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PRESENTATION

Operator

Good day, everyone. Welcome to the Ciena Corporation unaudited fiscal first quarter 2013 results conference call. This call is being recorded. At this time for opening remarks and introductions I would like to turn the call over to Cynthia Simsiman, Investor Relations Analyst at Ciena. Please go ahead.

Cynthia Simsiman - *Ciena Corporation - IR Analyst*

Thank you, Bethany. Good morning, and welcome to Ciena's first quarter 2013 review. I'm Cynthia Simsiman from Investor Relations sitting in for Greg Lampf, who is out sick today. Joining me on the call are 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. In our prepared remarks, Gary will discuss management's view on the quarter, and Jim will offer some color on the Q1 results and provide guidance for Q2. We'll then open the call for questions from the sell-side analysts, taking one question per person, with follow-up as time allows.

Before turning the call over to Gary, I'll 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-K filings. Our 10-Q is required to be filed with the SEC by March 14 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, Cynthia, and good morning, everyone. Thanks for joining us today. This morning, we announced a solid quarter that we believe represents a very good start to 2013. Revenue of $453 million was in line with our expectations. Whilst gross margin and OpEx were better than anticipated. Broadly, we view our Q1 performance as the result of focused execution of our strategy, as we continue to make good progress and demonstrate our ability to derive operating leverage from the business. Revenue and gross margin were both up significantly year-over-year contributing to an adjusted operating profit of 6% for the quarter. We continue to announce cross-portfolio Tier 1 wins around the world, including Comcast, [Tarter], and Reliance Globalcom, as customers increasingly embrace our open architecture. And with our number one market position in next generation networking in North America, and our number two position worldwide, we're clearly well-positioned in the competitive landscape with our approach as a focused specialist with global scale.

As expected, we did see the usual Q1 seasonal effect in the form of a heavily back-end loaded quarter for orders and revenue. And as a result we consumed cash in the quarter. In spite of the seasonality, we had solid order flow in Q1, with orders exceeding revenue. And we were pleased with the continued customer momentum for our solutions. In fact, with the industry structure continuing to change, we see expanding opportunity as we position Ciena to take advantage of the underlying market dynamics. Network operators are increasingly seeking solutions that converge not just transport and OTN switching functionality, but package switching, as well. Ciena's focus on these strategic parts of the network sets us apart both from suppliers, whose addressable scope is much narrower, and from those whose breadth is so general that they cannot offer expertise as deep.

Only Ciena converges market-leading technology in coherent optical transport, OTN switching, and package switching. We have a unique ability therefore to deliver comprehensive solutions that not only create bandwidth, but also access, manage, and add value to bandwidth across an automated packet optical infrastructure. Convergence of these network features is removing the traditional barriers between access, metro, core, and submarine applications. The tight integration and software unification across our portfolio enables Ciena to sell more converged solutions across more network domains.

While North American customers have been among the earliest adopters of these converged architectures, we are seeing the trend across all geographies. North America continues to be our strongest performing region. We are seeing more customers moving from architectural planning to deployment. And therefore we expect a strong 2013 for the region. In CALA and APAC, we continue to see strong growth, albeit from a smaller revenue base. Our share gains in CALA are being driven largely by winning in the Brazil market, demonstrated by a recent announcement with Telefonica Vivo. In APAC, we continued to win with PTTs and submarine accounts driving our growth in that region. In Europe our business is stabilizing. Although we're also starting to see increasing activity and opportunities, we are not yet anticipating that there will be significant improvements in this fiscal year.

Overall we continue to feel good about our position and our long-term market opportunities. And I think our Q1 results reflect our ability to continue to drive improved operating leverage. We believe the markets we serve will grow in the mid single digits in 2013. And we expect to grow faster than the market by continuing to win prime positions across major accounts worldwide. We believe that winning in these Tier 1 accounts is the best forward-looking indicator for the business. We continue to believe that our strategy and our open architectural approach lead the way in network convergence, aligning well with customers architectural directions and influencing their infrastructure decisions. And we see more and more customers buying cross-portfolio solutions as a result of that. The combination of our innovative technology, global scale, and customer relationships places us in a very strong strategic position.

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

Jim Moylan - *Ciena Corporation - CFO*

Thanks, Gary. Good morning, everyone. As we have previously discussed, our customers' network requirements are changing rapidly, driven by a need for converged transport, OTN, and packet switching solutions. By extending features and functionality across product lines, and uniting them with common software, we have evolved our portfolio to facilitate convergence. In turn, that portfolio evolution has led to changes in how we manage the business, as well as how customers evaluate and buy our products. We indicated last quarter that we would be updating our reporting segments to better reflect all of these changes. And Q1 is the first quarter to report results in our new segments.

A few segment highlights. In Converged Packet-Optical, our WaveLogic 3 coherent technology continues to ramp, with 6500 being the largest contributor in the segment. Beyond Tier 1s, our 100-gig customer base now spans every type of network operator, including content providers, federal and regional governments, and major enterprises. We're also seeing OTN and packet integration become increasingly important as the adoption of integrated switching on our 6500 platform is ramping nicely. With recent wins at PTTs in both Europe and Asia.

