23-Feb-2021

Infinera Corp. (INFN)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon and welcome to the Infinera Corporation Fourth Quarter 2020 Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note, this event is being recorded.

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

Amitabh Passi

Head-Investor Relations, Infinera Corp.

Thank you, operator, and good afternoon. Welcome to Infinera's fourth quarter of fiscal 2020 conference call. A copy of today's earnings and investor slides are available on the Investor Relations section of the website. Additionally, this call is being recorded and will be available for replay from our website.

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

These statements are subject to risks and uncertainties that could cause Infinera's results to differ materially from management's current expectations. Actual results may differ materially as a result of various risk factors, including those set forth in our Annual Report on Form 10-K for the year ended on December 28, 2019, as filed with the SEC on March 4, 2020; and our Quarterly Report on Form 10-Q for the quarter (sic) [quarter ended on] September 26, 2020, as filed with the SEC on November 5, 2020; as well as the earnings release and investor slides furnished with our Form 8-K filed today.

Please be reminded that all statements are made as of today, and Infinera undertakes no obligation to update or revise any forward-looking statements to reflect events or circumstances that may arise after the date of this call.

Today's conference call includes certain non-GAAP financial measures. Pursuant to Regulation G, we have provided a reconciliation of these non-GAAP financial measures to the most directly comparable GAAP financial measures in our fourth quarter fiscal year 2020 earnings release and investor slides, each of which is available on the Investor Relations section of our website.

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

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

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

Thanks, Amitabh. Good afternoon, and thanks for joining us today. I will begin with a brief review of the fourth quarter and full-year 2020 results, before discussing our expectations for 2021. I will then turn the call over to Nancy to cover the details of our financial performance and outlook.

Look, the fourth quarter was another strong performance quarter with solid execution across the board. Revenue came in line with our outlook, with non-GAAP gross margin and operating margin above the guidance range. On a year-over-year and quarter-over-quarter basis, we expanded margins, drove profitability and strengthened the balance sheet, while investing in technologies that will drive our future growth.

A notable achievement in the quarter was the generation of $40 million of free cash flow, which we believe is a key indicator of the progress we have made in improving the operational efficiency and financial health of Infinera. From a demand perspective, the quarter played out pretty well as we expected. While we did not see the typical year-end budget flush from our customers, we had a strong bookings quarter and ended the year with a book-to-bill ratio above 1.

Revenue from our ICP and other service provider customers was strong, including from EMEA and Asia Pacific regions, as was generally consistent with our expectations. Due to the diversified customer base we have, this strong demand helped offset demand softness in the industry experienced among Tier 1 North American service providers.

We won nine new customers across global ICPs, Tier-1s and other service providers for our 600-gig compact modular Groove GX platform, and made progress in advancing our open optical initiatives across the portfolio. We secured several 800-gig design wins and booked purchase orders from major ICP and a CSP customer in the quarter. We continued our efforts in qualifying and ramping the product, keeping to our timeline of a more meaningful financial impact from ICE6 in the second half of 2021.

We saw strong contributions in the quarter from our services and software annuity business, as our expanded footprint and value-added software drove healthy maintenance renewals. We remain focused on our investments in vertical integration, a scarce and highly differentiated capability in the industry.

As we look back to the full-year results for 2020, it's clear that the heavy lifting over the past few years to drive operational improvements is taking hold, as evidenced in our results. For the full year, we grew our non-GAAP revenue by more than 3% in a challenging environment, slightly faster than the growth in the overall optical systems market, as reflected by industry analysts.

We expanded our non-GAAP operating margin by nearly 600 basis points year-over-year, equating to $76 million in operating profit expansion; reduced inventory by $71 million; improved our cash flow from operations by $55 million; and ended the year with $315 million in cash and restricted cash. We did this while paying down accounts payable by nearly $100 million and investing close to $300 million in R&D and CapEx to fuel future growth.

From a product perspective, we had several highlights in 2020. Revenue grew in our compact modular Groove GX platform by almost 40% over 2019. And we added 32 new 600-gig customers for the year, including notable global Tier-1s and ICPs. We ended the year with a number two position in the compact modular market, a $1.5 billion market that is expected to grow 20% through 2023.

We achieved record revenue for the XTM metro platform, up 20% year-over-year, driven by 5G rollouts, working from home and mobile xHaul. During the year, we added 28 new XTM customers. We created additional customer traction with XR optics, as recently demonstrated with our technology trial with British Telecom, BT, who validated significant savings in an extensive study. XR optics received the award for the most innovative product at the 2020 ECOC industry conference in December. It's early days for XR optics, but we're optimistic that this innovative solution will open up a large market opportunity for Infinera and the industry for the future.

We made continued progress with ICE6 as we secured design wins, received purchase orders and delivered our first qualification units to a major customer prior to year-end. We feel confident in our ICE6 performance differentiation. We set new industry performance records in CSP and ICP trials in the fourth quarter, and are now focused on ramping production. As we have previously stated, we expect ICE6 revenue to begin its ramp in the second half of 2021, as we progress through the typical customer acceptance, certification and revenue recognition cycle.

Our pipeline is very strong and we are building backlog with additional design wins in purchase orders this quarter. To-date, our list of design wins in purchase orders includes well-recognized global Tier-1s, ICPs and other service providers.

I'm encouraged by the financial progress, operational improvements and technology innovation delivered by the Infinera team in 2020. We ended the year in a stronger position to achieve our target business model and our strategic goals. Looking ahead to 2020, we will be prudent in our outlook, especially with the first half of the year. For the full year, we expect the optical systems market to grow around 2% to 3% year-over-year, with growth weighted towards the second half of the year.

In the near-term, we are being cautious given the ongoing impact of COVID 19, newly developing semiconductor shortages that are not unique to our industry and extended lead times for some components. Looking longer-term, we see 2021 as a foundational year for us. We have a sound strategy and are well-positioned to execute. This is a great time to be a differentiated supplier of optical technology, and there is growing recognition of the market of the value we provide.

