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# Infinera Corp. *(INFN)*

Q3 2011 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Welcome to the Third Quarter Year 2011 Investment Community Conference Call of Infinera Corporation. All lines will be in a listen-only mode until the question-and-answer session. [Operator Instructions] Today's call is being recorded. If 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 competitors' products, and prospects of the company in Q4 2011 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 1st, 2011, for more information on these risks and uncertainties. Today's press releases including Q3 2011 results and associated financial tables and investor information summary will be available today on the Investors 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 includes certain non-GAAP financial measures. In our earnings release, we announced operating results for the third quarter of 2011, which exclude the impact of restructuring and other related costs and non-cash stock-based compensation expenses.

These non-GAAP financial measures are provided to facilitate meaningful year-over-year comparisons. Please see the exhibit of the earnings 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 our website.

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

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

## Thomas J. Fallon

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

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

I'll spend a few minutes today, commenting on our market position, touch on our Q3 results, and then conclude with some thoughts on our technology and the recent launch of our new DTN-X platform. Ita will then review our Q3 performance and Q4 outlook in detail, as well as provide some directional commentary on how we believe 2012 will trend in the context of the anticipated ramp of our new products.

With the recently announced DTN-X and the newly enhanced DTN, we have a portfolio of products that provide a wide range of transport capabilities, including 10G, 40G FlexCoherent and 500G FlexCoherent super-channels to address several growth markets. Coupled with our investments in an expanded and focused sales force, we are now positioned to service more opportunities with more customers than ever before in both key vertical markets and across geographies.

Consistent with my commentary last quarter, we continue to see an active market. In particular, we believe that the cable, content and subsea providers remain in an investment cycle, as does North American and European wholesale carriers. While there is demand for 40G in fiber constrained environments, particularly in submarine, it is also worth noting that demand for 10G remained strong. We believe that most carriers planning to expand capacity are looking to upgrade to 100 Gig and 500 Gig super-channels in 2012 and beyond. All of this activity is reflected in our recent financial performance and continued good momentum in bookings.

Relative to guidance, our Q3 revenues came in at the high end with a net loss that was better than forecast. We also experienced a continuation of healthy TAM purchases by an increasingly broad set of customers looking to meet their bandwidth growth needs.

As evidence of our deeper focus on verticals, in Q3 our top customer was one of the leading cable providers and our submarine pipeline remained strong. I'm also pleased to note that one of our Tier 1 customers was among our top five accounts for the quarter. We added three new customers in Q3 bringing our total to 93. One of them was a broadband stimulus customer.

We continue to see this funding as an ongoing opportunity, but as we've said before, timing of these awards can be unpredictable and we don't bake them into our business outlook. We believe our recently launched DTN-X and the roadmap it provides for customers has underpinned some of this overall increased activity.

On the new product front, we have received initial orders for our new 40 Gig product. We have begun shipping the 40G coherent line cards and we anticipate recognizing some revenue in Q4 which is dependent on the timing of customer acceptance. In Q3, we completed six trials or qualification tests for the 40G offering and 14 additional trials are scheduled or being scheduled across the next two quarters.

In the third quarter, Pacific Crossing, an NTT Communications company, and Infinera used a newly enhanced DTN to test what we believe is the longest transmission of 100 Gig service on the Transpacific route. This was accomplished with bandwidth virtualization using 40 Gig FlexCoherent channels across a length greater than 9,500 kilometers. During this test, we also demonstrated Soft-Decision FEC technology which will be implemented as part of our 500 Gig FlexCoherent super channels on the DTN-X platform in the future.

This brings me to the highlight of the quarter; our September 15 launch of the DTN-X. The DTN-X is based on our third-generation 500 Gig PICs, a pair of photonic ASICs that integrate more than 600 optical functions and will deliver the world's first 500 Gig FlexCoherent super channels. Unlike competitive offerings that are focused on solving fiber capacity problems only, the DTN-X will deliver a step function improvement in network economics to help service providers more efficiently manage the explosive growth of traffic brought on by video, mobile and cloud services.

The DTN-X is a next-generation multi-terabit, packet optical transform (sic) [transport] (6:30) platform that is fundamentally three products in one: A DWDM transmission system that will support the world's first 500 Gig super channels, unleashing cost-effective DWDM transmission capacity; an integrated OTN switching system that will scale from 5 Terabits in its first release to 100 Terabits in the future and will enable operators to efficiently tame those large pipes through grooming of traffic down to 1 Gig granularity; and third, a system that is designed to be upgradeable to MPLS switching in the future which will further enable convergence of the network for improved efficiency, reducing the number of interconnections between layers.

