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Infinera Corp. *(INFN)*

Q2 2011 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Second Quarter Year 2011 Investment Community Conference Call of Infinera Corporation. All lines will be in a listen-only mode until the question-and-answer session. [Operator Instructions] Today's call is being recorded. If anyone has any objections, you may disconnect at this time.

I would now like to turn the call over to Mr. Bob Blair of Infinera Investor Relations. Sir, you may begin.

Robert Blair

Head-Investor Relations, Infinera Corp.

Thank you. Today's call will include projections and estimates that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements address the financial condition, results of operations, business initiatives, views on our market and customers, our products and our competitor's products and prospects of the company in Q3 2011 and beyond and are subject to risks and uncertainties that could cause actual results to materially differ from such forward-looking statements.

Please refer to the company's current press releases and SEC filings including the company's annual report on Form 10-K filed on March 1, 2011 for more information on these risks and uncertainties. Today's press release is including Q2 2011 results and associated financial tables and investor information summary will be available today on the Investors section of Infinera's website. The company undertakes no obligation to update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this call.

This afternoon's press release and today's conference call also includes certain non-GAAP financial measures. In our earnings release, we announced operating results for the second quarter of 2011, which exclude the impact of restructuring and other related costs and non-cash stock-based compensation expenses. These non-GAAP financial measures are provided to facilitate meaningful year-over-year comparisons. Please see the exhibit of the earnings press release for a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP financial measures and an explanation of why these non-GAAP financial measures are useful and how they are used by management, which will be available today on the Investor section of our website.

On this call, we'll also give guidance for the third quarter of 2011. We have excluded non-cash stock-based compensation expenses from this guidance, because we cannot readily estimate the impact of our future stock price on future stock-based compensation expenses.

I will now turn the call over to Infinera's President and Chief Executive Officer, Tom Fallon.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

Good afternoon and thanks for joining us, with me are Chief Strategy Officer, Dave Welch and CFO, Ita Brennan.

I will spend a few minutes today commenting on our Q2 performance, the current industry environment, key technology trends and then conclude with an update on the development of our new products. This is a period of significant investment for Infinera as we continue to invest in our core DTN and develop multiple new products without the benefit of associated revenue from those new offerings. Having said that, we are encouraged by the company's Q2 performance, including an improvement in both bookings momentum and in continued progress towards market delivery of our development initiatives.

For our longer term success, we remain focused on executing our PIC-based digital optical strategy and product roadmap to enable the company to operate profitably and to achieve our long-term business model. In Q2 our revenues came in at the high-end of our guidance as we experienced a continuation of healthy TAM purchases by a broad base of customers, looking to meet their bandwidth growth needs.

In addition to the strong TAM purchases, we also saw growth in new optical capacity deployments, which establishes a base for future TAM purchases. The MSO space was especially strong with two customers from that category in our top five customer count for the quarter. We placed our strategic focus on the MSO market several years ago and based on our subsequent penetration of the leading cable operators in North America, we recently established a sales force dedicated to these customers to ensure we will continue to meet their needs on an ongoing basis.

We also saw stronger bookings in Q2 and, as a result, we exited the quarter with a larger backlog than in recent quarters. This is a reflection of overall continued growth in bandwidth demand across our customer base, our ability to win new footprint deployments, and our continued strength with the leading cable customers. We view this activity as a result of continued customer confidence in the unique Infinera value proposition, our product roadmap, and network vision.

We continued to diversify our revenue base with three greater than 10% customers in the quarter and a broad base of activity across a wide set of customers and multiple products. More than 25% of our 90 invoice customers now deploy both our long-haul DTN and metro ATN platforms, and six customers have deployed both DTN terrestrial and submarine solutions.

It is worth noting that we are seeing very good pipeline activity in the subsea segment, another area of strategic focus where we also recently deployed a dedicated sales force. Furthermore, we added two ATN customers growing our ATN customer base to 28. We also continued to build additional features and capabilities into our ATN platform adding even an aggregation functionality with our most recent release.

The continued trend for multiproduct purchases demonstrates our customer's increased commitment to the Infinera solution and validates the importance of the end-to-end benefits that our portfolio delivers. Our customers find that their businesses become more efficient when they extend the Infinera architecture through their transport topology, while accelerating their ability to deliver services to their customers.

Looking at the current WDM market environment, I would describe it as active, not robust, not soft, but with bandwidth growth continuing historic rates and evident pent-up demand. There is fairly aggressive pricing for new footprint as the industry navigates through the dynamics and uncertainties of 10G, 40G and 100G technologies in the marketplace at different points of their respective life cycles.

Looking ahead, we support the view of the industry analyst community that there will be an optical ramp starting in 2012 with acceleration through 2013 as the industry deploys 100G coherent solutions to complement 10G and 40G. We also agree that the need for intelligent transport, integrating DWDM functionality with OTN, will take on new criticality with this new bandwidth capability.

In spite of the anticipated growth in 100G, industry forecasts indicate that customers will continue to deploy 10G in significant volume for several years. So in tandem with our deployment of our 40G and 100G transmission, we believe 10G will continue to be a sizable revenue opportunity in the market and for Infinera.

in looking at the 40G market, we have several observations. First, we still view most of the deployment as a tactical bridge until 100G achieves carrier cost and scale, although it is an important market in the near term because customers are adding capacity now to satisfy real bandwidth requirements. Most of the industry believes the crossover to carrier cost and scale for 100G will not happen until 2013.

Second, industry analysts estimate 50% of current 40G is driven by 40G non-coherent solutions in China, and then in China the move to 100G is expected to be much lower.

And third, while some of our customers have had to opt for competitors' 40G solutions to meet near-term fiber constraints, many customers are managing their networks and waiting for our 40G to 100G solutions. We are encouraged by the level of engagement we are experiencing with both existing and prospective customers for these new products.

With the advent of 100G line capability, the need to groom smaller bandwidth services, typically 2.5G and 10G, into the larger pipe is paramount to maximizing network utilization. As a result, several competitors have recently announced projects to integrate OTN switching with DWDM.

A recent industry report from Infonetics showed the number of carriers with plans to deploy OTN switching is nearly 75%. Infonetics also refers that vendors will differentiate themselves not by the availability of the 100G technology but by the ability to tame these fat pipes with effective switching technology.