The dynamics we spoke of last quarter around bandwidth growth, accelerating a shift to open optical and the need for vertical integration are increasing in their importance. In addition, the geopolitical dynamics that are constraining Huawei's ability to grow have opened up a longer-term incremental $500 million to $1 billion annual market opportunity for us to pursue.

We see increasing RFP/RFQ activity, but it's early days and we would expect a more meaningful financial impact from these competitive displacements as we begin in 2022. For the full year, we expect to grow revenue slightly faster than the overall market, with a stronger second half as we see the impact of new products, including ICE6, GX and enhancements to our metro portfolio.

We will continue to prioritize our portfolio investments in high-value, fast-growing sub-segments of the optical market, including open optical, high-performance optical engines and differentiated pluggables. Lastly, we will remain laser-focused on operational excellence, expanding margins, driving profitability and generating cash flow for the full year.

Over the next few months, we will give you greater visibility into the growth drivers for our business as we lay out the key elements of our strategy, the market opportunity ahead for us and our path towards our long-term business model via a series of webcasts. The first of these events beginning in March will be extremely important in understanding the customer value proposition and market opportunity with open optical. We will culminate this series of events with a virtual Investor Day now being planned for later in Q2, where we will share additional details of our technology and financial road map to drive shareholder value.

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

Nancy Erba

Chief Financial Officer, Infinera Corp.

Good afternoon, everyone. Today, I will begin by covering our Q4 results and then provide our outlook for Q1. My comments reflect our non-GAAP results. For your reference, we have posted slides with financial details, including our GAAP to non-GAAP reconciliation, to our Investor Relations website to assist with my commentary. We expect that our Form 10-K will be filed with the SEC during the first half of next week.

We delivered another strong quarter with revenue in line with our outlook, and both gross margin and operating margin exceeding the high-end of our guidance range. Significant highlights in the quarter were our positive non-GAAP EPS and free cash flow generation, both of which were outstanding achievements to close the year in which we drove operational and financial improvements.

In 2020, we achieved revenue growth slightly above the market, meaningfully expanded operating margin, improved our cash flow and strengthened our balance sheet, all in the face of a global pandemic. The efforts we have undertaken to drive operational improvements are showing progress, as demonstrated by the leverage in our business model and non-GAAP operating profitability in the second half of 2020.

Q4 revenue was $354 million, near the midpoint of our guidance range of $340 million to $370 million, and up 4% sequentially in a challenging macroeconomic environment. 36% of our revenue came from the United States during a relatively weak quarter, characterized by industry-wide softness in Tier 1 carrier spending in the US, while internationally we saw strong growth in EMEA and Asia Pacific.

Gross margin was strong at 37.6% and above the guidance range of 34% to 37%. There were several factors that led to the strong gross margin performance, including better execution on cost reductions, growth of 600-gig products, strength in services, and modest improvement in the percent of vertically integrated products. Partially offsetting these positives were ongoing supply chain and logistics challenges, especially late in the quarter.

Operating profit in the quarter was $23 million or 6.6% operating margin, which was above our guidance range. Our operating margin in the quarter expanded by over 400 basis points, both sequentially and year-over-year, accomplished with stronger gross margin, lower operating expenses and productivity improvements, while continuing to invest in our key innovation programs.

Operating expenses of $110 million were lower compared to our $115 million to $117 million outlook range. While our continued focus on cost and spend management helped in the quarter, approximately $2 million to $3 million of costs related to R&D shifted from Q4 to Q1, and we had unforecasted benefits of $2 million.

The resulting EPS in Q4 was $0.13, driven by strong operating margin as well as certain items below the operating income line, primarily a $9.7 million foreign exchange impact from shift in the euro and various Latin American currencies. Excluding the foreign exchange impact, adjusted non-GAAP EPS in the quarter would have been $0.08 a share.

Moving on to balance sheet and cash flow items. We ended the quarter with $315 million in cash and restricted cash, up $100 million sequentially. Cash flow from operations was $52 million and free cash flow was $40 million, a significant improvement from the $192 million in free cash flow we utilized in the first three quarters of fiscal year 2020. The primary drivers of improved free cash flow in the quarter were higher profitability and working capital efficiencies.

We exited the quarter with $77 million drawn on our $150 million ABL. During Q4, we raised $62 million through our ATM offering for a total of $93 million in net proceeds raised in fiscal year 2020, and now consider the offering concluded. Regarding our capital structure, we are focused on building sustained cash flow generation through operational profitability, while maintaining access to ample liquidity to drive growth.

As I reflect on the full year of 2020, I am pleased with the financial improvement we made in the business. We ended 2020 with revenue of $1.36 billion, up 3.3% year-over-year; gross margin of 33.8%, progressively increasing through the year; and operating margin close to breakeven, up nearly 600 basis points year-over-year.

As mentioned previously, we exited the year with $315 million in cash and restricted cash. We generated free cash flow in Q4 and have our onetime cash outflows from integration largely behind us. Furthermore, we reduced inventory by $71 million, reduced both our past due accounts receivable and accounts payable, and completed a variety of process automation initiatives, while continuing to prioritize R&D investments in our strategic technology programs.

Looking ahead to the first quarter of 2021, we are planning for normal seasonality in our business, with revenue in the range of $320 million to $340 million. Incorporated into our revenue outlook is approximately $10 million of supply chain risk from COVID-19 and the industry-wide semiconductor shortages and lead times that David highlighted earlier.

We have, however, been taking preventative measures to minimize its risk going forward. It is important to note that against this backdrop of challenging supply chain dynamics, we are experiencing healthy demand in the current quarter. Despite normal seasonality, we expect gross margin to be in the range of 34% to 37%, up over 700 basis points year-over-year at the midpoint.

