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Infinera Corp. *(INFN)*

Q1 2012 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the First Quarter Year 2012 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 you have 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 the second quarter of fiscal year 2012 and beyond and are subject to risks and uncertainties that could cause actual results to differ materially 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 6, 2012 for more information on these risks and uncertainties. Today's press releases, including results of the first quarter of fiscal year 2012 and associated financial tables and investor information summary will be available today on the Investor section of Infinera's Website at infinera.com.

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 include certain non-GAAP financial measures.

In our earnings release, we announced operating results for the first quarter of fiscal year 2012, which exclude the impacts 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 Investors section of Infinera's website.

On this call, we will also give guidance for the second quarter of fiscal year 2012. We've 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 & Director, Infinera Corp.

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

I will start with some commentary on market trends, and how we believe they will impact architecture and technology choices by service providers moving forward. Then I will provide an update on the reception to our new products and highlight some results from our first quarter, before turning it over to Ita for a full review of our Q1 performance.

We continue to see three fundamental trends that are driving significant network traffic growth; cloud, mobile and video. First, cloud continues to grow in importance for our service provider customers across both enterprise and consumer applications.

Forrester Research predicts that the cloud service market will approach \$240 billion by 2020. Many analysts predict that most applications in the future will be cloud-based, increasing the role of the network. We see cloud growth driving a need for large amounts of optical bandwidth that can be provisioned quickly to absorb unpredictable spikes in the case of disaster recovery over large workload shifts. In order to satisfy this, without wastefully over provisioning these networks, carriers will require an optical layer that delivers large pools of virtualized bandwidth that can be deployed quickly in minutes instead of days or weeks.

Second, mobile traffic is growing rapidly driven by increasing access rates combined with an explosion of smartphones, tablets, and wirelessly connected laptops.

Industry analysts estimate mobile data usage will grow approximately 18-fold by 2016. There has been tremendous investment in 3G, 4G, and Wi-Fi infrastructure, but these are simply access methods into the wired backbone. And we anticipate this dramatic increase in mobile traffic will require additional optical investment.

Finally, we believe that streaming video will continue to be a huge driver for added optical capacity. Video is streaming from multiple sources, including user generated content from YouTube, from aggregators like Netflix and Amazon, from content creators like HBO and via service providers delivering managed IPTV services.

We're also seeing improved quality of each stream from standard definition to high definition and on to 3D. This growth in video traffic is being further amplified by cloud-based service delivery, mobile access and significantly increased wired broadband access capacity.

Overall, we see these trends underpinning the requirement for a significantly increased investment in optical transport spending. We believe this optical reboot is a cyclical transition that happens about once every decade.

It has just begun, evidenced by some 19 million miles of optical fiber that were installed in the U.S. last year, the most since the boom year of 2000 according to research firm CRU Group. All of this fiber will need to be lit. Dell'Oro sees the DWDM transport market growing at a five year compound annual growth rate of 10% to \$11.7 billion in 2016.

We believe that the traffic growth and patterns for cloud, mobile and video data will require investment in a next-generation optical network that can scale smoothly to multi-terabits while simultaneously delivering increased intelligence and functionality.

We believe that this increased intelligence and functionality will require OTN and MPLS switching integrated with DWDM into a single platform. Dell'Oro calls this segment optical packet transport, where they include Infinera's new DTN-X, and forecast it to grow at a five-year compound annual growth rate of 22% attaining \$7 billion by 2016.

Now, the challenge. Operators continue to see a decline in basic connectivity fees in the face of this tremendous growth. For example, according to a telecom market research firm TeleGeography, 10-gig prices linking London and Frankfurt are forecasted to decline 19% compounded annually from 2011 to 2018.

Historically, operators solve this problem by deploying increased optical transmission rates that would lower the overall cost per bit. This faster pipe approach is no longer sufficient to meet the new demands of scale, increased optical network functionality, and a lower total cost of ownership. Carriers needing new architecture to solve these problems, and we believe this, when paired with the commercial possibility of scalable DWDM and integrated OTN switching will drive a major secular transition.

They need to move from a world of dedicated ways to flexible pools of nearly infinite capacity, from rigid over provision of transport layers to an efficiently converged transport infrastructure, and from manual operations to intelligent automation. This architecture needs to not only scale with lower operational cost, but it needs to free up time and provide the tools to deliver new value-added services that drive profitable revenue.

We see this secular transition intersecting with the optical reboot cycle, providing an unprecedented opportunity that Infinera is uniquely well-positioned to address with our DTN-X platform. The DTN-X is ushering in a new era of next-generation network architecture, moving from the traditional world of multiple network layers, discrete analog optical implementations, and manually provisioned all optical networks to a converged high performance automated digital optical network.

This is not a vision, it is a capability that we are shipping this quarter, and only Infinera can deliver this now with DTN-X. Infinera is an innovator, not a commoditizer, and we have built a vertically integrated technology and supply model that allows us to develop and build leaderships with all of the key technology elements required to

deliver on this new architecture. We believe vertical integration and the associated R&D investments are mandatory to win in the next phase of this market.

As proof points, here is a sampling of leadership technology differentiators that we bring to the table with the DTN-X. First to architect and deliver a large-scale photonic integrated circuit, now delivering our third generation 500-gig PIC and already demonstrating results from our 1 terabit PIC.

First to architect and deliver FlexCoherent, software-programmable coherent transmission that optimizes reach and capacity, while reducing costs. First to architect and deliver 500-gig long-haul super-channels, scaling capacity without scaling operations, and upgradeable to 1 terabit super-channels in the future. First to architect and deliver a platform that integrates 5 terabits of best-of-breed non-blocking OTN switching with best-of-breed DWDM transmission without compromise. First to architect and deliver a platform that is upgradeable from OTN switching to MPLS switching, and that is also upgradeable from 5 terabits to 100 terabits of switching capacity in the future.

I cite these achievements to highlight our innovation and technology leadership and to point out that only now are we seeing our competitors follow in our path with their roadmaps. We are confident that photonic integration brings higher densities with reduced power and space, lowering cost in multiple dimensions while delivering tremendous scale on a single line card.

In the March quarter, two of our competitors purchased companies engaged in the research of integrated photonic technology, solidifying our long-held view that photonic integration is mandatory. We believe that we are years ahead of these competitors in terms of execution, investment, and learning curve, and in our IP portfolio.

