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Infinera Corp. (INFN)

Q1 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Infinera Corp. First Quarter 2021 Earnings Conference Call. All participants will be in a listen-only mode [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note that this event is being recorded.

I would now like to turn the call over to Amitabh Passi, Head of Investor Relations. Please go ahead.

Amitabh Passi

Head-Investor Relations, Infinera Corp.

Thank you, operator, and good afternoon. Welcome to Infinera's first quarter of fiscal 2021 conference call. A copy of today's earnings and investor slides are available on the Investor Relations section of the website. Additionally, this call is being recorded and will be available for replay from our website.

Today's call will include projections and estimates that constitute forward-looking statements, including, but not limited to, statements about our business plans, including our product road map, sales, growth, market opportunities, manufacturing operations, products, technology and strategy, statements regarding the impact of COVID-19, and industry-wide supply chain challenges on our business plans, and results of operation, as well as statements regarding future financial performance, including our financial outlook for the second quarter of our fiscal year 2021.

These statements are subject to risks and uncertainties that could cause Infinera's results to differ materially from management's current expectations. Actual results may differ materially as a result of various risk factors, including those set forth in our Annual Report on Form 10-K for the year ended on December 26, 2020, as filed with the SEC on March 3, 2021, as well as the earnings release and investor slides furnished with our Form 8-K filed today. Please be reminded that all statements are made as of today, and Infinera 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.

Today's conference call includes certain non-GAAP financial measures. Pursuant to Regulation G, we've provided a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP financial measures in our first quarter of fiscal year 2021 earnings release and investor slides, each of which is available on the Investor Relations section of our website.

And finally, as a reminder, we will allow for plenty of time for Q&A today, but we ask that you limit yourselves to one question and one follow-up please.

I'll now turn the call over to our Chief Executive officer, David Heard.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

Thanks, Amitabh. Good afternoon and thanks for joining us today. I will begin with a brief review of the first quarter results, and then turn the call over to Nancy to cover the details of our financial performance and the outlook for the second quarter.

Q1 marked another quarter of strong performance with solid execution across the board. Revenue came in just ahead of the midpoint of our outlook, with both non-GAAP gross margin and non-GAAP operating margin above the high end of our outlook. Each was up over 900 basis points on a year-over-year basis. During the quarter, we generated \$19 million of operating cash flow, which was up over \$100 million from the same quarter a year ago.

From a top line perspective, revenue came in as expected, as we navigated against a challenging supply chain environment impacted by COVID and industry-wide semiconductor shortages and extended lead times. We experienced strong sequential revenue growth with Tier 1 service providers, as spending recovered in the United States following a weak Q4. Most other customer segments performed generally in line with our expectations.

On a product basis, revenue grew in the double-digit percentage range on a year-over-year basis from our open optic (sic) [open optical] (3:59) portfolio, including compact modular and line system platforms. This growth was driven by network expansions, new customer wins and favorable traffic growth dynamics in the metro, including international 5G builds. Revenue was up on a year-over-year basis for our 600-gig GX product, as we added several new service provider customers and continued to expand our customer base.

Overall, bookings were robust, up double digit year-over-year with broad-based strength across customer verticals and regions. We had record bookings for our open optical compact modular platforms and near-record bookings for our open optical line systems, as service providers and ICPs plan for the rollout of 400-gig in the metro and 800-gig in the core. Within our subsea segment, bookings were up almost 150% year-over-year as service providers continued with their build-outs of subsea routes to handle the enormous traffic growth. Our recent bookings momentum, especially in line systems, reflect ongoing footprint expansion, which we believe is a positive precursor to anticipated future high margin revenue.

The metro network insertion opportunity continues to drive solid bookings for our metro products and 400-gig service demand is increasing. To that effect, today we announced the availability of 400-gig CFP2 interfaces to our metro portfolio. On the 800-gig front, ICE6 is now commercially shipping to customers, the pace of customer wins accelerated in the quarter, and we secured original purchase orders and design wins. Our list of customer wins includes Tier 1 global service providers and ICPs across both subsea and terrestrial deployments, as we remain on track for a more meaningful revenue ramp in the second half of 2021. We have built a healthy backlog and remain focused on ramping production to meet the strong demand we are seeing. We look forward to sharing additional details on our market traction and longer-term growth expectations for 800-gig at our Investor Day in a few weeks.

Overall, I'm encouraged by a very solid start to 2021 with broad-based demand strength across geographies, customers and our open optical platforms. While demand indicators are very encouraging across the customer base, supply constraints remain a challenge not only for us but many of our peers and companies across a broad spectrum of industries. We continue to work closely with our supply chain partners to address these industry-wide challenges and are positioning inventory to mitigate the effects of the component shortages and extended lead times.