We agree with the importance and the direction of OTN switching and with the assertion of what it will take to win attaining bandwidth capacity in the industry's fat pipes. In fact, Infinera started deploying integrated OTN

switching with DWDM when we first introduced our DTN in 2004 initiating the trend toward layer conversions and enabling the digital optical network.

While the industry appears to be following our lead in this architecture only the Infinera solution is PIC-based providing us a unique economic advantage in the conversion of information from the photonic to the electronic domain. Through higher level processing like grooming and switching is a requirement to be in the electrical domain. As the industry adopts this integrated approach, we believe that the historic dollar per bit per mile metric of transport network cost will be replaced with the metric of dollar per switched gigabit reflecting the value of an intelligent optical network.

I believe Infinera is well positioned as the industry's leader in switched OTN DWDM integration to address this opportunity and lead aggressively on this metric. Since first introducing integrated OTN switching, we have deployed over 8,000 DTN chassis worldwide and our customers have reaped the benefits of higher network efficiency, enhanced ease-of-use and a higher reliability of an automated network – mesh network. We are now evolving our portfolio to scale to solve this problem at 100 G and beyond.

Turning to new products, we expect to take orders on our 40G solution this quarter. It will have up to 160 waves and 6.4 terabits of capacity per fiber, twice that of most competitive offerings and the advantage of FlexCoherent capability. Our 500 Gig PIC with 100G coherent transmission is on track for launch this calendar year as we continued to make excellent progress for this development. By Q1 of 2012, we expect to begin shipping customer trial units and in the first half of the year, we expect to be able to support volume shipments for customer deployment and acceptance.

Meanwhile, our customers are very satisfied with their Infinera experience and our quality. We have surpassed 500 million hours of PIC field operations without a single PIC failure, a testament to our design practices, the quality of our manufacturing operations and TL certified processes. High quality and reliability are basic properties of the PIC and a natural benefit of integration. This will be more important and become an even greater differentiator for Infinera as our competitor resort to 100G discrete modules. In fact, we've calculated that the entire 100G PIC which integrates 60 plus discrete components is more reliable than a single pump laser in a discrete implementation. As a reminder, the new 500 Gig PIC in our 100G system integrates over 600 optical functions.

Before turning it over to Ita for a detailed review of our Q2 performance and our outlook for Q3, I want to thank our employees for their dedication to our customer success and their continued innovation as we scale the industry's only PIC-based WDM system with integrated OTN switching, the system that delivers the digital optical network. I would also like to thank our customers for their continued support in business. Ita?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

Thanks, Tom. I'll review our Q2 actual results and then follow that up with our outlook for Q3. This analysis of our Q2 results and our guidance for Q3 is based on non-GAAP. All references exclude non-cash stock-based compensation expenses and any restructuring costs.

Total GAAP revenues in Q2 were \$96 million compared to our guidance of \$92 million to \$97 million and revenues of \$92.9 million in Q1. We had three 10% customers in the quarter, which included Level 3, a large cable company and a European bandwidth wholesaler. Level 3 came in right at 10%.

Q2 was another strong quarter for TAM shipments combined with the significant increase in new footprint deployments. International revenues amounted to \$27 million or 28% of total revenues for the quarter. EMEA accounted for \$23 million or 24%, up from 22% in Q1. Our service revenue for the quarter were \$10.8 million, up from \$9.4 million in Q1. Service margins remained steady at approximately 66%.

Overall, gross margins in Q2 were 41%, down from 48% in Q1. This compares to our guidance of 40%. As anticipated in the Q2 guidance that we provided in April, margins were negatively impacted by competitive pricing pressure and an increased mix of lower margin deployments in the quarter.

In addition, we continue to see an approximate 2% to 3% negative margin impact related to new product introduction activities in our PIC FAB and systems manufacturing areas. We expect to continue to incur these expenses through the end of the year.

Operating expenses for the quarter were \$50.9 million versus our guidance of \$50 million and versus \$48.1 million in Q1. The incremental expense of \$0.9 million versus our guidance was primarily due to the acceleration of some NRE payments and some increase in sales expenses.

As we look forward to Q3, we expect operating expenses to be approximately \$51 million to \$52 million for the quarter. This represents an increase of \$1 million to \$2 million from our previous guidance. This increase primarily reflects additions to our 100 Gig roadmap, in response to deeper engagement and interest from existing and key potential customers for specific feature requests.

Overall head count for the quarter was 1,136 versus 1,118 in Q1. Headcount additions primarily occurred in sales and operations as we prepare for our 100 Gig platform. Our operating loss for Q2 was \$11.6 million. Other income and expense for Q2 was favorable at \$0.2 million. Net loss for the quarter was \$11.7 million, resulting in a loss per diluted share of \$0.11 in line with our guidance, which call for a loss of \$0.10 to \$0.12 per diluted share and compared to a loss of \$4 million or \$0.04 per diluted share in Q1.

Now turning to the balance sheet. Cash, cash equivalents and restricted cash and investments ended the quarter at \$279 million versus \$287 million in Q1. We used \$0.1 million of cash from operations in Q2 versus \$0.9 million in Q1.

DSOs were 70 days, up from 60 days in Q1, mainly due to linearity of invoicing with some exceptions occurring near the end of the quarter. Inventory turns were 3.3 times versus 2.5 in Q1. This increase resulted from higher shipments in the quarter and good progress on inventory management. Accounts payable days were 35 days, down from 39 days in Q1.

Capital expenditures were \$6.7 million in Q2 versus \$10.6 million in Q1. As discussed previously, we expect capital additions to be approximately \$40 million for the year. While we have been working to manage these expenditures as closely as possible, we expect to see CapEx payments of approximately \$10 million in the September quarter as we complete some key 100 Gig related milestones.

Now turning to our Q3 outlook. We experienced an improvement in bookings momentum in the second quarter. We've also seen some success in competing for new footprint opportunities both with existing and new customers.

Our Q3 guidance assumes continued strong demand for TAM to satisfy our customers' bandwidth needs and the completion of a number of significant terrestrial and submarine deployments in the quarter. While Level 3 is assumed to remain a significant customer in the September quarter, we do not anticipate that they will represent more than 10% of revenues.