Based on our experience, we also come to believe that truly understanding how to commercially manufacture PICs is an imperative for delivering on next-generation [inaudible] (10:30) architectures and long-term success in this market. While the industry is moving to 100-gig technology, we are leading the industry by envisioning and delivering commercially available 500-gig FlexCoherent long-haul super channels.

The OFC/NFOEC trade show this year, a number of competitors followed us with announcements and slideware around flexible modulation and metro super channels. While we appreciate our competitors' validation of the super channel approach and the value it brings to customers, what is missing in these announcements is that their super channel strategy doesn't meet the requirements of a long-haul network.

In long-haul networks, capacity dictates the operational and architectural benefits of super channels. They must operate over thousands of kilometers, and therefore, must operate in a QPSK modulation format. So, if our competitors deliver these metro super channels in the future they will be limited to applications of less than 700 kilometers of reach and are not applicable to long-haul networks. Only Infinera is delivering commercially available 500-gig long-haul super channels today, well ahead of any competition.

We also believe the new architecture requires the convergence of DWDM and switching married with GMPLS automated control. Convergence is important to reduce OpEx and increase CapEx efficiency, while distributed switching delivers network flexibility or more add-drop points and rapid deployment of bandwidth, all automated via GMPLS. Only Infinera brings over 10 years of experience in developing and seven years deploying this converged architecture, with our pioneering DTN and digital optical network.

Recently, we have seen a number of competitors announce their intent to retrofit switching to their DWDM platforms and retrofit DWDM to the switching platforms. We continue to believe the new DTN-X, which has been purpose built from day one for this integration will be the only platform on the market that allows all components,

including the optical functions based on our PIC technology to deliver best of breed switching integrated with best of breed DWDM without compromise.

DTN-X is being recognized by carriers around the world for its leadership, design and innovation, and we strongly believe it is uniquely positioned to capture the opportunity being created by the intersection of the cyclical optical reboot and secular optical re-architecture beginning this year.

At OFC/NFOEC this year, we announced our first DTN-X customer, Cable&Wireless Worldwide. A new Infinera customer, Cable&Wireless selected DTN-X as the sole platform for their Europe to Persia Express Gateway known as EPEG.

To-date, we've received DTN-X purchase orders from four customers; one from Cable&Wireless Worldwide, and three from existing customers, and we are in active contract negotiations with additional service providers. We believe this early traction is a tremendous sign of confidence in the DTN-X platform and affirms our view that this is an industry changing event.

Of the four Tier 1 trials planned in Q1, two resulted in purchase orders. One was split into phases and is ongoing and one moved to an in-country trial now scheduled in Q2 at the customer's request.

Looking ahead, we have six new trials planned for Q2 for a total of eight planned trials in total. These trials are a combination of Tier 1 global providers, cable operators and bandwidth wholesalers, and they are also a mix of existing and potential customers. I also want to note that we have started the OSMINE certification process to satisfy a North America Tier 1 associated with one of the purchase orders I mentioned already.

As a point of clarification, by Tier 1 I mean, a traditional large incumbent carrier typically with in-region and out of region regulated and unregulated business. This definition does not include cable operators, Internet content providers or bandwidth wholesalers.

As we stated on our last call, we are expecting to begin shipping DTN-X in volume to customers this quarter, and we expect revenue recognition in the second half of 2012. As we signaled on our February conference call, we are seeing some existing customers to DTN-X for new footprint. Implementing a new platform often includes a process of trialing, qualifying and running first office applications, which can take one or more quarters.

This transition will result in reduced revenues in Q2 until revenue recognition kicks in for the DTN-X in the second half of the year. As the capabilities and early success of the DTN-X challenge the more traditional approaches, we see competitors aggressively pricing their 100-gig offering, as they compete for the same footprint during the optical reboot.

Gaining footprint now will advantage Infinera's gross margin opportunity over time more than others who are using less cost effective commercially available optical technology. This footprint will allow us to leverage the scale advantages of our PIC-based vertically integrated model as our customers fill these initial installs with up to 8 terabits of capacity.

As a result, we are competing aggressively for these new footprint opportunities. It will describe how these factors playing out in the near-term when she provides our guidance, which will include some color on the expected revenue flow in the second half of the year when the revenues related to our early DTN-X success begins to materialize.

From our inception, Infinera's mission has been to transform the way telecommunications networks are built and to help our customers succeed. It is clear that our customers are entering a time of great challenge and great opportunity.

We believe DTN-X provides a new architectural approach that moves the industry from a world of status quo and incumbency to a world of innovation, scale, efficiency and simplicity. We believe that this platform is squarely located at the intersection of two events, the secular inflection point requiring a new architectural approach and the cyclical, optical reboot portending a renewed optical investment cycle.

Infinera is uniquely positioned with the DTN-X, and we are committed to winning. Before turning it over to Ita, I want to thank the Infinera team for meeting our commitments to customers, allowing us to deliver on the promise of helping them succeed in their markets.

And I'll close by thanking our customers for their continued business and partnerships as we move forward into the terabit age together. Ita will now provide a detailed financial review. Thank you.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

Thanks, Tom. This announcement of our Q1 results and our guidance for Q2 2012 is based on non-GAAP. All references exclude non-cash stock-based compensation expenses.

Total GAAP revenues in Q1 were \$104.7 million, compared to our guidance of \$102 million to \$108 million. We added four new customers in the quarter for a total roster of 102. The imminent completion of three previously announced mergers will reduce this number accordingly next quarter.

We added one ATN customer in the quarter for a total of 33 ATN customers. We had one greater than 10% customer in the quarter, which was an Internet content provider, with one cable operator and three bandwidth wholesalers completing the top five. International revenue amounted to \$31 million, or 29% of total revenues for the quarter. EMEA accounted for \$26 million, or 25%, with APAC and the other Americas representing 3% and 1%, respectively.

Our service revenues for the quarter were \$11.8 million, down from \$18.4 million in Q4. Service revenues in Q4 were higher than normal and included some catch-up amounts related to the renewal of a number of significant entitlement contracts. Services margins for the first quarter were at 60%.

Overall gross margins in Q1 were 40%, down from 42% in Q4, reflecting a lower services contribution, somewhat lower TAM shipments and a healthy common equipment mix.