We expect Q1 operating expenses to be between a $121 million and $125 million, up sequentially as we increase spend on DSPs, optical engines and pluggables to complement the strong momentum in long-haul and subsea with ICE6 and in metro with Groove GX and XTM. These investments are in highly differentiated and valued technologies for us. Additionally, we will see normal seasonal increases in Q1 employee expenses, a step up as we restore bonus accruals and salaries for certain employees that were reduced last year.

We expect Q1 operating margin to be between a loss of 4% and breakeven, an improvement of over 700 basis points year-over-year at the midpoint. Below the operating income line, interest expense will be approximately $5 million and taxes are estimated at $3 million.

Finally, we expect to utilize $10 million to $20 million in cash from operations in the first quarter, a market improvement from the same quarter in the prior year when we utilized more than $90 million and were in the midst of heavy cash integration costs. Our operating improvement creates a solid foundation for us to take advantage of customer insertion opportunities, drive market share growth and expand margins as we become more vertically integrated.

For the full year of 2021, we are planning for revenue growth slightly above anticipated market growth, gross margin expansion of 300 to 400 basis points, positive operating margin, and to generate positive cash flow from operation. Our expectations remain tempered on the first half, with revenue expected to be flat to slightly up as compared with the first half of 2020. We expect second half revenue growth coming from both market improvement and the ramp up of revenue from our new products. As we have shared on prior calls, we plan to expand our gross margin to our targeted mid-40% range as we exit 2022.

I would like to close by thanking the Infinera team, our customers and partners for the tremendous effort in this difficult time, and our shareholders for their continued support.

Gary, I'd like to now open up the call for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] Our first question comes from Samik Chatterjee with JPMorgan. Please go ahead.

Joseph Cardoso
Analyst, JPMorgan Securities LLC

Q

Hi, guys. This is Joe Cardoso on...

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

A

Hey, Samik. How are you?

Joseph Cardoso
Analyst, JPMorgan Securities LLC

Q

Hi. This is actually Joe Cardoso on for Samik. Thanks for the question here. I guess, my first question just has to do with – you guys have been seeing good momentum over the past couple of quarters around your metro platform, your modular platform and your 600-gig solution. And if we could bifurcate those for a second, how do you feel about your sustainability around the momentum you've seen in those product lines, particularly heading into 2021, and what is driving your confidence or visibility into that momentum?

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

A

Yeah. It's customer wins and insertion opportunities. So, I think the metro is continuing to grow. We continue to invest in those products going forward and we continue to see a nice sales pipeline and backlog to be able to fulfill. So, obviously, we think it's a healthy demand environment from a bandwidth prospective, and we've put the right investments in place to have the right products to serve the demand.

Joseph Cardoso
Analyst, JPMorgan Securities LLC

Q

Got it. And then if I could just switch gears here. Obviously, it doesn't necessarily come to a surprise that North American Tier 1 service provider customers were weak this quarter. I guess, can you kind of just dive into your visibility, what are you hearing from customers there as we kind of look into 2021? Like, what are they communicating to you in terms of their investment priorities? I'm assuming part of their guide there in terms of the second half recovery or a second half market growth is particularly [ph] like (22:28) around them kind of returning to investments. But just curious to hear what your visibility into it and what you're hearing from your customers specifically. Thanks.

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

A

Yeah. It's a good question. I think certainly the market analysts are predicting what the CapEx gains will be this year. That certainly was a decline year-over-year in Q4. Again, one of the advantages we have from our diversified customer base is that really didn't impact us greatly in Q4, as it did to some of our competitors.

As we look forward, look, I think traffic continues to grow in the core of their network, in the backbone. Data center infrastructures continue to get moved for hyperscale application loads. People continue to buy new iPhones that not only download a healthy video that is close to 50% of the traffic on the mobile network, but are now starting to upload, a new dynamic, are now starting to upload all their content to the cloud to back it up.

And so, look, I believe that there's always a pause at the beginning of the year, as people lay out their capital budgets with those large service providers. But they've got to continue to keep up with that bandwidth expansion, as I think you've seen from some of the public information coming from some of those large Tier-1s.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Thank you. Operator, [indiscernible] (23:52).

Joseph Cardoso
Analyst, JPMorgan Securities LLC

Q

Got it. Appreciate the insight.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Thank you.

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

A

No, appreciate it.

Operator: The next question is from Rod Hall with Goldman Sachs. Please go ahead.

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

A

Hey, Rod.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. Hi. Thanks for the question. I wanted to, I guess, come back to the supply constraint and ask you guys what you've factored into your 2021 revenue guidance for supply constraint, or have you factored that in? And is there any potential for that supply constraint to be lifted?

And then, secondly, I wonder if you could talk, David, a little bit, you said the second half of the year you think will accelerate. What kind of growth do you expect in the second half? I guess, you'd expect kind of mid-single digit. And do you – and what do you think the drivers of that growth are in the second half of the year? Thanks.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

Sure, Rod. I'll take the first part and then David can go to the second. In our outlook of $340 million to $370 million in Q1, we have $10 million built into that for, I'll call it, risk to the supply chain. All that said, we are actively working every single day to mitigate that risk. Teams are working really hard to do that. So we've got it built into our outlook and we're doing our best to mitigate it.

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

A

Yeah. And the second part of your question...

Rod Hall
Analyst, Goldman Sachs & Co. LLC

(

Can we – just to clarify that, you...

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

A

Yeah. Go ahead.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Yeah. I just want to make sure I got that. So you're saying $10 million for the full year is what you're factoring in or was that just Q1?

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

A

Q1.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

Just Q1.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Okay. And I was asking about the full year.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

So we aren't giving full-year guide at this point. We are going to be working through these constraints. We started to see them at the end of Q4 and are in the midst of it right now. We're going to do our best to mitigate them in the first half.

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

A

Yeah. You can think in the first half when you look at the supply chain...

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Great.