We firmly believe that the convergence of network layers can only be achieved when the best-in-class performance of each individual layer is realized in a single platform. This requires that the electronics and the optics scale at the same rate consistent with Moore's Law.

The DTN-X, unlike competitive offerings, was designed from day one to converge switching with DWDM transport without compromise. The purpose-built design centers around three unique technology building blocks; photonic integrated circuits paired with FlexCoherent technologies, custom switching ASICs, and intelligent GMPLS software. It is the only platform that will be available in the market that will allow all components including the optical functions based on our PIC technology to be consistent with Moore's Law, and therefore delivers simultaneously best-of-breed switching integrated with best-of-breed DWDM.

Because of this we believe that the DTN-X will deliver a step function improvement in network economics in its first release. When evaluating the DTN-X in a network typical of what you might find in North America, it delivers 50% less power consumption, a 67% reduction in field replacable units, and a requirement for 33% fewer racks than competing platforms. This is differentiated value.

Our launch of the DTN-X included a live briefing at our headquarters in Sunnyvale, a live and on-demand worldwide webcast and a global launch event in Germany, the UK, Spain, Italy, France, Singapore, Russia and Japan. Also worthy of note was a live demonstration of the DTN-X that showcased 500 Gig flex coherent super channels carrying a 100 Gig e-service over 3,000 kilometers. This seamlessly interoperated with the newly enhanced DTN using bandwidth virtualization to carry the same 100 Gig e-service over 40 Gig flex coherent channels across 3,000 kilometers.

The response from customers and prospects alike since the DTN-X announcement has been extremely positive. Combined with the DTN, Infinera now offers a complete solution for high capacity core, metro and submarine network requirements. Since its inception as a company, Infinera has innovated to make the network better, more scalable, more simple and more efficient, and provided a path for our customers to effectively manage the tremendous growth in transport traffic without needing to be encumbered with large technical and operational staff. We believe the new DTN-X makes good on this strategy and represents a step function solution, the industry's first multi-terabit packet optical network platform based on our 500 Gig PICs.

We are very excited about the DTN-X as it reinforces Infinera's position at the forefront of the innovation curve in the optical transport industry. We also believe it provides us the foundation for achievement of the leverage in our business model that will deliver appropriate shareholder return over the longer-term. We look forward to reporting on our progress to you as we work through customer trials and gaining acceptance with customers and prospects in the quarters and years ahead.

Before turning it over to Ita for a detailed review of our Q3 performance and our outlook for Q4, I want to thank our employees for their dedication in bringing the company to this important and opportune stage in our history. I would also like to thank our customers for their continued business as we work hard to help them win in their markets. Ita?

## Ita M. Brennan

*Chief Financial Officer, Infinera Corp.*

Thanks, Tom. I'll review our Q3 actual results and then follow that up with our outlook for Q4. This analysis of our Q3 results and our guidance for Q4 is based on non-GAAP. All references exclude non-cash stock-based compensation expenses.

Total GAAP revenues in Q3 were $104 million, compared to our guidance of $97 million to $103 million, and revenues of $96 million in Q2. Our revenues were broadly diversified across our customer base, with no greater than 10% customers in the quarter. Our top five customers accounted for 33% of revenues are made up of a cable operator, a Tier 1 customer and three bandwidth wholesalers.

Q3 saw a healthy mix in new footprint deployments combined with continued strong TAM shipments. International revenues amounted to $36.5 million or 35% of total revenues for the quarter. EMEA accounted for $26 million or 25%, up from 24% in Q2 with APAC and the other Americas, each representing 5%. Our service revenues for the quarter were $13.6 million, up from $10.8 million in Q2. Services margins declined to 58% from 66% last quarter, primarily due to a higher mix of lower margin deployment services.

Overall, gross margins in Q3 were 41%, the same as in Q2 and in line with our guidance of around 40%. These margins reflect a solid mix of lower margin new footprint deployments at competitive price levels as we compete for and win these opportunities.