For the full year of 2021, we continue to expect the optical systems market to grow 2% to 3% year-over-year and project that our revenue growth rate will slightly exceed market growth as we ramp our 800-gig solutions and enhance our metro portfolio with 400-gig optical interfaces on the XTM and GX series, complementing our 600G and 800G offerings. I am confident in the long-term market opportunities ahead of us. I continue to believe this is a great time to be a differentiated supplier of optical technology, and there is growing recognition in the market of the value that we provide and the scarcity of our vertical integrated capability. We see numerous insertion

opportunities ahead of us as the competitive dynamics with Huawei, the rollout of 400G in the metro and the deployment of our high performance 800-gig ICE6 solution.

Our strategic priorities remain focused on leveraging our core competence in vertical integration in leading high performance optical engines, accelerating the shift to open optical, and differentiating in next-generation pluggables with category-defining products like XR optics. This strategic focus should enable us to gain market share, expand our addressable market, and drive margins towards our long-term targets. We look forward to sharing additional details regarding our strategic priorities, portfolio evolution and financial road map at our upcoming Investor Day on May 19.

In closing, I want to thank the global Infinera team for their unwavering support, dedication and resilience, recognizing that the effects of the pandemic remain acute in several geographies where we operate. In particular, I wish to recognize the members of the Infinera family in India who are currently facing a very challenging and difficult period. In addition, I would like to thank our customers, partners and shareholders for their continued support.

I will now turn the call over to Nancy to provide additional details of the quarter and our second quarter outlook.

Nancy Erba

Chief Financial Officer, Infinera Corp.

Thanks, David. Good afternoon everyone. I will begin by covering our Q1 results and then provide our outlook for Q2. My comments reflect our non-GAAP results. For your reference, we have posted slides with financial details including our GAAP to non-GAAP reconciliation to our Investor Relations website to assist with my commentary.

I am pleased with our performance in the first quarter of 2021. Q1 revenue was \$332 million, above the midpoint of our outlook of \$320 million to \$340 million. We shared in our last earnings call that we expected approximately \$10 million of potential revenue impact from supply chain risk and COVID. In our assessment, we estimate that the impact we experienced was nearly double this amount in Q1.

There was one 10% customer in the quarter. 48% of our revenue came from the United States, as spending in the region recovered from a weak Q4, while international revenue was down sequentially on seasonality and the timing of certain projects.

Gross margin was strong at 37.6%, above the high end of our outlook of 34% to 37%. On a year-over-year basis, gross margin expanded by more than 900 basis points, as we benefited from meaningful improvements in our cost structure, which was reflected in higher product margin. We continued to experience the impact of industry-wide supply chain supply constraints from semiconductor shortages and higher component and logistics cost in the quarter.

Services gross margin decreased from a higher mix of professional services tied to the rollout of new projects and design wins. Ultimately, these project wins are a great leading indicator of higher margin revenue down the road.

Operating profit in the quarter was \$1.3 million or 0.4% operating margin, which was also above the high end of our outlook, with operating margin up almost 1,000 basis points year-over-year. The year-over-year improvement and better-than-anticipated profitability in the quarter were primarily due to stronger gross margins, and operating expenses of \$123.6 million were generally in line with our expectations.

The resulting EPS in Q1 was a loss of \$0.03 per share, representing a \$0.17 per share improvement year-over-year. Beginning with Q1 2021, we are excluding the impact of foreign exchange gain or loss from our non-GAAP results, as we believe it is not indicative of ongoing operating performance, has primarily been unrealized, and we are unable to provide an outlook since the amount is not predictable.

Moving on to the balance sheet and cash flow items, we ended the quarter with \$250 million in cash and restricted cash. Our ending cash position benefited from \$19 million of cash flow from operations and resulted in \$7 million of positive free cash flow after CapEx. It should also be noted that we repaid the \$77 million principal balance drawn on the ABL at the end of Q4 2020 and ended the quarter with no amounts [ph] drawn on the (12:54) \$150 million credit facility. We expect to use a modest amount of cash from operations in Q2, as we position our inventory for new product introductions, continued growth in the second half, and mitigation of the impact of component shortages and extended lead times.

Looking ahead to the second quarter of 2021, we are encouraged by the strong demand profile, as evidenced by our double-digit year-over-year growth in Q1 bookings and ending backlog. We are, however, mindful of the exacerbated supply pressures and have reflected approximately \$20 million to \$25 million of risk associated with these industry-wide supply challenges in our revenue outlook, with Q2 revenue forecasted to be in the range of \$345 million, plus or minus \$10 million. Even with this risk, it is important to reiterate that customer demand remains strong, including demand for our 800-gig product.

David noted earlier in the call, bookings were very strong for our line systems in Q1, as customers laid the groundwork to introduce 400-gig in the metro and 800-gig in the core. We anticipate that a meaningful amount of these line system bookings could begin to be recognized as revenue in Q2, and as a reminder, expect they will come with lower margins initially. Taking this dynamic into account, we are anticipating Q2 gross margins to be in the 35% to 37% range, up over 200 basis points year-over-year at the midpoint.

We are planning for Q2 operating expenses to be between \$125 million and \$129 million, with the sequential change primarily driven by an increase in R&D as we invest in continuing innovation and new program development. Given the market opportunities in front of us and our significantly improved financial position from just a year ago, we believe now is the time to lean in and accelerate R&D investments in highly differentiated and value-added areas, including optical engines and open optical platforms.

