Ciena Corporation

Fiscal Q1 2022 Financial Results Conference Call

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Simon Leopold, *Raymond James*

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PRESENTATION

Operator

At this time, I'd like to welcome everyone to the Ciena Fiscal Q1 2022 Financial Results Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. Thank you.

It is now my pleasure to turn the call over to Mr. Gregg Lampf, Vice President of Investor Relations. Please go ahead, sir.

Gregg Lampf

Thank you, Brent. Good morning, and welcome to Ciena's 2022 Fiscal First Quarter Results Conference Call.

Our call today is scheduled for up to 45 minutes.

With me today is Gary Smith, President and CEO, Jim Moylan, CFO, and Scott McFeely, Senior Vice President of Global Products and Services.

In addition to this call and the press release, we have posted to the Investor section of our website an accompanying Investor Presentation that reflects this discussion, as well as certain highlighted items in the quarter. Our comments today speak to our recent performance, our views 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 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, discussion of market opportunities and strategy, and commentary about the impact of COVID-19, supply chain constraints and geopolitical dynamics are based on current expectations, forecasts and assumptions regarding the Company and its markets, which include risks and uncertainties that could cause actual results to differ materially from the statements discussed today. These statements should be viewed in the context of the risk factors detailed in our most recent 10-K filing, and in our upcoming 10-Q filing, which is required to be filed with the SEC by March 11. 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.

As always, we'll allow for as much Q&A as possible today, but we ask that you limit yourselves to one question and one follow-up.

As a reminder, we will be hosting investor meetings with the sell-side at OFC tomorrow and Wednesday. We look forward to seeing many of you there.

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

Gary Smith

Thanks, Gregg, and good morning, everyone.

Before I speak to our results, I would like to express our care, concern and support for the people of the Ukraine, those with friends and family in the region, and with all of our employees, customers and partners who are feeling the weight of this situation. This conflict in the region is leading to tragic outcomes for the Ukrainian people, and with a significant and growing humanitarian crisis underway. We will be making a corporate donation to Ukrainian relief efforts, in addition to reinforcing with our employees at Ciena Care's Matching Program.

Whilst the Company has very limited exposure in the region and we do not expect there to be a material impact on our global business, we are complying with all U.S. and international sanctions and export control requirements imposed on Russia, including having already stopped shipments upon the escalation of the conflict. When combining those actions with our strong position to stand in solidarity with the Ukraine, we have made the decision to immediately suspend our business operations in Russia. Like everyone, we will continue to monitor the situation and, specifically, the potential for broader geopolitical and global economic consequences.

Moving to our Q1 results, today, we reported fiscal first quarter revenue of $844.4 million, adjusted gross margin of 46.2%, and adjusted operating expense of $290 million, in line with the revised expectations we communicated a few weeks ago.

As a reminder, these quarterly results reflect specific supply chain disruptions that happened late in our first quarter and occurred within an already challenged logistics environment that was worsened by the Omicron surge. To be clear, we have subsequently managed through those specific disruptions that occurred in Q1.

Importantly, long-term secular demand is very strong, driven by the acceleration of cloud adoption and traffic growth, and the desire to get higher capacity and more bandwidth closer to the end user. As a result, we're seeing extraordinary demand that is generating significant momentum in our business, including unprecedented levels of order bookings for our products and services. This is broad-based across our portfolio and geographic regions. Our order volumes are also benefiting, to some extent, from security of supply behaviors, with customers giving us extended visibility into their needs, as well as some demand catch-up type spending.

As we mentioned a few weeks ago, we are sharing additional metrics this quarter, that we don't typically provide. These metrics illustrate the demand environment and help form the basis for our confidence in the year. Specifically, our book-to-bill ratio in Q1 was in excess of 2.5 of quarterly revenue. This ultimately resulted in a backlog of more than $3 billion exiting the quarter, providing exceptional visibility for the full fiscal year.

Another highlight from the first quarter is strong revenue diversification. As we maintain our clear leadership position in web-scale, we continue to benefit from prioritized spending in DCI. In Q1, this resulted in non-telco revenue now composing nearly 41% of our business, up 16% year-over-year, direct web-scale revenue of 20%, an increase of 10% year-over-year. In addition, we had a solid contribution from cable MSOs in Q1, driven by both our long-standing customers, as well as many smaller customers with whom we've been gaining momentum. MSOs, overall, comprise 10% of total quarterly revenue in Q1, up nearly 70% from a year ago.