Operating expenses for the quarter were $52 million versus our guidance of $51 million to $52 million and versus $50.9 million in Q2. We saw some shift in spending priorities and requirements in the quarter due to increased demand from customers for lab trials and demos of our new products. This drove an increase in sales and marketing expenses, which was offset by some efficiencies around our R&D activities.

Looking forward to the December quarter, we expect operating expenses to be approximately $53 million, reflecting ongoing lab trial activity, from increase in sales commissions, and the inclusion of incremental costs associated with a longer 14-week quarter.

Overall head count for the quarter was 1,151 versus 1,136 in Q2. Headcount additions primarily occurred in sales and in operations as we continue to ramp our capabilities for the DTN-X platform.

Our operating loss for Q3 was $9.1 million. Other income and expense for Q3 was favorable at $0.4 million. Net loss for the quarter was $9.2 million, resulting in a loss per diluted share of $0.08 compared to our guidance which called for a loss of $0.10 to $0.12 per diluted share and compared to the loss of $11.7 million or $0.11 per share in Q2.

Now turning to the balance sheet; cash, cash equivalents, restricted cash and investments ended the quarter at $276 million versus $279 million in Q2. We've generated $4.1 million of cash from operations in Q3 versus the usage of $0.1 million in Q2.

DSOs were 60 days, down from 70 days in Q2, mainly due to better linearity of invoicing. Inventory turns were 3.5 times versus 3.3 in Q2. Accounts payable days were 43 days, up from 35 days in Q2. Capital expenditures were $5.9 million in Q3 versus $6.7 million in Q2. At this point, we expect capital additions to be approximately $35 million for the year. We continue to manage these expenditures closely as we complete some key DTN-X related milestones.

Now, turning to our outlook for Q4; our Q4 guidance assumes continued strong demand for TAMs to satisfy our customers' bandwidth needs and the completion of a number of significant new deployments. While we anticipate recognizing some revenue from our initial 40 Gig shipments this quarter, most of these shipments are for subsea deployments in multiple countries and require formal customer acceptance.

As a result there is some uncertainty as the timing of revenue recognition for these deployments and this is reflected in our broader than usual revenue guidance range.

We are in the process of assessing any impact on our supply chain from the recent flooding events in Thailand. At this point, although a portion of our supply chain is located in Thailand, we do not expect and have not reflected any significant impact from these events in our revenue guidance.

Turning to gross margin; gross margins are expected to remain as approximately 40% reflecting some lower margin new deployments and good mix of TAMs and the continued impact of the expenses related to our manufacturing build-outs.

The following guidance for Q4 is based on non-GAAP results and excludes any non-cash stock-based compensation expenses. Revenues of approximately $100 million to $110 million, gross margins of approximately 40%, operating expenses of approximately $53 million, operating and net loss of approximately $9 million to $13 million, based on average – our estimated average weighted diluted shares outstanding of $110 million. This will lead to a loss per share of approximately $0.08 to $0.12. Please note the basic share account is expected to be at $107 million for the quarter.

Before opening the call up for questions, I would provide some thoughts around our outlook for next year and beyond. These comments will focus on anticipated trends in the future rather than provide specific guidance as consistent with our history, visibility to extend it quarter-by-quarter performance is limited.

We believe that our competitive position has improved significantly with the introduction of our 40 Gig products and the launch of the demonstration of our DTN-X.

As discussed previously, we anticipate recognizing revenue from the 40 Gig products in the fourth quarter of 2011 and from the new DTN-X product in the second half of 2012. It is our belief that once fully ramped, the availability of these differentiated products would allow us to increase our market share as we expand into new markets and new geographies. As is typical in our industry, we expect initial shipments of our new products to have lower gross margin levels prior to achieving mature yields and increased scale.

In addition, success in winning new footprint in customers may negatively impact gross margin as we deploy lower margin common equipment. A certain level of new deployments is already built into the current gross margin levels with significant larger wins could have further impact. While we expect to complete the majority of our manufacturing set of activities in 2011 or early 2012, our current view is that any related gross margin improvement will be offset by new product cost and mix impacts in the near-term, resulting in gross margins consistent with current levels.

As we look beyond 2012, we expect our new product cost to improve as yields increase and volumes ramp. And as has been the case, product mix will continue to drive volatility on a quarter-over-quarter basis. However, as we increased revenues and the DTN-X product matures and capacity is added to these networks, we believe that margins will improve and trends towards our stated gross margin target of 50%.

