REFINITIV STREETEVENTS

# EDITED TRANSCRIPT

## Q4 2022 Ciena Corp Earnings Call

EVENT DATE/TIME: DECEMBER 08, 2022 / 1:30PM GMT

## CORPORATE PARTICIPANTS

**Gary B. Smith** *Ciena Corporation - CEO, President & Director*
**Gregg M. Lampf** *Ciena Corporation - VP of IR*
**James E. Moylan** *Ciena Corporation - Senior VP of Finance & CFO*
**Scott Alexander McFeely** *Ciena Corporation - SVP of Global Products & Services*

## CONFERENCE CALL PARTICIPANTS

**Alexander Henderson** *Needham & Company, LLC, Research Division - Senior Analyst*
**Amit Jawaharlaz Daryanani** *Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst*
**Catharine Anne Trebnick** *MKM Partners LLC, Research Division - MD*
**David Vogt** *UBS Investment Bank, Research Division - Analyst*
**George Charles Notter** *Jefferies LLC, Research Division - MD & Equity Research Analyst*
**James Dickey Suva** *Citigroup Inc., Research Division - MD & Research Analyst*
**Karan Juvekar** *Morgan Stanley, Research Division - Research Associate*
**Michael Edward Genovese** *Rosenblatt Securities Inc., Research Division - Senior Comm and Cloud Infrastructure Analyst*
**Paul Jonas Silverstein** *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*
**Samik Chatterjee** *JPMorgan Chase & Co, Research Division - Analyst*
**Simon Matthew Leopold** *Raymond James & Associates, Inc., Research Division - Research Analyst*

## PRESENTATION

**Operator**

Good day, and thank you for standing by. Welcome to the Ciena Fiscal Fourth Quarter and Year-end 2022 Results.

(Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Gregg Lampf, Vice President of Investor Relations. Please go ahead.

---

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

Thank you, Katherine. Good morning, and welcome to Ciena's 2022 Fiscal Fourth Quarter and Year-End Review.

On the call today is Gary Smith, President and CEO; and Jim Moylan, CFO. Scott McFeely, our Senior Vice President of Global Products and Services, is also with us for Q&A.

In addition to this call and the press release, we have posted to the Investors section of our website an accompanying investor presentation that reflects this discussion as well as certain highlighted items from the previous -- from the quarter and the fiscal year. Our comments today speak to our recent performance, our view on current market dynamics and drivers of our business as well as a discussion of our financial outlook.

Today's discussion includes certain adjusted or non-GAAP measures of Ciena's results of operations. A detailed reconciliation of these non-GAAP measures to our GAAP results is included in today's press release.

Before turning the call over to Gary, I'll remind you that during this call, we'll be making certain forward-looking statements. Such statements, including our quarterly and annual guidance and long-term financial outlook, discussion of market opportunities and strategy and commentary about impacts of supply chain constraints on our business and results, are based on current expectations, forecasts and assumptions regarding the company and its markets, which include certain risks and uncertainties that could cause actual results to differ materially from the statements discussed today.

Assumptions relating to our outlook, whether mentioned on this call or included in the investor presentation that we'll post shortly after, are an important part of such forward-looking statements, and we encourage you to consider them.

Our forward-looking statements should also be viewed in the context of the risk factors detailed in our most recent 10-Q filing and in our upcoming 10-K filing. Our 10-K is required to be filed with the SEC by December 28, and we expect to file by that date.

Ciena assumes no obligations to update the information discussed in this conference call, whether as a result of new information, future events or otherwise. As always, we will allow for as much Q&A as possible today. So we ask that you limit yourselves to one question and one follow-up.

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

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

Thanks, Gregg, and good morning, everyone. Today, we reported strong fiscal fourth quarter results, including higher-than-expected revenue of $971 million and adjusted gross margin of 45.2%. This performance reflects the benefit of some favorable supply chain dynamics that occurred in the second half of the quarter, including that we received more integrated circuits than expected from certain suppliers and that we were also able to procure more parts in the open market than originally projected. These developments enabled us to ship more product to customers in the quarter, especially modems, which also had a positive impact on both revenue and margin.

For the full fiscal year, we delivered revenue of $3.63 billion, essentially flat with fiscal 2021 due entirely to the challenging supply chain conditions that we encountered during the year. Despite the difficult supply environment in fiscal '22, we saw robust demand from customers across our segments, regions and applications, as evidenced by annual order growth of 26% and a backlog of greater than $4 billion as we exited the year.

Our results across FY '22, including the strong finish in Q4, demonstrate the continued volatility and unpredictable nature of the current supply dynamics. With respect to supply, overall, we are seeing ongoing signs of gradual improvement. The majority of our suppliers are delivering to their current committed lead times, and volumes are slowly increasing. And we also expect continued improvements in these areas as we move through fiscal 2023.

We are also starting to benefit from the various mitigation steps that we've taken over the last year or so. As a reminder, these include product engineering redesigns and qualification of alternative components designed to minimize the impact of supply chain challenges on our customers. At the same time, the unpredictable performance of specific vendors for a relatively small number of components, even if they are low cost, low value, can negatively and disproportionately impact our revenue and significantly shift our product mix, which is what happened in Q3 of last year.