From a portfolio perspective, our core Optical business remains incredibly strong, and we continue to win more than our fair share. We added 16 new customers for WaveLogic 5 Extreme in Q1, bringing our total to 156 customers globally. Also, in Q1, revenue for our flagship 6500 platform increased 20% year-over-year. This performance reflects the monetization of some of the new deals that we secured over the past couple of years that are now beginning to deploy. It also includes activity with existing customers who are now building out additional capacity and new routes.

As we indicated previously, we anticipated this shift in product mix for Fiscal '22, and we expect it to continue throughout the year. We expect this to result in a higher percentage of revenue from line systems and common equipment than we've seen during the last two fiscal years, particularly in our core Optical business. We also continue to win new business in next-gen metro and edge use cases. In fact, we reached a milestone of 150-plus total Adaptive IP customers during Q1.

Overall, in Routing and Switching, we had a strong first quarter, with revenue up 33% year-over-year, including a $12 million contribution from the Vyatta platform, that we recently acquired from AT&T.

Our Software and Services business also continues to gain momentum. Revenue for Blue Planet Automation Software and Services was up 25% year-over-year and revenue for our Platform Software and Services was up nearly 50% from Q1 of last year. Within that business, revenue for our newly introduced MCP domain controller almost doubled from this time last year.

Now, with respect to the supply chain environment, as we mentioned a few weeks ago, deliberate actions we've taken to invest in our growth will provide us greater flexibility, beginning in the second half of this year, basically, to manage current supply chain challenges. Specifically, we made decisions, roughly, nine months ago to place significant orders with our suppliers to meet our expectations for a strong second half, similar to last year, and an outsized '22 revenue growth rate. We've been accumulating components, that are not as scarce today, in order to be efficient and prepared to produce finished goods more quickly when supply constraints ease for semiconductors and integrated circuits. Additionally, we've invested in manufacturing capacity that we expect to come online later this year.

Overall, we are very positive about the strong demand environment, aligned with additional supply chain capacity and flexibility, and increased visibility into the remainder of the year, based on our order flow and backlog.

With that being said, I'll hand it over to Jim to review additional financial details of Q1, as well as provide our outlook for Q2 in the context of our expectations for the full fiscal year. Jim?

James Moylan

Thanks, Gary, and good morning, everyone.

As Gary mentioned, total Q1 revenue was $844.4 million. Adjusted gross margin in the quarter was strong at 46.2%. This reflects a particularly strong revenue contribution from our Software and Services businesses, that helped to offset some of the impact of the higher supply and logistics costs we are seeing. Q1 adjusted operating expense was $290 million. With respect to profitability measures, in Q1, we delivered adjusted operating margin of 11.8%, adjusted net income of $72.6 million and adjusted EPS of $0.47. In addition, we used cash from operations in the quarter primarily related to significant investments in inventory, something we believe will be a significant differentiator over time. Finally, Adjusted EBITDA in Q1 was $123.7 million.

Reflecting the addition of the net proceeds of our successful bond offering in January, we ended the quarter with approximately $1.7 billion in cash and investments.

With a strong balance sheet, we continue to return capital to stockholders. In Q1, we entered into an ASR arrangement under our new share repurchase program, repurchasing $250 million of common stock in the quarter. The final settlement of the ASR was completed in Q2 and approximately 3.6 million shares were repurchased through the arrangement. Keep in mind that we have an additional $750 million authorized under our current repurchase plan, which we intend to utilize by the end of Fiscal 2024.

Turning now to our guidance. As we said a few weeks ago, we continue to expect to achieve our annual revenue guidance of 11% to 13% growth for Fiscal Year '22. Our confidence in this outlook is based on a very strong demand environment, expected benefits from our continued investments in supply chain capacity, and greater visibility provided by our order flow and backlog. More specifically, we expect a strong second-half performance this year, primarily driven by a significant increase in supply chain capacity in the second half. You will recall that this is similar to the revenue profile we delivered last year, with particularly strong growth in the second half over the first.