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

A

Rod, when you look at the first half at the supply chain shortages, typically that number of $10 million represents a pretty good number in terms of risk of what we see for the front half of the year. And we'll continue to work to try to mitigate anything for the back half of the year. But that's kind of all contemplated in our internal plans as we go forward. And we'll be more thorough in our Q2 view as we go into Investor Day with the remainder of the year.

To your second question, just as we look at the rollout of new technologies and our new technologies that are loaded into our portfolio, both 600-gig, 800-gig and our metro products, that will really be driven into the back half of the year based on, again, customer trial, certification and the revenue recognition process. We see big drivers for growth in the second half being this move to compact modular systems, with open line systems allowing us new insertion opportunities on a global basis. So, 5G is continuing to roll out, bandwidth is continuing to grow and, again, the nature of that bandwidth, both uplink and downlink, is going to be a big driver for the next couple of years.

Rod Hall
Analyst, Goldman Sachs & Co. LLC

Q

Okay. Thanks a lot, David.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Thanks, Rod.

Operator: The next question is from John Marchetti with Stifel. Please go ahead.

John Marchetti
Analyst, Stifel Financial Corp.

Q

Thanks very much. David, I was wondering if you could spend a minute just talking about some of the strength that you saw sequentially in the European and Asian markets. I understand the weakness in North American Tier 1, but those markets were a little bit stronger on a sequential basis. I'm curious if you're seeing the release maybe of some pent-up demand as stuff was delayed through the bulk of 2020 and now some of that's easing up? Or if it's the result of new footprint wins or something along those lines?

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

A

Yeah. I think, in Asia, we had some new footprint wins and some opportunities, obviously, given both the pent-up demand in the front half and the better competitive environment for us in Asia. So we had some nice wins there, again, more along the lines on our metro portfolio.

And in the Europe market, traffic continued to diverse across continents. And so we continued to be very well positioned in that market to be able to drive that growth as well. And obviously, on a weighted average basis, against the weakness in the overall North American market, that was a good thing for us in the quarter.

John Marchetti
Analyst, Stifel Financial Corp.

Q

Got it. And then, Nancy, if I can just ask a quick question on the services side. We've had a couple of good quarters of growth. You mentioned you had some renewals. I mean, do we expect that to trend sort of with revenue? As we go forward here, is there more sort of catch-up to be done on the services side? Because that's obviously been part of the margin expansion story as well. Thank you.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

Sure. Good question. Yeah. Q4 is typically the quarter when we start – we see these renewals. So it was a good Q4 for us. And we will expect and do expect to see services continue to grow with the revenue base. So we're really pleased with the business, the work the team has been doing in a very challenging environment right now to get out and work with our customers.

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

A

And that's the value of growing the embedded base and having the appropriate software to drive those renewal opportunities and create those software annuities for us. Anything else, John?

John Marchetti
Analyst, Stifel Financial Corp.

Q

No, that was it. That was my follow-up. I didn't want to get greedy.

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

A

Okay. Thanks, John.

Operator: The next question is from Alex Henderson with Needham & Company. Please go ahead.

Alex Henderson
Analyst, Needham & Co. LLC

Q

Thank you very much. First, just a clarification, you gave book-to-bill. Was that the book-to-bill for the fourth quarter, or was that book-to-bill above 1 for the full year, or both?

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

A

So, given we don't provide quarterly book-to-bill, we had a strong bookings quarter in Q4 but that was book-to-bill guidance for the year.

Alex Henderson
Analyst, Needham & Co. LLC

Q

For the year, great. What I really wanted to ask is the commentary around the geographies. You had some pretty clear strength in Europe and APAC. Are those installations that are ongoing and therefore we should expect that to continue? And similarly, if there was a singular point of pressure at a Tier 1 in the US, is that something that we should anticipate will continue as we move forward because of a change in their spending patterns? Or was that particular downdraft in the US simply a function of timing of programs?

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

A

Thanks. Hey. It's a good question, Alex. Yeah. No, from your US question, it's 100% timing. We're continuing to position well with the US service providers and Tier-1s. To your question of international, we've been working really hard to expand our footprint. And so, again, we're going to have – we've been laying out some good line systems over the last two quarters and expect that to continue over the next two quarters. And we're seeing the growth from those.

And we talked about some new wins last year that we won in the Asia Pacific marketplace and those are beginning to bear fruit, which is a nice thing. So I would expect to see that continue, albeit these things ebb and flow on a quarterly basis.

Alex Henderson
Analyst, Needham & Co. LLC

Q

And then for the follow-up question, if I could, no mention of Huawei in anything that's been said so for. I assume that you're seeing significant change in the status of Huawei at a lot of your customers or potential customers. Can you give us some context and some sense of what kind of momentum there might be in winning new customers, new footprint from either a 800-gig or from the Huawei replacement opportunity?

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

A

No. Thanks, Alex. Yeah. I think we're just trying to be cautious not to get ahead of our skis in pounding this one too hard. We are seeing a tremendous uptick in RFP/RFQ activity. We are bidding deals. We are getting design wins. And as you know, by the time we get the gear ordered, deployed, out there and scored as revenue, we just expect that to be a growth dynamic as we get into 2022. But it is accelerating. But as you probably heard from others in the industry, it is a multiyear gain, of which we expect to see the first appreciable uptick as we exit 2021 into 2022.

Alex Henderson
Analyst, Needham & Co. LLC

Q

Great. I appreciate the answers. Thank you.

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

A

No, thanks, Alex.

Operator: The next question is from Simon Leopold with Raymond James. Please go ahead.

Simon Leopold
Analyst, Raymond James & Associates, Inc.