Our Packet Networking business continues to be driven by growing demand for ethernet. Several of our major North American customers are ramping up the rollout of their business ethernet offerings to meet this growing demand, particularly for ultra high-speed services. And we continue to see momentum in mobile backhaul. In fact, today, Ciena serves over 50% of the fiber-fed sites in North America.

Finally within our Software Applications and Services segment, enhanced software-based programmability and integrated management continue to be focal points for customers. We saw a meaningful sequential uptick in software revenue. And we are pleased with the customer adoption of our new network transformation solutions. To assist you as you convert your models to these new segments, we've updated the recast segment financial data for fiscal 2011 and 2012 on the investor section of Ciena.com. Q1 revenue for 6500 came in at $206 million. And we will provide this product line detail through fiscal 2013 to help with this transition period for your modeling.

Lastly, looking back on 2011 and 2012, the margin ranges for each of our new segments have been as follows. Converged Packet-Optical has been in the high 30%s to the mid 40%s. Packet Networking has been in the mid to high 40%s. Optical Transport has been in the mid 40%s. And Software Applications and Services has been in the high 30%s to low 40%s, depending on software content. These broad ranges are neither specific to Q1 nor intended to provide guidance for any future period. They are also subject to fluctuation based on a number of familiar factors, like customer and geographic mix, the mix of products within each of the segments, and the level of sales of new platforms and related start-up costs. While we provide this information today to help you with your models, going forward, and in keeping with our standard practice, we will only break out gross margin at the product and service levels in our reported results.

I'll now take a few minutes to provide some detail on the quarterly results that we published earlier today. I will be speaking only to non-GAAP results, so please refer to this morning's press release on our website for the reconciliations to our GAAP results. With an adjusted operating margin of 6% on revenues of $453 million, we are pleased with the progress we've made in improving the operating leverage in our business in the first quarter. Q1 gross margin came in higher than expected at 44.6%, as a result of solid execution and a combination of other factors. First, we had a strong overall product mix, including higher margin converged packet switching and software content across the portfolio. Second, we are beginning to see the impact of some of the operating efficiencies that we've been discussing in recent quarters, such as product cost reductions and direct order fulfillment. Operating expense in Q1 came in lower than expected at $177 million, largely a timing issue related to some projects in R&D and real estate. We now expect these expenses to occur in either Q2 or in subsequent quarters.

Turning to cash, our cash position ended at $637 million, which was lower than Q4. This also was largely an issue of timing due, due in part, to the seasonal impacts Gary mentioned a moment ago, including the timing of a larger portion of sales occurring later in the quarter, which contributed to lower collections. We continue to believe that we will generate cash again for the year in fiscal 2013. Orders were greater than revenue in Q1, consistent with our expectations. In terms of our balance sheet, we completed a convertible note exchange offer in Q1, which strengthens our balance sheet and provides enhanced financial flexibility. You should note that this exchange resulted in a one-time non-cash loss of $28.6 million, as described in our reconciliation of adjustments in today's press release.

I'll now turn to guidance for the fiscal second quarter of 2013. Absent any significant changes in exchange rates, our guidance is as follows. We expect Q2 revenue to be in the range of $465 million to $495 million. We expect Q2 gross margin to be in the low 40%s. While our Q1 gross margin validates our ability to achieve our long-term target range in the mid 40%s, we believe we are not yet in a position to achieve sustained mid 40%s gross margins. We expect to begin deployment of some new international transport wins and other projects that we won in 2012. We also expect to continue to win new network builds in 2013. As we have seen in the past, timing uncertainties and start-up costs associated with these new wins and early-stage network deployments may cause some downward pressure on margins and quarterly fluctuation. Consequently, consistent with our previous statements, we continue to expect gross margins for the remainder of the fiscal year to be in the low 40%s percentage range.

For operating expense, we expect Q2's adjusted OpEx to be in the low $190 millions range, reflecting some of the expenses that did not occur in Q1, as we previously expected. We've said repeatedly, that our OpEx does include a number of large projects, the timing of which is difficult to predict. As a result, we have seen and there will continue to be quarterly fluctuations in our OpEx. That said, our OpEx plan for the year is unchanged. And we continue to believe that our average quarterly OpEx for the full fiscal year will be in the high $180 millions.

With regard to other income and expense net in the first quarter, we project an expense of approximately $11 million relating 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 102 million total shares. Diluted share count will vary depending on your assumptions about our profitability.

That concludes our prepared remarks, so with that we'll move on to Q&A. As a reminder, we will be taking one question for sell-side analysts, with follow-ups as time allows. Bethany, we'll now open up the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Kevin Dennean with Citigroup.

