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<<Amit Daryanani, Analyst, Evercore ISI>>

Delighted to have Ciena here for our next fireside chat and we have Ciena CFO, Jim Moylan, over here. Thanks a lot for your time, Jim. I always appreciate it. I guess before we just kick this whole thing off up, I'd love for you to maybe just recap – you just reported last week. So maybe just recap sort of what your folks reported and maybe just touches on the supply chain dynamics that we discussed on the call. I'd love to get your perspective there and then we can dig into some of the questions from there.

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Sure. Well, I got to say; we were disappointed in our results for the quarter. We reported \$168 million or something of revenue against the guide that's on around \$900 million. We were very disappointed by the performance of a couple of our suppliers in the quarter who really gave us very unreliable supplies of a very small number of parts. It cost us about \$60 million of revenue. Our guide was \$870 million to \$930 million, and so we would have hit the high end of the guide had we had those parts. I'm getting an echo. Is there an echo? No, that's better. That's better. Thank you. Okay.

And it so happens that these parts are – there's integrated circuits and they go into the production of a modem. We lost essentially \$60 million of modem revenue in Q3, which is higher margin. So cost us a couple of 100 basis points of margin. So it was a disappointing quarter. We all know that everyone is experiencing the combination of high demand and supply chain difficulties. We've been able to navigate through them for the most part; this situation is quite unusual in that, as I said, it's a small number of suppliers, a very small number of parts that's costing us a lot of revenue.

We don't see that moderating in Q4. We think that we guided down for Q4 based on what's happening there. As we look out, we have taken action to either redesign boards or to specify other parts for these particular parts that are in such unreliable and short supply so that, we think, as we move into next year, we'll start to get some relief based on the work that we're doing there. Hopefully, we'll get a little improvement on the part of the two or three suppliers who are really giving us the most difficulty right now.

The other thing I'd say, too, and that people should know that these suppliers don't just provide this small number of parts. They give us dozens or even hundreds of parts. And for the most part, their supply has been reliable. 90-plus percent of their parts are coming in per lead times. It's these small number, which is giving us a real hard time.

So that's what is happening here. In the meantime, our order book was very strong. We had 1.3 book-to-bill ratio. Our backlog grew which is – it's sort of a two-edged sword.

We love the fact we're getting demand. We're getting stronger demand than anybody. But our lead times are high, and so it goes in the backlog and we can't deliver it.

So anyway, our business is in great shape. We still have the best technology in the industry. We love the fact that we have opportunities in the routing and switching business. We are investing ahead of that. Our OpEx is a little higher this quarter as a result of investing ahead of that because we want to have the kind of capabilities that will enable us to keep gaining share not just in optical but in routing and switching.

<<Amit Daryanani, Analyst, Evercore ISI>>

Got it. That's a really helpful overview of last quarter. But one of the things I think you folks talked about when it came to fiscal 2023, I don't know what quarter, too early on this. There is no formal guide so I want to be cognizant of that. But I think what you talked about was that, we expect growth to be better than 6% to 8%, which is sort of a longer-term growth rate you've talked about. Maybe just talked about what's driving this trend when you say we can do growth, it will be better than 6% to 8%? And does that assume that you actually work through some of the backlog that you've accumulated so far?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Yes. This is the way I would go about answering that question just for the benefit of people who are not familiar with our company, our business grows – our business is based upon growth and bandwidth demand. And that's been growing at a very high rate for a long, long period of time. It's been growing at, call it, 30% a year for a long time. As long as we can look back and as long as we can look forward.

In the face of that, our technology and others innovation takes about 25% a year out of the cost of the product. Now of course, this is – none of this is straight line. All of it is stair-stepped, but that's the way the industry has worked for a long period of time. That's how you get to an industry that's growing at 3% to 5% a year. And in the face of that, we've grown, if you look historically, pre-COVID, we grew at about 8.5%, something like that.

At the same time, at about that time, we said our long-term growth rate in an industry, which grows 3% to 5%, should be 6% to 8%. That was what our expectations were. And we did a three-year financial description of what our parameters would look like back then.

What's happened since then, and by the way, we're still confident in that sort of picture of the industry. A lot has happened since then. We know that. We had a COVID disruption to CapEx. We've had now supply chain situations which have limited the amount of deliveries that we and others could make. So really, for the last three years, if you include this one, we haven't been growing at all. We've been sort of flat. And that means that our

– and by the way, we've not lost any share. We think that we gained about one percentage point of share in the first half of this year.