These investments are intended to enhance our market position as we take advantage of the transition to higher speeds in the metro and core, the rollout of pluggables and competitive dynamics in the industry. We expect Q2 operating margin to be negative 1%, plus or minus 200 basis points. Below the operating income line, we expect other income to be a net expense of approximately \$5 million, driven primarily by interest charges, and taxes are estimated at \$3 million.

For the full year, consistent with the statements on our last earnings call, we expect optical systems market to growth 2% to 3% over 2020 and for our revenue growth to be slightly above market as we balance the strong demand environment with semiconductor shortages. We expect second half revenue growth to be driven primarily by the conversion of our backlog and continued sale of our new product portfolio. We will continue to take advantage of footprint expansion opportunities, as they come our way, to drive additional market share gains, and at the same time, are committed to driving gross margin expansion of 300 to 400 basis points compared to fiscal 2020. Furthermore, we are still planning for positive non-GAAP operating margins and cash flow from operations for fiscal 2021.

I would like to close by thanking the Infinera team, our customers and partners for the tremendous effort in these challenging yet exciting times, and our shareholders for their continued support. I look forward to seeing you all at our virtual Investor Day on May 19.

Cole, I'd like to now open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. And we will now begin the question-and-answer session. [Operator Instructions] And our first question today will come from Michael Genovese with WestPark Capital. Please go ahead.

Michael E. Genovese

Analyst, WestPark Capital, Inc.

Q

Hi. Thanks very much. Thanks for the question.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Hey, Michael.

Michael E. Genovese

Analyst, WestPark Capital, Inc.

Q

So, you're talking about preparing the metro for 400G and preparing the long haul for 800G. So, besides orders, could you talk some more about different verticals, different order trends you saw in the quarter, because they sounded strong and I'm not sure I got everything down. But is it just a matter of placing the orders? Is there any product that they're taking first in the second quarter and then other things will ramp in the back half of the year? I'm just wondering what preparing you need, ends up new ordering and not taking anything, or are they actually building networks right now, if that makes sense.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Oh, sorry. Yeah. So we had a strong order demand in Q1, meaning we received purchase orders for products and we shipped some products for revenue and some products that weren't for revenue. Line systems typically get shipped out first to be able to build that footprint to expand both in subsea, the core and in the metro. So our comments are demand is very strong both for our infrastructure products for the metro as well as the long haul. And our tempered comments are really around something that's more industry-wide, which is the access to semiconductors and components, given longer lead times and shortages in the industry.

Michael E. Genovese

Analyst, WestPark Capital, Inc.

Q

Okay. So, just a couple of quantitative follow-ups. So, number of – I mean, can you give us the number of customers or number of trial numbers? I mean, Ciena is out giving us customer numbers for their new chip. And then, secondly, I think you said \$20 million, revenue maybe could have been \$20 million higher in the first quarter. Is there a second quarter supply chain number that we expect to be held back by?

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yeah. So, on the ICE6 detail, I'm going to ask you to stay tuned for Analyst Day. We plan to have a pretty fulsome discussions on the 19th of May. And then, regarding revenue, yes, we saw at least – we saw up to \$20 million in terms of supply that constrained our ability to shift for revenue in Q1. And with Q2, what I factored into the \$345 million midpoint is another \$20 million to \$25 million for Q2. So you can think about that, as we've got the demand, we've got the backlog though, we need to get the supply in and get it out to customers.

Michael E. Genovese

Analyst, WestPark Capital, Inc.

Q

Great. Thanks a lot.

Amitabh Passi

Head-Investor Relations, Infinera Corp.

A

Thanks, Mike.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Thanks, Mike.

Operator: And our next question will come from John Marchetti with Stifel. Please go ahead.

John Marchetti

Analyst, Stifel

Q

Thanks very much. Nancy, just following up on your last comment there answering Mike's question, for these shortages that you're talking about, the \$20 million in 1Q, the \$20 million to \$25 million in Q2, those are in backlog, right? It's not that those are out and into some place. Those are in your backlog and in those order numbers that you referenced as being strong in the quarter.

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yeah. Let me correct. So, for Q1, we had built \$10 million in when we started the quarter. What we actually saw was \$15 million to \$20 million in terms of impact. Some of that carried over and was moved through in Q2. Some of it wasn't, some of it has continued to build. And so as we look at Q2, we see another \$20 million to \$25 million on top of the \$345 million as our midpoint in terms of risk that we've built in for our outlook.

John Marchetti

Analyst, Stifel

Q

Got it.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

And John, just to be clear, those are orders in backlog that we don't think will be fulfilled in the quarter because when somebody takes a lead time of a part from 8 weeks to 12 weeks to 30 weeks to 50 weeks, you're not going to be able to fulfill that turnaround time in the first two quarters.

John Marchetti

Analyst, Stifel

Q

Understood. Just wanted to make sure...

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

The underlying demand is strong.