Operating expenses for the quarter were \$52.5 million and below our guidance of approximately \$54 million. This reduced spending versus guidance reflected some changes in the timing of some non-recurring engineering expenses and the effect of some R&D cost savings in the quarter.

Looking forward to the June quarter, we expect operating expenses to be approximately \$54 million, including OSMINE certification cost associated with the Tier 1 agreement and the rollover of some NRE cost from the first quarter.

Overall head count for the quarter was 1,210 versus 1,181 in Q4. Headcount additions primarily related to direct labor for manufacturing and some sales adds. Our operating loss for Q1 was \$10.4 million; other income expense for Q1 was unfavorable at \$0.1 million.

Net loss for the quarter was \$11.2 million, resulting in a loss per diluted share of \$0.10, compared with our previous guidance, which called for a loss of \$0.10 to \$0.14 per diluted share, compared to a loss of \$6.7 million, or \$0.06 per diluted share in Q4.

Turning to the balance sheet. Cash, cash equivalents, restricted cash and investments ended the quarter at \$240 million versus \$253 million in Q4. We used \$5.8 million of cash from operations in Q1 versus \$5.1 million in Q4. DSOs were 57 days down from 65 days in Q4. Inventory turns were 2.5 times versus 2.9 times in Q4.

Overall inventory levels increased to \$102 million in Q1. DTN inventories remained higher than normal due to some excess supply put in place to mitigate the impact of the Thailand floods. Actions are now being taken to return DTN inventory to normal levels by the end of the June quarter.

We continued production of components for the new DTN-X product and will move the complete system to production in the June quarter. As a result, we expect to drive increased DTN-X inventory levels in advance of recognizing revenue on the DTN-X in the second half of the year.

Accounts payable were 44 days, down from 53 days in Q4, reflecting lower inventory receipts at the end of the quarter. Capital expenditures were \$13.6 million in Q1 versus \$16.1 million in Q4. Q1 CapEx included final payments on some of the fab-related projects undertaken last year. Capital expenditures are expected to return to lower levels in the second half of the year, as all DTN-X investment activities are completed.

Now turning to our outlook for future quarters. As Tom mentioned earlier, adoption of the DTN-X has been strong, and we are seeing some existing customers shift their new footprint demand to that platform.

As a consequence, we experienced lower than expected bookings in our DTN platform in the first quarter and ended with the period with lower than normal DTN backlog. We believe this is in part due to planned DTN-X transitions, and may also be reflective of normal seasonality as our first quarter bookings have historically been lower than other quarters.

With our current visibility, we expect overall bookings levels to recover in Q2, with the DTN-X expected to account for a meaningful portion of those bookings. As we do not expect to recognize revenue from the DTN-X in Q2, this will likely result in reduced revenues for the quarter. However, this should allow us to enter Q2 with a healthy backlog and good prospects for topline growth in the second half. At this point, we believe revenues for the second half of 2012 will range from approximately \$230 million to \$260 million.

Now turning to gross margins. As Tom mentioned, we have seen more aggressive pricing from competitors on a number of new 100-gig footprint opportunities. In most cases, we are responding with increased levels of upfront discounts in order to secure the initial footprint and have access to the future network fill.

Each fiber and line system deployment will now support up to 8 terabits of capacity, providing the opportunity to sell additional high margin network fill in the future.

On the cost side, we are executing well and our [indiscernible] (22:48) from an operations execution perspective. We are experiencing good cost reductions in the fab and expect based on current trends that the DTN-X line module costs will decline satisfactorily over time.

We expect to recognize our first DTN-X revenues in the third quarter. All these shipments should help topline growth. They may have a negative impact to gross margins in that quarter, as we sell the first and highest cost PICs produced in our fab.

All things being equal, the initial footprint pricing dynamics described above when, coupled with a higher level of common equipment and the DTN-X ramp up costs we had already factored into our 2012 model, may result in gross margins for the year somewhat below our previous guidance of approximately 40%.

Importantly, we believe executing on winning this new footprint now will allow us to capture the volume needed to leverage our 500-gig PIC baseline module cost advantage and drive to expanded margins in the future.

Looking beyond 2012, we believe there was solid revenue growth. Our vertically integrated model can deliver significant leverage and allows for good margin expansion.

In addition, over time we would expect to see a more balanced mix of new footprint acquisition and network fill that should also improve our gross margin structure.

Now returning specifically to Q2 guidance, while we expect Q2 bookings to recover, a meaningful proportion are expected to relate to the DTN-X platform and will not drive revenues for Q2.

In addition, the overall lower volume for the quarter combined with the higher mix of lower margin new deployments is expected to pressure gross margins. TAM shipments are expected to be in a range similar to Q1 levels. With these factors in mind, the following guidance for Q2 is based on non-GAAP results and excludes any non-cash stock-based compensation expenses.

Revenues of approximately \$92 million to \$100 million, gross margins of approximately 36% to 38%, operating expenses of approximately \$54 million, operating and net loss of approximately \$16 million to \$21 million and based on estimated average weighted diluted shares outstanding of \$114 million, this would lead to a loss per share of approximately \$0.14 to \$0.18. Please note that the basic share count is expected to be 110 million for the quarter.

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

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] The first question is from Ehud Gelblum with Morgan Stanley. Your line is open.

Ehud A. Gelblum

Analyst, Morgan Stanley & Co. LLC

Q

Hey, guys, thanks. I appreciate it. Couple questions, Ita, if we can go – and Tom, if we can kind of go through the guidance and the pieces of that. So, we are looking at high – mid to high \$90s million for Q2. How are you sure – and then it picks up in the \$230 million to \$260 million for the – so it picks up significantly in the back half of the year.

How are you sure that the pause in DTN – I know you had part of the seasonality, but how do you know that the pause in DTN is going to be picked up by DTN-X? You're trialing at eight people right now. When you say you're going to recognize DTN-X revenue in Q3, is that with all eight or is that only with like one or two of them. I'm assuming Cable&Wireless is probably the first one you will recognize with, but when you saw the order book come down now for DTN, was that – did it only come down for those eight that are trialing DTN-X or did it come down with other guys as well?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

So the – first of all, we have orders for – from four customers that we have already taken and typically, if we've taken orders from a customer at this point in a cycle, we would ship and revenue that in that current quarter. In this case, we plan on shipping, but we won't be able to revenue that until the second half of the year. Two of the customers – two of the opportunities would be for opportunities that are – would be incremental or what the DTN would service.