So that's what's happening here. That means, by definition, because demand for bandwidth has grown, that our customers are operating their networks hotter than they would like to. They want our gear. That's why we have such demand on our system.

So all that is happening. Another thing that's happened is that we have this rural broadband initiative, which is going to, we think, add a little bit to the growth rate of the industry over the four- or five-year period that this money gets rolled out from governments around the world. So all of it, our business is really great. Demand is great. We're just having trouble delivering.

And therefore, when we look at next year, and we haven't guided. But the growth rate is going to be big. It's really not going to be a meaningful growth rate because we've had sort of depressed revenue for a few years. I think we're going to have some time out there as the supply chain situation eases, we're going to work off our backlog and we're going to work it off in a hurry. And that means some time out there, and I don't know if it's next year or the following year, we're going to have some very, very strong quarters, two or three very strong quarters. That's just because customers want the gear. For the most part, they'd take it today, if they could get it, and they'll take it as soon as we can deliver it. That means that we'll have a super strong year or maybe even more than one year. Then I think we moderate back to the 6% to 8% or maybe a little higher because of the broadband stuff in terms of the growth rate.

So our situation is complicated, but we're the strongest company by far in the optical business. We're the best company with the best technology in this business. We have great opportunities to grow in routing and switching. And so we're pretty confident about our future as we move through time. We just need to work through the issues we're seeing today in the supply chain.

<<Amit Daryanani, Analyst, Evercore ISI>>

Got it. And I guess due to the supply chain just to go back to that, some of your peers, maybe a lot of your peers have talked about, broadly speaking of the supply chain, based on sure signs of improvements, things are starting to alleviate a little bit more. I know the issues you had were very specific to a few components, few suppliers, broadly, is the expectation that the worst from a supply chain basis is more behind you, as you go forward, it starts to improve?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

I think generally, yes. And we see that for the 95% of our parts that – and suppliers that are delivering according to schedule that, that reliability has increased. If you go back two or three quarters, the parts other than those few were delivering at 60% reliability per

lead time. Today, all those other parts are delivering at 90% reliability according to lead times. So yes, we have seen some general improvement in our supply chain.

But I have to say that these few small parts, it's gotten worse for us. We didn't see these missing parts or we didn't see these parts go missing in earlier quarters, third quarter was the first time we saw it. So clearly, that situation has gotten worse. If you look out in time, really, for the supply chain to get back to what it was prior to all of this, you really have to see lead times come in.

And that's going to be – I don't think you're going to see lead times come in to what they were before all of this for a while. That's going to take one of two things. A big increase in supply capacity adds, these foundries take a long time to build, and they're very expensive or a significant decline in demand. A big recession could create decline in demand because every business uses semiconductors now. Any manufacturer part has a semiconductor at it. So if you saw a recession, if the consumer really dropped in it's spend on consumer electronics or if the automobile industry started going into a decline that would free up capacity in these foundries. Those are the two things that have to happen, and it's not going to happen overnight.

<<Amit Daryanani, Analyst, Evercore ISI>>

All right, that's fair. In the meantime, you do have a really big backlog number.

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Yes.

<<Amit Daryanani, Analyst, Evercore ISI>>

Because you typically had, right? I think last quarter, the number was \$4.4 billion, as you discussed, right?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Yes.

<<Amit Daryanani, Analyst, Evercore ISI>>

One of the big debates, I think, investors end up having, when we talk to them at least is how real is this backlog? How durable is this real backlog? And do you end up with a bad scenario where supply improves and you see backlog cancellation. So how do you convince one that this is a real backlog and it will convert to revenues over x number of years?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

I understand that people would question it because it's the – if you sort of believe everything else that we're saying to the world. It's the only thing that could go wrong in our story, right, is that somehow there is something wrong with our backlog. And so yes, it's an obvious question, and I think it's certainly understandable that people would ask it. I think that that concern is very much misplaced though. It's just not conceivable that this is not real demand.

First of all, as we started with, demand for bandwidth continues to grow. These networks need our gear, and they have to have it. So this is real demand. We also have, for our top 50 customers, which is 95% or something of our revenue, we have a dedicated sales team that knows a lot about their customers' networks. We have a lot of gear in those networks. We monitor our gear. We know that their networks are at high rates of utilization. So that's another reason why it's real demand.