As Tom mentioned in his remarks, we expect to take orders for our 40 Gig solution in Q3. However, our guidance does not anticipate 40 Gig revenues in the quarter due to the time required for deployment and revenue recognition. Gross margins were expected to remain at approximately 40% reflecting current pricing conditions, a good mix of TAMs and new deployments in the period and the continued impact of expenses related to our manufacturing build-out.

The following guidance for Q3 is based on non-GAAP results and excludes any non-cash stock-based compensation expenses. Revenues of approximately \$97 million to \$103 million, gross margins of approximately 40%, operating expenses of approximately \$51 million to \$52 million, operating and net loss of approximately \$11 million to \$13 million. Based on estimated average weighted diluted shares outstanding of \$110 million, this will lead to a loss per share of approximately \$0.10 to \$0.12. Please note that the basic share count is expected to be at 106 million for the quarter.

Finally on an administrative point, we want to draw your attention to the fact that Infinera will have a 14-week quarter in Q4 2011 in accordance with our fiscal calendar.

Operator, would you now please open the call up for questions. Thank you.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Thank you. And our first question today will be from Subu Subrahmanyan from Sanders Morris. Your line is open.

Subu Subrahmanyan

Analyst, TheJudaGroup

Q

Thank you. If you could talk about two things, Tom, you had mentioned the mix between 10 and 40. If you can talk about if you think the 10-Gig market is still growing or if 40 is primarily the close driver in long haul? And, what percentage of the market or the long haul market those two pieces are beginning to address?

And then for Ita, can you talk a little bit in terms of revenue upticks, why we're not seeing a little bit more gross margin uptick, and factors that are weighing on gross margins, when do you start expecting to see them abate and start moving back higher towards kind of the high 40s, 50% range?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Okay, Subu, I'll take the first question which I think was our view of what's going to happen in the 10-Gig market. I think two things, one we still see a lot of robust demand for 10-Gig. We still see a lot of applications where 10-Gig is going to provide sufficient capacity, sufficient fiber capacity for customers for a long time. And I also looked at lot of industry data, and the industry data kind of reflects what we also see.

So, industry data says port count moving forward for the next several years is flat to slightly up, there was going to be a continued probably compression of price on a unit basis. So, revenue for the 10-Gig market space might come down slightly. But, units are expected to be flat to slightly up and that's the same thing we see.

I think 40-Gig, my view and as I talked to customers and the mix that with what I see from the analysts, 40-Gig is expected to continue to grow on a port basis fairly significantly over the next several years, but I don't fully believe that. I think if you parse out what happens in China and as I talked to customers around the world in different markets for the vast majority of them they are waiting to deploy 100-Gig, though their timeline on 100-Gig varies anywhere from 2012 to 2014.

I think my view – our view is that 100-Gig, once it starts hitting the appropriate price points, appropriate scale and demonstrates the ability to roll that out efficiently, will start more rapidly consuming that 40-Gig demand. Now having said that, the 40-Gig market today is fairly substantive, probably well over \$1 billion, so it is a attractive market in the near term. Does that answer your first question?

Subu Subrahmanyam

Analyst, TheJudaGroup

Q

Yes, it does. If I could just follow-up from your own 40-Gig product you mentioned that some of your customers, while temporarily or to some smaller degree, deploying competitor products are waiting for your own product. Could you, I mean, just talk about over the next six to nine months should we expect 40-Gig to reach 10%, 20% of revenue, just kind of a sense of how big 40-Gig could become as we wait for 100-Gig to ramp in the late 2012, early 2013 timeframe?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah, I'm not prepared to break out our revenue by specific segments. But I – we've a number of customers – a couple, like I said we've lost a couple of opportunities but there are number of opportunities that we're currently engaged with and there is a couple that we certainly are beginning to work on for the early part of next year.

So we think it's a – it does two things. One, it helps us preserve at market share, but two it opens up a fairly substantive market that we today can't participate in with a currently shipping product. So, I'm fairly optimistic that for the customers who have deployed DTNs and would like to increase their fiber capacity, Infinera is going to provide the best, easiest, lowest cost solution for them to do that. It will also open up the opportunity for us to participate in more RFQs that today we are eligible for. So I think that it should certainly help us preserve and then grow market share within that market. Having said that, I still do believe most customers with big deployments are waiting for 100-Gig.

Subu Subrahmanyam

Analyst, TheJudaGroup

Q

Got it. Thank you.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

And then Subu just to come back to your gross margin question. I think the first kind of short-term impact that's in there is about two to three percentage points of impact from the new product introduction activities around the fab and systems manufacturing. So that's something that should go away end of the year once that product actually goes to production and starts going to inventory et cetera. So that will be an immediate kind of pick up, once we kind of move the products to production.

Above that we're definitely seeing some pricing pressure that's directly linked to the fact that we don't have a 40-Gig product today and we're responding with 10-Gig products to address customer needs. So you can expect some of that to go away as well once that product comes to market.

On the other hand, we are seeing a healthier mix right, so back end of last year when we were doing 50% gross margin, we didn't have a healthy mix of commons. So the commons mix is back and we're pleased to see that. So that impact will remain there. As we progress to 50% gross margin, it's going to require some additional scale versus where we are today and obviously the 100-Gig product – the 40-Gig product, the 100-Gig product contribute towards that over time.

Subu Subrahmanyam

Analyst, TheJudaGroup

Q

And could you just tell us what the TAM number was for the quarter?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I'm not going to give the exact number. I mean it was in excess of the 2,400 kind of baseline that we set and it was more or less consistent with what we had included in the guidance in April when we guided the quarter.

Subu Subrahmanyam

Analyst, TheJudaGroup

Q

Got it. Thank you, guys.

Operator: Thank you. And the next question will be from George Notter, Jefferies. Your line is open.

George C. Notter

Research Analyst, Jefferies & Co., Inc.

Q

Hi, thanks very much. I was definitely pleased to hear you guys provide more detailed timeline around delivery of the 100-Gig product line. What's changed in terms of the development in particular that allows you guys to now flush out that timeline for folks, do you indeed have more confidence in that timeline? I mean, kind of walk us through the puts and takes on your confidence in that delivery date, and the opportunity to make it earlier or later or how that could adjust based on different factors? Thanks.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah, George, yeah, clearly we changed kind of the guidance on when we would launch the product from Q4 to sometime later this year. And that does imply our internal belief that we are gathering more and more data that says that we continue to remain on track to customer trials by Q1 and volume shipments by Q2. So, the increased engineering diligence, the continued milestones that we are achieving internally are reflecting on us reserving the opportunity to potentially announce it between now and the end of the year. So it's just – George it's just engineering practice and validation as we continue to check off the boxes of deliverables.