So without the DTN-X we would likely not have won those deals. Two of the DTN-X POs that we received to-date are from customers that had we not had the DTN-X, I believe they would have deployed the DTN because they are investing in the DTN-X as a scalable future versus the DTN, wouldn't be able to satisfy it now. So, I think that if I look at both the POs we've received and the eight trials, in addition to the four POs, we're seeing a mix of new opportunities that without the DTN-X we would not have an opportunity for, and we're seeing an opportunity for our current customers to continue a Infinera path by the next generation architecture.

So I feel pretty comfortable that the DTN-X will have an opportunity to sell to both types of customers, new and potential, but also current and the fact that we are taking orders today have four to-date from four different customers, and normally would recognize that revenue. That revenue goes into the back half, which should be incremental assuming that there is some level of continued Internet demand for in general. So, all things being equal, we feel pretty comfortable that the DTN revenue will have a continued ongoing healthy revenue stream and the DTN-X represents a new opportunity for new customers and opportunities that will be incremental to the company where the DTN wouldn't have satisfied it. It's a long winded way of answering your question Ehud. Does that answer your question?

Ehud A. Gelblum

Analyst, Morgan Stanley & Co. LLC

Q

It sort of does, although it does seem as though – that from the two to second of those two customers, second two of those payers for which they would have bought the DTN, but they're now buying the DTN-X, it's somewhat of a push out from Q2 into Q3, Q4, but it's the same that they would have – same demand that they would have had anyway. It sounds like you only have two customers that are actually adding DTN-X in that market expansion from the DTN-X. And so, it seems pretty heady to see \$115 million, or let's say \$120 million, \$125 million revenue quarters in the back half of the year just based on two customers that will have incremental. What else gives you confidence?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Well, that's two customers to-date and six additional new trials scheduled for Q2 and these customers that we're trialing are pretty big opportunity type customers that typically the DTN would not have allowed us to win, so these are large scale type customers that could buy substantive amount of product.

I don't anticipate certainly all six will give us POs in Q2. I'm hopeful that over a period of time, all six will give us POs and not all of that revenue would recognize or happen in this year, but some of it will. And the DTN-X is opening a new class of customer and a caliber of customer that is trialing with us, we're pretty satisfied with.

Ehud A. Gelblum

Analyst, Morgan Stanley & Co. LLC

Q

So it sounds as though we are counting on those customers those – whatever portion of those six that trial in Q2, to come through and push through that \$230 million to \$260 million, so my guess is if they're trialing in Q2, that revenue doesn't get recognized until Q4. So, it sounds like, we're probably hugging \$100 million in Q3, and up a much, much bigger number in Q4, is that right?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Well, I'm not going to give you a Q3 number. We gave you – we spent a lot of time looking at what the opportunities are in the back half of the year and as you know, the fidelity between quarters is quarters is challenging, but we feel comfortable with the \$230 million to \$260 million range in the back half.

I did mention that we are in contract negotiation with a couple of other people, so it's not just we have four orders, and we've got to start to work on some others. We're in the midst of contract negotiations with some other customers that I'm highly confident will close this quarter.

Ehud A. Gelblum

Analyst, Morgan Stanley & Co. LLC

Q

Okay. Great. One last thing if I could, the competition in this environment that you talked about, that you both talked about, is this – it sounds like it's worse than it was six months ago. What kind of – where – what areas do you see it in? Do you see it in 10-gig as well? Is it only in 100-gig? Where do you see it? Is it from one customer or one competitor in particular, or has the entire environment gotten worse and what do you think predicated it?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Yeah, I see – as we have said that for a period of time we've been competing aggressively with the DTN, and have had to make commercial terms that would allow us to compete where we didn't have 100-gig, so that's been fairly challenging, and that's not new. What is I'm – surprising a little bit is that there is a lot of pricing competition for

100-gig footprint, and it seems to be becoming more intense in certain areas. Certain markets like submarine it's, I would say, the most intense.

And I think that people view like we do that the opportunity to fill fiber capacity for a longer period of time with more bandwidth, you have to win that footprint. So, I think that there is a level of competition to make sure that there is an opportunity to create the fill based upon harder commercial terms upfront.

Ehud A. Gelblum

Analyst, Morgan Stanley & Co. LLC

Q

Wouldn't that competitor feel the same way you do and therefore, aren't we stuck in a situation with no natural equilibrium?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

I assume the competitor feels the same way I do. I think that the opportunity for this industry always is the fill is where you are allowed to make a reasonable return, and footprint right now during an expansion of market, I think, is viewed as critical by the participants in that market. So, I think it's going to be a fairly competitive environment.

Ehud A. Gelblum

Analyst, Morgan Stanley & Co. LLC

Q

Okay. Appreciate it. Thanks so much.

Operator: The next question is from George Notter with Jefferies.

George C. Notter

Analyst, Jefferies & Co., Inc.

Q

Hi, thanks very much guys. I guess I – just back on that prior question. So, you're talking about revenues in Q2 in the high \$90s million, how many customers do you think you'll really experience an overhang in DTN demand from because of the DTN-X? And I guess I'm wondering, as we go out, you've got certainly many, many other customers in the fold for the DTN, is it logical that those folks potentially start looking at the DTN-X, you'd have additional overhang in demand on your hands as we go out through the balance of the year?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

No, I think the way I view it, is it's not – most of our customers who are interested in the DTN-X, it's not like they flip a switch and then move from DTN to DTN-X. There is a different class of product. The DTN has 400-gig capacity, a line card on the DTN-X has 500-gig.

It is a different class of product. Do – have people been buying the DTN while waiting for the DTN-X? Some range of customers have been, because they see the ability to utilize the DTN continues to be market leader in 10-gig and provide a very good economic solution. I think that I don't view it as much as they're making a decision to not buy the DTN, I see it as a decision that they're making in infrastructure, a network infrastructure that can scale to multi-terabit, and in certain parts of their network that's going to be mandatory. In other parts of their network, the DTN is going to continue to provide an exceptionally compelling value proposition.

I don't know any customer that I have today for the DTN that is not going to buy more DTNs because of the DTN-X. But if somebody is putting in a new core to their backbone or if somebody is putting in a massive new region, the DTN-X is a great way to do that and DTNs are still going to be extraordinarily useful in regional, metro, and in certain core applications where the bandwidth and the fiber is just not required.