With respect to Q2, we expect to deliver revenue in a range of $930 million to $970 million and adjusted gross margin in the 42% to 44% range. This reflects our expectation for a revenue mix in Q2 that includes a larger proportion of lower margin common equipment. Taking into account our gross margin performance in Q1 and our outlook for Q2, we continue to believe that our gross margin for Fiscal Year ’22 will be in a range of 43% to 46%.

Finally, we expected adjusted operating expense in Q2 of approximately $300 million.

In closing, we are taking advantage of our market leadership within a very strong demand environment, leveraging our differentiated balance sheet, leading innovation and R&D capabilities, and deep and growing customer relationships around the globe as strategic advantages. We expect investments in our business, including in our portfolio, our go-to-market resources and, importantly, our supply chain capacity will position us well to navigate challenging market conditions and deliver the outsized revenue growth in Fiscal Year ’22 to which we have guided.

Lastly, before we open the call to questions, I want to highlight that we continue to make progress on many ESG initiatives. We recently made available an updated presentation on the IR section of our website that provides new details on our activity in this important area. We encourage everyone to take a look.

With that, Brent, we’ll now take questions from the sell-side analysts.

Operator

Your first question comes from the line of Amit Daryanani with Evercore. Your line is open.

Amit Daryanani

Thanks for taking my question. The first question on my side, can you just talk about, you know, historically, what do price increases look like to Ciena and what you do for your customers, and how does that look like in calendar ’22, and what’s sort of embedded in your guide for price, from a pricing perspective?

James Moylan

I’m sorry, Amit. You’re talking about price increases?

Amit Daryanani

Yes.

James Moylan

Well, the dynamics of our industry have always been such that technology reduces the cost of our goods by 25% a year, a significant amount of cost reduction in our products, which competition, basically, causes us to pass along to our customers. When you get a 30% increase in the underlying demand for capacity, that’s how you get to an industry that grows 5%. So, it’s actually been common for us over many years to show lower prices per unit of capacity.

Now, we are talking with our customers today about the fact that our costs actually have gone up quite a bit, particularly with respect to semiconductors and integrated circuits, and so we are talking with our customers about sharing in this cost increase. We don't expect that that will have much effect this year. If anything, it'll be an effect for next year. But, price increases are somewhat of a rarity in our business.

Amit Daryanani

Fair enough, and maybe—I was hoping you could spend a few minutes just talking about the web-scale business. You saw nice double-digit growth in the January quarter. What's enabling that, organic, was it share gain, and how do you see that segment stack up for the rest of the year?

Gary Smith

Hi, Amit. I think what we're seeing is, obviously, increasing DCI buildouts globally. We've got a very large market share in web-scale, as you know, but we actually think we're probably going to be taking share, based on some of the commitments that we're seeing being placed on us already. So, I think it's just a very healthy market, that's really building out more and more data centers around the globe. We have multi-faceted relationships with these web-scale players, both in terms of domestic, international, submarine, and I think not just in terms of point-to-point, but also a very large 6500 network capacity with a lot of these players, as well. so, it was a very good quarter and we're going to have a good year with web-scale.

Amit Daryanani

Thank you.

Operator

Your next question comes from the line of Tim Long with Barclays. Your line is open.

Tim Long

Thank you. Gary, I was hoping you could talk a little bit about some of the businesses you're calling out, Routing and Switching and the Software and Blue Planet businesses, that performed very well in the quarter. Could you talk a little bit about kind of, you know, cross-sell in that area, are you willing—how good are you at kind of pulling the install base over and how much of that is winning new customers with those offerings? Then, the follow-up would just be could you just talk a little bit about the Europe and Asia theaters? They look to be a little bit under pressure year-over-year. Was that components or is there something else going on in those regions? Thank you.

Gary Smith

Why don't I take that one first, Tim, and then work back through, and then talk about the Software and cross-selling, and then Scott will talk a little bit about the Packet Routing and Switching?

On Europe and Asia, we're seeing strong demand across all geographies, so I think, really, Q1 was more about supply constraint than really extrapolating out too many dynamics around the different geographies. Particularly, in Europe, we're seeing strong demand, really, after a period of under-investment, frankly, over the last few years, even pre-COVID. So, I think Europe is going to be very strong. India, I think, was also down in Q1, but I think is going to have a very good year, based on the order flows. So, that's probably a good example. I just think it's—I wouldn't extrapolate too much out, based on the challenges around supply constraints, which is going to be with us for a while.