The other thing is that these are big companies that just don't operate that way, double and triple ordering and then cancellations of orders. In my career at Ciena, I have seen a handful of cancellations in very, very unusual situations. That's just not the way our business works. So at the margin, could a few things happen, yes, of course? I'm not going to deny that nothing will ever get canceled. But I'd just say that this is very much a misplaced concern from our point of view.

<<Amit Daryanani, Analyst, Evercore ISI>>

Got it. Fair enough. Cloud, I think, and cloud optical, I guess, has been one of these major points of strength for the company. And you obviously have a very high degree of market share there. So maybe just touch on what are you seeing in the cloud optical space? What does the growth rates over there look like? And somewhere in there, maybe you weave in, Cisco and Acacia have been making a lot of noise in the space. So what do you make of with them as well?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Yes, there are a lot of names given to that particular group of customers. We call them webscale, others call them web titans. You're referring to them as a cloud. But essentially, we think of that business as anyone who has a web-based business model. And for the most part, these companies just about all of them, not all, but just about all, are not in the networking business per se. They are in other businesses. They are in connecting people or advertising or whatever they are in, they use networking to enable their business.

And their businesses have been growing at fantastic rates so they need more and more networking. They essentially have data centers around the world, and they want these data centers to be connected, and they want them all to be updated and provide the same information to every customer around the world all the time. That's their plan, and that's why they've spent so much money on the quality of their networks.

We don't see that going away in any way, shape or form. Now I will say this, that it's not monolithic that – let me back up and say we have roughly 70 or 80 customers in what we call our web scale category, four of which are very important to us. We are concentrated in those four, and you would probably recognize all of their names. They don't have the same business model and they don't move monolithically. Their behavior is slightly different. So you can see, in any given year, one customer might be going gangbusters and really, really spending, another one might just be in a digestion period for a while. But if you look at the overall rate of spend by those companies; their CapEx has grown at well above double-digit rates for a long, long time.

We do think it's possible. And you kind of see it in some of their numbers that their rate of CapEx growth might moderate to something around 10%. Now that's a pretty big increase in CapEx. And we also say too that we have a very strong market share in that vertical really because they place a very high importance on the quality and the performance of their optical gear, and we have the best by far. So we've taken a lot of share. We have a lot of share. We have said now for at least a year, maybe a couple that it's going to be hard for us to continue to gain share in that business because they're going to want to have choices. All customers want to have choices. So we think it's hard for us to continue to gain share, but we should grow with that business, and it's been growing at double digits.

Now when you think about it this way or that way, then think about what the service provider growth has to be in order to get to an overall industry that's going 3% to 5%, it's pretty low. So anyway, that's – but they have a different business model, and they are constrained in CapEx in ways that the web scale guys are not. I guess the strongest thing I can say there is that that's a business that we started with when they started buying network gear, and we have grown with them as they have grown with us. Our relationships with the web-scale players are much deeper and more strategic than they were three and four years ago, and we're working on some really exciting things with these companies.

<<Amit Daryanani, Analyst, Evercore ISI>>

Got it. Cisco and Acacia made a fair bit of noise. Presence fell in this space. I'm curious what's your perspective on them? And really your market share is a byproduct for that in that space?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Well, we respect both well, Cisco and Acacia. Acacia has a very good optical offering. We believe that ours is better. And because the web scale guys do rely on performance. That's why we've had so much market share gain. But I'd say that they are going to use the next best alternative. And in our view, Acacia is a good next best alternative, and they will gain some share. Now when they've made those noises, were they talking about optical, were they talking about switching, what were they talking about or both?

<<Amit Daryanani, Analyst, Evercore ISI>>

I mean I think it's both and their perspective is almost optical can be the entry way to sell more traditional networking gear switching around into these hyperscale vendors?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

True. Okay. Good. The way I see the world is this, that if you think about the last whatever, five, eight, 10 years, there's been a very much concentration of market share in this business. And frankly, and I'm speaking about optical at that point. If you look at it just on the optical side, then market share has concentrated in three entities, China, Inc., ourselves and Nokia. That market share has grown from 50% to mid-60 percentage points over the past several years. What's happened is smaller companies are getting squeezed out.