Conversely, our Q4 results, particularly on revenue and margin, illustrate how these same supply dynamics can have an unexpected and disproportionate impact in a favorable direction. So to be clear, the volatility can obviously manifest as both headwinds and tailwinds. But generally, we believe them to be moving in a positive direction.

With respect to demand, we remain very positive that the fundamental drivers, including 5G, cloud and automation are durable over the long term. Based on these drivers in network investment, we continue to see a strong demand environment in the coming quarters and the next several years.

Importantly, we are confident that our leading technology as well as our strategy to expand our addressable market in key areas are closely aligned with these drivers and the areas of investment for our customers.

As we look to FY '23, specifically the combination of continued signs of gradual supply improvement and our significant backlog gives us confidence that we will deliver outsized year-on-year revenue growth and gain market share. Jim will expand upon this shortly with more specifics on our outlook and how we are thinking about our business over the longer term within these demand and supply conditions.

Before he does that, I want to share a few highlights from the fourth quarter and fiscal year. A particular note is the growth in our routing and switching portfolio, for which quarterly revenue was up nearly 40% year-over-year in Q4 as we benefited from the addition of the Vyatta Solutions and organic portfolio enhancements.

In fact, during Q4, we reached a milestone of more than 200 Adaptive IP customers, fueled by momentum in coherent routing, metro aggregation, PON and high-speed business services. And we continue to invest in our next-gen metro and edge strategy, particularly in our routing and switching portfolio.

As you saw, we recently closed the acquisition of Benu Networks, and announced that we are acquiring Tibit Communications, which we expect to close in Q1 '23. These acquisitions will enable us to build upon our existing strategic investments in fiber broadband access and pursue a larger set of opportunities in this market segment.

Specifically, the addition of advanced subscriber management and next-generation PON technologies will advance our ability to address fast-growing applications, including residential broadband, enterprise business services and fixed wireless access. This also represents a significant addressable market expansion for Ciena, something we've been talking to you about for some time within our Routing and Switching segment and is expected to be a considerable investment area for many of our customers.

In optical, we added 15 new customers for WaveLogic 5e in Q4, bringing our total global customer count to more than 200 with more than 50,000 WaveLogic 5e modems shipped to date. In Blue Planet, we won several new logos during the year while expanding our presence at a number of Tier 1 service providers.

Additionally, our strategic win at DISH has now gone live with both our inventory and our service order orchestration solutions. And our network transformation services grew 50% year-over-year. I think this really reflects the increased demand from customers to move from legacy to next-generation networks.

And lastly, with respect to diversification, our non-telco revenue was approximately 40% for the year. And within that, 4 of our top 10 customers were major web scalers. And like last year, we had more than $1 billion in orders from web-scale customers in FY '22, once again demonstrating continued strong demand from this key customer segment.

With that, I'll now hand over to Jim to take us through the results in a little more detail and provide our outlook. Jim?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Thanks, Gary. Good morning, everyone. As Gary mentioned, we delivered a very strong Q4 performance. Revenue came in at $971 million, well above the midpoint of our guide. This revenue result speaks to the durability of demand and the clear need by our customers for more equipment faster.

Importantly, it illustrates what can happen when we get more of the components that have been in the shorter supply and which have most severely gated our deliveries to customers. Additionally, it reflects some benefit of additional production capacity brought on with our investments, which helped us to deliver our largest shipments month in history in October.

Q4 adjusted gross margin was strong at 45.2%, reflecting a favorable product mix as well as lower-than-expected incremental supply and logistics costs in the quarter. Adjusted gross margin in the quarter benefited from the greater-than-expected supply of key components, allowing us to deliver more modems. Clearly, availability of components and the performance of our vendors play a disproportionate role in our quarterly mix of deliveries.

Q4 adjusted operating expense was as expected at $313 million. With respect to profitability measures, in Q4, we delivered adjusted operating margin of 13%, adjusted net income of $91 million and adjusted EPS of $0.61 per share.

In addition, in Q4, our adjusted EBITDA was $154 million. Cash used in operations was $14 million. We continue to build inventory of certain components in Q4 while we wait for delivery of those components that are the most constrained. We also experienced a back-end loaded quarter, which caused accounts receivable to increase.

With respect to our performance for the full fiscal year, annual revenue was $3.63 billion. As Gary mentioned, we ended the year with $4.2 billion in backlog, slightly below where we ended in Q3, but still nearly double our backlog as we entered fiscal 2022. We've obviously seen periods of record order volumes and significant backlog growth in fiscal year '22.

That said, as supply chain conditions gradually improve, we expect order growth relative to revenue and backlog to moderate over time even in a strong demand environment. Adjusted gross margin for the year was 43.6%, a good result and in line with expectations. And adjusted OpEx for the year totaled $1.17 billion.