Turning to anticipated operating expenses in 2012; while we do not anticipate adding any significant incremental head count, we will see the full annualized impact of the sales and marketing head count that we added throughout 2011 and expect to see ongoing demand from customers for lab trials and demos throughout the year.

In addition; financial performance for 2011 was such that it resulted in the payments of reduced levels of sales commissions and minimal other incentive compensation. As we look to 2012, assuming meaningful revenue and market share growth and the achievement of other planned metrics, we would expect to incur increased levels of incentive expenses.

All of these factors combined are expected to result in higher operating expenses on a year-over-year basis. All things being equal, we will look to manage these expenses for 2012 to ensure that they grow at a rate that is substantially less than our revenue growth rate for the year.

As we look beyond 2012, we believe that while operating expenses will increase in absolute dollars, they will decline as a percentage of revenue providing leverage to the bottom line. We'll remain committed to growing into the 35% operating expense at-scale target called for in our long-term business model.

In summary, we believe that our new products put the company in a stronger position to grow revenues and increase market share over the coming years. As the business scales and products mature and capacity is added to new networks, margins should trend to the 50% target.

We intend to grow operating expenses at a slower pace than revenue and this combines with the gross margin improvements, should allow meaningful flow through to the bottom line and move us towards a double-digit operating income metrics called for in our long-term business model.

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

# QUESTION AND ANSWER SECTION

**Operator**: Absolutely. [Operator Instructions] Our first question will come from Rod Hall of JPMC. Your line is open.

### Ashwin Kesireddy
*Analyst, JPMorgan Securities LLC*

Q

Hey, this is Ashwin filling in for Rod. Just wanted to understand the upside that you saw in Q3, trying to understand what's the main contributor there; is that a new broadband customer or something else going on?

### Ita M. Brennan
*Chief Financial Officer, Infinera Corp.*

A

Yeah, I mean, I think if you look at the metrics that we provided around customers, we saw a pretty broad-based momentum around bookings really across all customers, right? We saw a strong TAM bandwidth demand as well and it touched a lot of customers. So, I think it wasn't one particular account that drove kind of the upside. It was just a general momentum.

### Ashwin Kesireddy
*Analyst, JPMorgan Securities LLC*

Q

All right. Just one more question on – can you just comment on regional-wise development of revenues; are you seeing any particular region of weakness?

### Ita M. Brennan
*Chief Financial Officer, Infinera Corp.*

A

Yeah, I mean, I think we saw a little uptick in Europe and we continue to invest in Europe and continue to make progress there. So, we're pleased with that. We also had 5% of revenue in APAC and also 5% in the other Americas, and that's kind of – that shows progress in those regions as we have new deployments there. That number does move around on a quarter-by-quarter basis, but we are kind of investing in non-U.S., if you like, business and we're starting to see some traction there.

### Ashwin Kesireddy
*Analyst, JPMorgan Securities LLC*

Q

Obviously, some other vendors have indicated that they are seeing increased caution in customers, so did you guys see something similar to that; any increased caution in your customers?

### Thomas J. Fallon
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

A

I think that a lot of it depends on what part of the market you're selling into. I certainly see in Europe, if the financial services or the end user, there is caution there. I think that – so far what we've seen is not much exposure to that portion of the industry for us, so, we continue to talk to, as we mentioned in the call, a strong cable provider demand and strong wholesalers both in North America and in Europe, and we continue to see South America be strong. There is a lot of places that our competitors are that we aren't in, the Middle East for instance, so I don't have any reference there and we're very small in APAC today though we continued to invest in it, so I don't have any context there. While I continue – and we continue to be concerned about the overall economic environment, so far our momentum of business continues to be strong and we're seeing at as Ita said across a broad mix of both geographies' end markets.

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**Ashwin Kesireddy**
*Analyst, JPMorgan Securities LLC*

Q

All right, thanks.

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**Operator**: Our next question will come from Blair King of Avondale Partners. Your line is open.

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**Blair King**
*Analyst, Avondale Partners LLC*

Q

Well, great, appreciate you taking the question. I was going to ask you, if you don't mind, if you could help understand, I think you gave some color around what the customer mix at least in the near-term on 40 Gig will be given the trial activity there, but if you could give us a sense of what your thinking is in terms of product mix over that period of time relative to 10 Gig? That would be helpful and then as you kind of think through 2012, and I know you don't like to breakout all this, but in your general sort of broad stroke thinking, how should we think about sales split between 10 Gig, 40 Gig and 100 Gig product sales through the course of 2012?