Kevin Dennean - *Citigroup - Analyst*

Congratulations on a solid set of results. Jim or Gary, a question for either one of you. I think the tone that you're taking towards North America is a bit of a change. You're calling out a strong 2013. Can you walk us through a couple things. One, what are you seeing change in the customer base that gives you the confidence into that visibility? And in part with that, how should we think about, or what do you think the key drivers will be in North America? Should we see 100-gig deployments accelerate? Faster adoption of OTN? And what do you think this could mean for the 5430 cycle?

Gary Smith - *Ciena Corporation - President, CEO*

Thank you, Kevin. Why don't I take that. Regarding North America, I think we've been saying for awhile, the last 18 months or so, noting a number of design wins that have taken awhile to operationalize. I think what we're now seeing is those actual deployments rolling out. So we've won the architectural design for a lot of these new networks and we now actually are seeing them being actively deployed. And I would say largely, Kevin, that's around those large Tier 1 carriers, in general.

I would also say, from a technology perspective, it is across the spectrum of the open architecture. So it's 100 gig, it's OTN, I would also say it's packet-based, as well. And I think, as we mentioned in the prepared remarks, we're actually finally seeing, I think, ethernet business services widely being rolled out by a number of the Tier 1 carriers. So I think we feel a little more optimistic around the financial impact, if you like, of those wins now beginning to show into our financial performance as we go forward into North America.

Kevin Dennean - *Citigroup - Analyst*

Okay, terrific. Thanks very much. I'll drop back into the queue.

Operator

Mark Sue with RBC Capital Markets.

Mark Sue - *RBC Capital Markets - Analyst*

Gary, maybe just some high level directional comments related to the pace of your order growth in bookings. Does the vector of the order trends correlate with the commentaries from some of the service providers for the full year? And it also sounds as if the order trends, your order trends, are shaking off the typical seasonality that you do see. Maybe if you could give us some thoughts there, as well.

Gary Smith - *Ciena Corporation - President, CEO*

Yes, I would say, Mark, that Q1 is always a bit of a challenge for us on the order side, and it's not perhaps the best barometer. I think last year we actually exceeded our revenues, as well, because revenues were particularly low last quarter or a year ago. But in previous quarters we've actually eaten into our backlog in Q1, which has been a typical seasonal model. We've not seen that in the last couple of Q1s, and I think that's positive. I think the real indicators for us will be as we go through Q2.

We finished with a strong Q4 in terms of order intake. And our backlog was the highest backlog we've ever had turning into the year. We're seeing from an activity point of view continuing good activity across the board, both in North America. I talked about CALA and APAC. And I would also say even Europe, though we don't expect that to really impact the results this year. We're seeing a lot of activity and opportunities within some of the big Tier 1s around the globe, as well. So early days in the year, but we built backlog coming out of Q1 and I think that's positive.

Mark Sue - *RBC Capital Markets - Analyst*

Got it. Jim, maybe a quick one for you just on your specific plans to strengthen your balance sheet, and perhaps also cash flow, how we should think about that, not only when quarters are seasonal but perhaps for the full year for cash flow.

Jim Moylan - *Ciena Corporation - CFO*

Yes. We did consume some cash in the quarter, as I said. We had a pretty heavily back-end loaded quarter, which means shipments were late. We ended up not being able to collect on shipments, a number of the shipments that occurred in the quarter. The second thing that happened was, you'll note that our inventory increased.

The biggest increase in the inventory was due to what we call our off-site inventory, which is inventory at either customer premises or getting ready to be deployed to customer premises that has not yet been accepted by the customers. I do believe that that also is an indication of the holiday season, and the fact that things don't really get going until January, which is the last month of our quarter. So we did build working capital in the quarter. We don't intend to do, or at least do that as much, as we go through the year. We do expect to increase our cash balance for the full year, from the end of year 2012 to the end of year 2013. I would guess that we're probably going to increase our cash in Q2, as well.

Mark Sue - *RBC Capital Markets - Analyst*

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

Operator

Kent Schofield with Goldman Sachs.

Kent Schofield - *Goldman Sachs - Analyst*

You talked a little bit about the gross margins through FY '13. Can you remind us just again how we get to the mid 40%s looking at the product sets, as well as it looks like Americas were at the high end as a percentage of sales compared to the recent past.

Jim Moylan - *Ciena Corporation - CFO*

Yes. We were very pleased with our margin result in Q1. We think it is an indication of what we can do when things happen right for us. And I think it's a step on the path to sustainable mid 40%s margin. But as we look at the rest of the year, we think that some of the things that happen in the quarter are just going to change a bit. We think we are going to probably increase our mix of transport, for the next quarter at least.

And, also, we do have some wins that are rolling out. And as we said in the past, that start-up costs and one-time costs associated with deployment of new deals are going to impact our margin. So again, I'd say we're happy with the margin for this quarter. We think we are on the road to better margins over time. But right now, we think our sustainable margins are low 40%s.

Kent Schofield - *Goldman Sachs - Analyst*

Thanks for the detail.