Given our large order intake throughout the year, we paid higher sales commissions than we had planned. However, with lower-than-expected revenue and operating income, we will pay a much lower corporate incentive bonus than originally planned. If normalized for these 2 items, adjusted OpEx would have been just over $1.2 billion, which was what we expected and guided for the year.

Moving to profitability. Adjusted operating margin in fiscal year '22 was 11.2%, and adjusted EPS was $1.90. Free cash flow for fiscal '22 was negative $259 million. This reflects the increase in inventory caused by lack of availability of a few key components.

Finally, our balance sheet remains strong as we ended the year with approximately $1.2 billion in cash and investments. Just as a reminder, we also met our goal of repurchasing $500 million in shares in the year and plan to repurchase shares in fiscal '23 in the range of $250 million.

Turning to guidance. In the last few years, our revenue has been relatively flat as a result of the unique market conditions that stemmed from a global pandemic, which led to the supply chain crisis. Looking forward, we see signs of continued gradual supply improvement, which, when combined with our significant backlog, sets us up well for outsized growth in fiscal '23.

Accordingly, we expect to grow our revenue in the year in the range of 16% to 18%. To be clear, this outlook includes key assumptions that are particularly important in a still uncertain environment.

First, with respect to macroeconomic conditions and geopolitical dynamics, due to the size of our backlog, we believe our fiscal '23 outlook is somewhat less dependent on the macro environment than in a typical year. That said, to be clear, our guide assumes that the global economy does not significantly worsen and more importantly, that there are no material adverse effects on our business.

Second, with respect to component availability and general supply conditions, as Gary mentioned, we continue to see and we expect volatility, but we have seen overall improvement. Our forecast assumes that supply chain dynamics do not worsen.

With respect to gross margin for fiscal 2023, our outlook reflects the expectation that supply and logistics costs will ease somewhat but will remain elevated. And that as supply improves, we will take more revenue on the new wins we've secured over the last several years -- 2 years.

Accordingly, we believe that our gross margin for the full year 2023 will be in the range of 42% to 44%. With operating expense we can intend to continue investing strategically in our business in order to expand our addressable market and to advance our position in key growth areas. Therefore, we expect adjusted operating expense to average $325 million per quarter in fiscal '23.

I'll point out that we are using an as adjusted tax rate of 22% in our fiscal '23 outlook. The 1.8% rate increase from last year's 20.2% rate takes into consideration our best estimate of having increased taxable income and higher tax rate locations during the fiscal year.

In the more immediate term, for Q1 2023, we expect to deliver revenue in a range of $910 million to $990 million, adjusted gross margin in the low 40s range and adjusted operating expense between $320 million and $325 million. Looking beyond next year, we remain confident in the positive secular demand drivers, including continued growth in bandwidth demand, which over a long period of time has been unaffected by macroeconomic conditions.

We believe our customers will be compelled to prioritize network CapEx to address this demand over the coming quarters and years. And as we continue investing in our long-term strategy to expand our addressable market, we will be in a strong position to intersect those customer network investments.

All of that, in combination with more normalized supply chain conditions, positions us well to deliver strong revenue growth over the next several years. More specifically, we expect the industry to grow in approximately the mid-single digits percentages during this time period, and we intend you to gain footprint and take market share as we have over the last decade.

That said, our revenue growth over the next 3 years will not be linear, particularly given our expectations for outsized revenue growth in fiscal '23 predominantly driven by improvement in supply. Our revenue growth expectations for fiscal '24 and fiscal '25 are based on an assumption of more normal business conditions, which are, by definition, more dependent upon the macro environment.

Nevertheless, we are confident in continued strong demand dynamics and our leading market position. For that reason, we currently expect to deliver a 3-year annual revenue growth rate in the 10% to 12% range throughout fiscal 2025. That does take into account the 16% to 18% next year. Furthermore, we expect over the next several years that adjusted gross margin will improve to the mid-40s range and that we will increase profitability.

In closing, while '22 has been a challenging year for Ciena because of supply chain conditions, our market position has never been better, and we expect that it will continue to improve. Demand for bandwidth is growing at rates of 30-plus percent. Demand for capacity from customers is sturdy, and Ciena has the best technology and customer relationships in the industry.

We believe that our supply chain will continue to improve as we move through '23, which will enable us to better service the strong demand from customers. And we believe that our financial results will reflect this.

With that, Katherine, we'll now take questions from the sell-side analysts.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions)

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

We're also aware of a technical issue with the Q&A line. We're resending a link to the sell siders for you to be able to access that way.

**Operator**

Our first question comes from Meta Marshall with Morgan Stanley.

**Karan Juvekar** ***Morgan Stanley, Research Division - Research Associate***

This is Karan Juvekar on from Morgan Stanley. Congratulations on the results. And I guess just first question being, as you've seen supply chain loosen up a bit in the second half of the quarter, have you seen any changes to maybe customer conversations, maybe with conversations with customers that have moved to other vendors or maybe just generally at a high level, any incremental hesitation around macro and maybe any purchasing patterns?