George C. Notter

Analyst, Jefferies & Co., Inc.

Q

Got it. Okay. So, then, if I – if I were able to split out – if I just step back and I look at the two classifications of customer opportunities, I mean, how would you parse that? Do you think that 50% of your current revenue today on the DTN would be ongoing over time and have a long tail to it, and you grow the DTN-X on top of that, or is it a higher percentage or lower percentage? How should I parse the two opportunities?

David F. Welch

Director, Chief Strategy Officer & Executive VP, Infinera Corp.

A

George, maybe it's better said – Dave Welch, if maybe I can contribute to the answer here. The majority of DTN-X revenue in business that we have is going to continue forward. As we've had in any of our products, customers go through in cycles of looking at either adding new routes, lighting up a new rail or a new fiber on top of a current network that is growing is in those opportunities that are evaluating to put DTN-X in as opposed to DTN.

So all the fill associated with everything that we've deployed before, the lowest cost addition of bandwidth is to continue to do that. We expect that to go on, and that takes years to fully fill their deployed networks. So if you wrote – it is a – you know I'd put it at kind of a 15%, 20% of our DTN revenue are evaluating DTN-X proportion of that and the rest of it is perfectly happy with the product that they have, and they're going to continue on.

And the majority of the DTN-X is, frankly, bringing in new markets and new customers and new applications of a product of a scale that we haven't had before, and that's what most of the customers that we have bringing in, they're looking at their existing customers, but they are looking at DTN-X for applications that we've never competed with before. So, that's been -

George C. Notter

Analyst, Jefferies & Co., Inc.

Q

Got it. Thank you very much. That's very helpful.

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Okay.

Operator: The next question is from Kevin Dennean with Citi.

Kevin J. Dennean

Analyst, Citigroup Global Markets (United States)

Q

Great. Thanks very much. Just a couple of quick housekeeping questions to begin with. On services, Ita, I heard you mention that services were down off of a tough sequential comp to give us some catch-up revenues? There is a lot of volatility in services over time. Should we think about that, about the service revenue snapping back in two quarter or in the second quarter, or do we stay around these levels?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean, I think if you look at Q4, that was particularly high, right. We had a good level of deployments happening in the quarter, and we also had some catch-up stuff on some large annuity contracts. So, I think Q4 was actually higher than our typical run rate, if you look back over time.

Kevin J. Dennean

Analyst, Citigroup Global Markets (United States)

Q

Yeah.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

I think the Q1 range, we probably with some more deployments, probably a little bit higher than that, but that's probably more of a typical run rate for us on a normal quarter.

Kevin J. Dennean

Analyst, Citigroup Global Markets (United States)

Q

And then, on services gross margins, how should we think about that going forward? What's kind of the normalized range there, because I would imagine that the gross margin level this quarter was a little depressed just on kind of revenue scale?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean, those margins do move around a bit, depending on the deployment levels, mix in there, right. I mean, I think if you look back historically, we've been anywhere from about, say, 58% up to as high as 65%, 66%, right. So, that's been kind of the typical range, and also, the 60% is, it's not completely out of bounds, right, but it does have that range to it, depending on how much deployment stuff we're actually doing in the quarter, because the deployments will have lower margin than, say the, annuity services, which have almost 100% margin, right.

Kevin J. Dennean

Analyst, Citigroup Global Markets (United States)

Q

Okay. And then, question for me is on gross margins and the impact of ramping your 100G PIC. So, it sounds like little bit of drag current quarter, maybe it persists for a while. You mentioned that you expect to drive costs down on a – I think you used the word satisfactorily. How should we think about the progression of gross margins through the year?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean, I think -

Kevin J. Dennean

Analyst, Citigroup Global Markets (United States)

Q

I'm sorry to interrupt, but how big a drag are we seeing right now?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean, I think if you think about our gross margin through the end of the year, we've always talked about this two to three points of kind of ramping DTN-X overhead rate if you like, that's in there, right. And I think that's – that's there probably through the end of the year, maybe it starts to get better in Q4, right, get a little bit better in Q4 and then kind of burns off as we start to kind of be truly in full production looking into the new year, right?

So I think about the impact of DTN-X through kind of the end of the year is, we've got some impact in Q2. When we actually ship those initial units, we'll have a little bit more impact in Q3 and then in Q4 we should be starting to get back to something that approaches a more normal production, but still not fully ramped and not fully optimized, right.

Kevin J. Dennean

Analyst, Citigroup Global Markets (United States)

Q

Okay. And [audio gap] (40:10) for me in your OpEx guidance, that includes OSMINE cost?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean, what you'll see with OSMINE is it's going to be in every quarter, probably between now and through the end of the year at least, right. And so it's for smaller amounts, but it's spread out over a period of time. We had already kind of included that in our guidance, that there would be some OSMINE activity, so really we're just kind of fine-tuning that. But it's always kind of been built into the OpEx guidance.

Kevin J. Dennean

Analyst, Citigroup Global Markets (United States)

Q

Okay. Great, thanks very much.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Thanks, Kevin.

Operator: The next question is from Rod Hall with JPMorgan.

Rod Brantley Hall

Analyst, JPMorgan Securities LLC

Q

Yeah, thanks for taking my question guys. I just wanted to drill into the pipeline a little bit more, just to make sure I understand it. So, I understand that you've got these eight trials running. I wonder if you could say whether those are limited by the availability of equipment or is that the total number of people that are interested in trialing the DTN-X right now; just some kind of indication of where we are in the process of spinning trials up, and if you could elaborate on the number – maybe how many people you've got it active in the DTN-X sales pipeline that would also be useful. Just kind of figure out what the potential for additional trials is, and how the whole sales cycle might progress? Thanks.

David F. Welch

Director, Chief Strategy Officer & Executive VP, Infinera Corp.

A

Yeah, so let me, this is Dave Welch again, let me see if I can answer that for you, and probably will not be able to answer it satisfactorily. But the interest, back off and talk at a high level, the interest in DTN-X is great. There is a significant across our customer base as they see various values of that through that we have a at the beginning of

the quarter where we are today we have a number of committed trials to come in either in our lab or their lab to be able to execute on what I would call present as a qualification process trial as opposed to an early evaluation trial.