George C. Notter

Research Analyst, Jefferies & Co., Inc.

Q

Got it. And then any commentary on where the product could come in terms of price performance and I heard you earlier talking about price per Gigabit switch, but on a price per Gig transported basis, is there some kind of

metric we could use to compare that to your current 10-Gig offering or where maybe the marketplace is on 100-Gigs, any kind of sense for it would be great? Thanks.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

I'm going to George wait until we have the launch of the product to discuss those types of specifics, but we believe two things; one, we should lead in the dollar-per-switched-Gigabit, the value of OTN and integrated DWDM has always been immense in the network and as you have the bigger pipes and sub-wavelength services that value is going to become more distinct, but we also realize that we are competing in a transport market without integrated OTN for customers who have a different architectural approach and we know we have to be competitive in that arena also. So the specifics will come when we launch the program.

George C. Notter

Research Analyst, Jefferies & Co., Inc.

Q

Great, thank you.

Operator: Our next question is from Ehud Gelblum from Morgan Stanley. Your line is open.

Ehud A. Gelblum

Managing Director, Morgan Stanley & Co. LLC

Q

Hey, guys, thanks. Appreciate it. A couple of questions if I could. First, on the Level 3 relationship, when they – as you get Global Crossing in there, are you already seeing Global Crossing business or is that to come in future quarters and how do we look at the evolution of the Level 3 business with Global?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

So we have a very good relationship with Global as you know. We also have an ongoing and good relationship with Level 3. That acquisition has not taken place yet, so they are still operating and treating us as two independent entities. We continued to quote opportunities with both of them and they are treating us independently at this point.

My expectation is once they do complete that acquisition, they will look to ways to certainly optimize the joint network and my expectation is that we are certainly going to be one of their preferred suppliers, but my estimation is also that their overall CapEx expenditures will decrease. That's one of the values obviously of the integration. That's not a complete statement everywhere, some have – one has better footprint in North America, one has better footprint subsea and in Europe. But the combination of the two should have less CapEx, but we believe we are going to have every opportunity to compete fully for those opportunities and we are going to continue to do that.

Ehud A. Gelblum

Managing Director, Morgan Stanley & Co. LLC

Q

That was actually one of the arguments for the merger in the first place, the acquisition, that they don't overlap as much as people think, but when you look at your businesses and your footprint over there, do you expect that some of that rationalization will hurt your net business for the two of them or do you think that there is opportunity – additional opportunity at Global Crossing that you didn't get, that you may now be able to get because of the added relationship?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah, it's just too early to tell. We – like I said, they are by a variety of laws prohibited from dealing with us as an aggregate. They are keeping themselves distanced. So we only can participate with them independently right now and they are not – because they are still independent, they are not sharing any type of potential plans.

I am pretty optimistic in regard to the fact that we have great relationship with both of them. We have a very, very large installed base with both of them. So, it should leverage – if you are looking for efficiency and you spend less CapEx, taking advantage of what you have in place to me is probably the best way to do that.

Ehud A. Gelblum

Managing Director, Morgan Stanley & Co. LLC

Q

Right. I don't imagine they would move anywhere else, I am just wondering how that would impact your business with them.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah, we don't know yet.

Ehud A. Gelblum

Managing Director, Morgan Stanley & Co. LLC

Q

Okay. It's you mentioned and I think Tom you mentioned as well that there was a couple of comments about pricing pressure in 10G and in the market. I think at one point, you had mentioned that the 10G market next year once 40-Gig and 100-Gig or once 100-Gig gets going, 10G would continue to grow from a unit basis but that ASP declines would sort of outlay it and I think you said that the 10G market would decline.

Where are those pricing pressures coming from, it sounds like you are getting the pricing pressure today. It's you mentioned it may actually go away, I was just trying to correlate those two comments. And it sounds like pricing pressures in 10G doesn't – they don't sound like they're going to be going away. So, it doesn't – I am just wondering how much – A), how much gross margin lift do you expect from – I'm sorry for being complex on this, okay, don't want to talk in circles – but how much gross margin lift do you expect in the 10G market as you get your 40-Gig out there?

And then also where are you getting the ASP declines in 10G next year and going forward? Is that coming from as you're trying – getting the new 10G customers? Is it defending your base? Are there still people aggressively going after 10G markets? I mean maybe is it more U.S. versus international? Just trying to understand, get some more color around the ASP declines in 10G I guess.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

I think there is a couple of dynamics on 10G pricing. First in the industry, you can probably expect roughly 10% a year in ASP degradation on this type of technology, and that's one of the dynamics. The second dynamic is as 40G becomes more economic, there is a new choice that people can have and they make that trade off. And because we have not had the 40 or 100G in our portfolio to-date, we have had, I would say, probably more pressure on our 10G than some of our competitors who have those tools, so we're responding not only to the typical reduction in

ASPs in the industry, but are happy to make commercial terms to make sure our customers aren't penalized for continuing to choose Infinera.

As we add 40 and 100G into our portfolio, we will now be able to offer those customers the choice that they want that best serves their needs at economics that are attractive both to the customer and to us. So I think that 40G pricing is becoming more competitive. 10G we are responding to what has been a lack in our portfolio. And 100G I still think is a fairly high price technology, and based on the volumes I don't consider it a market yet but it's clearly going to be an emerging market that becomes significant certainly by 2013-2014. So I think part of it is just normal pricing in the industry, part of it is our commercially responding to a short-term hole in our portfolio.

Ehud A. Gelblum

Managing Director, Morgan Stanley & Co. LLC

Q

Where do you see pricing right now for 40G versus 10G and 100G? Is 40G less than four times 10G and is a 100-Gig less than 2.5 times 40G? Or on a per bit basis, how do they kind of line up right now?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah, I think it's important to segment out first of all by long haul versus metro and coherent versus non-coherent. I see, interestingly, 40-Gig coherent starting to become price competitive with 40-Gig non-coherent. And I think that that's just our competitors who are delivering that technology to market trying to earn market share while there is too few suppliers and a reasonable amount of demand. And that must come out of margin because coherent costs more.