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

So why don't I take the second part of that? The answer to your question is no, we haven't. We continue to see, as we talked about in the earlier comments, very strong demand characteristics across the board, across geographies, across applications, across different customer segments. And that's evidenced from a demand point of view in the outsized order that we -- orders that we received in the year.

When you think about it, we've got 26% order growth in the year. And that's a very strong indicator around demand. And a lot of our customers still want the equipment faster than we can get it to them for all the secular demand dynamics that we're aware of. So not seeing any change right now across the customer piece in terms of demand. Scott, do you want to comment on any of the supply chain stuff specifically?

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

In the supply chain stuff side that Gary mentioned it, we got more supply of components than we were expecting in the second half of the quarter. And that was across the board, but particularly important was those constrained components also we saw more supply. We also have more success in procuring those in the open broker market as well.

And given the investments that we've talked about in the past around building up a bigger manufacturing capacity so we can turn those components into finished goods faster, that came into play significantly in our month of October. And I think Jim mentioned, our biggest shipment month ever.

**Karan Juvekar** ***Morgan Stanley, Research Division - Research Associate***

Got it. Okay. That's very helpful. And then just a quick follow-up on maybe just quantifying or just any idea on how much of a benefit in the quarter the price increases was? And maybe how should we expect that to trend sequentially to Q1? Anything we should expect, an uptick sequentially? Or how we should think about that?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Still not seeing a ton of effect of that price increase in Q4. We did not see it. As we look into our backlog, it is there. It's fully encompassed in our guide. And without giving a number, I'll just say that it's in the single-digit percentages ranges.

**Operator**

Our next question comes from Paul Silverstein with Cowen.

**Paul Jonas Silverstein** ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***

Gary, Jim, I did hear your responses to the previous question during the call, but I'm still going to ask you 2 related questions. One, one of your competitors have made comments about competitive gains. They clearly were referring to you, and I trust you listened to the Infinera call about competitive gains due to inability -- your inability to deliver because of the supply constraints. The question obviously being to what extent that has been an issue. But from your comments, it doesn't sound like it's a big issue.

The other related question, again, from your comments, it sounds like not an issue, but given [Huawei], Corning, CommScope's commentary, a lot of which seem to be specific to AT&T, but perhaps other Tier 1s as well, it doesn't sound like you're seeing weakness, but I want to ask you the question.

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

Look, let me take the first part of that, Paul. Listen, there's been a lot of volatility with sort of whipsawing in supply and demand at any one moment in time and any given account. If we're sharing with others, then they're obviously going to try and get supply from who they can.

I would say, overall, and we are also taking new accounts as well. Overall, I mean, I think the order demand and the performance in Q4 kind of speaks for itself. And we expect very strong share gains, which are really built into our backlog and our guidance for the year. So our share gain is in our orders, and customers have voted. And they continue to migrate towards the best technology at scale, which is what Ciena has. Take part of that question, do you want to?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Our outlook for all of our major customers is good, and our order volume is good. We're not seeing any sign of weakness in AT&T or any of our major customers.

**Paul Jonas Silverstein** ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***

All right. And Gary, just to be clear, going back to the share gain commentary, if you have lost in certain situations share because of inability to deliver, you're telling us that's not among Tier 1s or it's not something you think is...

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

We've not lost any major customers whatsoever during this. And if there are particular, one moment in time someone shipped more than we have into that, we think that is transitory given the demand characteristics that we're seeing and engagement with these customers.

---

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Just to be clear though, Paul, we did see a relatively small number of cancellations in the quarter, probably the same dynamics that Gary is talking about. But that number has been overshadowed by the strong demand that we see overall. And whatever share we might have lost in any account, I'm confident that we will get it back over the coming quarters and years.

---

**Paul Jonas Silverstein** ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***

All right. And for my follow-up, there's obviously been a lot of investor concern about web scale, the health of web scale, in particular. From the commentary of the various major web-scale players, it certainly suggest they're not coming back or (inaudible). They set a strategic -- what are you guys seeing from that segment, obviously, not just here now, but looking downstream?

---

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

So we had a very strong performance, both in terms of revenue and in terms of order intake. It was well over $1 billion. We're continuing as we work with them in FY '23, we expect to shift revenue significantly more to GCN than we did last year.

And that's a combination of orders that we've got in the backlog and other orders that we're about to get. So it varies between the various players there. But overall, we see pretty strong demand as they continue to focus on building out their networks.

---

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

I also say that we have over the past few years developed a much deeper and more strategic relationship with those web-scale customers, who are driving so much of what's going on in our industry. And so we're very excited by the fact we're engaged with them by much more than just plain data center conditions. And hopefully, we'll be able to tell you about some of that stuff as we move through time.

---

**Paul Jonas Silverstein** ***Cowen and Company, LLC, Research Division - MD & Senior Research Analyst***

Guys, can I ask for a clarification on one thing? For those of us who remember your acquisition of Catena back in 2004, which was as identical to your acquisition of Tibit as 2 deals could be. And correct me if I'm wrong, but there is nothing left of Catena employees, revenue, nothing.