John Marchetti

Analyst, Stifel

Q

...that was actually in backlog, right, okay.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yes.

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yes.

John Marchetti

Analyst, Stifel

Q

And then, you mentioned some of the strength in the sequential recovery anywhere in the Tier 1 service provider market in North America. I was wondering if you could just talk a little bit about what happened in ICP and in sort of the other service provider category where those were a little bit weaker. You said they came in roughly in line with what you were thinking. Just given the strength...

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah.

John Marchetti

Analyst, Stifel

Q

...that we saw in cable, maybe you can just talk through what you saw in some of those markets for us.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah. I mean, ICP sector, as we've always said, is very lumpy. And so it really is a bookings to revenue story, right? So, in Q4, one of our top bookings customers was an ICP. In Q1, one of our top bookings customer was an ICP. The billings did not fall within the quarter. So, again, we continue to see strength within the ICP customer segment. It's lumpy. We feel good about the overall spend rate going into the back half of the year. Again, I think we saw a recovery in Asia in terms of the order pattern as well. It tends to go weaker in terms of the billings, but heavier in terms of bookings on a forward basis. Did that help, John?

John Marchetti

Analyst, Stifel

Q

It did. And maybe just lastly, like I said, on the cable side, did jump there both sequentially and year-over-year. Was that one specific deployment that came through or was there something more broad-based in that?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah, I think a couple of – call it, two or three customers' projects that came in strong.

John Marchetti

Analyst, Stifel

Q

Thank you. Appreciate the color.

Amitabh Passi

Head-Investor Relations, Infinera Corp.

A

Thanks, John.

Operator: And our next question will come from Fahad Najam with MKM Partners. Please go ahead.

Fahad Najam

Analyst, MKM Partners

Q

Thank you. I just want to – I caught the call a bit late, so I may have missed. So I apologize if I'm asking you to repeat yourself. But can you remind me how much of an impact you saw in the quarter from component shortages? I heard some comments about backlog moving over to \$22 million, but I didn't catch up the whole conversation. So, if you can just repeat yourself.

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Sure. For Q1, we saw \$15 million to \$20 million in terms of an impact to revenue from the supply challenge. And what I indicated is that, for 2Q, we're anticipating that to be between \$20 million to \$25 million.

Fahad Najam

Analyst, MKM Partners

Q

Got it. Given the lead times are now, for example, [indiscernible] (24:10) talking about well over 40 weeks, are we more likely that those orders are not likely going to be filled in 2Q? So, can you kind of give us a sense on how you're thinking about or how is your visibility with your customer? Are they sharing their order trends with you far out into the future and how does that look, and if you can quantify that for us, please?

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yes. So, our customers – I mean, this is not a – this is certainly an industry-wide dynamic right now. So, people are being transparent. Our customers are being transparent in terms of their needs. We are building and shipping as quickly as we can to fulfill the backlog. And as I said in my comments, we are still expecting to grow slightly ahead of the market for the rest of the year. But there is that risk still on the supply side that I don't have

tremendous visibility into the back half from the standpoint of the supply piece of it. But from a demand piece, we feel very good about the strength we're seeing.

Fahad Najam

Analyst, MKM Partners

Q

Got it. And one last question if I may. On your ICE6, you've obviously got a new purchase order, as expected, for hyperscale customer, if it is. Can you share with us what type of design wins you have so far, any quantifiable data? I believe your competitor Ciena has mentioned that they've got over 7,500 800-gig modems shipped. So, can you just...

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Sure.

Fahad Najam

Analyst, MKM Partners

Q

...kind of compare the order trend? And what kind of ramp are you seeing in terms of 800-gig versus your previous generation of cycle compared to 100-gig, 400-gig? What kind of ramp are you seeing with 800-gig?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

That's a good question. Look, I think the good news is, for 800-gig, I think the ramp appears to be quite faster than previous generations. We think that based on geometry of the network, it will be a long cycle as well. We have experienced design wins, purchase orders, and have just begun commercial shipments of the product across both the ICP and service provider segments, across both terrestrial and subsea applications those wins and purchase orders have come from.

And as Nancy said, in just a couple of weeks here on May 19, we'll try to give you more of the math of where we see those wins and where we see 800-gig technology going, how long that life cycle really will be, what will be the magnitude or a size of that over time and what that does to our business model.

Fahad Najam

Analyst, MKM Partners

Q

Appreciate the answer. Thank you.

Amitabh Passi

Head-Investor Relations, Infinera Corp.

A

Thanks, Fahad.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Thanks.

Operator: And our next question will come from Samik Chatterjee with JPMorgan. Please go ahead.

Samik Chatterjee

Analyst, JPMorgan Securities LLC



Great. Hey, guys. Thanks for taking the question. Just want to start off with the supply constraints. And sorry to ask on this again, just any visibility – any insights you can share on what components are the most constrained? Particularly if we go from, like the open line systems to the compact modular systems to, like, more of your long haul systems, what is – where is the shortage impacting more, what are the constraints you're seeing? And then I have a follow-up as well.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.