Jim Moylan - *Ciena Corporation - CFO*

I do want to clarify one comment I made with respect to Mark's question, because I probably mislead some people here. We are likely going to pay off the 2013 convertibles in Q2. That's about $216 million, which will go out of our cash balance. So when I referred to our increase in cash, it's a increase net of the pay-off of the convertible notes in the second quarter. Sorry for that confusion.

Operator

Simon Leopold with Raymond James.

Simon Leopold - *Raymond James & Associates - Analyst*

I was hoping we could drill down a little bit on the trends in the Converged Packet business. I appreciate you giving us the additional detail on the 6500. And helping us make the transition to the new disclosures. So it does appear, then, that the switching business was up sequentially in January, and back on the trend that we saw through the middle part of 2012.

I'd like to try to get a sense from you of how you see the switching business trending through the year, whether we get to see the projects that slipped, or whether we're at a new stable level. And then the other part of the CPO business I'd like to get a sense of. And you implied or suggested we would be up sequentially in April. I want to get a sense of, is this driven by the release of the single channel 100 gig or is there just a more broad trend driving the ramp there? Thanks.

Gary Smith - *Ciena Corporation - President, CEO*

Simon, why don't I take the first part of that, and then maybe Tom can get down to some of the specifics that you talked about. I think within the Converged Packet piece, our more traditional way of looking at it, our historical way of looking at it, if you did that analysis, we were up in the quarter. And I'd expect reasonable growth throughout the year for that. The thing that I would highlight, and one of the reasons, obviously, we moved to this kind of segmentation is there's a fair amount of switching actually now contained within 6500. And we saw that in this quarter and we can see a continuing ramp of that. Approximately it's about, the 6500 revenue, it's approximately 10% of that revenue is really switching. And we'll talk about that anecdotally as we go through the year. But I think this convergence with packet switching, OTN, and the 100 gig, within this packet optical portfolio, I think we're going to see very strong growth during the year.

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Simon, to your point on switching trends, I think you'll see that, in fact, you're right, we are up year-on-year. And we mentioned over the last couple of calls that we've largely gotten past some of the operationalization issues that we talked about. And we've begin to go to deployment. Now I'll remind you, it's early days on this, and things tend to move around quarter to quarter. But broadly we remain encouraged about the switching business as we go through 2013. In the quarter, we added a couple of 5400 customers. So in addition to seeing some of the business that we've landed last year begin to come to revenue, we're also continuing to add some new customers during the quarter.

With respect to your question on the new single carrier 100g, what we call WaveLogic 3, I wouldn't say that that's necessarily the driver of growth. I'd say the driver of growth is really the overall increase in demand for 100g and the fact that we've won a number of important Tier 1 customers. In fact, at this point I'd say we've announced more Tier 1 100g customers than anybody else in the industry.

Simon Leopold - *Raymond James & Associates - Analyst*

And just to clarify, what I'm really trying to struggle with here is the switching business is a very good gross margin and the transport not so good. And so we're sensitive to the mix when we think about the year. And that's really what I'm trying to understand better, is the full-year mix between lower-margin transport and higher-margin switching.

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Right. As we said last time we talked, and I think we continue to believe this, we expect the proportion of switching and carrier ethernet, the higher-margin portions of our business, to be higher in 2013 than they were in 2012. So I think that's going to be one of the things that gives us some positive output pressure on margin. Also the fact, as we've talked about before, that we're adding switching capability to our transport platforms also gives us the opportunity to improve the margin profiles of some of those. All that said, as Jim mentioned in the prepared remarks, we do expect to do some new deployments and those come with start up costs. And that could produce a countervailing negative pressure on margin.

Jim Moylan - *Ciena Corporation - CFO*

What I'd say, Simon, is, as you would suspect, when we're given gross margin indications for Q2 and for the rest of the year in the low 40%s, we've tried to incorporate the effects of all that, including what we see as an increased switching mix, including a continued percentage of what was traditional 6500 revenue, which is switching blades. And, as you know, it's getting more and more complex to separate out the margin impact of each of these things. But just bottom line is that low 40%s guidance is intended to reflect our view of what's going to happen in all of those categories.

Simon Leopold - *Raymond James & Associates - Analyst*

Thank you.

Operator

Ehud Gelblum with Morgan Stanley.

Ehud Gelblum - *Morgan Stanley - Analyst*

Following a little bit on the line of the same type of questioning, the old CESD with the 3000 series that's now in Packet Networking, that seemed to stay strong now for the second straight quarter after starting to come back up. You mentioned, Gary, you talked about ethernet business services at a number of customers. You initially primarily had one large Tier 1 North America. Can you give us some color on how many customers are deploying that 3000? And should we be modeling this going forward staying in the close to $50 million range? Or is that going to still fluctuate around? Or is it going to get higher, and it should really be, a year out, more like $60 million a quarter?