Now I recognize that was a copper DSL-based solution. The market is incredibly different. This is optical. Maybe that's the answer. That's just a very different environment, and you're a very different company than you were 15-plus years ago. But any lessons learned from that field?

---

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

Well, I think you answered the question on that, Paul. I think you're absolutely right. We're a much different company. We've got much greater scale. And I think the complementary nature within the switching and routing technology that we have is -- the context of it is very different because we can wrap all that stuff around.

And the customer relationships that we have. We're now the largest player by quite a large way in the space that we're in. And those relationships have been developed and matured. And we think now that with bringing on Benu and Tibit, it really provides an excellent complement to the portfolio that we've already got.

---

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

And to be clear, Paul, it's approaching 20 years, so...

---

**Operator**

Next question comes from Samik Chatterjee with JPMorgan.

---

**Samik Chatterjee** ***JPMorgan Chase & Co, Research Division - Analyst***

Great. I had a couple, and maybe if I can start with the gross margin outlook here. Jim, the gross margin outlook that you're providing, I don't know if you can walk us through a bit more of the puts and takes because it does sound like with the revenue -- outsized revenue growth you're expecting, you should have a bit more leverage to the gross margin, particularly with most of the sort of new product shipping at that time.

But maybe help me understand sort of any pressures, and also sounds like your sort of pressures from a supply logistics perspective are going down. So we would have expected a higher number. Maybe walk me through the puts and takes, and I have a follow-up.

---

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Yes. The big driver of our gross margin is mix of products, and we do have sort of a continuum of margins. Typically, the early parts of projects we're laying down with line systems or we do that at lower gross margin. When we fill those line systems with capacity, we're putting in cards or modems, which are higher margins. That's just the way the business works. It helps our customers get through the early less than fully loaded conditions in their network. So that's the way it works.

This year or in 2023, our expectation is that our mix will shift pretty significantly toward line systems. That's why we made the comment that we're talking about starting to ship on some of our new wins that we've had over the past year. So that's what's going on in our gross margin, and we'll see how it comes out, but that's our expectation.

We do think that the exception costs will ease in terms of the percentage margin effects. But they're still going to be there, and that's going to impact gross margin. What we've said is that, that probably cost us 400 basis points or something like that last year. And it's going to cost us something like that, although maybe a little less in '23.

And finally, I'll make the point that we are totally outsourced in terms of our manufacturer. And so our cost per unit is mostly variable. We don't have a lot of fixed cost in our gross margin. We do have some, and that helps when we get our volumes. But the biggest part of our cost structure is variable and varies per volume.

---

**Samik Chatterjee** ***JPMorgan Chase & Co, Research Division - Analyst***

And for my follow-up, if I can sort of ask you about what's sort of embedded in terms of supply improvement in your fiscal '23 revenue guide? Because when we look at sort of -- even the average of 3Q and 4Q, you're above a $900 million run rate, and you're expecting that to go north of $1 billion.

Is that generally as you talked about more predictability from your suppliers, and the upside there could be being able to buy more from the open market? I'm just trying to understand what's embedded in the guide for supply? And what sort of downside or upside to that number can come from?

---

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

Yes, Samik. So first of all, just starting with what we're seeing in the environment today and a little bit in the rearview mirror. Things are getting better gradually. People are delivering more reliably to their commitments, and they are delivering more components to us period-over-period. You saw that in our Q4 results, and you're seeing that in our Q1 guide.

Looking forward, in terms of their commitments to us, they are committing more components to us going forward as well, and that's factored into our guide. In addition to that, we've talked in the past about a bunch of mitigation activities that we have control of, redesigning products to open up the aperture in terms of alternative design sources, building up a manufacturing capacity such that we can turn finished components and finished goods faster for our customers.

All those things will benefit us in '23. And we've taken that into account as well as the learnings of the variability that we've seen to try to give you a balanced view of where we think we're going to land from a supply and therefore, a revenue perspective in '23.

---

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Specifically, we assume that supply chain dynamics do not worsen. Specifically, we believe that component suppliers will largely deliver on their current supply commitments. And we do not expect to encounter any substantial new decommits that we cannot mitigate, given all the work we've done in our R&D group.

**Operator**

Our next question comes from Alex Henderson with Needham & Company.

**Alexander Henderson** ***Needham & Company, LLC, Research Division - Senior Analyst***

First question is on the mix assumptions for '23. Can you talk a little bit about the -- you've talked about $4.2 billion in backlog, but underneath the surface of that is also your service business, which doesn't show up in backlog but is related to additional shipments. So can you talk about the growth assumed in service versus product in the guide?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Well, services are in our backlog, Alex, just to be clear. When we get orders, we get orders for the product and related services. So it is in our backlog. The $4.2 billion includes a meaningful amount of services.

I believe if you look at the various pieces of our services business, which we have maintenance, we have deployment, and then we have advanced services, we expect to see strong growth, stronger than average on the advanced services. We do probably -- we'll probably see higher-than-average demand on implementation because we did a lot of motives in the past year, and we expect that we'll have more line systems, which comes in many cases, with implementation. So those are the parts of the services portfolio that we think will grow faster than average. The maintenance, we think will grow, but probably in line with our product.

