FINISAR CORPORATION

Moderator: Jerry Rawls
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OPERATOR: This is Conference #61565276

Operator: Good afternoon, ladies and gentlemen. Welcome to the Finisar Corporation First Quarter Results Conference Call. A quick reminder, today's call is being recorded.

At this time, I would like to turn things over to Mr. Jerry Rawls, Chairman and CEO. Mr. Rawls, the floor is yours.

Jerry Rawls: Thank you, Sarah. Good afternoon, everyone. We appreciate your taking the time to listen to our conference call today.

A replay of this call should appear on our website within eight hours. An audio replay will be available for two weeks following the call by dialing 1-(855)-859-2056 for domestic, or 1 (404) 537-3406 for international and then follow the prompts and enter conference ID 61565276.

I need to remind all of you that any forward-looking statements in today's discussion are subject to risks and uncertainties which are discussed at length in our annual and quarterly SEC filings.

Actual events and results can differ materially from any forward-looking statements. In addition, the company undertakes no obligations to update any forward-looking information presented.

Unless otherwise indicated, all results discussed are on a non-GAAP basis. A complete reconciliation of our GAAP to non-GAAP results may be found in our earnings press release and in the Investor Relations section of our website.

We have prepared some slides for today's earnings call. You can view them by connecting to the Investor Relations page of our website at finisar.com. Click on Investors and then scroll down to Webcast Archives and click. You'll see a listing for today's first quarter 2018 earnings call.

Now before we discuss the quarter, I wanted to comment on yesterday's press release announcing my intention to retire sometime in the next year or so as the CEO of the company.

Since Frank Levinson and I started the company nearly 30 years ago at Quonset hut in Menlo Park, the company has far exceeded my expectations. It has grown to be one of the world's stop optics companies, with industry-leading revenues last fiscal year of more than $1.4 billion.

I would like to thank all the employees of Finisar for their efforts, as well as our customers for their support in making this happen.

While I will miss working at Finisar on a day-to-day basis, I am confident that we have laid a solid groundwork for continuing to build on the company's success and its market-leading position. Now on to the quarter.

We experienced strong demand in our first fiscal quarter for our 100-gigabit QSFP28 transceivers for data centers. However, our overall revenues for the first fiscal quarter were $341.8 million, a decrease of $15.7 million or 4.4 percent compared to the fourth quarter of fiscal 2017.

This decrease resulted primarily from a decline in telecom revenues and 10-gig and below datacom transceivers.

Now I'll that Kurt to review the rest of the numbers. Kurt?

Kurt Adzema: Thanks, Jerry.

Sales of datacom products decreased by $8.4 million or 3.1 percent compared to the fourth quarter of fiscal 2017, primarily as a result the lower sales of our 10-gig and lower transceivers, partially offset by increase of sales of 100-gig QSFP28 transceivers for datacom applications.

Sales of telecom products decreased by $7.4 million or 8.1 percent compared to the fourth quarter.

In the first quarter we had 2 10 percent or greater customers.

Our top 10 customers represented 62.5 percent of revenues compared to 58.9 percent in the fourth quarter.

Non-GAAP gross margins were 34.9 percent compared to 36.2 percent in the fourth quarter, primarily due to lower revenue levels.

Non-GAAP operating expenses were $73.2 million compared to $71 million in the fourth quarter.

Non-GAAP operating income was $46 million or 13.5 percent of revenues compared to $58.4 million or 16.3 percent of revenue in the fourth quarter.

Non-GAAP income was $45.8 million or $0.40 per diluted share compared to $57.5 million or $0.50 per diluted share in the fourth quarter.

Average diluted shares for non-GAAP purposes totaled 115.7 million.

Average diluted shares are expected to be approximately 116 million in the second fiscal quarter.

Interest and other income was approximately $2.4 million in the first quarter.

Non-GAAP taxes for the first quarter were approximately $2.65 million.

Non-GAAP taxes for the remainder of the fiscal year are estimated at approximately 6 percent.

Capital expenditures were approximately $51.9 million in the first quarter.

Construction continues on the third building of our Wuxi, China manufacturing site. We expect the construction of this building will be completed in the second half of calendar 2018.

Capital expenditures for the second quarter of fiscal 2018 are estimated to be approximately $50 million to $55 million.

We've excluded from our non-GAAP results a number of charges or benefits that are either noncash or that we consider outside of our core ongoing operating results. These totaled $25.9 million of charges last quarter. If you include all these items as required under GAAP, we generated net income of $19.9 million or $0.17 per diluted share compared to net income of $130.2 million or $1.13 per diluted share in the fourth quarter.

That concludes my comments, and I'll turn it back to Jerry.

Jerry Rawls: Thanks, Kurt. We expect revenues for our second fiscal quarter of 2018 to be in the range of $322 million to $342 million.

We expect revenues for datacom products to be relatively flat in the second quarter. We expect growth for 100-gig QSFP28 transceivers as well as initial sales of our high-powered VCSEL arrays for 3D sensing. We expect this to be offset though by declines in both 100-gigabit CFP and CFP2 Ethernet transceivers and the decline in 10-gigabit and lower data rate transceivers.

We expect telecom revenues to decline compared to the prior quarter primarily because of lower demand from our Chinese OEM customers.