Gary Smith - *Ciena Corporation - President, CEO*

First of all, in the overall packet networking space, ethernet business services, I think we're seeing broader adoption across a number of carriers. I think we've got about, at the last count I think there was about 130-plus customers overall. And that continues to expand. I think we've got actually a couple of Tier 1 North American carriers now rolling out. I think, really, the overall ethernet service is really the fastest growing part of this enterprise data services market. And I think that's really beginning to move now. And we expect the percentage of revenue coming from ethernet business services to increase as part of this segment. It's not as opposed to just wireless back-haul. I think we're really beginning to see ethernet business services take off.

Ehud Gelblum - *Morgan Stanley - Analyst*

Can you tell what percentage of that business is wireless back-haul versus ethernet business services? And has that changed over the last few quarters? It sounds like you're more excited about the business ethernet service side than the bubble back-haul. Or are they both growing?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

We see them both being important issues. But I would say that the growth rate on ethernet business services is likely to be higher because it's coming from a smaller number. And it's actually fairly early days in the deployment of ethernet business services. But one interesting thing to keep in mind is that, if you look at the new services that service providers have launched in the US since divestiture, ethernet business services right now is the fastest growing one they've seen. So that's one of the reasons we remain encouraged by that.

Ehud Gelblum - *Morgan Stanley - Analyst*

And then, finally, the software number was up incredibly strongly quarter over quarter. Should we be looking at what drove that? Is it more of a quarter record type of attach rate? And should we be looking at that staying there?

Jim Moylan - *Ciena Corporation - CFO*

Yes, I think the way to think about that is we put a lot of effort over the past few years into developing software. First network management software and now application software. And all of it is about intelligent networks and allowing operators to do more and better things with their networks.

It's our intent to continue to grow our software piece of our business. Without being specific about the direction of that number, I would say that that's a point of emphasis for us. It's a good margin enhancer and we intend to drive that pretty hard this year.

Ehud Gelblum - *Morgan Stanley - Analyst*

Great. Appreciate it, thank you.

Operator

Scott Thompson with FBR Capital.

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

We've talked in previous quarters about percent of sales that came from outside carriers. Is that helping margin? And what's the status on percent of sales outside of service providers?

Gary Smith - *Ciena Corporation - President, CEO*

I think it was pretty constant in the quarter. It's approximately 25%. The lines are blurring between the traditional carriers, et cetera. But if you look, that includes government enterprise, essentially, Scott, research and education, those kind of spaces. And it's been fairly constant because the carrier business has been growing, as well. Basically we're going to see over a period of the next couple years how that plays out. But we're seeing pretty good growth in those spaces.

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

And then as you ramp OpEx, should we expect that to grow a little bit or should it just have a steady growth rate? Will it help diversify the revenue stream?

Jim Moylan - *Ciena Corporation - CFO*

We do think that that portion of our business will grow over time. The thing that gets a little complicated here is, if the big Tier 1s in the US really came on strong this year, that would overwhelm what would happen in the enterprise space. But we're not necessarily predicting that. I'm just saying you have to be careful. I would say that enterprise, government, research are areas where we are increasing our effort. And so I do think over time they will grow faster than our traditional carrier business.

Gary Smith - *Ciena Corporation - President, CEO*

The other thing I'd say, Scott, to your point around an OpEx, what we're seeing is really operating leverage there. Because we've got a lot of partners addressing that space, not least of which are the major Tier 1 carriers that we're partnering with into a lot of these enterprises. So we think that's a model that has good operating leverage for us. We're investing in it and we are putting more operating expense into it. But we're also seeing good returns from it. And so we think that's something that, whilst we can invest in it, we're getting good returns on the way.

Jim Moylan - *Ciena Corporation - CFO*

Just to clarify, our OpEx plan for the year is unchanged from the beginning of the year. And we said that we thought that for the year we would average in the high $180 millions. We said that last quarter. We continue to believe that. For the full year we think we're going to average in the high $180 millions. We haven't really changed any of the elements of our plan. However, I would say that part of our plan did entail some allocation of resources to that non-traditional carrier space.

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

Thank you, guys.

Operator

Rod Hall with JPMorgan.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

I've got a couple. I just wanted to ask you, on the gross margins, what's going on with the pricing environment. It looks like mix has affected those gross margins positively. But also just wondered if you guys could comment as usual on the pricing environment. In particular, we're hearing that Chinese vendors are losing optical deals in Europe over security concerns. And I wonder if you could comment on that and whether you think that helps to stabilize the pricing environment or not.

And then I also just wondered, maybe Gary, if you could give us some color on this back-end loading of the revenues. Do you think that that's a precursor for a more rapid ramp of revenue recognition? I know that you guys have named a lot of deals but we haven't seen a lot of the revenue yet. So is that beginning or are we still in the phase of rollout here where things are pretty lumpy and it's going to be volatile?

And then Jim, maybe just a quick one. Could you tell us, can you give us any idea how much of the OpEx is non project-related and what the trends there are? Because I know the project-related stuff is what's driving a lot of this OpEx volatility. Thanks.