On the Software side, as Jim said, we had a strong quarter, good growth on both Blue Planet, which really is focused at the service-creation layer, and the automation, we've seen a lot of carriers, particularly as they've gone through COVID, really now prioritize the automation of their networks, so we're seeing very healthy demand in Blue Planet. Similarly, MCP, which is really the automation at the network layer—now, you know, the numbers look very good from a growth point of view, but we're coming from a newly introduced platform, but we're very encouraged with what we're seeing there, and that's into—we've not MCP into pretty much all of our major customers around the world, and that gives us a platform to up-sell various applications on top of that, and then, obviously, into the services layer with Blue Planet, as well, just part of our strategy. Then, obviously, as we're seeing the convergence of Packet and Optical, we've invested heavily in our Switching and Routing portfolio.

Scott, any other …

Scott McFeely

Just on the Routing and Switching piece, I think where we're seeing strongest demand and the biggest success is where our service providers or MSO customers have built out their fiber plants closer to their end customers, whether that be a wireless play, an enterprise play or a residential play, and obviously we've got tremendous relationships with those service providers and MSOs around the world, so that helps in that conversation. As we look forward, we're certainly starting to see some of the Tier 2 and Tier 3 providers looking for end-to-end solutions, so being able to offer both the core and those access and aggregation solution plays to our strength, as well.

As you think about the next-generation metro and edge, we firmly believe the winning hand there is going to be optimized routing and switching, optics photonics and multi-layer control. Gary talked about the Software assets there. Those have a strong value proposition when you start to look at those networks coming together, as well.

Tim Long

Okay, thank you.

Gary Smith

Thanks, Tim.

Operator

Your next question is from Rod Hall with Goldman Sachs. Your line is open.

Rod Hall

Yes, hey, guys. Thanks for the question. I just wanted to come back to the backlog of $3 billion and ask maybe a couple questions on that. One is, do you expect that to rise further in the coming quarter or two, or do you think that this is the peak and you start to work the backlog down? Then, my follow-up will be regarding backlog, as well?

James Moylan

Well, it's always dangerous to say what's going to happen in any given quarter with respect to orders, but we do expect a strong order flow this quarter, and I wouldn't be surprised if the backlog grew this quarter, and as we look out, we're going to have a very good year. I'd just ask everybody to remember, though, that a lot of this order flow is people giving us visibility into their order flows—into their demand for this year, and, in some cases, even into next year, and so it's great, it's wonderful, we're seeing strong demand, but shouldn't extrapolate what's going on now into any sort of revenue expectation.

Rod Hall

Right, that makes sense, Jim, and then I wanted to also ask—it's great that you guys have this visibility to the end of year, I think that's the first time ever we've seen that on Ciena, with that kind of visibility, given the industry, but I was wondering where do you think you might finish the year in terms of backlog? Do you expect half of that to be gone? Can you give us any idea kind of where the backlog might end up by the end of the year?

Gary Smith

Rod, I absolutely get the question. I just don't think that would be appropriate for us to extrapolate out, because we'll then get into a conversation about '23. We're one of the few companies that's actually giving guidance for the full year of '22. I think we'd be getting a little ahead of ourselves to do that. But, to Jim's point, it's very strong demand characteristics. It's security of supply, absolutely, there's a large portion of that. But, we also feel that the secular demand around cloud adoption is going to give us a multi-year platform here for growth. So, we feel very good around the secular dynamics of our space and our position in it just continues to get stronger. In all likelihood, to put a pin in it, we are going to probably have orders outstrip revenue in Q2, as well. That's our expectation. We'll see how that plays through for the rest of the year.

Rod Hall

Okay, all right. Great, thanks a lot, guys, appreciate it.

Gary Smith

Thanks, Rod.

Operator

Your next question is from Paul Silverstein with Cowen. Your line is open.

Paul Silverstein

Thanks. Gary, Jim, I was hoping you could provide some more granular insight regarding revenue diversification from a customer perspective. I know there hasn't been meaningful concentration in a long time, but as you look forward over the next four quarters, and beyond, I assume the strength you're looking at is not a function of any one or two customers, but is far more broad than that, but any granularity both within the web-scale and, more broadly, beyond web-scale. Then, I've got a follow-up.