I do see that 40-Gig is probably a coherent somewhere between price parity with 10-Gig to somewhat below price parity, so starting to become a better economic answer. 100G, it's fairly broad because it's not a pretty broad mix because it's not highly deployed yet. And I've seen some very aggressive pricing, but for the most part I see it at or around a little above 10G equivalent pricing. But I think that the 100-Gig, like I said, the data points are few and they're very customer dependent and strategic. This isn't dependent upon to win those markets. I think it's not a good litmus yet for what the 100G is in the market. 40G, however, is becoming much more competitive.

Ehud A. Gelblum

Managing Director, Morgan Stanley & Co. LLC

Q

Great, I appreciate that. Thank you very much.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Thanks, Ehud.

Operator: Our next question will be from Rod Hall, JPMC. Your line is open.

Rod Brantley Hall

Senior Analyst, JPMorgan Securities LLC

Q

Yeah, thanks for taking my question. I just had a couple I guess. One is, Tom, I guess could you talk a little bit about your 40-Gig pipeline and what it's shaping up to look like? I mean, is it too early to say or do you have some indication for what that pipeline might look like? And should we expect some kind of revenue boost in Q3 when that starts to ship?

And then the second question is just a clarification on timing on 100-Gig. I guess by saying "later this year," you really mean H2 because otherwise you would have just stuck with Q4. And so what I'm wondering is, why stick to the Q1 trial start. I mean, it would seem to me that if you shipped in Q3 – or if you announced in Q3, you might be able to start trialing in Q4. So if you could just comment on that, I would appreciate it.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yes, on the 40G, it was specific that there is no revenue baked into our guidance for Q3. Revenue depends upon getting an order, shipping it, customers deploying it, and then us doing acceptance with them. So the revenue, we anticipate will not be in Q3, and our guidance assumes no revenue in Q3.

In regards to the pipeline, we see I think a couple kinds of demand. One, the submarine market continues to have 40-Gig as a strong, a very strong desire or an absolute requirement. And as we've deployed this vertical submarine sales team, we are seeing more activity and more deals than we had before. So to me, that's good news.

Part of the challenge is that a lot of these have a requirement of 40G on the RFQ checklist. We have not been able to have that to be able to check that box until now. So I think that part of the pipeline is going to be customers that we're starting to engage with.

Some of the customers, however, as we've said before, we've had some of the 40-Gig tested by customers. And there is a reasonable amount of short-term demand that people would like to deploy over the next six months. And we're also talking to a number of our large installed base customers who have plans and they are evaluating these plans for early next year. And the choice that I read from them is, are they going to deploy and upgrade their current DTN with a 40-Gig module or are they going to wait for 100-Gig? And that is an open issue.

So I think that pipeline out early next year, I don't have as much clarity on other than I see some significant opportunities, I just don't know which technology they are going to deploy for fiber optimization. In the near-term, most of the opportunity revolves around submarine. And then --

Rod Brantley Hall

Senior Analyst, JPMorgan Securities LLC

Q

Okay. And then on the timeline for the 100-Gig in terms of trials?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah, so our confidence in achieving our engineering deliverables continues to increase, which increases our confidence in providing a broader window for when we will launch this product. I'm still going to be cautious around setting expectations to customers until we continue to check off a few more of our deliverables, so that they can make appropriate buying decisions and testing decisions. If we continue to make progress along the timeline we are, potentially having them later in the year would be possible. But at this point and knowing what I know and, just as importantly, what I don't know, I only feel comfortable basically saying and committing that it will be in Q1.

Rod Brantley Hall

Senior Analyst, JPMorgan Securities LLC

Q

Can I just on the way you think about the timeline, from the time that you announce to the time that you actually go into trial, so when we see an announcement come whenever that happens to come, whether it's Q4, Q3 or

whenever, how long should we be adding – how much time should we be adding to that before we would expect to have, for you to have trials in place?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah typically when we announce a new product, quite frankly you just see kind of a press release from us and say, hey, here is this new product that we are either taking orders for or shipping. This new platform is such a fundamentally large program and such a fundamental change to what's available in the industry, we are going about really for the first time a product launch. So there is no litmus based on the history of what you could assume.

I think instead of assuming or looking for timelines after that, my guidance would be to kind of listen to what we're saying and reflect on that versus what we've historically done. We are bringing this product out from a perspective of public launch so that people, customers and the industry can assess what the impact will be on 2012.

What I'm mostly interested is customers seeing it very publicly so that they can have an increased level of confidence that when we say we're going to be doing lab trials with them and we say we're going to be ramping this into volume production in Q2, they have a level of confidence as they are making significant capital plans for 2012 network deployments, and I want them to have the full visibility of where we are at.

Rod Brantley Hall

Senior Analyst, JPMorgan Securities LLC

Q

Okay, that's great. Thanks a lot, Tom.

Operator: Thank you. And the next question will be from Sanjiv Wadhvani from Stifel Nicolaus. Your line is open.

Sanjiv R. Wadhvani

Managing Director, Stifel, Nicolaus & Co., Inc.

Q

Thanks so much. I joined the call a little bit late, so I'm sorry if you've already addressed this, but I think Ita you mentioned that margins are going to drop in the current quarter because of some pricing pressure on 10-Gig, but you also are going to see an increased TAM shipment. So I'm just curious to see sort of if you could weigh both those factors and then sort of talk about how they're going to shake out over the next three months?

And then on the TAM shipment side I know visibility is usually typically low, but are you expecting it to sort of hover in this 2400 mark over the next few quarters or where do you expect it to sort of fall out?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yes I think firstly on the margin. So we guided the margins for Q3 to be at 40% which is in line with the 41% that we did in Q2 around that area, and that's really reflective of versus the higher margins that we'd seen in the past quarters we had talked about there being a healthier mix of common and new deployments in the guidance, we talked about there being some healthy TAM number in the guidance, and then also some of the fixed cost stuff that we talked about previously both for the fab expansion and for new product introductions. All right, so I think we're reasonably consistent with where we were for Q2, we are still seeing those impacts that we had talked about last quarter versus Q1.

Sanjiv R. Wadhvani

Managing Director, Stifel, Nicolaus & Co., Inc.

Got it, all right. Thanks so much.