What I think Cisco decided to do in acquiring Acacia is that they saw an opportunity in the optical space. There are also architectural changes that are happening that are converging optical and routing and switching. They saw that TAM sort of converging. And they made that move in order to make sure that they were successful. So what I'd see is that over the next five, eight years, our biggest competitors in every space, whether it's web scale or whether it's in service provider, are going to be Nokia and Cisco. Cisco is going to become a much more important competitor to us than they have been in the past.

<<Amit Daryanani, Analyst, Evercore ISI>>

Got it. One of the other dynamics that comes up a fair bit is this, the Huawei impact, right? And I think it's this compelling growth opportunity that Ciena and probably everyone else has in the space. Maybe just talk about how does that transpire over the next five years, call it? And sort of what does the cadence of those wins look like for you?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Yes. The Huawei situation is very interesting. And the way we look at the world is this, that there are going to be some countries and regions in the world that are not going to care, whether they buy Chinese or American gear, they're going to want the cheapest available alternative. And those are countries in Africa and parts of South America and some parts of Asia. There are – and, of course, China. There are other countries that are going to be inimical to Chinese gear, including places like Japan, Korea, Vietnam, India and of course, the U.S. and Canada. And I'm sure I missed some other countries.

Western Europe is the most interesting battlefield though. There is probably \$500 million to \$800 million or maybe more gear being purchased annually from Huawei in Western Europe. There has been a growing swell of anti-Huawei sentiment in those countries of Western Europe. It sort of peaks and ebbs though, and it's not consistent, and it depends upon what's happening in the world. My own feeling is that the Russia-Ukraine situation,

which is being sort of softly supported by China, is not going to help Huawei going through time.

So we see that opportunity ahead of us. It's going to be attacked by ourselves and Nokia in particular. And we see that we're going to get some of that. Now we've already seen some of that. We see it in some of the smaller economies. We see it in the Nordics. We see it to some extent in the southern European countries. But the big economies of Europe, Germany and France really have not made a big move away from Huawei. And if you look at the numbers, the most recent couple of quarters, Huawei is growing in Europe. So I think that's a function of the fact that they're never going to be ripped and replaced, that in order for us to gain this share, there have to be new big build-outs of next-generation gear, and that has to happen by these companies in order for us to get that share.

The other thing that's happened most recently is that Huawei seems to have access to parts, better access than Western companies. And I think that's part of the reason why Germany and French companies are continuing to buy from Huawei. In the U.K., it's a little more mixed picture. We have a big business in the U.K. with British Telecom and Vodafone, and Huawei is being pushed out, but those big economies in Europe will ultimately, I think, no longer buy from Huawei, so opportunity for us.

<<Amit Daryanani, Analyst, Evercore ISI>>

And is there a way you would kind of put the aggregate opportunity? What does that look like for you, from a total dollar basis, and how long does it take for to convert?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

The size of the European market?

<<Amit Daryanani, Analyst, Evercore ISI>>

Yeah.

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Yeah. We guess it's between \$500 million and \$800 million, maybe more, maybe \$1 billion, but it's a big number. And when does it become available to us? I think it becomes available to us over years as they do these build-outs.

<<Amit Daryanani, Analyst, Evercore ISI>>

Got it. Routing and switching is something that's been a fairly sizable growth driver for Ciena. Maybe just talk about what led you to push deeper into that marketplace versus sort of sitting – sticking to the core optical space? And how do you see that market transpire from a growth perspective for you?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Yeah. I'd say our strategy on routing and switching has evolved over the past many years, frankly. We started by acquiring World Wide Packets in 2008, which was a packet switching business. We knew that some of our customers were very interested in that at sell-side towers in order to transport the signals from the towers into the core. And that was the core of our business for a while.

We then saw our customers looking at business Ethernet opportunities and using our gear to transport to and from the enterprise. Out of that and working with our biggest customers, we can see that they were thinking and evolving the way they think about their networks. It's partly because a lot of data is going to the edge now partly because of COVID, partly because of 5G, partly because of a lot of other things. But they no longer can afford to put a router at every node of the network. They have to use a converged platform that's got optical capability and also has a routing or switching or both kinds of capabilities.