Gary Smith - *Ciena Corporation - President, CEO*

Why don't I take one of the latter ones first, Rod, and then Jim can take the other. The back-end loading, I really think the back-end loading was particularly a facet of the Q1 dynamics. Remember, it's November, December and January is the quarter. So it's typically a back-end loaded quarter and we saw that, the seasonal effect of that. I think underlying that, though, is my comments around the Tier 1 North Americas now beginning deployment. I think we are seeing that. It takes awhile to operationallize some of those decisions and I think we're seeing across-the-board now that stuff beginning to roll out, and I think will continue during 2013.

Jim Moylan - *Ciena Corporation - CFO*

By the way, Rod, that was three questions.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

I thought it was two and a half, Jim.

Jim Moylan - *Ciena Corporation - CFO*

Just to note. Anyway, on the question about OpEx, just as a rough number, and this can vary a bit, but our people costs are 70% plus or minus of our OpEx. Which means that the remainder is a bunch of projects. And particularly in R&D, in IT, and in real estate, we typically are doing a number of projects. Which entail, in the case of R&D, prototypes and NRE. In the case of IT, it's system implementations. In the case of real estate it has to do with the continuing restructuring, et cetera, moves that we're doing around the world. And so these things are difficult to predict. They happen at different times. And so that would answer that question.

On the pricing environment, here is what I'd say about that. We know that this is a competitive business. We also know that a number of our competitors are having difficulties of various kinds. In some cases, difficulty in penetrating the US. In other cases, they are losing traction in the market. And therefore, one might expect some continued pricing competition, and sometimes intense pricing competition from those people who are attempting to remain relevant.

We are also an attacker. All of the things that are happening to our competitors really give us opportunity out there, opportunity to continue to take market share. And as an attacker, it's just usually the case that you do have to give some front-end concession of some sort, whether that's in the form of lab gear or start-up costs or something, in order to take a position in a network. So it's hard to comment on the overall pricing environment. What I can say is that we're pleased with the direction we're going with respect to market share. And that could impact our margins.

Rod Hall - *JPMorgan Securities Inc. - Analyst*

Great, thanks a lot guys.

Operator

Amitabh Passi, UBS.

Amitabh Passi - *UBS - Analyst*

Jim, I wanted to clarify a point you made on gross margins. I think you said expect low 40%s for the rest of the year. I believe last quarter you also said for the full year you expected gross margins to be generally flattish. I wanted to know, given the performance in the first quarter, do you now think that full-year gross margins would actually end up being higher relative to last year? And then just as a follow-up, on your Optical Transport segment I think we've seen five quarters of negative year over year growth. Given some of the international projects and the ramp that you're expecting, do you expect Optical Transport to actually show year over year growth in any particular quarter for the rest of the year?

Jim Moylan - *Ciena Corporation - CFO*

Sure. I believe what we said last quarter was we could expect to see a small increase in margin, or something like that, from the full year 2012 to the full year 2013. We've now, as we've looked at our year, we can be more specific about that and say that low 40%s is where we are. We're not really trying to change our guidance per se. What we are being is more specific about the guidance that we earlier provided. And the second question?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Yes, with respect to the optical transport revenues, they in fact have been going down. But the thing I want to point out is, remember, when we did the resegmentation, we put 6500 in with our Converged Packet-Optical. So what you're really seeing there is a migration in customers from buying simply optical transport to buying a combination of optical transport and switching. If you look at those two in aggregate I think you'll continue to see growth.

Amitabh Passi - *UBS - Analyst*

Okay. So just for Optical Transport, would you still expect that downward pressure to persist through the rest of the year?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

It's hard to talk about individual quarters but what I would say broadly is the trend in the industry is away from standalone optical transporting to award common optical transport and switching.

Amitabh Passi - *UBS - Analyst*

Okay, thanks.

Operator

Sanjiv Wadhwani with Stifel Nicolaus.

Sanjiv Wadhwani - *Stifel Nicolaus - Analyst*

Gary, I just wanted to take another shot at the pricing environment. Obviously last year we saw some (inaudible) pricing on 100 gig, with, I think, statistics saying that pricing fell 50% through the course of the year. I'm just curious whether, given the caveats of what's going on with Alcatel Lucent and Huawei, et cetera, are you starting to see a little more rational behavior over the last couple of months? Again, I do understand that as the year progresses that could fluctuate. Just wanted to see what you have been seeing in the last couple of months in terms of pricing behavior. Thanks.

Gary Smith - *Ciena Corporation - President, CEO*

I think the broader point that you're bringing up is really one of the industry structure. And I think the shake-out that's broadly going on, I think, is helpful to us. And I think our strategy around being a focused player with global scale, I think, is beginning to play out, both in terms of the new wins. And I think, to some extent, as well, our value proposition that we're focused on yields a higher premium in the marketplace. So that helps us, as well. We deliver more value to our customers because we're a focused player with leading technology. And we have deep relationships and understand the business issues that our customers are dealing with. I think our large competitors are focused on a lot of other things. And as Jim alluded to, they have some particular challenges right now that vary in nature but I think presents an opportunity for us.