Yeah. What I would tell you is that they're pretty broad. I mean, this isn't just semiconductors but microprocessors which can be on a fan tray than a product portfolio. A little bit more profound with some of the more legacy products, because the newer products, not only from our procurement standpoint and what we've planned for, but just from a aging fab standpoint tend to be the first that are prioritized. So, a little bit more on the legacy.

Again, I think it's a broad swath across the industry. I think we've got good partnerships going with our contract manufacturers as well as with our supply chain partners that continues to say why more and more vertical integration and control of your supply chain is strategically important. And again, we started this activity in December. I would tell you, we saw a more profound impact in Q1 and it accelerated a bit in Q2, and we provided those numbers as best as we can see them.

Again, we're working in the back half. Again, with longer lead times, you tend to have a little bit more partnering on behalf of our customers as well to partner and reach out. So, that's what we're in the process of doing for the back half. Little early to call.

Samik Chatterjee

Analyst, JPMorgan Securities LLC



Okay. Second question I had was, you mentioned share gains and particularly in relation to 2Q, where you're guiding gross margins to be slightly softer than 1Q as you deploy the line systems. Where – and maybe I missed this because I jumped on a bit late, but which custom segment is that primarily that share gain coming from? And also, just going back to your comments for the full year where you're expecting to outperform relative to the market, just if you can share where are you seeing the biggest drivers in terms of market share wins this year? So, both on near-term Q2 and then a, well, full-year commentary just on market share will be helpful.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.



Yeah. It's a good question. So, certainly, we're coming across both terrestrial and long haul network. So you're going to see long haul and subsea and core metro opportunity as, again, 400-gig insertion opportunity with our existing platforms as well as long haul platforms with 800-gig. There's just less players in the marketplace with open line systems. It has given us an ability to insert quicker. That's happening across geographies, again both in Europe, Asia and North America.

Samik Chatterjee

Analyst, JPMorgan Securities LLC



Okay. Thank you.

Operator: And our next question will come from Alex Henderson with Needham. Please go ahead.

Alex Henderson

Analyst, Needham & Co. LLC

Q

Oh, great. Thank you. So I was hoping you could talk a little bit about the nature of the orders that you've received. Clearly, 800-gig products are well into the back half of the year. So, would you include the 800-gig orders for the back half on a product that's not shipping in that backlog? Or is the backlog predominantly related to the existing products that you have available on the marketplace today?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah, So, no, and the backlog does include 800-gig products as well as our existing product set. As we've said for a couple of quarters now, we're ramping production and that's the biggest piece. It's a good issue to have. Demand is extremely strong. So we expect the backlog that we've accumulated here to-date and that we continue to book and win, to be deployed and then converted into the revenue and cash flow cycle as we get into the back half here.

Alex Henderson

Analyst, Needham & Co. LLC

Q

Within that context, your only other 800-gig competitor stated that they were the only company shipping product on their last call. I assume that that is not an accurate statement that you have shipped in limited quantities in the pre-ramp process. Is that a fair statement?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah. We have shipped. Again, for qualification, we're now shipping for that commercial deployment that, again, we would expect to then convert into revenue in the back half. Albeit they've shipped more quantities and were a few quarters, we feel very, very good about the performance of the product that we have. And it's going to be a long cycle. So we continue to be excited about the rollouts.

Alex Henderson

Analyst, Needham & Co. LLC

Q

And one last question along the same lines. Can you talk about what portion of your business in the order book is coming in with respect to open line systems and to what extent your installed base is – what percentage of your installed based is currently open line systems? Thank you.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yes, all good questions, Alex. We'll try to have a little bit more color. We've got that for the Analyst Day on the 19th. But [ph] near (32:54) to say, when we say record – near-record bookings for line systems, when I look at the last three quarters of our line system bookings, they've been profoundly up from prior periods. So it's a meaningful percentage but, yeah, a good pick up on trying to give you a little bit more quantification on what percentage of the total is that.

Alex Henderson

Analyst, Needham & Co. LLC

Q

Okay. Great. Thank you very much.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Thanks Alex.

Operator: And our next question will come from George Notter with Jefferies. Please go ahead.

George C. Notter

Analyst, Jefferies LLC

Q

Hi, guys. Thanks a lot. Obviously, big piece of the story here is the margin expansion and where you guys can get to prospectively. Could you give us a sense for what mix of the revenue comes from products that are vertically integrated?

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yeah. I mean, the percent this quarter was up slightly from where we were in Q4. You can see the step up in margins, primarily driven by cost reductions, but an increase in the level of vertical integration also helps there. As we've said, as that percent grows and our objective is by the end of 2022, as we're exiting, we will be at our target gross margin model which is in the mid-40s. I would say, right now, that number is certainly below 50% and not where we want it to be long-term, but it is improving quarter-to-quarter.