So in that discussion there is many early evaluation trials that we engage in to varying degrees with our customers. If we look at our 100-plus customers that we've engaged with over the years, we are not going to have 100 guys walk in here and eval the product. We're going to have typically it's the larger capacity networks that are going to come in here and evaluate our product, and they are going to try and time that for when they see new applications and new capacity builds in their cycle to come on out.

And so – it's not just the availability of the product that dictates when they buy it; it's the availability of the product at times is when they need it, when they need to make that technology transition. So, the interest is high. I don't want to go through and quantify that, but we have a – I think the general mixture of what we see of new customers, new applications and current customers and old applications with current customers. That mixture that we're presenting to you is fairly consistent as we look forward.

Rod Brantley Hall

Analyst, JPMorgan Securities LLC

Q

And just to clarify kind of what you're saying there, the eight trials you guys have talked about, those you would classify as qualification trials and then you're saying that there is a bunch of other customers that are in early evaluation stages on the product. Is that the right way to think about it?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Yes. It's Tom. The trials that we're doing, the eight we are talking about is a level of rigorous test that typically takes couple of their engineers, customer engineers three to five days, and it's typically linked to a deployment opportunity that they are truly evaluating a product against, that is a what we consider a trial here.

So there is one finite capacity, but more importantly there is a customer desire to make a final decision on a product to go through this level of testing. In addition to that as Dave pointed out there are a lot of demonstrations. There are a lot of customers coming in where they get a couple hour lab tour and be able to see the gear working, play with it for a couple hours. That's for them to get a sense that of what's available and as they're going into some type of RFI or some RFQ point, whether they want to include Infinera on that. And then above that we would have just pipeline quoting.

So we have a lot of pipeline activity where our sales guys are bringing us opportunities, responding to bids, depending on our success with that bid that could either lead to a demo where they could test and say that we want to make Infinera have the shortlist and then that would lead to a trial. So, the trials we are doing are fairly late stage in a cycle, and they're fairly intense from a customer perspective on amount of time commitment they have to spend, both here and in preparation for it, because they will typically have to generate a test plan of what they want to do when they're here.

Rod Brantley Hall

Analyst, JPMorgan Securities LLC

Q

Okay. And you're saying, Tom, that it is capacity limited, so that if you had unlimited capacity in your labs, you'd probably – you might have more than eight trials?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

I don't know. That's hard to say. I mean, you can only do so many, it's not infinite. Yeah, a trial takes; a successful trial takes about a week, so we're doing about eight this quarter, a quarter's 13 weeks. Now, if somebody came in and said listen I really want to trial this, we have an opportunity, we're going to go take that trial. If they say we have an opportunity for Q4, they will probably say we want to trial it in Q3.

Rod Brantley Hall

Analyst, JPMorgan Securities LLC

Q

Okay, all right. Thank you.

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Trying to cram as many in as possible. I'd rather be horribly successful with the ones we're doing.

Rod Brantley Hall

Analyst, JPMorgan Securities LLC

Q

Yeah, makes sense. All right, thanks a lot.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Thanks, Rod.

Operator: The next question is from Alex Henderson with Miller Tabak.

Alex B. Henderson

Analyst, Miller Tabak + Co. LLC

Q

Thanks. So, I just wanted to talk a little about the trajectory of margins and the pricing commentary. It's quite obvious when you look at the results out of Sienna over the last 18 to 24 months, that part of their problem is that they've been shipping at very low cost a lot of chassis and not shipping a lot of blades into them because they go out 40% loaded, and it takes them at least a year to year and half from the time they get shipped to those chassis out to absorb that initial slug of capacity. So, what you end up with is chassis versus TAM mix being quite negative.

Is it not reasonable to think that if you have success with the DTN-X that you would see a similar window to absorb the initial capacity that goes out loaded on the DTN-X boxes and therefore, have to price down to get that valuable footprint in order to have the opportunity to sell TAM into the future periods?

David F. Welch

Director, Chief Strategy Officer & Executive VP, Infinera Corp.

A

Okay. Let me see if I can give some insight in that. There is absolutely a variation in gross margin between first-in cost and fill cost. Our product architecture and our product cost structure is different than our competitors, and that allows a different profile and a different recovery period from first-in cost. What Tom tried to infer in his commentary is that the upside margin for Infinera based on our advanced technology and our photonic integration, and that we're vertically integrated on our coherent technologies, et cetera allows us to have a gross margin recovery that we believe is much faster than some of our competitors out there.

Alex B. Henderson

Analyst, Miller Tabak + Co. LLC

Q

I wasn't trying to imply there would be the same margin structure, but the structure that I'd just expected where you're talking about shipping primarily chassis in a new product launch for better part of a year before you start to see the absorption of the initial capacity to ship along with the chassis on the first install to get the TAM sales in that [inaudible] (48:24) after the fact. And if that's 12 months, that would imply that you're not going to get the high margin TAM revenue in until well into 2013.

David F. Welch

Director, Chief Strategy Officer & Executive VP, Infinera Corp.

A

Yeah, I think that the – keep in mind our system's made up of three pieces, there is common chassis, there is long haul bandwidth, which is what are photonic integrated circuits deliver, and then there is tributary access. Tributary access is a smaller granularity than our 500 gigabit and our initial deployments will go out with a small capacity of tributary bandwidth and – but they will quickly deplete that tributary bandwidth unless you start adding on, and so our margin profile, it won't be 12 months for a margin recovery.

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

We also it's important to remember that the optical layer that Dave referred to the DTN-X completely compatible with the optical layer we've been selling for a long time, and that invariably carries a very low margin. So, customers who already have our optical infrastructure we will have the opportunity to upgrade them and achieve margin recovery much faster than if you're deploying overall optical layer in addition.

Alex B. Henderson

Analyst, Miller Tabak + Co. LLC

Q

Okay, second question, could you talk to the – you've got a very large installed base of customers, by my count little over 100 now. Can you tell me what portion of those would actually have a network that could handle a DTN-X size platform because obviously the bandwidth is substantial, compared to some of the smaller service providers?

David F. Welch

Director, Chief Strategy Officer & Executive VP, Infinera Corp.

A

Yeah, that's a little bit hard question to answer and frankly, the pertinent question is to answer it more on a dollar basis as opposed to a number of customer basis. And I think that being that anyone who is truly in the long-haul business will at some point in their cycle have an interest in the DTN-X. Our customers that are in the metro, more of a metro or metro regional network, their interest is going to – it will take longer for those capacity demands in areas that are more fiber rich to take advantage of it. Our business is not, is not a super majority, but it's certainly a majority of our business is true long haul carriers and subsea carriers have an interest in that, that immediately.