**Alexander Henderson** ***Needham & Company, LLC, Research Division - Senior Analyst***

So would your services then be a double-digit growth rate or a single-digit growth rate? I'm just trying to gauge the mix for the year.

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

I don't think overall, we would be double digit -- I'm sorry, yes, we'll probably be double digits. Yes.

**Alexander Henderson** ***Needham & Company, LLC, Research Division - Senior Analyst***

Right around 10% is probably the right answer. The second question I have for you is relative to the backlog. $4.2 billion in backlog is an enormous number. If I take 17% growth, that's $617 million off of your '22 base.

So how much do you think the backlog will work down? And if the backlog is still, say, I don't know, $3 billion next year at the end of the year, doesn't that imply continued outsized backlog going into '24 and '25 even?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Very hard to predict where our backlog is going to be next year. It's going to be good, though. I can certainly expect that to be the case. Our backlog at the end of this year will depend upon what customer behavior is like, how our lead times change and of course, our deliveries during the year.

So it's just hard to predict that specific number on backlog, but it's going to be good. Now we said we're going to grow 10% to 12% average over the next 3 years, which implies higher than our previously stated growth for the long term in fiscal '24 and '25, not a lot higher but somewhat higher.

**Operator**

Our next question comes from George Notter with Jefferies.

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

Great to see the improvement in supply chain for you here. I was curious about what the expectations are for the Tibit and Benu acquisitions. I guess I'm wondering if they're significant piece of your revenue expectations for January and then also for the full year. And then also curious about what kind of cost structure comes with those acquisitions?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Yes. We don't expect to close on Tibit until sort of towards the end of this quarter. And Benu is not large in terms of revenue. So really nothing significant in Q1. As we move through the year, we'll see some from both of those, but it's less than a couple of percentage points of our revenue.

However, what it will do, the combination of those 2 acquisitions will help us as we attempt to build out our PON solutions and our position in that PON market. So we are very excited by it. And as far as the OpEx, it's in the sort of $20 million to $30 million of OpEx next year.

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

Got it. For the full year? Or is that -- that's not per quarter, I assume.

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Yes. Full year.

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

Okay. Got it. Great. That makes sense. And then do you guys have a purchase commitment number out of curiosity for the end of the year?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

We'll get you that. I don't have that right now, but I'll get it to you, George.

**Operator**

Our next question comes from Simon Leopold with Raymond James.

**Simon Matthew Leopold** ***Raymond James & Associates, Inc., Research Division - Research Analyst***

Just maybe first, a quick clarification on some of the metrics here. Gary, you said that backlog remained over $4 billion. I think last quarter, you talked about $4.4 billion. And I assume that certainly part of the whole sort of normalization process, we've got to begin to be working down backlog, so understandable.

But I want to verify that backlog did come down by roughly $300 million to $400 million. And I assume orders this quarter were down year-over-year. Is that a metric you're able to share?

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

Yes. Yes, it's down about $200 million. So you're right, went from about $4.4 billion to about $4.2 billion. You're right, I would -- as Jim was saying, this should normalize over time. We're not going to continue to run with this kind of backlog, given the size of business we are and the growth that we're seeing even with I think we're going to have -- to the previous question, longer lead times for a while than we've all seen traditionally. So I expect us to have a longer backlog.

I'll give you another interesting sort of statistic so far in Q1. We're off to a very strong start on orders in Q1. And in fact, despite the fact that we've upped our guidance in Q1, sort of midpoint of the range, about sort of [9 50], we still expect to build backlog in Q1. We're seeing very strong order flows already in the current quarter that we're in.

**Simon Matthew Leopold** ***Raymond James & Associates, Inc., Research Division - Research Analyst***

And then in terms of my more substantive question, I wanted to see if you could elaborate on your thoughts on India as a market. I recall, I think it was 2018. It was, I think, just over 9% of revenue and slowed down subsequently. It seems very evident that India has changed for the mobile infrastructure suppliers.

I know you've got some operations there. If you could elaborate what you expect over the next 1 to 2 years from that region.

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

Yes. India has been a big market for us. It's gone through some cycles, for sure. And I think -- I guess what's behind your question as well is it's now with the whole sort of 5G commitments that everybody has made -- going through a very bullish cycle for the next couple of years.

And we have #1 market share in India, and we're very well positioned to take advantage of that growth. You're beginning to see that show up in the numbers. India, I think, off a fairly low number relative to where it's been, we're up about 30% year-on-year and a quarter change. And year-on-year in total is about 10% to 12% growth. So you're beginning to see that come back. I would expect that to be an outsized growth driver for Ciena for the next 1 to 3 years, absolutely.

**Simon Matthew Leopold** ***Raymond James & Associates, Inc., Research Division - Research Analyst***

And does it have a negative impact on your margin? Because the RAN vendors all talk about great revenue, but then dilutive to gross margin, neutral to operating margin. You're in a different business. I just want to make sure folks understand what it means to you from a profitability perspective as well.