Q

Operator: The next question will be from Simona Jankowski from Goldman Sachs. Your line is open.

Simona K. Jankowski

Research Analyst, Goldman Sachs & Co.

Hi, thank you so much. Just wanted to ask some questions on the pricing that you expect for your 40-Gig and 100-Gig products relative to the market price. So in particular just looking at history obviously when you guys came out in 10-Gig your pricing was very, very disruptive partly as a result of your technology advantage. Do you expect that delta to be similar for 100-Gig and then should there be really no pricing delta on the 40-Gig note considering that it's not PIC-based?

Q

David F. Welch

Director, Chief Marketing & Strategy Officer, Infinera Corp.

Yeah, I think Tom addressed the question around what the economics of our 100-Gig in the earlier question which is basically we're going to defer any conservation of that until we get into the product launch and what level of disruption and what the right metrics are for that. We obviously believe PICs in general are an economically enabling technology and we'll have no reason to back off from that. On the 40-Gig we've also talked about that before where we believe that as we are basing the 40-Gig on technology which is based on discrete component technology that we would expect those economics would come out more in line with where the rest of the market is.

A

Simona K. Jankowski

Research Analyst, Goldman Sachs & Co.

Sure, and then would it be fair then to say that so as long as 40-Gig begins to ramp but until 100-Gig begins to ramp, that might actually still have a negative impact on gross margins? So even as I recognize some of the things you mentioned with the manufacturing cost and system manufacturing and so forth going away by the end of this year, but then as 40-Gig begins to ramp as a percent of your revenue in the next couple quarters before 100-Gig begins to ramp, would you not expect margins to go lower or if not, why not?

Q

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

Yeah, I mean it depends on the 40-Gig deployments. I mean particularly if we are deploying 40-Gig cards into existing footprint and networks, then I think any negative impact at a corporate margin level would be limited. If we're doing the new footprint deployments then we'll have to see how that plays out. I mean a 40-Gig deployment, new footprint deployment versus a 10-Gig deployment today where we're having to do some additional discounting because we don't have the 40-Gig, it's hard to tell how that would kind of roll up at a corporate level.

A

Simona K. Jankowski

Research Analyst, Goldman Sachs & Co.

So just kind of comparing the line card to line card on a per Gig basis, it would not be the case that the 40-Gig line cards would be lower margin than 10-Gigs just by virtue of not using the PIC?

Q

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean I think at a pure FRU level this – the PIC definitely drives some cost advantage, right, but again in terms of the overall network and an overall network deployment, I think it's – unless it's a greenfield scenario and even then versus kind of the current 10-Gig deployments that we're doing, it may not have a significant impact on margins.

Simona K. Jankowski

Research Analyst, Goldman Sachs & Co.

Q

I see, so in your view it's more important whether or not it's kind of new footprint or line cards as opposed to the delineation per se of 10-Gig versus 40-Gig in terms of your overall margin and mix?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean that's definitely a factor and then where is your baseline is versus are we competing against a 40-Gig with a 10-Gig solution versus now deploying a 40-Gig. I think that changes the dynamic too.

Simona K. Jankowski

Research Analyst, Goldman Sachs & Co.

Q

And then – sorry, go ahead.

David F. Welch

Director, Chief Marketing & Strategy Officer, Infinera Corp.

A

And if I can add to that the – what 40-Gig does is it creates more TAM slots for the same common footprint, increases it from 1.6 terabits up to 6.4 terabits of effective TAM slots, right. So the dynamic which tends to offset the margin on the FRU is the margin of the network actually goes up and in the early days those two will be competing. However, long-term you have four times more high-margin opportunities by deploying 40-Gig in the network.

Simona K. Jankowski

Research Analyst, Goldman Sachs & Co.

Q

Got it, okay, that's very clear. And then just in terms of the overall mix, I think the industry right now is close to 30% of all DWDM revenues are 40-Gig or 100-Gig. And I think for some of the leaders like Ciena or Huawei, it's closer to 50%. When would you guys expect to be at levels like the industry? So say, should we expect that once you're shipping in volume say in Q2 of next year, within a year or within two years after that you might hit 60% of your revenue being 40 or 100-Gig?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

I think there is two dynamics one is we have to obviously win networks and customers have to deploy and customers have to – we have to recognize that revenue. So I think that for the first half of the year you should anticipate zero revenue recognition for the program. I also think that revenue recognition will be slower from a perspective of how long will these large networks take to deploy. I certainly believe over the long-term there is no reason that we shouldn't have same type of market share for the higher bandwidth that we do with 10-Gig.

.....
Simona K. Jankowski

Research Analyst, Goldman Sachs & Co.

Q

Okay. That's very helpful. Thank you.

.....
Operator: Our next question is from Blair King, Avondale Partners. Your line is open.

.....
Blair King

Vice President & Senior Research Analyst, Avondale Partners LLC

Q

Yeah, hi, hey Tom, just a couple quick questions. You had spent some time in your opening remarks talking about the success in the cable market and your dedication of the sales team to that group of customers. Is there anything that has changed within cable that's driving the incremental success there? Or can you just put some color around what's going on in cable for us?

.....
Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

There is a couple of things that's going on in cable, one is just their fundamental bandwidth to deliver to homes is growing remarkably fast. And I think at least what I am exposed to a number of them is growing faster than they had anticipated. They obviously bake into their planning growth but we are seeing growth beyond their normal planning cycle.

The second thing that's happened is we have now what I would say created a critical mass of success with cable providers and these cable providers serve multiple markets. And as our growth has happened and we have been very, very successful in a number of markets, they are starting to deploy us as both those markets grow but in adjacent markets. And we are very optimistic about our opportunity to continue to win new markets in the cable space.

I think a lot of this – it's all oriented to all the video that is occurring, it's all the new services, it's Netflix, it's video everywhere. And they are well positioned to have to carry that but also in a position to have the opportunity to carry it, and they seem to be responding fairly aggressively to that opportunity.

We continue to benefit from our installed base and the experience they have had with Infinera and they are – what we are finding more likely to come back to us versus go somewhere else, because we solve their solution for them exceptionally well.

.....
Blair King

Vice President & Senior Research Analyst, Avondale Partners LLC

Q

Okay, and does that include both a mix of DTN and ATN in the cable space by and large?