We saw that as an opportunity to extend our optical leadership into that converged market. Our view has always been that the optical market is something like a \$13 billion TAM market. And we think that with these changes in the way networks will be architected and built that our TAM will be in the \$22 billion range within a few years. Our early efforts have been very successful. We have a cell site router with one of the major U.S. Tier 1s. We have looked at inorganic opportunities. We acquired Vyatta from AT&T here at the beginning of this year and that is a virtual router, which is being used by AT&T and one or two other customers, we see opportunities there. We'd love to find something else inorganic that would move us along further. But in the meantime, we're spending a lot of money with our OpEx inorganically in order to develop the capabilities that we're going to have to have in order to take share in this space.

<<Amit Daryanani, Analyst, Evercore ISI>>

Got it. 400ZR is one of these big topics everyone focuses a fair bit on. And there's a lot of – a fear around it for a lack of a better word. I'd love to get your perspective, how do you think the ZR market kind of grows and transpires from here? How is Ciena doing within it? And then maybe a third part of it, there is a nagging fear that the more ZR scales up, the bigger the ASP compressions could be in the space. How do you sort of think about all that?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Yes. 400ZR is something that we and others have been talking about for at least four years. And we really at OFC in 2018, we talked about building a small form factor optical capability, including a plug and potentially selling DSPs. So we started talking about it back then. We said then that we thought it was going to be a \$400 million or \$500 million market for the – over the next few years. We're now sitting here four years later and it's

still not a \$400 million market. And really, the reason is pretty understandable. It's a difficult technology. It was hard for people to get it done in the time frames that they were talking about back then. The other thing is this, it is a spec, 400ZR is a spec. It defines the reach of the signal, and it defines the power consumption of that plug.

Those two parameters by very – by definition, frankly, limit the applicability of the 400ZR to a very small number of places. We still think that it's going to be a \$400 million to \$500 million market over the next few years. And we believe, and it's been echoed by others that we have the best plug in the industry. We have the furthest reach, and we have the lowest power consumption. So we're thinking of it as an opportunity for us.

Now I would say, yes, there is price compression. It's a plug. It's not a system. Hopefully, the margins will be good because it's not – doesn't have all the steel around it and silicon. But we see price compression in our products anyway. We have over a long period of time. And so the fact that we might see a lower ASP on a plug, it doesn't necessarily restrict our ability to grow by 6% to 8%. First of all, it's not a big enough part of the market for a while. And secondly, we think we're going to have a good market share, some of which is a new market for us. When you think about that \$400 million to \$500 million, half of it is the replacement of the Inphi plug at Microsoft. And the other half is with another webscaler who is looking at building a white box with a plug in it. I think we'll place in both of those opportunities and one of which is new ground for us.

<<Amit Daryanani, Analyst, Evercore ISI>>

Got it. A couple of minutes left. So I do want to ask you this question on gross margins, which is I think this year, you're going to do about 42% gross margin in Fiscal 2022. Next year, growth should be better than 6% to 8%, right, in the – discussion we've had. Historically, when growth is that strong, gross margin will certainly go down because new project mix goes up and that tends to be a bit of a drag, right? Could 2023 be different? And if so, why would that be the case?

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Well, what I'd say is, I think that we're going to recover to our mid-40s gross margin over time. I don't think it happens next year. I'm not going to make a call on gross margins next year today. But other than to say that I don't think we'll get back up to the 45% range. But there are a lot of things that are going to impact our gross margins next year. One of the big reasons, in fact, the most important reason our margins are down where they are today is that in order to get the parts that we need to build our gear, we're paying \$150 million or more of broker fees in order to get access to parts.

Now I don't think those go away completely next year. But I also think that they could moderate and that could help us. On the other hand, when we look at our backlog, we do have a high proportion of line systems in our backlog, and those will come out at probably a little lower than average corporate margin. So you've got things that are moving in both directions here. I'd say that whatever we do with gross margins next year,

they're going to get better over time, and we will return to that mid-40s that we have been enjoying for a while.

<<Amit Daryanani, Analyst, Evercore ISI>>

Fair enough. I think we're up on our time here. So thank you very much for your time, Jim.

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Thank you, Amit.

<<Amit Daryanani, Analyst, Evercore ISI>>

Appreciate it.

<<Jim Moylan, Senior Vice President and Chief Financial Officer>>

Good to see you.

<<Amit Daryanani, Analyst, Evercore ISI>>

Thank you.