we are fulfilling both with our 8700 platform and our (inaudible) products and that's really driven by continued migration in the mobile backhaul space to 3G and to 4G. And the other thing we're seeing in CALA is bespoke built. In part driven by web-scale players asking local carriers to build in country capacity for them and that's all 100 gig or in some cases 200 gig.

Catharine Trebnick - *Dougherty & Company - Analyst*

Oh, thank you very much.

Gregg Lampf - *Ciena Corporation - VP of IR*

All right, well with that, we appreciate everybody's taking the time. We're approaching the bottom of the hour. Thanks for listening. We look forward to catching up with everyone over the next following weeks. Thanks.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Have a great day, everyone.