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**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

Yeah, I mean I think it's difficult to kind of piece it apart in those particular pieces, right? That's not really how we think about the network sale and the bandwidth sales into those networks, right? I mean, we will sell the capacity to the customer that the customer needs for that network. I mean, that said, there is a ramp happening here, so we're starting to see shipments of 40 Gig. There is trial activity. We have some opportunities in the pipe where we have verbal acceptance of those deals and then we have further deals out where we're going to do trials and they will turn into revenue later on, right? We've talked about the DTN-X and the fact that we will ramp that product in the second half of the year, and that you should expect to start to see revenues in the second half of the year. So, I think if you think about it as an overall ramp of non-10 Gig revenue if you like as we grow, that's probably not a bad way to think about it.

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**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

A

Yeah, Blair. This is Tom. I want to add one comment. I think a lot of people view the 10 Gig market and they continue to view it as being replaced by 40 Gig and 100 Gig and I just want to reiterate our view and it's the view that most of the analysts share that on a port basis [audio gap] (24:40) expectation is for the same reason that we're able to enter the market and create a dominant market share we believe that we're going to continue to have very good 10 Gig business.

In the high-bandwidth market, we have not had the tools to address that market. So we view that as upside to us and we view it really as a high-bandwidth market that's less defined around 40 Gig or 100 Gig and more defined around capability. We continue to believe that 40 Gig for us and others is more going to be a transition technology, but it's an important technology because it allows us to sell in places we haven't and I think the number of trials we've demonstrated to-date and have lined up is a indication that our customer base is very excited about having that tool for their toolbox. But I also think that the larger opportunity is going to be for the 100 Gig and what I consider the 500 Gig market. We are the first people to bring on a single line card 500 Gig capacity, and if you want to talk about network economics and you want to talk about leaping forward to where the market is going, I think that there is not enough discussion around when will 100 Gig start to ramp which I think is in 2012 at the earliest really from a substantive market perspective and what impact will 500 Gig play in that. If it's a real high-bandwidth market, I think Infinera is uniquely positioned to take advantage of that.

**Blair King**
*Analyst, Avondale Partners LLC*

Q

Right, okay. And just not to shift gears entirely here but a little bit on just sort of the pricing that you're seeing on the 40 Gig and given the concessions that were being made earlier in the year, have you seen any ease in those concessions now that the 40 Gig product is in fact shipping and the 100 Gig product is close to ready?

**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

Yeah, I mean, we are certainly in a better position competitively now that we have the 40 Gig shipping and we're getting closer to the 500 Gig product shipping. So, certainly in the competitive dynamic of a deal negotiation, we're in a better position than we were prior to this.

**Blair King**
*Analyst, Avondale Partners LLC*

Q

Okay.

**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

A

I'll also make one comment on our 40 Gig regardless of the price of a port, the most economic way for our customer base to upgrade the higher fiber capacity is to use our 40 Gig and that takes it to a different competitive on this than if you are out trying to get a greenfield win. So, I think that from a greenfield opportunity we now have tools in our toolbox, and from an installed base opportunity, we've given our customers the ability to do investment protection, we're providing them world-class 40 Gig in an economic model.

**Blair King**
*Analyst, Avondale Partners LLC*

Q

Okay. That helps. Thank you very much.

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

**Jeremy David**
*Analyst, Morgan Stanley & Co. LLC*

Q

Hi, good afternoon. It's actually Jeremy David on behalf of Ehud Gelblum. I wanted to ask about [ph] this trend in (27:30) services you saw; it seemed like in terms of mix, it was a record quarter for services. Could you elaborate on what drove that mix shift to services?

**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

Yeah, I mean, a lot of our volatility around services is related to deployment services. So, when we're doing large network deployments, we will see an associated increase in deployment services revenues, and that's what we saw this quarter, right? So, we had seen a number of large deployments completing in the quarter and with that comes the services.

**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*
A

And that's also the compression for the margin of the services; deployment services carry a less rich margin than other services that we provide.

**Jeremy David**
*Analyst, Morgan Stanley & Co. LLC*
Q

Okay. That's helpful. If I can have a follow-up, I would like to ask about the 14-week quarter and the impact it has on revenue and OpEx as per the guidance?