In terms of, to bring that down a level to your specific question, I would say our experience of adoption of these kinds of technologies like 100 gig, it's what we've seen in the past. You have steeper declines on the initial curve, and then whilst the pricing environment remains competitive it does stabilize. And I actually think we're beginning to see that right now on a global basis with 100 gig.

Sanjiv Wadhwani - *Stifel Nicolaus - Analyst*

Thank you.

Operator

Michael Genovese with MKM Partners.

Michael Genovese - *MKM Partners - Analyst*

I just wanted to ask a question about the OpEx guidance for the April quarter. You mentioned, as going from the $177 million you just did to the low $190 millions, some specific R&D and real estate projects slipping from the January to the April quarter. But I also want to ask if we should read anything about your order outlook and order intentions into that number, because obviously the sales force gets compensated on orders. And with that higher level of OpEx, should we read into that that we again expect another solid quarter for orders in the April quarter that would be sequentially up? Thanks.

Jim Moylan - *Ciena Corporation - CFO*

Yes, we do expect a good orders quarter. I'd say as we sit here today we think we'll do well on orders. When we gave that OpEx guidance, though, it really wasn't so much intended to give any sort of signal about orders. It was really just to reflect the fact that our plan for OpEx is the same as it was at the beginning of the year. Remember, last year, we said what we were going to do on OpEx and we pretty much nailed it. There were some quarterly fluctuations last year, as well. So we think we'll continue to see those quarterly fluctuations. But as I said, Michael, our plan right now is the same as it was at the beginning of the year, for the full year.

Michael Genovese - *MKM Partners - Analyst*

Great. And just as a super quick follow-up. Do you have any update on a metric for 10g and 40g percentage of business? You've given that in the past and I'm wondering if that's changed at all early in this fiscal year.

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

What we typically talked about, Michael, is percentage of 40g and 100g in our Optical Transport business. And that's still around 60%. It's up a little bit from last quarter. We haven't broken out specifically any more beyond that.

Michael Genovese - *MKM Partners - Analyst*

Thanks.

Operator

Catharine Trebnick with Northland Securities.

Catharine Trebnick - *Northland Securities - Analyst*

Tom, my question is more related to the type of traffic you're seeing on the enterprise. One of the things that I've been hearing a lot from different carriers is that you're having more data center to data center traffic. And if that's the case, would there be a change in the overall product set or the solution that Ciena would offer? Thanks.

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Catharine, it's an interesting question because, as virtualization has happened inside the data center, we're now starting to see it happen between data centers. So where enterprises were pooling their resources inside a data center, now they're pooling them across the entire operation. So that does tend to make the network piece a bit more important. And it does tend to make certain network performance parameters, things like latency and things like that, a good deal more important. I don't know that it necessarily changes the complexity of the products that we sell.

You're going to see the same types of interfaces -- ethernet, OTN, in some cases full wavelength -- going between these places. But what you may see is an increased need to be able to respond dynamically. And that's one of the things that our open architecture was really set up to do, was to be able to allow software to have the network interact with what's going on inside the data center, to better be able to serve the needs between the data center. So, in that case, I think you'll see things like network automation and some of the software components perhaps become a bit more important. But in terms of overall product mix, I don't know it's going to have a huge effect.

Catharine Trebnick - *Northland Securities - Analyst*

All right, thanks a lot.

Operator

Natarajan Subrahmanyan with The Juda Group.

Natarajan Subrahmanyan - *The Juda Group - Analyst*

My question is about the Packet products transition within the Converged Packet-Optical Transport. Gary, you mentioned that not only is it OTN switching and coherent transport but you're seeing some demand for packet switching in that. Can you talk about where you are in the process? Obviously you have the packet traction with the ethernet products with business ethernet and mobile back-haul. Can you talk about it in the core?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

Yes, I'll take that one actually. The thing that we're seeing here is just, particularly as you move into the metro area, there's more need to have additional service delivery capability built onto the optical transport platform. So we are beginning to see a need for packet switching being integrated into the packet optical transport platforms. And as you'll see over the course of the year, we'll begin to roll out features on the products that expand the capabilities that we currently have in that area.

Natarajan Subrahmanyan - *The Juda Group - Analyst*

And just to follow-up, can you talk about 100 gig, how big it is becoming as a percentage of transport? And is 6500 all coherent 40g, 100g at this point, or is there some 10g on 6500, as well?

Tom Mock - *Ciena Corporation - SVP Corporate Communications*

There is 10g on 6500. But as we've said before, the majority of our optical transport business, 60% or so, is coming from 40g and 100g. But we haven't broken out 40g and 100g separately.

Natarajan Subrahmanyan - *The Juda Group - Analyst*

Got it. Thank you.