Alex B. Henderson

Analyst, Miller Tabak + Co. LLC

Q

[inaudible] (50:58) your customer base still metro or regional and therefore, would not be likely candidates for even moving to a DTN-X, so when we look at customer base of 102 and say okay half of that's 50, we're doing eight, it gives us a better handle on what portion of the customer base is viable candidate for a trial.

David F. Welch

Director, Chief Strategy Officer & Executive VP, Infinera Corp.

A

Yeah, I don't think – I'm not sure I could give you what the accurate number is on the quantity of customers at this point. So, I'll have to defer that question to another time.

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

We also need to be careful of assuming that every customer is going to trial it. If it's a DTN customer today, there is a reasonable percentage of them that will not do a trial. They will do a first office application. Two of the first POs we have were not based upon them coming in and doing trialing. They know our gear. They know the software release is based upon a previous release. They are very comfortable saying, we are going to roll this out based upon our history with the company.

Alex B. Henderson

Analyst, Miller Tabak + Co. LLC

Q

One last question, then I'll cede the floor, because it is on the same basic concept, which is – can you talk a little bit about, what portion of your customer base that are looking at the DTN-X product would have an acceptance criteria that would cause an extended delay in the timing of the recognition of the revenues?

I know you're saying you're going to have revenues in the back half of the year, but are some of the installations in the back half also going to be deferred into 2013 for revenue-rec purposes?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean, I think we've talked about it before, Alex, very much the existing customers, with existing contracts, what we're seeing is those customers are not really trying to go change the terms of their contract. So, we have customers in that bucket who are taking revenue and allowing us to take revenue on shipment and on receipt, we are not seeing people come and say well I want to change that for the DTN-X, right. I think for new customers who haven't used the product before then you will see a longer acceptance period.

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

And on submarine invariably whether it's new product or old product they want to see the submarine link up and running for a period of time before they will sign off on it. And that's to me less to do with the DTN-X and more to do with the submarine market.

Alex B. Henderson

Analyst, Miller Tabak + Co. LLC

Q

I'll cede the floor. Thank you.

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Okay. Thank you, Alex.

Operator: The next question is from Sanjiv Wadhvani with Stifel Nicolaus.

Sanjiv R. Wadhvani

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Thanks so much. Tom, I just want to take a crack at the second half trajectory. If you look at your revenue run rate over the last six quarters or so and this has rounded up to about \$100 million a quarter. If you're guiding to \$230 million to \$260 million for the second half, and if you assume that \$100 million comes from the DTN every quarter, does that mean that the DTN-X is going to be between \$30 million and \$60 million for the second half?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Well, the way you did it would.

Sanjiv R. Wadhvani

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Not for me again.

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

We just spent a full day with all of our sales team on rolling up and looking at very specific DTN-X opportunities. We're typically hesitant to give out guidance beyond the quarter. We have not done that, and we are doing that this time, because quite frankly, we think Q2 is a – an anomaly. Its revenue is down, but we have the opportunity. We've won four new DTN-X customers. We have a pipeline full of trials that are coming, and we're in negotiation with a number of other DTN-X opportunities.

We either believe that we are going to win those, and what we're going to start shipping, taking orders for in Q1 and Q2 and start shipping in Q2 translates into new opportunities or it doesn't. We believe it does, so we wanted to share with you our observation, and it's based upon a roll up of what we have done with all of our various regions on the opportunities that they see both for the DTN and the DTN-X.

And the reason we are creating a kind of out of process guidance for that is because I don't believe that revenue reflection of Q2 is representative of the opportunity that we see with DTN-X. We started taking orders for DTN-X in Q1. We never have a quarter and a half until we recognize revenue. This is an anomaly on there and quite frankly, any forecast can be wrong, we would not give that forecast unless we had done the work and the diligence of being able to say this is what we can touch and see.

Sanjiv R. Wadhvani

Analyst, Stifel, Nicolaus & Co., Inc.

Q

Got it, fair enough. I guess the other question on the OSMINE certification that you're going through, you have already done some prior certification with Qwest and I'm trying to figure out if this is DTN-X with the same customer, brand new customer, any color there?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Well, I'm not going to give any color there. We've done two OSMINE releases. We did our release three with OSMINE. We did our release six at OSMINE, and that was at a customer request. OSMINE is a non-trivial expenditure and the DTN we did it based upon a specific request from a customer. We're also doing as Ita has said, we had baked OSMINE into our planning, but we're also doing at a specific customer request. And that's all I'm going to say about it.

Sanjiv R. Wadhvani

Analyst, Stifel, Nicolaus & Co., Inc.

Q

All right, fair enough. Thanks.

Operator: [Operator Instructions] The next question is from Simona Jankowski with Goldman Sachs.

Simona K. Jankowski

Analyst, Goldman Sachs & Co.

Q

Hi, just wanted to ask one more follow-up there on the second half trajectory. So, can you just give us a sense for when you think DTN-X revenues will cross over the halfway point in terms of percent of the total? I mean, it sounds like that might even happen exiting this year, but do you think that will be exiting this year or more first half of next year?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, we are not in a position to do that yet Simona. We will provide more color kind of on the product split as we kind of report the actuals, but we're not going to try to project that at this time.

Simona K. Jankowski

Analyst, Goldman Sachs & Co.

Q

Okay. And then a couple of follow-ups on the margins in the next few quarters as well. I think there was some helpful discussion there on how long you think it will take for the proportion of common equipment to TAMs to normalize. And it sounds like you thought that would be less than a year before that aspect of pressure on margins is released. And please correct me if I misunderstood that. But the follow-up is, there is also kind of the yield aspect in terms of your PICs, which are obviously new technology and much larger. So, how long do you think before kind of the yield in the manufacturing aspect of your new PICs normalizes back up to what your historical 10-gig or 100-gig PICs have been?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah, I mean, I think as we commented in the remarks, we are seeing good traction kind of in the fab around the cost, and it is trending kind of as we expected, right. So, I think we have – we had originally guided 40% gross margin for the year you know with kind of some of the volatility that we're seeing and I think we'll be somewhat below that, but not – if we get the topline and the revenue growth that we are projecting then, you're not significantly off of that, right.