**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*
A

Yeah, I mean I think on a revenue level it's tough to say that the 14th week has any impact just because it rolls into the holiday season et cetera. From an OpEx perspective, there is probably about $1 million maybe a little over $1 million of incremental OpEx in there that's related to the 14th week.

**Jeremy David**
*Analyst, Morgan Stanley & Co. LLC*
Q

Thank you.

**Operator**: Our next question will come from Kevin Dennean of Citi. Your line is open.

**Kevin J. Dennean**
*Analyst, Citigroup Global Markets (United States)*
Q

Great, thanks. Hey guys. How are you?

**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*
A

Hey Kevin.

**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*
A

Good.

**Kevin J. Dennean**
*Analyst, Citigroup Global Markets (United States)*
Q

Hey. Just a couple of quick questions around 2012; as I understand you don't really want to give detailed guidance here, but just in terms of thought process. On the OpEx levels, I think I heard Ita say that we're going to anniversary – selling and marketing will be higher as we anniversary or feel the full impact of the costs. So, should we think about the current run rate as being a pretty good go-forward number and then just layer in some incremental expenses related to new business wins? Is that the right way to think about it or is – should we think that the base for 2012 to be higher on sales and marketing?

**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

Yeah, I mean I think if you think about the Q4 run rate, right, as a proxy for our current head count et cetera, right, and then on top of that you'll probably need to layer in some more of the incentive stuff that we talked about, right, and how we think about it is we're going to manage this based on top-line growth and success, right? So as the top-line grows from a revenue perspective, we would expect to grow the OpEx but at a substantially lower rate, right? So if we don't see the success on the top-line then some of the growth of the OpEx will not happen and we're going to manage to kind of within those metrics.

**Kevin J. Dennean**
*Analyst, Citigroup Global Markets (United States)*

Q

Right. And when you ship a system for trial to a customer, does that hit sales and marketing or R&D?

**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

So if it's a pre-qual system, right, where we haven't yet qualified the product, it will hit kind of into the first bucket that touches it, right. So if we used it first for sales and marketing, we send it out to a customer for a lab trial, it will be recorded as sales and marketing expense. If it went into an R&D lab first and then we kind of moved it around later it would hit as R&D. So there will be some fluidity in between those two buckets around customer lab trials until, kind of, all the product is released.

**Kevin J. Dennean**
*Analyst, Citigroup Global Markets (United States)*

Q

And then one last follow-up on R&D. Should we think about any kind of ancillary or expenses related to either qualification, Telcordia, anything like that? And are there NREs that we should think about popping up through 2012 related to DTN-X or do you think that we're pretty much past that?

**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

Yeah, I mean, I think we'll see a shift in terms of what the R&D dollars are being spent on, right, during that time period. But it is our intention to kind of again stay within the bounds of those broad goalposts that we outlined, which is that will grow, but substantially less than revenue.

**Kevin J. Dennean**
*Analyst, Citigroup Global Markets (United States)*

Q

Okay. And then if I could just two quick ones for Tom Fallon. Hey, Tom. Just wondering if you have any sense for the back half of 2012, when you look at some of your key markets, North America, Western Europe. What do you think the mix for the industry in long-haul will be between 10 Gig, 40 Gig and 100 Gig in terms of revenues?

**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

A

I don't have any better assessment of that than certainly the industry analysts do. Yeah, I think one of the things that you always have to remember particularly around 40 Gig today is China uses a disproportionate amount of 40 Gig and whether they're going to move to 100 Gig or not is still an open question. And I think that will be dependent upon when the Chinese supply base is ready to take 100 Gig out to the world and use that market to increase the volume. So I think that a lot of that will come out of China.

I think that in North America there will be a substantial amount of requirement for high capacity, whether it's 40 Gig or 100 Gig or 500 Gig. I have a bias toward 500 Gig. I think subsea is going to continue to -- and that's really not any specific geography, that breaks up multiple geographies. So I think subsea is going to require and have a lot of opportunity for high capacity capabilities. So I don't have any insight. Dave, do you have any insight beyond [indiscernible] (32:55)?