Q

Great. Thanks for taking the questions. First thing, I wanted to just maybe unpack the gross margin forecast a little bit. I'm trying to understand the sequential decline you're guiding to. Volume is not down all that much, and I'm just wondering how much of the sequential decline is because you had a very favorable customer mix in your fourth quarter or if there are other issues in the supply chain. But maybe if you can help build a bridge between Q4 and the Q1 guide gross margin? Then I've got a follow-up.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

Sure. Well, Q1, you know this, is normally a seasonally down quarter, right? So there is impact on margin from that. But as we look at the mix we're expecting for next quarter in terms of the product mix, that's going to have an impact. And we're going to continue to try and drive and focus on the same things we've been focusing on, which is insertion opportunities, which is driving cost reductions and which is providing excellent service to our customers.

As we look forward, we plan for the year to expand gross margins 300 to 400 basis points. So, that full-year expansion is similar to what we have been saying for the last year or so. And we continue to see our ability and are confident in our ability to achieve that margin expansion for the full year.

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

A

Yeah. I would say there is a bit of mix in terms of line system deployment that we intend to see. But let's not forget, and I know last year Q1 is a terrible compare because we're up 700 basis points to the midpoint, but we are feeling more confident. And again, last year we talked about our margin expansion of 200 to 400 basis points after we got off our Q1 call and that was delivered in 2020. We expect and are confident in that 300 to 400 basis points in 2021.

Simon Leopold
Analyst, Raymond James & Associates, Inc.

Q

Great. Thank you for that. And then, as a follow-up, I wanted to dig in a little bit deeper on the longer-term Huawei opportunity. I appreciate the timing issues, that I get.

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

A

Yeah.

Simon Leopold
Analyst, Raymond James & Associates, Inc.

Q

What I'm trying to gain is really a better understanding of your competitiveness. If we consider the fact that Transmode was a European asset, you have the root set in Nokia Siemens Networks, also a European domiciled asset, you clearly have relationships in Europe. So, with that kind of as a backdrop, how do you see your ability to take some of that Huawei share versus your closest competitors in that market?

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

A

Yeah. I think as we continue to invest in innovative technologies and the right feature sets to get there, I think we're uniquely positioned. And as you mentioned, Huawei, certainly there's an opportunity there and maybe some of the other suppliers that could step up to that are going through their own vulnerabilities at this stage. So I think we're very well positioned to go through it. We've got resources all over this and are treating this as a very focused go-to-market activity for our company. We just, again, don't want to get ahead of our skis here in terms of expectations.

Simon Leopold
Analyst, Raymond James & Associates, Inc.
Q

Thank you.

Amitabh Passi
Head-Investor Relations, Infinera Corp.
A

Thanks, Simon.

Operator: The next question is from Meta Marshall with Morgan Stanley. Please go ahead.

Meta A. Marshall
Analyst, Morgan Stanley & Co. LLC
Q

Great. Thanks.

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

Hey, Meta.

Meta A. Marshall
Analyst, Morgan Stanley & Co. LLC
Q

Hey. Just a couple of quick questions. Just in terms of as 800-gig gets rolled out over the next year, just are there still ICP or major customers of Cloud Xpress that still need to be moved to Groove before – we can kind of assume shorter upgrade cycles from Groove to 800-gig versus the bigger lift that might need to be from Cloud Xpress to kind of the Groove platform in general? And then maybe second question, just is there still a gross margin drag from kind of a ICP customer on 200-gig versus 600-gig, or is that headwind gone away at this point? Thanks.

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

No, both excellent questions. So, on the first one, on these compact modular platforms, it's a lot easier to insert into that environment because, quite frankly, you can have co-existence or rip and replace, just like servers are in data centers.

So, when it comes to the opportunity, don't forget we're still selling a lot of 100-gig, 200-gig, and we're still selling the Cloud Xpress platform, XT platform as we go. So, that is not one that disappears. Those tend to have very long cycles. Now, we believe 800-gig will be a very long cycle. We think this is a four to six years cycle product as we get it out into the marketplace.

On your second question, yeah, absolutely, in some of the product categories where we're not vertically integrated, that can have a drag and still has a small drag on the company. And I would expect that to continue through 2021 and as we get into 2022, for that based on product cycles to really begin falling off.

Meta A. Marshall
Analyst, Morgan Stanley & Co. LLC

Q

But just in terms of – I thought there was a ICP customer who had started their transition to 600-gig and away from 200-gig, which was particularly kind of detrimental to gross margins. Just any progress there on that specific customer being a definitive headwind?

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

A

Yeah. So, as we mentioned, our 600-gig sales did go up in Q4 and in particular with an ICP. So, that was contributory to the margin increase that we experienced in Q4 as we predicted earlier in the year.

Meta A. Marshall
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thanks.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Thanks, Meta.

Operator: The next question is from Jeff Kvaal with Wolfe Research. Please go ahead.

Jeffrey Thomas Kvaal
Analyst, Wolfe Research, LLC

Q

Yes.

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

A

Hey, Jeff.

Jeffrey Thomas Kvaal
Analyst, Wolfe Research, LLC

Q

Thanks very much. Good afternoon, everyone. I am hoping maybe to broaden the competitive landscape competition question a bit. You mentioned vulnerabilities from some of your rivals impeding their ability to take away share from Huawei.

It sounds as though maybe there are some opportunities to take share from other folks other than Huawei, that would be very, very helpful. Thank you.

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

A

Yeah. I just – I think when we look at the overall optical market, right, it's a very large market with many players in it. But when we look at it, the number one player is Huawei, and obviously there's a vulnerability there. The number three player there is Nokia and certainly they're going to go through it. It's publicly acknowledged they're going through their own portfolio rationalization and their prioritization of their resources, which I would imagine are very weighted on 5G.

And when we look at the technology cycles of where they've invested, they have not invested in that 800-gig cycle as well. So, look, what a difference a year makes? For us, we are now in the financial position, the operational position and the technology position to play a little bit of offense. And again, now we're really being mindful, but we think that there's opportunity for us to grow our share in the future. This is a foundational year for us to really set our feet on solid ground and in the back half of the year to really begin with that share gain and with the Huawei opportunity as we get into 2022. Did that help?