James Moylan

We're seeing demand very broadly around the world and across verticals, Paul. Our concentration numbers, generally speaking, haven't changed significantly, except that the percentage which our two biggest customers represent has come down quite a bit, but our top 10 customers are around 50%, and that's been that way for a long time, I think it will continue to be, but beyond that, the top 10 customers, in terms of volume, we have a whole long list of customers that are seeing the same kind of demand on their networks that the bigger companies are, and we are winning our fair share, or more than our fair share, frankly, of all of those buildouts.

Paul Silverstein

Within Routing and Switching, how much of the growth you're looking at going forward is a function of new customers, new projects, new customers versus new projects or extended projects of existing customers, and I'm talking organically (multiple speakers).

James Moylan

You're talking about winning Routing and Switching from customers who are not current Optical customers; is that what your question—is that the basis of your question, Paul?

Paul Silverstein

No, I'm talking about Routing and Switching, incremental revenue from …

Scott McFeely

Paul, I would articulate it—I think your question is, is how much of it is sort of continued buildouts from the existing footprint versus new application footprint, not necessarily new Ciena customers, but new application footprint?

Paul Silverstein

Well, how much is from existing Routing and Switching customers, how much is from customers that haven't yet bought Routing and Switching?

Scott McFeely

Okay. I think, for the time horizon, certainly, the growth trajectory that we see in Routing and Switching has an expectation and dependency on us winning new logos, but for 2022, the bulk of it is sort of the existing applications and existing customers.

Paul Silverstein

Okay, thanks, guys.

Gary Smith

Thanks, Paul.

Operator

Your next question is from Simon Leopold with Raymond James. Your line is open.

Simon Leopold

Great. Thank you for taking the question. I know you've talked about your efforts to raise prices to offset costs, and you've counseled us that it doesn't really affect Fiscal '22, but is effective in Fiscal '23. Given the progress to date, do you have a sense of how to quantify, essentially, of revenue growth tailwind for

Fiscal '23 coming from the price increases? Essentially, I'm looking for some quantification or some sense of the progress you've made talking to customers about higher prices, and then I've got a quick follow-up.

Gary Smith

Simon, let me take that. It's an ongoing conversation. I think they've progressed very well. Obviously, most of our major customers understand very well the global issues that we're all facing. So, I would say it's been very constructive and very positive. But, as Jim said earlier, that's not going to impact any of our financial performance, probably, in this year, and I think, just from a '23 perspective, Simon, it's way too early to start talking about next year. We're already providing pretty detailed guidance for this year, and one of the few companies to do that, but I just don't think it would be appropriate for us to get into those kinds of things about '23.

I would say we feel very positive about the strong secular demand and our position in the space, and we think this is going to be clearly a multi-year growth platform for us, but I just don't think it's appropriate to get so far ahead of our skis right now.

Simon Leopold

Okay, and just as my follow-up, it appears that your Services gross margin was actually a bit better than the last four quarters or so, and I'm just wondering whether there was something unusual in this quarter or whether we should think about more sustainability of a better Services gross margin, and if so, why?

James Moylan

Well, as you know, Simon, our Services revenue pack is made up of a whole list of projects that are in various stages of their lives, and so I'd just attribute that movement to ebbs and flows of the business, it's going to move around a bit, but I'd say this, we've been very pleased with the progress we've made on our gross margins in Services over the last several years. We've done a lot of things in our Services supply chain and capacity set to enable that gross margin, and so we're pleased with where it is, and, hopefully, it'll get better over time, but we don't think that you should take too much out of any one quarter.

Simon Leopold

Thank you.

Operator

Your next question comes from the line of Jim Suva with Citigroup. Your line is open.

Jim Suva

Thank you. I think it was in the prepared comments by Gary, you mentioned kind of a little bit more mined business. Just curious, is that because you've seen a meaningful increase in demand for it or because you have the ability to secure the supply of such products and, therefore, meet demand, where other ones, you've had more supply challenges, I'm just kind of curious about that, and the sustainability, is that something we should expect to continue to be a little more tilted in that direction? Thank you.