George C. Notter

Analyst, Jefferies LLC

Q

Got it. Okay. And then I think part of the narrative here was that there are a couple of big, I guess, step functions up in gross margin going back away now I think from the conversation. But I think you said there was 1,000 basis points of improvement as you went from, for example, 200-gig to 600-gig. And here I think we're talking about versions of the group. And another 1,000-basis-point improvement as you step up to ICE6 just because those products are more vertically integrated. Is that still the right math in how you think about the organic margins on those products?

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yeah, I think it's still pretty close. And when we talk about our road map in the Analyst Day, we're going to lay out a structure not just for 2021 and 2022, but out beyond and into the 2023-2024 timeframe, and really walk through how that margin expand and the importance of owning as much as you can of your supply chain and being vertically integrated.

George C. Notter

Analyst, Jefferies LLC

Q

Got it. Okay. So, I guess I'll just ask it this way, and sorry to belabor this, but I assume your viewpoint of the margin structure on ICE6 hasn't changed.

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Correct.

George C. Notter
Analyst, Jefferies LLC

Q

Okay. Awesome. Thanks, guys. Appreciate it.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

It is still...

George C. Notter
Analyst, Jefferies LLC

Q

Sorry, Nancy.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

Oh, no, that's okay. What we had said about ICE6 as a vertically integrated product is you should be able to see 2,000 basis points improvement at a product level.

David W. Heard
Chief Executive Officer & Director, Infinera Corp.

A

Above a merchant product, George, but then you have to do the weighted average math. So we'll show you guys in Analyst Day how the vertical integration impacts our portfolio as a percentage of the VI of total product. We'll also show you on an annualized basis, like we've provided, that we expected 300 to 400 basis points of improvement full year this year to last year and Q1 started out with a reasonable lift to that with a 900 basis lift, albeit on a weaker compare from last year given the major subsea deployment.

George C. Notter
Analyst, Jefferies LLC

Q

Got it. Thank you guys very much.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Thanks, George.

Operator: And our next question will come from Simon Leopold with Raymond James. Please go ahead.

Simon Leopold
Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you for taking the question. I wanted to ask you a little bit about the Huawei backlash opportunity as you see it. And in terms of what I'm looking at, your European business has been good beginning fourth quarter last year. You had a good quarter at the beginning of this year, but we keep hearing about how this being a very long-term opportunity. So I'm asking this question as kind of two parts. What do you see happening near-term in terms of Huawei backlash opportunity? And then how do you see this playing out over the long-term? Thank you.

David W. Heard
Chief Executive Officer & Director, Infinera Corp.

A

Yeah. Good question, Simon. So, if you're asking, are we hiding the fact that we're secretly winning the Huawei opportunities, look, we've won two or three Huawei opportunities. I think a small handful of them are being won, but quite a few are being big. So you wouldn't see those in revenue yet. At best, we would get into kind of Q4 revenue period. But as we've said prior, we really do see this as a longer-term 2020 dynamic on the uplift.

We are seeing, when you look at the competitive field for long haul and metro and subsea, again, an opportunity of insertion again with Huawei not being allowed to play in many of these circumstances and there not being many other competitors, the ability to go pick up that share. But in many of the metros, it is re-architecture, restructure. It's a lot different than just point-to-point links on a long haul network or a subsea network.

So we think 2022, that'll begin to pick up steam in our top line and you'll see that in our Analyst Day. And then, as we get into 2023 and 2024, it's a big part of our investment curve of our vertical integration penetration as you get to XR and other pluggable technology that will improve our margin profile going forward...

Simon Leopold

Analyst, Raymond James & Associates, Inc.

Q

And do you have your own...

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

...and our top line.

Simon Leopold

Analyst, Raymond James & Associates, Inc.

Q

view on how to size – sorry, do you have a view on how to size this opportunity? We've heard numbers ranging to sort of \$1 billion in Europe. If you look sort of global ex China, it could be a \$2 billion opportunity. How are you sizing the sort of TAM of Huawei backlash opportunity?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah. Look, I think when it's all meted out, you see this as potentially a \$1.5 billion opportunity and that's not going to be eaten all by one supplier. So I kind of think of it as – we've told our sales teams, go out and get yourself a path to \$1.5 billion of Huawei opportunity.

Simon Leopold

Analyst, Raymond James & Associates, Inc.

Q

[indiscernible] (39:31)

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah. Thanks.

Operator: And our next question will come from Rod Hall with Goldman Sachs. Please go ahead.

Bala R. Reddy

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

Q

Hi. This is Bala Reddy on for Rod. Thanks for taking my questions.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

[ph] Hey, Bala. (39:49)

A

Bala R. Reddy

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

I had a quick follow-up if I can. Starting just on the 800-gig product that you're currently shipping, could you talk about whether you feel the product is more or less complete in terms of functionality and feature set, or do you feel like maybe you need to further improve or maybe modify it?

Q

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

Well, as you'll see at our Analyst Day, rolling out a product and continuing to enhance its performance and feature set, we'll always continue to. But for the applications that we are contractually bound to, for the first shipments, yeah, the product is complete. But like all of our products, you'll see additional performance gains and feature sets.