Jeffrey Thomas Kvaal
Analyst, Wolfe Research, LLC

Q

Yes. Yeah, that that's where I was hoping you would go. So, thank you. My follow-up is a similar question just on the DSP side. Now that we've got pretty good visibility on the Acacia deal closing, I'm wondering if you have further comments on how Acacia being part of Cisco may change the competitive dynamics in this space.

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

A

Look, I think since the company was founded, Tom and Dave have talked about the importance of vertical integration. It's one of the things that recruited me here to the company because it is such a valuable asset, as bandwidth continues to grow and as these systems go at higher and higher speeds and bigger and bigger waves.

So, look, I think it's essential for companies to have scale and vertical integration, which is why we are investing a significant portion of our R&D dollars in that portion of the market. And it just so happens we're doing that at a time when people can open up line systems to let the best transponder win. And as you know, our aim is always to build the best product to drive that price performance dollar per bit spectrum efficiency on a go-forward basis.

So, look, we're going to take every competitor very seriously. I think that Cisco-Acacia is now – will be positioned as a vertically integrated scaled competitor. And we look forward to meeting them in the market as they complete the transaction. So, pretty profitable week for Acacia for that one week that they broke up.

Jeffrey Thomas Kvaal
Analyst, Wolfe Research, LLC

Q

Yeah. Yeah, it was. Not bad. Okay.

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

A

So it's the value of vertical integration...

Jeffrey Thomas Kvaal
Analyst, Wolfe Research, LLC

Q

Thank you both very much.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Thank you, Jeff.

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

A

All right. Thanks, Jeff.

Operator: The next question is from Jim Suva with Citi. Please go ahead.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you very much. I know you mentioned that you expect, like, the market to grow next year and for you to outgrow that. Can you talk a little bit about seasonality for this year for the quarters? You mentioned kind of seasonal for the March quarter, but I am wondering about beyond that. And not really comparing it to last year because last year was COVID, but any comments on seasonality on revenues or costs that we should be mindful of? Like, are there additional merit increases coming on or seasonality, something that we should be mindful of versus your historical excluding COVID? Thank you.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

Yeah. Good question, Jim. As I mentioned in the prepared remarks, we're expecting the first half of the year to be flat to slightly ahead of the market and ahead of what we did last year, with growth really coming in the second half of the year.

In the first half and in the first quarter in particular, you're right, we do have increased employee costs, which are normal for the first quarter of the year as taxes and other payroll impacts take effect. And then, for us explicitly, in 2020, as we were really focused on driving profitability in a COVID environment, we did take salary reductions for certain employees and reduced bonus. So those will be added back in the year as well.

But really the year in total growing slightly ahead of the market, really important. We are driving profitability. We plan to be cash flow from operations positive, generating cash and expanding our margin 300 to 400 basis points.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Okay. And then my last question is, your commentary of growing slightly more than the market, people different parts of the country view slightly differently. Is that kind of 100 to 200 basis points? Is that kind of 300 to 500 basis points? I'm just kind of curious, what's a general view of how you define slightly, if possible, or at least help us bracket it, so we don't over-exaggerate or get too ahead of ourselves.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

I would say, 1% to 2%, I mean, low-single digit, right...

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Got you. Yes.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

...above market.

Jim Suva
Analyst, Citigroup Global Markets, Inc.

Q

Thank you so much. Yeah, above the – that's above the market. Thank you so much for your details and quantification. Just greatly appreciate it.

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

A

Thanks, Jim.

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

George C. Notter
Analyst, Jefferies LLC

Q

Oh, hi, guys. Thanks very much. I guess, I wanted to ask about the ICE6 contribution in the year. So, as you look at that top line growth you expect for the year, is ICE6 a big contributor there? Is it 5 points of revenue in the year, 10 points? I mean, any kind of ZIP code you could give us around that would be great.

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

A

Yeah. We plan for the back half financial ramp that, again, we continue to mention we'll start based on the revenue recognition cycles. We're not expecting that to be -- based on port shipments – when you look at total port shipments, we're not expecting that to be a double-digit contributor, a large double-digit contributor in 2021. We're expecting the orders and backlog that we get throughout the year to set up for a nice back half exit to the year and a really healthy ramp in 2022.

George C. Notter
Analyst, Jefferies LLC

Q

Got it. And then just to clarify, when do you expect the initial rev rec on ICE6? Is that Q1 then or is it Q2?

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

A

As we said, the ramp of anything meaningful that we think you want to pay attention to would be in the second half.

George C. Notter
Analyst, Jefferies LLC

Q

Got it. Okay. Great. And then there's also – I think there was some development going on, on a DTX (sic) [DTN-X] version of ICE6 that's more oriented around carrier customers. Is that still under development and when might that be coming to market?

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

A

Again, we've got a whole host of ICE6 developments coming to the market. Our first products coming out are both for the ICP as well as the CSP customers. But over the next 18 to 24 months, we'll continue to have both performance enhancements as well as additional products coming in the market. But that first product on the GX platform is honed both for the ICP as well as the CSP market in terms of features and functionality. And we've already received purchase orders from both ICPs and large CSPs for them.

George C. Notter
Analyst, Jefferies LLC

Q

Got it. Okay. All right. Very good. Thanks a lot. I appreciate [indiscernible] (47:41).

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Yes. Thank you.

Operator: The next question is from Ryan Koontz with Rosenblatt Securities. Please go ahead.

Ryan Koontz
Analyst, Rosenblatt Securities, Inc.

Q

Hi. Thanks for the question. Circling back to the ICP topic, pretty good quarter there. How would you characterize your business there? Is it mostly long-haul or more metro DCI? And how would you characterize a threat from ZR to that business? Thanks.