James Moylan

We are seeing a higher percentage of commons and photonics this year, as compared to previous years. That's a good thing. That means that the buildouts that we—the wins that we've had over the past few years are starting to build out, and so you can expect that to be a good thing for our future. What we said was that the gross margin guide for Q2 is as a result of a higher proportion of lower gross margin commons and photonics, so all of that is sort of a piece.

Gary Smith

Jim, the other thing I would add there is it's also—in the context of this, there's a number of wins that we had—frankly, some of these date back to pre-COVID—that kind of got put on hold, from an operational point of view, over the last couple of years and we're now seeing them deploy. So, it's new accounts and new customers that we're deploying there, and, as Jim said, that's very positive, it bodes well for their commitment to the future to us, but it's also existing customers now reinvesting in their both capacity and network modernization. So, it's this classic sort of line system, photonics and commons, which then will follow as they fill in with cards over time. It is constrained by supply chain, but we're also seeing it from an order point of view, as well.

Jim Suva

Great, thank you for the insights, it's appreciated.

Gary Smith

Thank you, Jim.

Operator

Your next question is from Tal Leoni with Bank of America. Your line is open.

Tal Leoni

Hi, guys. I went to see—I went to Mobile World Congress last week and I was surprised with how much discussion there was for white box routing with pluggables, and also pluggables in traditional routers. The question is—I understand that there is great demand in current times and the current buildout is probably not with these kind of solutions, but thinking about the long term, what is the implication for demand in your space and how are you positioned if the market migrates to these kind of solutions? Thanks.

Scott McFeely

Tal, it's Scott here. I'll separate out the sort of white box phenomena from your second theme there, which is kind of—I'll call it convergence.

Personally, I think, for our customer segmentation, we're not really seeing a lot of deployments of the white box piece, because, frankly, as you sort of disaggregate the stuff, someone has to put it back together again, and that's typically not the business of our customers.

On the convergence piece, for some parts of that work, we do see that as an evolution. We've talked about this in our next-generation metro and edge capabilities, where we really firmly believe the winning hand there is going to be best-in-class optics, best-in-class photonics, lightweight routing and switching capabilities, and the off-box software control systems that allow you to manage and automate that network across the layers cost-effectively, and we have been investing in those threads for a long time and part of the fruits of that investment you're starting to see come with growth in our Routing and Switching business.

Tal Leoni

So, your position is it's not going to happen for now because of certain things, and I agree with you, but what happens if it happens? What happens if pluggables are going to be deployed by carriers or demanded by cloud companies? Does it mean that Ciena is going to see shrinkage or a decline in demand in the market, or (multiple speakers).

Scott McFeely

Different parts of the network are going to have different evolutions and solutions. We firmly believe that the core infrastructure of the network is not going to sacrifice an ounce of performance and, therefore, is going to continue to be separate deployments. As you get closer to the edge, we think the convergence does have a play, and we think that's a greater opportunity than a threat it is for us, because there's other spend that we are not—haven't historically been addressing, that is now available to us.

Gregg Lampf

Remember, we talked about an expanded TAM and part of this is the context of what we're talking about here.

Scott McFeely

Exactly.

Tal Leoni

Got it. Great, thank you.

Gary Smith

Thanks, Tal.

Operator

Your next question comes from the line of Meta Marshall with Morgan Stanley. Your line is open.

Meta Marshall

Great, thanks. Maybe just on the second half ramp, understanding that you're not guiding into Fiscal Q3, but should that be a step-function as we head towards the second half of the year, or kind of a more gradual ramp as capacity comes from supply chain bottlenecks releasing? Then, the second question, I mean, I would assume not, but any impact to subsea consortiums, or anything, just given the geopolitical—kind of heightened geopolitical environment we're seeing right now? Thanks.

James Moylan

Yes, what I would say, Meta, is that Q3 has always been a very strong quarter for us, just given the sort of annual sequence of the way our customers operate, and so we'll see a nice—or I think we'll see a nice move in Q3. You ought to look at last year, look at last year and derive your view of what this year's going to look like based on last, because that's kind of the way we're thinking.