A

We tend to build lots of feature functionality into our original products, which is why you see them a little bit later than some of the competition. Some can argue us to that strategy, but kind of given our size, scale and focus on vertical integration, that's our current plan of record.

Bala R. Reddy

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

Okay. And could you maybe provide any performance comparison between the ICE6 and Ciena's product? Or should we wait for the details on the Analyst Day? I just want to check.

Q

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

I think it's better to – I think, again, I think everybody's question will be on what's the size of the market opportunity and then in terms of the rollout how are we going to compare it both performance-wise and slope-wise in terms of the shape of the ramp. So we'll go through that as best as we can on May 19th.

A

Bala R. Reddy

Analyst, Goldman Sachs (India) Securities Pvt Ltd.

Okay. Fair enough. Thanks.

Q

Operator: And our next question will come from Jim Suva with Citigroup Investment Research. Please go ahead.

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Thank you very much. As you sit there as CEO and also CFO and work together, and we've been through first geopolitical wars then COVID challenges, now chip challenges, I wonder do you look at this business and maybe think is it prudent to keep more inventory, keep more chips on order, inventory stocking. I'm just wondering

Q

strategically just seems like one shock after the other. Unfortunately, it's been tough for all of mankind and everything. But I'm just wondering if you are thinking that maybe structurally just makes sense to hold and procure more chips and inventory in case something happens down the road.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah. It's a good observation. Certainly, as we got into December, we began to position ourselves with our contract manufacturers and supply chain partners to begin trying to plan out better over the period. Luckily, year-over-year, when you look at our cash consumption last year this quarter and our improved position now, we're able to do such. And it does remind you that the more your supply chain you can put in your own hands, the safer you can be. But I don't disagree. We're in the period of that kind of provisioning.

Again, what tends to happen in these situations is people just call off orders unexpectedly in terms of our suppliers. And that's what we're trying to watch. So, yeah, having more inventory on hand is a great way to combat that. And I don't doubt that we faced past challenges both as a world, as a country and as a company, and that's what we do. This is just part of our job. I think locusts are coming up on the East Coast from what I understand. So we're waiting for the next one.

Jim Suva

Analyst, Citigroup Global Markets, Inc.

Q

Thank you so much for the details and look forward to the Investor Day in a few weeks.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah. Thanks, Jim.

Operator: And our next question will come from Jeff Kvaal with Wolfe Research. Please go ahead.

Jeffrey Thomas Kvaal

Analyst, Wolfe Research, LLC

Q

Yes. Thanks very much. My question is similarly on margins. I guess I'm wondering to what extent, if any, are the semi constraints affecting? So, when do you expect to get those margin gains? And that might be because the components are hard to get and therefore one has to pay a bit longer or it could be because the timing of the shift to internal is a little bit later. But could you just kind of help us with how quickly you would like to get to those goals and is that changing?

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yeah. Definitely, Jeff. So, you saw that we did have a good Q1 in terms of margins...

Jeffrey Thomas Kvaal

Analyst, Wolfe Research, LLC

Q

Yes.

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

...coming in ahead of our outlook and that really was based on focused cost reductions that we have been driving for some time. But it was also offset, as I mentioned in my comments, by exactly what you're referencing, right, the increase in certain component costs, the long lead times. And as we look out for the year, part of the reason why we're maintaining this 300- to 400-basis-point improvement year-over-year is because of that level of uncertainty.

We feel good about where we are in terms of margin in Q1 and Q2, with the deployment and the revenue recognition cycle starting. I've given a little bit lower guide on margins for Q2, but we intend to be able to hit the 300 to 400 basis points for the full year.

Jeffrey Thomas Kvaal

Analyst, Wolfe Research, LLC

Q

Okay. And then, secondly, you were very helpful in the pluggables session a few weeks ago. Thank you for that. I understand you're being reasonably thoughtful about where you are prioritizing your investment dollars in the pluggables market. And I'm hoping you could share with us a little bit of your thinking about what you're excited about and what you might be trying to sensibly avoid in terms of the pluggables opportunity?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah. And we'll go through a bulk of this at the Analyst Day on May 19th because not many people know what our investment strategy has been and we've been investing for over a year-plus now in this category because it's essentially part of what we do.

One, we put out a 400-gig pluggable that we talked about today in the metro. That's certainly a merchant offering, just like we have with 100-gig and 200-gig in the metro product lines. Most of these markets both 400-gig and 800-gig are nascent right now and are going to be very, very large as we get into, what I call, the meat of the market in 2022, 2023, 2024. Those are going to be big market for 800-gig and 400-gig. So, certainly, we have the 800-gig vertical integration we feel good about. We've already started our next-generation of high capacity architecture for the next-gen there.

On the 400-gig piece, getting more of our own vertical integration in those pluggables is important. Intersecting them now, again, wasn't within our investment horizon, but hitting that need of the market by 2023 with some of our own content to be able to alleviate both the margin and open up some market opportunity with XR and then having a next-generation product that really changes the game on the edge with a point-to-multipoint solution. And again, XR has been our focus. And we'll go in quite a bit deeper in our Investor Day and really get through that. Makes sense?