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**David F. Welch**
*Director, Chief Marketing & Strategy Officer, Infinera Corp.*

A

Yeah. I might add a couple things. A good way to look at – thinking about it is break it down between greenfield and brownfield opportunities. Brownfield opportunities will typically have a tendency towards the 10 Gig or the 40 Gig. The greenfield opportunities are going to have a tendency towards our competitors' 100 Gig and our 500 Gig super-channels on that. And those mixes obviously swing over time and they'll swing over time a transition over the course of 2012 and probably the beginning of 2013.

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**Kevin J. Dennean**
*Analyst, Citigroup Global Markets (United States)*

Q

Okay, great. Thanks very much.

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**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

Thank you.

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**Operator**: Our next question will come from George Notter of Jefferies. Your line is open.

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**Jody Farquhar**
*Analyst, Jefferies & Co., Inc.*

Q

Hi, it's actually Jody Farquhar on for George Notter. I was wondering could you guys provide any kind of more clarity on how much of the quarter upside was due to unexpected TAMs?

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**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

Yeah, what we've said was our TAM volumes were good and well in excess of kind of – we had set this baseline of 2,400 TAM, so it was well in excess of that, but that was in our guidance I mean we had anticipated that the TAM volumes would remain strong. So really, I think the remainder of the upside was really just across general customer bookings and not really pinned to any particular customer or cause right.

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**Jody Farquhar**
*Analyst, Jefferies & Co., Inc.*

Q

Okay, cool, thanks. And just to follow up on the broadband stimulus comments; is there anymore – can you – any further color you could provide there, you know, the size of the win that you received in the quarter, how the pipeline is looking there, any further commentary would be helpful? Thanks.

**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

A

I probably won't go into the size of the win, but what I would like to reflect is that in the broadband stimulus we continue to see a number of opportunities. As we said in the commentary, we don't necessarily forecast them within our business outlook because they one can take a very long time because as they are dealing with the government there is lots of regulations around when you get funding against your paperwork. I think that if you look over the history of our success in broadband stimulus, we have won a large number of them and the ones we've won have come back and continued to buy from us because I actually think that it's actually creating economic stimulus in the areas that they are being deployed and that is rewarding them with more opportunities for bandwidth requirements and rewarding us for incremental growth, both of new footprint, but expanding the TAMs that are in that.

So I continue to be reasonably bullish on the outlook of our ability to win broadband deals and the effect the broadband deals are having on the industry. I'm not going to go forecast out to what it looks like in the future because I think considering the overall budget challenges that are faced, I would have no better perspective than anybody else what the outlook of those programs are going to be. But I do think that we are going to – as those funds are made available, I think that we are in a position that in my mind we have a – we should win a disproportionate number of them.

**Jody Farquhar**
*Analyst, Jefferies & Co., Inc.*

Q

All right, great. Thank you.

**Operator**: [Operator Instructions] Our next question will come from Nathan Johnsen of Pacific Crest. Your line is open. Mr. Johnsen, please check the mute button on your phone.

**Nathan Johnsen**
*Analyst, Pacific Crest Securities LLC*

Q

Yeah, thanks for taking my question. The main thing that I was curious about is if you guys were able to provide any additional metrics as it relates to customers evaluating the new DTN-X platform, are you guys able to talk about either lab trials that are undergoing or RFPs that you guys have been able to respond to that are associated with the DTN-X platform.

And then just, secondly, I was hoping you could restate – I missed the numbers associated with trials for the 40 Gig, coherent, so if you could just repeat those numbers that'd be great?

**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

A

Yeah, sure, let me start with the number for 40 Gig, and I think we said that we've completed 6 last quarter and we have 14 in the process of either have been scheduled or are being schedule across Q4 and Q1 and that's dependent upon both our availability, but typically it's customer availability of when that gets scheduled. So I'm actually delighted with that number of customers who have actually seen real products, real software, tested that product and software and quite frankly that's a precursor to them, certifying the software and ordering the product.

It's too early to give those metrics out for the DTN-X. Just as a reminder, we stated that our public plan of record is for customer, trial starting in Q1 for doing lab demos and then ramping to full production by end of Q2. So we will provide metrics that will allow you a sense of the traction that we are creating with the DTN-X when we are closer to that point in time, similar to what we are now doing with the 40 Gig, where we're trying to be very transparent and very public around the customers' response as measured by their willingness to make an investment and evaluating in their networks or our labs, the gear.

Nathan Johnsen
*Analyst, Pacific Crest Securities LLC*

Q

Okay, that's very helpful. And one last question just on looking into 2012, you guys are clearly looking to get back to a share gain scenario, I was wondering if you see that ramping fairly steady throughout the year or should we expect some sort of step function or accelerated market share gains throughout the year.