Gary Smith

Meta, on the second part of your question, we're not—it's early days, but we're not seeing any geopolitical fallout yet on any of the submarine system, cables, or any of the rest of it. Frankly, quite the opposite, we're seeing very robust demand around the globe for that.

Meta Marshall

Great, thanks.

Gary Smith

Thanks, Meta.

Operator

Your next question is from Fahad Najam with Loop Capital. Your line is open.

Fahad Najam

Good morning, and thank you for taking my questions. Gary, I wanted to kind of get your help in understanding your comment about strategic investments in increasing supply chain capacity for the second half. Can you elaborate a little bit more? Is it just you procuring more components or are you adding more manufacturing lines? How much of this expansion or increase in supply chain capacity is a permanent investment versus just buying more inventory?

Gary Smith

Yes, I'd say all the above, but, Scott, do you want to …

Scott McFeely

Yes, I think you can think of it in three swim lanes.

One is we're not following, I guess, the just-in-time inventory approach of yesteryears on the components that aren't in short supply. You can see it in our raw material inventory. We've sort of been building that up, waiting for the more constrained components, so that we can that into finished goods quickly. So, that's number.

Number two is we made the decision nine-plus months ago to bet heavily on significant growth in our business in the second half of the year and put significant demand on—I'll just say the component industry, playing to the rules of their new extended lead time, so we're not expecting any change in lead times, but we made that bet a long time ago.

Then, the third thing is, in order to turn it into finished goods in a faster manner, we've increased our capacity on the production side, largely in the tests capacity, so we can turn that around quickly.

So, those are the three main things.

Fahad Najam

Okay. So, if some of the stuff that you invested in is inventory and some of it is permanent, like the additional test capacity, how should we think about the implications on your gross margins going forward? Assuming your 6% to 8% long-term guidance holds, does that have any meaningful impact on the trajectory of the gross margin, or does that also mean that you're probably better positioned to guide (multiple speakers).

Scott McFeely

Yes, the way you should think about it, I think, in terms of—if you're talking strictly about the capital investment on the production side, it's a minor needle-mover from a gross margin perspective. We're really talking about pulling forward investment capacity that we would have put in place in '23, anyways.

Fahad Najam

Okay, appreciate the answers. Thank you.

Gary Smith

Thanks, Fahad.

Operator

Your next question comes from the line of Alex Henderson with Needham. Your line is open.

Alex Henderson

Great, thanks. You made the comment in your prepared remarks that you expect a significant improvement in the back half of the year in terms of components, yet when I talk to virtually everybody else in the industry, they're saying that conditions have not improved and, in fact, may have eroded. The rate of decommits on orders has gone up. Virtually, every other manufacturer has done the same thing you've done, which is stretched out their orders and committed to significant increases in the future. Your third quarter fiscal year is pretty close, I mean, that's the July quarter. So, what gives you the confidence that the supply chain conditions are going to improve and you're not going to get decommits, based off of what seems to be continued stretching of duration across the entire industry, as well as decommits showing up at a lot of other vendors?

Scott McFeely

There's a couple of things in there. I'll, first of all, talk about lead times. From what we've seen, lead times haven't really changed. They did a step-function a while ago to be pretty extreme in terms of lead times. They haven't gotten worse, they haven't gotten better, and we're not depending on them getting better. We put orders in a long time ago, playing by the new rules, and betting on our business, and if others didn't make that bet, then I can see their showing up today trying to do it, they're facing those lead times and they're stretched out. Now, what we've been following very, very carefully, whether or not those component suppliers have been delivering to their new advertised lead times, and for the most part, I'd say, yes, they have.

Then, you talked about decommits. From our perspective, the decommits, in terms of the quantity of them, haven't really changed. They're happening, absolutely. I would actually say they're actually less severe than they were three to six months ago, in the sense of the numbers are probably the same, but the magnitude of the decommits are different. If you go back three to six months, what we were seeing is decommits pushing out quarters at a time, and sometimes not even reconfirming the quantities. Now, we're talking about those quantities are showing up, but the impacts are days and weeks. That's what we're seeing in our supply chain.

We made these bets a long time ago, Alex, and if others are trying to make them today, I can understand the difference.