Jeffrey Thomas Kvaal

Analyst, Wolfe Research, LLC

Q

Great. Look forward to it.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Thanks.

Operator: And our next question will come from Meta Marshall with Morgan Stanley. Please go ahead.

Karan Juvekar

Analyst, Morgan Stanley & Co. LLC

Q

Hi. This is Karan on from Morgan Stanley. Thank you for the question. So I know most of this will be saved for the Analyst Day, but I guess just at a higher level, how have conversations been with customers on XR optics and sort of when do you think they could be more material to contributions?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Yeah. So, very, very good engagement on the customer behalf. The edge of the network is really driving to 5G and mobile edge compute, and it kind of requires a new architecture to drive agility and kind of cloud elasticity to the edge. So the customer reaction to the base technology has been very good.

The fact that we're making this an open architecture, meaning providing it allowing others to build on it, similar to XR, I think has been positively endorsed. And in terms of its impact to our business model, if it's okay, let's save that to the May 19th discussion.

Karan Juvekar

Analyst, Morgan Stanley & Co. LLC

Q

Yes. That makes sense. Thank you so much.

Operator: [Operator Instructions] Our next question will come from Dave Kang with B. Riley. Please go ahead.

Dave Kang

Analyst, B. Riley FBR

Q

Thank you. Good afternoon. Sorry, I got on the call a little bit late. So I may have missed it. But I heard you saying orders were pretty strong. Did you disclose what that was or maybe perhaps book-to-bill?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

We did not. We just said pretty strong. So, I think we – and we continue to build backlog as we exited Q4 and then again into Q1.

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

And that bookings were up double digits.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Double digit, yeah, sorry.

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yeah. Double-digit growth.

Dave Kang

Analyst, B. Riley FBR

Q

Got it. And then, Nancy, so regarding OpEx, \$127 million for second quarter. You usually give a kind of flavor for out-quarters. How should we think about second half?

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yeah. I think for the second half, the range we've put out for Q2 is probably what we should use for now. We are focusing our investment dollars in the key technology areas that we've been highlighting and looking to lean in there a little bit through this year. So, in that \$125 million to \$129 million range, I think, is appropriate for the rest of the year.

Dave Kang

Analyst, B. Riley FBR

Q

Got it. And my last question is regarding on your gross margin outlook of 36% for June quarter. Are you baking in sort of like chip prices increasing?

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Yeah. That would all be included in there in terms of cost increases, but also the impact of the line system deployment that we've been seeing great demand for. They're going to start to walk through revenue in Q2, and those tend to have lower margins initially and then the margin improves as they fill. So it's a combination of both.

Dave Kang

Analyst, B. Riley FBR

Q

Some of your peers, they believe that this current quarter that we are in will be most challenging as far as chip availability is concerned. Do you agree with their view?

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

No, I think we think – I think, again, given we put a larger degree of risk in this quarter, we just see that accelerating out just based on the math of the lead times.

Dave Kang

Analyst, B. Riley FBR

Q

Okay. All right. Thank you.

Amitabh Passi

Head-Investor Relations, Infinera Corp.

A

Thanks, Dave.

Operator: And our next question will come from Alex Henderson with Needham. Please go ahead.

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

Came back for another one.

Operator: It appears that [ph] the caller (51:59) have dropped out from the queue. So our next question will come from Christian Schwab with Craig-Hallum Capital Group. Please go ahead.

Christian David Schwab

Analyst, Craig-Hallum Capital Group LLC

Q

Hey. Guys, I just have one quick question. On the component constrained volume that you can't ship last quarter and this quarter and potentially what might even come in Q3, I just want to make sure I understand that you believe that there's a long product life order that is sitting there that that volume isn't going to be lost to some other competitor who might be able to ship product that you can't ship. Is that fair?

Nancy Erba

Chief Financial Officer, Infinera Corp.

A

I think that it's fair. I think though we don't know what we don't know, right? There may be some over time that shift. But right now the information that we have from our customers is very strong demand. They're placing bookings, which means we have POs in hand and certainly we're going to watch for any of that. But right now we're really focused on supplying and getting the backlog to our customers.

Christian David Schwab

Analyst, Craig-Hallum Capital Group LLC

Q

Great. No other questions. Thanks.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

A

Thanks.

Operator: And this will conclude our question-and-answer session. I'd like to turn the conference back over to David Heard for any closing remarks.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

Yeah. No, I appreciate all the questions. Certainly, we're excited about the opportunity in open optical and about the recent performance of the team in these last consecutive quarters. We're also very mindful of the external environment we're in, not just from a macroeconomic perspective and a supply chain perspective, but from a world challenge perspective. And again, our family members in India, our thoughts and prayers are really out with you. These are really unprecedented times. I continue to be humbled by the relentless will to win from the Infinera team and very much appreciate the ongoing support with our supply chain partners, our customers and our continued shareholder support. So, thank you all. Please be safe and be well.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time and have a great day.

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