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

Generally speaking, the way they do their project builds, yes, they put line systems out, which is generally lower margin. And we'll see a little bit of that, but they tend to build out quite quickly in terms of capacity.

So generally speaking, it's not dilutive to our overall margins. It may sort of ebb and flow quarter-to-quarter whatever. But generally speaking, I mean, it's consistent with our overall margins there.

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

While we're waiting for the next question, I got the answer to George's question about purchasing commitments, it's $2.6 billion.

**Operator**

Our next question comes from Amit Daryanani with Evercore ISI.

**Amit Jawaharlaz Daryanani** ***Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst***

Congrats on (inaudible). Maybe (inaudible) start off with as you think about fiscal '23 guidance, which is fairly robust, can you just talk about how do you think growth stacks up across the different verticals? And do you see as fast to going versus maybe a little bit slower, what's that 16% to 18% top line growth?

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

I would expect -- I mean, next year, FY '23, our balanced view is it's really all about supply and not specifically demand. So with that as a caveat, I'd say pretty strong demand across the board.

I think GCNs, I would highlight, has been very strong in terms of our revenue guide for the year. So I expect very strong growth from the overall web scalers.

I think certain geographies, we just talked about one, India, I expect to be strong. I expect to see strong growth in the cable space in North America.

Switching to routing, I would also highlight relative to -- we saw about 40% growth this year. Some of that was nonorganic. But we're seeing a lot of new wins in that space, as we talked about. So I think the -- there's various different applications and geographies that we think are going to be hot for the next year or so. Those are the ones that would come top of mind.

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

And overall, we'll just again point out that demand for bandwidth globally continues to grow at outsized rates, 30-plus percent. That has been -- that growth rate has been really unaffected by whatever happens in the macroeconomic environment.

That's what we've seen for a long, long time. So our outlook for the year assumes based on our past experience that any effects in our business with respect to customers' CapEx or their ability to take their products from us are immaterial.

**Amit Jawaharlaz Daryanani** ***Evercore ISI Institutional Equities, Research Division - Senior MD & Fundamental Research Analyst***

And that's really helpful. And then just a follow-up. How should we think about the cash flow generation into fiscal '23? And sort of, I guess, to some degree, do you think inventory levels have peaked and this has to trend lower? Just any parameters on how free cash flow would stack up in '23, would really helpful to understand that. And maybe explain that? Do you see a capital allocation evolving for that free cash flow hopefully improve next year?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Yes. We're not going to see an enormous amount of free cash flow in '23 partly because we're going to spend a couple of hundred million or so on acquisition of Tibit. Generally speaking, too, we don't expect that our inventory level is going to decline sharply this year. We could be wrong. I hope we're wrong. That would mean we ship more than we expect to ship now.

But we expect our inventory position to come down, just not as far as it will in subsequent years. So without giving a number today, I can just say that we're not going to be in the free cash flow generation mode that we have been in past years. We'll have free cash flow, of course, but it's just not going to be as big as it's been.

**Operator**

Our next question comes from Jim Suva with Citi.

**James Dickey Suva** ***Citigroup Inc., Research Division - MD & Research Analyst***

Given the backlog and your strong guidance for fiscal '23, can you comment a little bit about seasonality? I would assume that seasonality, I mean, with COVID, it's been a long time since we have normal seasonality. But could you comment about seasonality for fiscal '23? I would assume the backlog and supply makes seasonality kind of less relevant?

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

Yes, Jim, I would -- yes, I mean that really is the answer to that. I think it is less relevant. It's interesting that we're seeing even stronger order flows in the Q1 that we're in right now. And typically, it would be lower.

So I think because of all the whipsaw of demand over COVID and the supply chain, I think those dynamics have kind of been thrown up in the air. And I think it's going to take a while before they kind of bed back down again, frankly, because people want to make sure that they're in the queue and that they are able to get the security of supply and even if it is further out.

So it's sort of uncharted territory for us in terms of the seasonality piece. The whole -- I mean, as I think about FY '23, just to sort of simplify it, it's really all about what we can ship and supply. It really is. That's going to be the cause of any ebbs and flows in the various quarters. It's all about supply.

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

If you take the midpoint following year, 22%, which is a little higher than what we've experienced for the long period of time. So that just sort of proves out what Gary is saying. It's all about how fast we can get components and deliver to customers, not so much the typical seasonal order pattern.

**James Dickey Suva** ***Citigroup Inc., Research Division - MD & Research Analyst***

And then my follow-up is, you mentioned backlog went from $4.4 billion to about $4.2 billion. And then earlier in the call, you mentioned that really, the upside to the quarter came late in the quarter. You got a fantastic month of October, outsized growth.

So is that fair to say that $200 million work down in backlog that we could actually see a faster work down in inventory -- I'm sorry, on backlog that you've progressed in the quarters ahead because it was kind of an outsized month for the quarter? Or how should we think about the cadence of the backlog?