If you look beyond that I think what starts to happen as we take out some of the DTN-X overhead type margin impacts that we've had, you start to ramp some volume and then you really do start to see kind of the flow through on the model, right, where you start to truly ramp the fab and have you know leverage the fixed cost that are in the fab, and then you can start to see margins expand again through kind of next year.

Simona K. Jankowski

Analyst, Goldman Sachs & Co.

Q

Right. But that's more of an overhead comment. What about just the yields themselves, so more the variable cost as opposed to the fixed cost drag?

Ita M. Brennan

Chief Financial Officer, Infinera Corp.

A

Yeah. I mean, the yields are ramping along kind of a similar relative recurve, as they did with kind of the Gen 1 and Gen 2 products, right. So, we would expect to hit [indiscernible] (58:40) yield some time next year, right. I'll ask Dave to kind of maybe talk a little more on that.

David F. Welch

Director, Chief Strategy Officer & Executive VP, Infinera Corp.

A

Our yields on our PICs, I caution you that, it's not – the question you're trying to get at is what the cost structure is of our business. The yields of our PICs are – they are ahead of schedule. They're fine. The PICs work. It is the usual capability, the technology's there, and we can make as much as we need of it. And we sell systems. We sell networks. These are highly complex things of which the PIC is an enabler for cost structure elsewhere in the system, but it is not the dominant cost structure. We're not a component company.

Simona K. Jankowski

Analyst, Goldman Sachs & Co.

Q

Okay, fair enough, and then just last quick one. And I realize this might have been too recent to kind of have all the details, but in terms of the proposed acquisition of Cable&Wireless by Vodafone, is there any change there that you think might happen relative to your involvement, either in terms of incremental opportunities at Vodafone or maybe a change in how Vodafone wants to run that piece of the Cable&Wireless business?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Yeah, I think there's two parts to the question in my mind. One, does it affect what our current plans are in the short-term with rolling out the DTN-X with Cable&Wireless. I don't believe that there is any impact to the current plan we have of rolling out the DTN-X against the current contract with Cable&Wireless.

For longer term, it's a much bigger question. I don't think that the acquisition will close; earliest will be August, I think latest is October, and I think that more than likely new decisions will probably have a period of reluctance to make big commitments to anything. I feel very comfortable that the current PO and plan of expansion with their EPEG network is on track. Beyond that, Simona, I think it's too early for anybody to say what will happen.

Simona K. Jankowski

Analyst, Goldman Sachs & Co.

Q

Okay, terrific. Thank you very much.

Operator: The next question is from Michael Genovese with MKM Partners.

Michael Genovese

Analyst, MKM Partners LLC

Q

Hi, great, thanks very much. Tom, you spoke earlier in the prepared remarks pretty enthusiastically about the optical reboot cycle and the expansion for optical and then meanwhile, as we are on this side, you were pretty angsty about CapEx this year and is it strong, is it weak, is it front-end loaded, is it back-end loaded, is there an optical cycle or not. So, when you talk about all these decisions being made and this capacity going into the network and capital dollars being spent, is this something that's happening this year in your view, or is it more of a 2013, 2014 event?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Well, I think it's mixed. I mean, a lot of discussion happens around AT&T and Verizon CapEx and for good and bad; we're not exposed to that right now. My commentary on a kind of optic reboot is based upon two things. I just see, quite frankly, the investment happening in wireless, the investment that has to at some point translate into core networks. I see what's happening with datacenter distribution, I see what's happening with all of those types of activities, and at some point, there has to be a resurgence of CapEx, that's part of it.

The second part is I see the amount of quoting and activity that we have, and it's quite substantial right now. Certain areas of the market are making decisions without question for this year, and those include cable, those include submarine, those include a number of activities that are happening in Europe.

There are some very substantive builds being planned. That is outside of quite frankly, the market of what does AT&T and Verizon plan on spending in CapEx. Those are very big numbers. I certainly anticipate, hopefully, the DTN-X will help us move the progress of having that to be more germane to our conversation. But I see the opportunities – a lot of people are saying Europe is soft, our Europe in Q1 was actually pretty darn good, and we see lots of activity there. So, I think people are making investments where their networks are needing to expand for new services whether they're low latency commercial services or cloud services or just video content. I see substantive investments being made.

Michael Genovese

Analyst, MKM Partners LLC

Q

All right, great, that's a great answer. And then just a follow-up – or separate question. Earlier in your response to an earlier question, you talked about OSMINE – I'm sorry, you talked about evaluations of DTN-X, early stage to late stage and typically, where in that process would a request from the customer [indiscernible] (63:21) come in? Would it be earlier or later in the evaluation process?

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

It's socialized early in it, and it is finalized in a contract phase where you will do it or I'm not buying from you.

Michael Genovese

Analyst, MKM Partners LLC

Q

Right. So, but, but – along with that, I mean, just generally speaking, I mean, so they say – they say, you know, I'm not buying from you? Do they promise you anything in [inaudible] (63:44)

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

A

Yeah, quite frankly, they are very reasonable business people. They use OSMINE certification to help run the back end of their businesses. They have no desire for us to indiscriminately spend money on OSMINE if they don't have a business need that they think that DTN-X can help solve.

We're doing it based upon the strong belief that they have every intention to roll out the DTN-X. OSMINE is a gate to that. Obviously, the product has to go into their network, and it will go into their network, but it has to be successful when it goes into their network. I mean, that's up to us to make happen and I have every confidence that we will make that happen. So, I believe OSMINE to me isn't a threat, it's an opportunity that basically says we

are going to go roll out your stuff in the network, but for us to mass deploy your stuff, you got to do it within a context that makes our business successful and you have to do OSMINE for that, and that's why we are doing it.

So far when we've rolled out OSMINE historically on both release three and release six; it's been an extremely good investment for us.

Michael Genovese

Analyst, MKM Partners LLC

Q

Thanks, Tom.

Thomas J. Fallon

President, Chief Executive Officer & Director, Infinera Corp.

Thank you all for joining us today in the call. We appreciate your interest and questions. We look forward to keeping you informed on our progress in the months ahead as we execute on our significant opportunities with the DTN-X and of our strategy to win in the marketplace. Have a great day.

Operator: Thank you for participating in today's conference call. You may disconnect at this time.

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