Thomas J. Fallon
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

A

So I think that, I'm going to break it into 10 Gig, where we continue to have and maintain a very strong percentage of the 10 Gig market. As you well are aware, the 40 Gig took a reasonable percentage of growth into the new space of higher capacity fiber bandwidth and we have not had a tool until now, I think that we will – the plan is certainly to start recapturing some of the market share that we've lost by having insufficient tools in our toolbox and I think that with 100 Gig and our 500 Gig super-channel, we are going to have an opportunity to play very effectively in a market that is very young and we are early to this market and we are going to help accelerate that market and take what I believe is a significant portion of that new market that we help accelerate.

And that's a different challenge than we face before, which is going into a market that was mature and taking a portion of that market that was very significant. This time we have to take a significant piece of a market, but we also have to help accelerate that market.

How fast the industry adopts the 100 Gig technology and 500 Gig super-channels, I think it's too early to really declare. We're going to get smarter over the next six months as we get closer and closer to customers and real deployment plans. And I think that it's imperative that we help accelerate the 100 Gig market because if you look at the forecast today, it's not sufficient, most of the market continues to be at least viewed as being 10 Gig and 40 Gig. Our job is to help accelerate that 500 Gig PICs.

Nathan Johnsen
*Analyst, Pacific Crest Securities LLC*

Q

That's very helpful. Thank you.

**Operator**: Our next question will come from Sanjiv Wadhwani of Stifel Nicolaus. Your line is open.

David Kaczorowski
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Hi folks. This is Dave Kaczorowski in for Sanjiv. Most of my questions have been answered. You talk about the rev rec for the 40 Gig. We're in Q4 right now. Have you recognized revenue so far for the 40 Gig?

Ita M. Brennan
*Chief Financial Officer, Infinera Corp.*

A

No, we have shipped product associated with the 40 Gig product. Those deployments are subsea deployments with multiple countries and in multiple places of the world. So our caution around the rev rec is really for an acceptance to happen on some of those networks, we need all of those links to be completed by the end of the quarter. And so, our caution is really can we actually get all of those links completed more than it is anything to do with particular product or a particular customer.

**David Kaczorowski**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay. And can you talk a little bit about the competitive landscape in the 10G with the pricing pressure that we've been seeing, have there been any changes in that dynamic?

**Ita M. Brennan**
*Chief Financial Officer, Infinera Corp.*

A

No, I mean, I think pricing remains competitive. We continue to compete with -- in the 10 Gig space pretty effectively. We've continued to have good revenue traction around the 10 Gig products and we expect that to continue. But I don't think you are going to see any improvement and that pricing compression situation has been pretty consistent through the industry. Right? So I don't think you are going to see a dramatic change in how the 10 Gig pricing compresses. What we are seeing for us is that we now have 40 a Gig product to bring to the table when we are in some of those pricing negotiations?

**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

A

Yeah. We do not have to commercially respond with 10 Gig when 40 Gig or 100 Gig is required, and that's not been a position we've been in before. So we anticipate we're going to be able to stave off some of the commercial response we've had to make. And I agree with Ita that I would anticipate that 10 Gig overall pricing in the industry will continue on its trend of roughly 10% per year, that's been a metric that has held true with some variations for a very long time.

One of the comment on – that I'd just add to Ita's in regard to submarine and acceptance, anything that's not recognized in Q4, this business is ours assuming that they quality it, our anticipation is if things go as planned, we'll have an opportunity to recognize that in Q4. But when you're having to ship into multiple countries, the ingoing transactions are sometimes very, very inefficient, particularly in Third World countries and that's where a lot of our hesitation comes from. That revenue would be recognized, saying something remarkably challenging in Q1, but I would anticipate also – right now, the bulk of our transactions are around submarine, I would anticipate in the quarter, we would have some terrestrial opportunities which would be less likely to have an extended acceptance because it will be vastly North America.

**David Kaczorowski**
*Analyst, Stifel, Nicolaus & Co., Inc.*

Q

Okay, great. Thank you very much.

**Thomas J. Fallon**
*President, Chief Executive Officer, COO & Director, Infinera Corp.*

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

**Operator**: Thank you for your participation on the conference call. All parties may now disconnect.