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

A

Yeah. No, it's a good question. The threat from ZR, everybody continues to – this has been an ongoing discussion for a couple of years. And I think as ZR comes in, folks using the optic for ZR and ZR+ in the metro I think has been sized by [indiscernible] (48:26) 2024 to be about an $800 million, $900 million market out of a $12 billion-ish market opportunity.

We do have a good mix of business with the ICPs. It is both in metro DCI, long-haul and subsea. And those are areas in ultra long-haul and subsea where you will not see ZR based on reach and you will not see ZR+ based on spectral efficiency or reach performance. So we continue to view ZR and ZR+ when it gets here as a nice cost reduction for our metro opportunities. and again, the forecasts continue to come in. When those products will be available, we're very active in that since we have the compact modular platforms that can use those as well. And again, it's not a huge impact to the overall market. Again, I think you're showing me now it's closer to 400-gig to 600-gig...

Ryan Koontz
Analyst, Rosenblatt Securities, Inc.

Q

Right.

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

...by 2024 of the total.

Ryan Koontz
Analyst, Rosenblatt Securities, Inc.
Q

Okay. [ph] That 2023. (49:32) Super helpful. And just a quick clarification. On the $10 million supply chain impact, is that...

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

Yeah.

Ryan Koontz
Analyst, Rosenblatt Securities, Inc.
Q

...included in the guide that's at risk or is that above the guide that is pushed out?

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

So the guide excludes the $10 million that we would have been able to get...

Ryan Koontz
Analyst, Rosenblatt Securities, Inc.
Q

Yeah. Perfect.

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

...if those conditions did not exist.

Ryan Koontz
Analyst, Rosenblatt Securities, Inc.
Q

Yes. Perfect. Thanks so much.

Amitabh Passi
Head-Investor Relations, Infinera Corp.
A

Thanks, Ryan.

Operator: The next question is from Tim Savageaux with Northland Capital Markets. Please go ahead.

Tim Savageaux
Analyst, Northland Securities, Inc.
Q

Hey. Good afternoon.

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

A

Hey, Tim.

Tim Savageaux
Analyst, Northland Securities, Inc.

Q

Hey, there. I'll try not to ramble here, but hopefully you'll see where I'm headed. And the question about the dynamics in Q4, I thought you guys were pretty sanguine about the Tier 1 issue on the last call kind of looking forward. And obviously you saw some pretty significant declines. I assume you didn't have any 10% customers in the quarter, maybe not even for the year, but could be close.

I don't know if you address that, and that's sort of parenthetical, but given the degree of weakness with your historically largest customer, I mean, did that come somewhat as a surprise and were you able to then proactively offset with opportunities in Europe and Asia? It seems like you did have receivables extend and some of that dynamic could have been there. I'm just interested in your thoughts on that.

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

A

Thanks, Tim. So, certainly, our number one customer was an 11% customer for the year.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

For the year.

Tim Savageaux
Analyst, Northland Securities, Inc.

Q

Okay.

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

A

And look, those large customers ebb and flow. So, the likes of the Verizons, the AT&Ts, companies like that ebb and flow. I think we saw the North American service provider CapEx on the top was down year-over-year 22% or so. And I think that was experienced by a lot of the competition in terms of their guide.

We just have a more diversified customer base. We are winning insertion opportunities in those Tier-1s, which, as you know, take time to be able to scale and grow. We do believe, again, those Tier-1s are expected to grow their CapEx. And we're expecting that to really take more of the effect in the second half of the year, which I think is consistent with other companies in our infrastructure space in terms of what they're seeing.

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

And on your comment on the DSOs, remember that in Q4 we have the renewals for the services piece, so that tends to bump up DSO in Q4.

Tim Savageaux
Analyst, Northland Securities, Inc.

Q

Got it. And if I could follow up briefly. I mean, I think...

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

A

Sure.

Tim Savageaux
Analyst, Northland Securities, Inc.

Q

...what you saw there with that customer was a pretty broad-based shutdown that impacted a lot of different people. So, that's more kind of along the lines of program timing. Although, as we head forward, to what extent does competition share shifts at that customer or other large North American customers impact your first half or your annual guide relative to some of the supply issues and other factors that you mentioned? Thanks.

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

A

No, I appreciate that. Again, based on our customer mix, Tim, we have more to gain than to lose there. So it's been factored in our current outlook, factors in a lighter spending from Tier-1s in the front half and a heavier in the back half. And again, we've got, as Nancy said, a pretty strong start to the quarter. We're just not going to get ahead of our skis. We have a nice pipeline, our product portfolio is feeling good and it's time for us to execute. But, again, we're trying to be very mindful of the front half of the year given the market conditions.

Tim Savageaux
Analyst, Northland Securities, Inc.

Q

Okay. Thanks.

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

A

Thanks, Tim.

Operator: The next question is from Fahad Najam with MKM Partners. Please go ahead.

Fahad Najam
Analyst, MKM Partners

Q

Thank you for taking my question. I have a couple of questions, if I may. One kind of focused on the near-term on, if I look at the 800-gig opportunity with ICE6, if I were to compare this to your leading competitor, I think they've mentioned they have [ph] 5,000 modems (53:52) shipped to almost 70 customers. By my math, that suggests that they're probably seeing a 2x ramp in their 800-gig shipment versus any previous upgrade cycle. Can you share with us how many design wins you've had? I may have missed it. And can you quantify what kind of a ramp or magnitude of ramp you are seeing with 800-gig design wins? And then I have a longer-term focused question.

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

A

Yeah, it's good. Yeah. No, it's good. So, Fahad, good question. I think in the first piece, the pipeline and demand in front of us is strong and continuing to grow. So it's surprisingly strong given past generations of technology. So, that's good. As we mentioned, we closed several purchase orders and design wins in Q4. Those continued to build in Q1. And as we get into our Q1 results and into our Q2 Investor Day, we'll be able to kind of start plotting that course. But it is – I agree with you, it is going to be a steeper and longer curve than previous technology generations in our opinion based on the facts that we see in front of us. You had a second question?