.....
Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah, it includes both DTN and ATN. ATN – actually the cable space was one of our first market segments that deployed the ATN. And they continue to deploy it and once again the goal is to deploy it in a market and then step and repeat that across multiple markets.

Blair King

Vice President & Senior Research Analyst, Avondale Partners LLC

Q

Okay, and then last question for you on the OpEx side. OpEx of about \$51 million to \$52 million is your guide for 3Q, right?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Uh huh, yes.

Blair King

Vice President & Senior Research Analyst, Avondale Partners LLC

Q

And that's driven by additional feature requests and some acceleration in NRE, I guess. Can you give us a sense of how we should be thinking about OpEx as we move into Q4 and would you expect it to be down from Q3?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I think the best guidance we could give right now is that it will probably be flat in that \$51 million to \$52 million range. The R&D piece pretty much stays flat, and we will have some pressure from a sales commissions perspective et cetera in the back end of the year. So I would think keeping it flat to that guidance is what we see right now.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Hey, Blair, let me just add one comment on the features and the increment on the R&D. And we spent obviously a significant amount of money introducing, and developing and bringing to market our 500-Gig PIC and our new platform. I am very excited about that platform. And as we have the opportunity to start engaging with customers more and more deeply as we increase their interest in the platform, they come back and this is to me is a sign of success.

When they say, we love it, but this feature that you have out a year later we really would need to have that earlier if we were going to be able to deploy it successfully in the near term. We go and assess those feature requests and invariably they are features on our roadmap that we share with the customers and we start getting a level of hearing the same thing from multiple customers. It's something that we planned on doing, but we thought we could defer it. When we get a multiple request that they need that feature for successful deployment, the incremental margin or dollars that we're spending to pull these features in we think is probably the best money we could spend if it increases the probability of very large scale deployments of this new platform.

So that's why you are seeing this increase. It's really features that were on our roadmap but we're pulling them in and corresponding to those features being pulled in, the first thing we look is can we push anything out. We really aren't in a position to push any features out but we made that – we did the diligence around that, so we are pulling those features in and spending what we think is the small incremental money, it's not small money but small incremental money to the cost of the platform to help assure the platform success in the market earlier.

Blair King

Vice President & Senior Research Analyst, Avondale Partners LLC

Q

Got it. Thanks. Thank you very much Tom for that --

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A little longwinded; sorry about that Blair.

A

Blair King

Vice President & Senior Research Analyst, Avondale Partners LLC

No, I appreciate it. Thanks.

Q

Operator: And our next question will be from Alex Henderson, Miller Tabak. Your line is open.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Hey guys. Couple of quick stuff. First what was the fully diluted share count? I know you gave the basic but I didn't see the fully diluted?

Q

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

The actual was 108 million shares for the quarter and we guided 110 million diluted for Q3.

A

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

And that's all shares outstanding assuming full conversion and all that?

Q

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

That's a fully diluted calculation.

A

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Okay.

Q

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

But obviously anything that's anti dilutive is not included in that.

A

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Great, great okay. I just want to know what the variance was. Second I was a little confused about the 10% customer commentary. I thought you said that the two cable were 10% customers were two of your largest customers and you gave Level 3, but I thought there was another one, so do you have four 10% customers here?

Q

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

No, so we had three 10% customers, one was Level 3. There was a cable customer and then there was a European bandwidth wholesaler.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

Well I thought you had said that two of your cable companies were your top five customers.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Two in the top five was Tom's comments and --

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

So it's just under.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

...the top five, yeah.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

I get it, okay. And then did you give a customer count or number of new customers for the quarter?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

I think we did --

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

90.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

...somewhat in Tom's script, so it was 90 total customers and we added 4 in the quarter.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

Plus 4, great. And then going back to the 40-Gig product, so if the product goes GA and then you've got trials starting in 3Q assuming you get a completion of those trials and actually install product, how long do you expect it to be from installation to revenue recognition?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

We would anticipate revenue recognition in Q4.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

So is your typical revenue recognition fairly short in terms of the acceptance criteria associated with deployments because this is mature technology?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Every customer has different requirements for revenue recognition. As I mentioned most of the 40-Gig early deployments we're looking at are in the submarine area. Submarine has very specific requirements that you'd have to deploy and you have to have the network up and running and they'll do a significant amount of testing before they would sign off that the submarine network meets the requirements and that can take a couple of months. So that is typically the longest. Other customers quite frankly when we have an installed base of them for current product, rev rec happens upon shipment of product, but since this is a new product mostly going into submarine, the 40-Gig – we don't anticipate rev rec to happening until Q4.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

Okay, so then on the 100-Gig from the time you get completion of trial to revenue recognition, how – since that's a new platform obviously a full new product launch, I would assume particularly given the inclusion of new feature sets that that window is longer.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yes, so first of all Alex I apologize, I thought you asked about 40-Gig a second ago, you asked about 100-Gig?

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

First I started with 40 and then I'm shifting now to 100.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Okay. So, for a 100-Gig it will – my anticipation is it will be longer. Typically, this is not always the case, but typically people are going to want to put it in their labs first and they'll qualify it in the lab and they'll typically want to do a first office application so they will install it in a portion of their network and once that portion of the network is signed off, you'll recognize revenue on that portion of the network and that's typically once it's up and running and has been tested for a period of time that they feel satisfied of how it's carrying live traffic. Typically then that will go and allow that customer that we will have revenue recognition upon either shipment or upon receipt, but the first part is typically not always but typically after a first office application success.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

Yeah. So I understand the mechanics of how that works, I'm trying to get a handle on what the length of time you anticipate for the new product which is a new platform --

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

...as opposed to the 40-Gig which is simply a line card in existing platform, how long do you think that runs? If it's two to three months on a new card, I would think on a new platform that it could be four to six months something in that range, is that reasonable approach to think about how long from the time they qualify it in their lab and do the installation and the time of the installation goes in that first footprint to actually getting to the revenue recognition.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

The lab tests are very variant depending on what class of customer it is, but I would say that you could count on lab testing taking anywhere from one month to, if it's a Tier 1, it could be six months, then it will go – once that's done they're certified for first office application and revenue rec for that would probably in the order of two to three months typically.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

Two to three months, okay, that's what I was looking for. So it's – you think it will basically be the same amount of time for field certification and acceptance as your 40 Gig then?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

But it's different because the 40 Gig – well it's the same and different. 40 Gig is going to be as I mentioned mostly going into submarine networks and any submarine network you typically we find you have to – each submarine network you deploy, they want to certify that deployment. On terrestrial, it is different. Once they've certified, your technology and your first office application, we find that they typically don't require that certification moving forward. On the submarine...