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

I think it's very difficult for us to predict that, to be honest. And that's why I sort of shared with you what we're seeing in Q1. I actually think our backlog is going to go up in -- coming out of Q1. Even though we've upped our shipment and our revenue guide for Q1, I think midpoint was [8 70]. And I think we've just this morning shared midpoint would be about [9 50].

Even with that, we still think we're going to add backlog coming out of Q1. So I think it's just a testament to the, A, the strong demand characteristics that we're seeing across the board; and B, supply chain is improving, but lead times are still long.

**Operator**

Our next question is from Catharine Trebnick with MKM Partners.

**Catharine Anne Trebnick** ***MKM Partners LLC, Research Division - MD***

Excellent print. Can you describe the target markets you're specifically looking at with these 2 new acquisitions? It looks like you're trying to go more into the regional market, but just clarify that for me.

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

Catherine, the 2 acquisitions from a solution perspective, I'll talk to are broadband access part of our portfolio, which is one of the key use cases we've talked to you about as part of our next-generation metro and edge TAM expansion. So anybody building our next-generation fiber access solutions would be the target market.

There's lots of activity. Of course, some rural broadband funding that speaks to your Tier 2 opportunity, but there are also Tier 1s around the world that are looking at their architecture for their fiber build-outs as well. And we're attacking both of those spaces.

**Catharine Anne Trebnick** ***MKM Partners LLC, Research Division - MD***

And then how much does this lift your total addressable market?

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

We were -- we had indicated with our focus on next-generation metro and edge that our TAM expansion had basically almost doubled, and we had talked about that in the past. This really is a part of securing a stronger solution portfolio set to go after that already announced expanded TAM.

**Operator**

Our question comes from Mike Genovese with Rosenblatt Securities.

**Michael Edward Genovese** ***Rosenblatt Securities Inc., Research Division - Senior Comm and Cloud Infrastructure Analyst***

I just wanted to clarify on the gross margin for this quarter that you reported, the strength. Was that really all mix towards modems? Or was it supply chain improvement? Is there not only better supply, but is it more -- coming at a more reasonable price than before?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

Mostly mix. We did see some improvement from expectations in our, what we call, exception costs, which are a combination of logistics costs and the premium costs that we paid, but it's mostly mix.

**Michael Edward Genovese** ***Rosenblatt Securities Inc., Research Division - Senior Comm and Cloud Infrastructure Analyst***

Okay. And then just quickly, for this year, for '23, I didn't really hear a gross margin outlook for the full year. I got a revenue outlook for the full year, but I mean, should we think this year 43.6, I want them on consistently for this year. Is that fair?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

We said 42 to 44 for the full year. Average it will be in low 40's in Q1.

**Operator**

Our next question comes from David Vogt with UBS.

**David Vogt** ***UBS Investment Bank, Research Division - Analyst***

I know we've danced around sort of the backlog and the strength of the business question, but I want to maybe take a longer-term view and maybe pull back a little bit. If I look at your business back from, let's say, fiscal '19 before COVID, and I kind of run it forward through your '25 guidance, I think at the high end of your 3-year plan would suggest that your business would have grown at a 6% CAGR, which is kind of consistent with your model.

I mean, is that the right way to think about it as we go through '23, '24 and '25, backlog normalizes, and we're back to sort of a normalized mid- to slightly better growth dynamic for the overall business?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

I actually think that's a pretty good way of thinking about it because our market has been roiled very significantly over the past 3 years, and we're going to have outsized growth for the next 3. But I'd just say this, if you deconstruct the 10% to 12% average annual growth rate that we project for the next 3, and you say we're going to do -- we believe we're going to do 17% in '23, which is the midpoint of our guide, then the growth rates for the last 2 years are actually a bit higher than what we have called before.

Remember, we've said 6% to 8% was our long-term growth rate for a great number of years now. So I think the business is strong now, and we have not just the fundamental growth that we've seen, but also the subsidies for broadband that is -- that are going in the U.S. and other places.

**David Vogt** ***UBS Investment Bank, Research Division - Analyst***

Right. And maybe just a quick follow-up. I know you've talked about backlog being difficult to predict. But can you just share with us sort of what underpins the '24, '25 from a backlog perspective versus in-period orders and how you're thinking about that?

**James E. Moylan** ***Ciena Corporation - Senior VP of Finance & CFO***

The '24, '25 is much more dependent upon orders that will come in over next year and the following years. '23 is we've got the backlog, frankly, to deliver '23, we just have to get the parts. So it's -- we assume that we're going to have good orders as we move through '23, '24 and '25, and that underpins our guide. The thing I didn't mention when I was talking about the outlook is our TAM is expanding. And that's something that we're attacking and with early good returns.

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

Thank you, David, and thank you, everyone, for joining us today. We appreciate the opportunity to speak with you. We wish you all a happy holiday, and happy new year. We're looking forward to connecting with you all over the next week or 2. Thank you. Have a good day.

**Operator**

This concludes today's conference call. Thank you for participating. You may now disconnect.