Alex Henderson

Okay. Second question, if I could. You talked about your strategy around pricing, and I understand it, it makes sense, it's consistent with Ciena's strategy historically. Some of your competitors, though, have been much more aggressive on price; in particular, Cisco has had multiple price increases. Have you seen a change in the pricing environment from the competition, whether it be Cisco, Nokia, or some of the other vendors that are in the field, that's creating a little bit of a benefit to you in terms of share, as well.

Gary Smith

I think it's too early to tell on all of that, to be honest. I think some of these things get announced and a lot of the sort of price increases that some of the people you talked about there are really in the enterprise space, which I think you've seen more aggressive price increases, too. Some of that bleeds across, for sure. As Jim talked about earlier, we're in an unprecedented environment from a price dynamic in the carrier and infrastructure space. I think that's pretty much playing through how we anticipated. We have had some very constructive conversations with most of our—with all of our major customers, they understand that situation, and that will start to play through over the next one to three years. But, we really haven't seen any massive changes in the competitive environment. It's really—particularly right now, all of that is hidden by all of the constraints around supply. It's more about can you supply something than what the price is, frankly, and so it's going to take a little bit longer for that to play through.

I would say this, though. Given Scott's comments around the scale of the commitments that we've made to our supply chain and the step-up that we've taken in that a long period of time ago, our guidance of 11% to 13% growth this year on revenues, the order backlog that we've shared with you, what's absolutely crystal clear is that we're going to be taking market share this year and beyond.

Alex Henderson

Super. Thank you very much.

Gary Smith

Thanks, Alex.

Operator

Your final question comes from the line of Samik Chatterjee with JPMorgan. Your line is open.

Samik Chatterjee

Hi. Thanks for squeezing me in here. Just, if I could start on gross margin. Jim, I just wanted to see if I could get some color on you now reiterating the gross margin guide for the full year, which is great to see, but can you maybe share any quantification of what the impact from the supply chain costs or higher supply chain costs will continue to be for the fiscal year? The second part to that, quickly, is how should I think about the better Software that you had driving the better gross margin in F1Q, how should we think about that guide forward to the full year? I know it's a wide range, but is Software now going to be doing better in terms of revenue for the full year than you imagined earlier because of the strong start, and does that flow through to the full year margins? Thank you.

James Moylan

Yes. Now, I'm going to use some numbers here, and I think you ought to be really careful with these numbers, because I have to in order to illustrate the point, right?

The last time we talked about our long-term gross margins, before COVID, we centered them around 45%, roughly. That's what we centered our view of gross margins. We then went through a COVID period of time in which capacity was the most in-demand quantity, and so, therefore, our gross margins did go up quite nicely to the high 40s. We said, though, that they were going to get back to these—once we got through the COVID period of capacity adds and get back to a more balanced mix of line systems and commons and photonics and capacity, that we would naturally get back toward that mid-40s range. So, where are we in all that? I think we're heading toward that period of time where we're back in that range. However, we guided this year to 43% to 46%. Again, just taking the midpoint of the range, that's 44.5%. So, you could sort of quantify that the effect of the extra costs in our supply chain based on that difference. Now, I would caution you to not make any absolute judgments about this, but that's sort of in the range of where we are.

Now, the other thing that always has an effect on our margin is mix. It's a mix of the type of products, stages of the various projects that we have with our customers, software. All those things do impact our gross margin, and it's hard to call, but I'd say this, we've been pleased with the fact we've been able to maintain gross margins in this sort of unprecedented period of cost increases, and we expect, over time, that we'll get back to something more like the long-range number that we had projected earlier, and perhaps better.

Samik Chatterjee

Are you thinking Software—how's your expectation for the Software case, given the strong start?

James Moylan

Well, we had an unusually high quarter in Q1, but Software is part of our strategy. We've invested pretty heavily in our Blue Planet mix. We've also added a lot of capabilities on the platform side within CP. I think we have an industry-leading management system. So, yes, that's definitely going to be a higher percentage of our revenue—we think it's going to a higher percentage of our revenue going forward, and that'll help with gross margin.

Samik Chatterjee

Thank you. Thanks for taking my questions.

Gregg Lampf

Thanks, Samik, and thank you, everyone, we appreciate it again.

We express our care and concern for all the Ukrainian people and our hopes for a peaceful future.

We look forward to seeing everyone at OFC. Thank you.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's conference call. You may now disconnect.