Operator

Tim Long with BMO Capital Markets.

Tim Long - *BMO Capital Markets - Analyst*

Just to follow-up on a question here. On the cash flow, Jim, I think you said you'd be positive for the year. Any view of that would be more positive than next year. Obviously dynamics are improving so just curious if you think cash flow will be better than last fiscal year. And then another follow-up on the revenue recognition. I just want to understand, I feel like we've had 1 year, 1.5 years of strong orders, and still struggling on the rev rec. Do we feel like we've crossed the hump there, where that will not be an inhibitor of revenues or growth over the next few quarters here? Or could some of the new orders that you're expecting start to run into some rev rec issues, as well? Thank you.

Jim Moylan - *Ciena Corporation - CFO*

Let me take the second one first. What we have seen in our business, as we talked about last year a number of times, is that our business is changing, particularly as we move internationally. We're engaged, in many cases, in building out full networks. Which means that it's not a network element shipment and rev rec. It's a complete network. In a lot of cases we're doing the installation. And that clearly means that we're going to have stuff in deferred cost of sales or deferred revenue, or however you want to look at it. A higher percentage of our backlog is going to be in that business.

Now, I think inevitably there's going to come a time when that percentage of our business is going to stabilize. Until that happens, then our backlog is going to grow faster than our revenue. I don't really have an idea right now as to when it does stabilize. I would say that this current quarter is a positive indication that perhaps we're starting to stabilize that piece of our business as a percentage of our total business. But, again, it depends upon how much we win and where we win it. The submarine business, in particular, is a business which takes a fairly long time to get to revenue recognition because it's many countries and long, complicated networks. So that's what I'd say about that comment.

On cash, I think we'll overall have a good cash year. Again, I just want to make sure that everybody understands. Our cash balance will go down for the year because we will likely pay off the convertibles, the 2013 convertibles, with cash. But net of that, our cash balance will grow through the year. The extent of that growth really depends on two things. The rate of growth of our revenue, because, by definition, when you grow revenue your receivables balance is going to grow. Our success in controlling our inventory, I think we're going to have a good year in inventory this year. And then, finally, the extent to which our quarters are back-end loaded. All those things enter into the play as we try to figure out what our cash is going to do. But my overall view is that cash trend is good and will continue to get better.

Tim Long - *BMO Capital Markets - Analyst*

Thank you.

Operator

Brian Modoff with Deutsche Bank.

Brian Modoff - *Deutsche Bank - Analyst*

A couple questions. Can you first talk about, give us a little more granularity on what you think it's going to take until you really start to see stability in gross margin that's in the mid 40%s longer term? And then, I know you only guide quarter to quarter, but for the full year, do you see double-digit growth as doable for you? Or what's your view on the growth trends as you move through the year? You hinted a little bit about carrier CapEx in North America getting stronger. Our checks, certainly, at Mobile World Congress, were indicative of something like that. Would that be a key driver for you, seeing that double-digit growth for the year? Thanks.

Gary Smith - *Ciena Corporation - President, CEO*

Brian, why don't I take that. In the margin, there's clearly a lot of moving parts on the margin, and the mix within the mix of the products. I think what you saw in Q1 was really a validation of our ability to get into that mid 40%s margin, which we've talked about as being the longer-term goal for the business on a sustained basis. The levers that were pulled for Q1 were things around packet convergence was strong. The software showing was strong, which is initiatives we've been working on for a long time. And also supply chain and cost reductions, as well, also kicked in. So that's contributed to the Q1 margin.

As Jim talked about, as we look out over the year, we do think a lot of those things will continue to play during the year. But we also think that will be counterbalanced somewhat by a number of the new wins that we begin to initially roll out, particularly internationally. And the start-up costs, if you will, of those helping defray the switch from essentially our competitors to Ciena networks. So, it's also linked into the market opportunity that we see, Brian, with the dynamics that are playing out on a global basis. And balancing that with the desire to increase our operating leverage.

And to your point around growth, I think this is difficult to predict. I think what we can predict, I think with some confidence, is that we're going to grow faster than the market. I remind folks that last year the market actually contracted for the first time for a long time about 6% or 7%, and we actually grew about 5%. Now, whether we can keep that premium growth over the overall market remains to be seen. But I think we're confident about being able to do that. And I think the environment, generally, with some of the Tier 1s in North America now rolling out, and some of the other projects that we've won internationally, I feel a little more optimistic this year than I did at this point last year around the overall industry. Dependent on things like macro-economics, et cetera, but I do feel better this time.

Brian Modoff - *Deutsche Bank - Analyst*

Okay, thank you.

Operator

At this time I'd like to turn the call back to Cynthia Simsamen for any closing statements.

Cynthia Simsamen - *Ciena Corporation - IR Analyst*

Thank you, Operator. That concludes our call for today. We would like to thank everyone for joining us. Have a good day.

Operator

Ladies and gentlemen, this does conclude today's conference. You all may disconnect and have a good day.