Fahad Najam
Analyst, MKM Partners

Q

Yeah. So, on your comment about component shortages and your book-to-bill, I just want to make sure I understand that your book-to-bill comment doesn't factor in any kind of push-outs of revenue that you may have booked this quarter that was impacted. First, if that's the case, do you see any revenue impact this quarter from component shortages? And is the book-to-bill kind of being driven by any kind of over-ordering by your customers who are concerned about component shortages throughout the year?

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

A

Yeah. It's a good question. And Nancy will jump in here. But I think – no, I mean bookings – our book-to-bill ratio that we look at was to give you color that our bookings in Q4 were strong and that we ended the year with more bookings than revenues, so we're carrying backlog.

The suggestion on the supply chain, we did start to see this in Q4. And it's not just the semiconductor shortages but also COVID. And I think, Nancy, that was about $5 million of impact-ish...

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

Yes.

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

A

...to our quarter that, again, will always impact, even more heightened as you end the year. And as we go forward, as we said, that's a $10 million impact in Q1, given some of the lead times associated with some of the semis that are coming out. Some have been quoted as moving from 16 weeks or 14 weeks to 30 weeks or 52 weeks. Now, we saw this early and saw our supply chain began to react because we're in the right working capital position that we're in. Thank you, Nancy and team. We are in a much better position to respond and our supply chain team is doing a nice job there.

Fahad Najam
Analyst, MKM Partners

Q

Got it.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Thanks, Fahad.

Fahad Najam
Analyst, MKM Partners

Q

Appreciate it.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Thanks, Fahad. Next question?

Operator: Next question is from John Roy with Water Tower Research. Please go ahead.

John Roy
Analyst, Water Tower Research LLC

Q

Great. I wanted to take a step back a little bit. I know we're getting near the end here. And I wanted to talk about how much you're being held back by COVID? Do you feel that if things get better in the next nine months or whatever and then the vaccines go through et cetera that you really could see an acceleration of things? Or are you pretty much going as fast as you can? Was really curious as to how much you feel like you're being held back by the lockdowns.

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

A

Yeah. I mean, it's hard to quantify. Everything is harder in COVID, servicing, equipment, rolling new technologies out, everything across the board is certainly harder in a COVID environment. But, yeah, look, the team buckled down. And if you look at the results as we are in Q1 now and where we were last year, I think we accomplished a heck of a lot in that environment.

Now, customer spend and ability to get new technologies, implement across borders, and implemented I think you've heard that across. But at this point in time, we're not going to look what the annual number in the uptick be if went away because we're just not thinking that way. We're thinking, hey, we built a solid foundation. We're in an entirely different spot now than we were last year and we're trying to, again, as I mentioned, move from that defense to offense because we think there is a real market opportunity in front of us. Regardless of whether there's COVID, supply chain shortages, our job is execute with any market condition that surround us.

John Roy
Analyst, Water Tower Research LLC

Q

Right. That's great. And also maybe in the future, as these things progress, obviously any kind of [indiscernible] (58:51) things changing on the COVID front from your supplies and your demand would be greatly appreciated, so we can know at least what you're seeing. And that's it for me.

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

A

Yeah. We're trying to do that. It's a good point. We're trying to do that by incorporating it, giving you the color on what impact we kind of saw in Q4, what impact we're seeing in Q1, trying to be mindful and give you that data, so you can kind of digest it.

John Roy
Analyst, Water Tower Research LLC

Q

Great. Thank you.

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

A

All right. Thank you.

Amitabh Passi
Head-Investor Relations, Infinera Corp.

A

Operator, we'll take one last question.

Operator: And that question is from Jon Lopez with Vertical Group. Please go ahead.

Jon D. Lopez
Analyst, The Vertical Trading Group LLC

Q

Hey. Thanks very much. I just had a clarification and then one question. Nancy, the deferred in Q4 was pretty strong. It looks kind of, I don't know, upper end of seasonal, perhaps a bit better. Is that all just the services renewal or was there any product contribution in there? Can you just maybe talk a second about what drove that?

Nancy Erba
Chief Financial Officer, Infinera Corp.

A

Sure. It's both. So, services certainly drive the deferred revenue you see in Q4. But as we've talked about, we're seeing good demand and we did see increase in both product as well as services in Q4.

Jon D. Lopez
Analyst, The Vertical Trading Group LLC

Q

Okay. Great. And then I just want to come back to the Tier 1 side for a quick second. If we kind of take that one big customer out, your Tier 1 business for the year – for the quarter and for the year was actually quite strong. I mean, it looks like you grew kind of double-digits for the year in what was in a terrific environment. I guess I'm just wondering, can you just talk a bit about what drove that portion of the business specifically, kind of Tier 1 ex the big customer? Was there anything one-timey, COVID-related in 2020? And is that sort of a sustainable base that you think you can build from in 2021 and beyond?

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

A

A sustainable basis, especially when you compare to the competition. And in a lot of these Tier-1s, as I mentioned, we have more opportunity in front of us than risk. So, all of their infrastructure build...

Jon D. Lopez
Analyst, The Vertical Trading Group LLC

Q

Very good. All right. Thanks for the help.

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

A

All of their infrastructure builds more opportunity than risk.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to David Heard for any closing remarks.

David W. Heard

Chief Executive Officer & Director, Infinera Corp.

Yeah. No, I appreciate everybody's thoughtful questions. What a year – what a difference a year makes for us. 2020 was a solid year for Infinera. I would like to thank our customers, suppliers, partners and our shareholders, and especially our employees who braved the global pandemic to do some really heroic things on behalf of our customers and the overall ICP community to keep the world humming and to keep bits going across and keep the world connected.

We're really excited for the opportunities that we face in 2021, and I will tell you, our focus, our laser focus is on execution. So, thank you all, and be well.

Operator: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.