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

It sounds like 3Q – or to 4Q is when you would expect first revenues in the 100 Gig then of next year?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yeah, it's just at this point too hard to say. I mean let us launch the product, let us get our lab trials done, and we can update you as we get more data.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

Okay. So let me go back to the gross margin question that a number of people have tried their hand at. It sounds like continuing price pressure and ASP pressure on 10 Gig is an evident issue for the foreseeable future. It sounds like you have a number of large program chassis deployments ending in 3Q, so maybe a little bit of a mix shift back to more PIC, less chassis in 4Q and into the first half. But then you've also got a new product in 40 Gig ramping, which obviously would have some negative initial margin pressure and then gradually improve over time as you ramp the volume. And then you've got initial field trials, which obviously would pressure margins. So it sounds like you're not talking about getting back to 50% gross margins in the next four, five, six quarters. Is that the right way to think about this?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean we're not guiding margins out past kind of the next quarter at this point, right. So for Q3, we've guided approximately 40%. That's consistent with what we saw in Q2. And the dynamics that you just described are all present there, right. We've got a good commons mix with some large submarine, terrestrial deployments happening. We've got some pricing pressure for sure with particular customers on new deployments. And then we have some fixed cost that's rolling in there.

In terms of beyond that, there's a lot of dynamics that will play in there. And again, once we kind of launch the 100 Gig product, we'll get to talk some more about the 100 Gig margins. That will play in there, and then scale and volume will obviously play in there as well.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

I think one of the things to think about it is, today we have as I mentioned in my script, we have expense structure of both manufacturing, operation, and service sales around 10, 40, 100 Gig technologies. Yet we're only benefiting today on revenue from 10 Gig technologies. As the volume of product goes up across all those, our margin structure gets relief across all of those. So if we continue to experience, as I mentioned, fairly good demand right now and if we can leverage that into these new technologies, we are very expectant that our cost structures can take advantage of the scale across all three technologies versus just the expense across all three technologies.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Q

You'd said there were some several large projects that are completing in 3Q. Should that – does that imply a little bit of falloff in large projects into 4Q?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

No, it was not meant to imply anything about Q4. That was really just giving you the visibility that we have to what's in the guidance for Q3.

Alex Henderson

Technology Analyst, Miller Tabak & Co. LLC

Okay, I'll cede the floor. Thank you.

Q

Robert Blair

Head-Investor Relations, Infinera Corp.

Thanks, Alex. We'll take our final questioner. Thank you.

A

Operator: Thank you. The next question is from Mike Genovese, MKM Partners. Your line is open.

Michael Genovese

Executive Director & Senior Analyst, MKM Partners LLC

Great, thanks a lot. Can you give a backlog number for the quarter? I think you gave it in the previous couple of quarters.

Q

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

Yeah, we don't typically give the backlog number other than at yearend. I will say that it's up from the \$35 million that we kind of came into the year with. So we did see some good bookings momentum in the quarter and it did increase from there.

A

Michael Genovese

Executive Director & Senior Analyst, MKM Partners LLC

Okay. And then on the opening comment from Tom about the industry analysts talking about a 2012 kind of optical cycle, can you just expand that a little bit more, where you're hearing that from, whether you're seeing that in terms of your customer conversations, and basically what are your thoughts on how the market should trend in 2012?

Q

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

Yes, I'll start with a little of my view of history of 2011. I think people started out believing it was going to be a fairly good year and then they kind of moved it back and said 2011 second half of the year was going to be fairly robust. And I think most people now are talking about 2012 and beyond being more robust and less of an expectation in the market that the back half of 2011 is going to be a real ramp. And that's coming from both – mostly from suppliers and a little bit from analysts and some customers.

A

Though, as Ita mentioned, we are – we did see a robust, more robust, demand in Q2 and we've started out Q3 with fairly good demand too. But as I said, it's not strong and it's not soft, it's a healthy market right now. And the only reason that I bring it up is because there were expectations of a booming second half. And I continue to think that it is not as strong as people had anticipated. And there is an expectation as more 40 Gig solutions and, more importantly, as more 100 Gig solutions come to market that the ramp will probably start in the 2012 and 2013 timeframe.

Michael Genovese

Executive Director & Senior Analyst, MKM Partners LLC

Q

Great. And along those lines, considering that that lines up perfectly with your 100G timeline, can you give us a view on the traditional Tier 1 business, Tier 1 wireline carriers, especially in the U.S. but also in Europe where it seems like you had some success in Europe but it's limited. I mean, do you think that you're going to be able to break through here either in North America, Europe or even Asia with some real household names on the carrier front as they look to deploy more 100G product?

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

Yes, so two things; one, our goal is to sell product wherever there is large bandwidth. Tier 1s represent one group that certainly carries a lot of bandwidth, but there are number of markets also that, quite frankly, are about as large or larger than some of the Tier 1s. I think we view them all as strategically important.

Second of all, I think my view is consistent, or it has been, to break into the Tier 1, you have to have a new capability at the time that they have a new need. They typically are too big to go back and certify something in that is not solving a new problem for them. I believe our new platform, quite frankly, has a great potential to be solving a new need for them right at the same time that they are looking at changing their network architectures moving forward. That's from commentary both from North America Tier 1s and also international Tier 1s.

So I do believe our opportunity is with this new platform. We continue to introduce and sell to them around this new platform. We continue to get, in general, very favorable feedback around this new platform. And some of the requests on the R&D are directly attributable to that market. So we are responding to continue to make the product more compelling for that specific market. Having said that, we're going to go sell it wherever there's large bandwidth requirements.

Michael Genovese

Executive Director & Senior Analyst, MKM Partners LLC

Q

Great. Thanks a lot.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

A

You're welcome, Mike.

Thomas J. Fallon

President, Chief Executive Officer, COO & Director, Infinera Corp.

Thank you again for joining us this afternoon. We appreciate your interest in Infinera and your questions today. We look forward to staying in touch in the months ahead.

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