We expect second quarter non-GAAP gross margins to be approximately 33 percent to 34 percent due to lower revenue levels, higher depreciation levels and the impact of the annual employee merit increases that took effect approximately August 1.

We expect operating expenses to be approximately $75 million to $76 million. The increase in operating expense over the prior quarter is expected to be primarily driven by the impact of the annual merit increases.

Non-GAAP operating margins are expected to be in the range of 10 percent to 11 percent. Non-GAAP earnings per diluted share are expected to be in the range of $0.27 to $0.33 per share.

We remain very optimistic about our long-term growth prospects and we expect to increase our revenues in the second half of the fiscal year. This growth will be driven primarily by sales of 100-gigabit QSFP28 transceivers for hyperscale data centers and high-powered VCSEL arrays for 3D sensing.

While we continue to make progress with our high-powered VCSEL array program, the timing of our production ramp has been delayed due to a change we needed to make in our manufacturing process. Therefore, while we do expect to receive customer approval to ship production units in the second quarter, we only expect to achieve a relatively low level of revenue in the quarter. We expect to start shipping much larger quantities in the fiscal third quarter.

In addition, by the end of the second quarter, we expect our 100-gigabit, 200-gigabit coherent CFP2 ACO transceiver to be fully qualified by a key OEM customer that's supplies into the Verizon Metro network.

And in the third quarter, we also expect our ROADM line card to be qualified at the same customer. And now with that, I'm going to turn it back to (Sarah) and open it up for questions.

Operator: Thank you, at this time if you would like to ask a question, please press star and then the number one on your telephone keypad. Once again, that’s star and then the number one on your telephone keypad. Your first question comes from James Kisner with Jefferies.

James Kisner: Hi guys, thank you so much. So I guess, the first question is in gross margin. You give several factors there, just seems like it's down a fair amount here in the guidance. You talk about, maybe you can quantify these relative factors and how they're affecting guidance for gross margin?

Kurt Adzema: I'd say between depreciation and is probably going to increase somewhere in the range of $1.5 million to $2 million. Merit increases impact us, I'd say in somewhat similar way. And then, obviously, lower revenue levels.

James Kisner: So in addition to the depreciation, is that all from expansion for traditional components?

Kurt Adzema: I would say it's primarily related to the VCSEL project. So we've put a lot of equipment into place, we don't have the volumes yet to offset that.

James Kisner: OK. And then related to the, I guess, you talked about just your 3D sensing being a lot bigger volumes here in the quarter after the next one. Could you help us out there, is it tens of millions?

And maybe talk about how this trajectory did to look after that quarter that it keeps going up and remain as a certain level? If you could help us monitor, that would be great.

Jerry Rawls: I think beyond that quarter, it's totally dependent upon our lead customer and their demand. Now they're very optimistic, but I don't think I can go further than that.

James Kisner: But you say this is tens of millions of dollars in your first quarter ramp here?

Jerry Rawls: I think, yes. I think it will be measured, it will be more than 10. I don't know if it will be 100.

James Kisner: OK. Last thing, on inventories. I see it ticked up quite a bit here. What's driving that?

Kurt Adzema: Well, I think that's primarily driven by the fact that we've expected stronger growth. And so we've built up some inventories based on those expectations.

And so I'd expect those increases to moderate as we grow into that inventory level.

James Kisner: Is there risk of obsolescence from that?

Kurt Adzema: No. I think most of the growth in the inventories have been based on kind of our newer products. And so we don't think there's a meaningful risk there.

James Kisner: Congrats, Jerry, on moving on. Thanks for all your leadership of the company.

Operator: Your next question comes from Doug Clark with Goldman Sachs.

Douglas Clark: I want to follow up on the VCSEL 3D sensing component. You talked about the delay being due to the change in the manufacturing process. Can you talk a little bit more about that?

And then also on the context of last quarter, you had expected to be kind of customer approved in very short order. It sounds like that customer approval still waiting to come. Can you talk about the signpost or what needs to happen until we get that?

Jerry Rawls: Well, I can't give you much detail about the exact change and the documentation that goes with that. But suffice to say, that, that change required a delay in the customer approval for the production quantities.

We have not shipped thousands, maybe hundreds of thousands of unit so far. But production units are millions of units. So we haven't hit that level yet.

So that production, I mean, that approval we think will come this quarter, in our second quarter. And we will ship, I don't know a few million dollars worth probably in this quarter.

Douglas Clark: OK. As a follow-up to that. Is there a risk that for this flagship lead customer that it becomes kind of a sole-source situation and the opportunity really is on other kind of OEM, handset OEM guys?

Jerry Rawls: Well, there's always risks in every part of our business. So I don't think that that's a risk here. But we are -- of this whole area, we think this is a very exciting area for 3D sensing for a lot of different industries.

It's some of the analyst reports that I've seen and the projections for this VCSEL, high-powered VCSEL array market are pretty astounding. So we have put a lot of money into this and we hired a lot of people.

Douglas Clark: OK. And then my other question was, it was helpful to get kind of the updated time line on the qualifications on to the North American customer on the ACO and the ROADM side.

Looking at ROADMs in China, what is the time line at this point, in your opinion, on seeing that kind of commercialize in both quarters?

Jerry Rawls: Well, there are some small deployments that are going on in China right now by China Telecom and China Mobile. We are participating in those and we're supplying a fair number of wavelength-selective switches.

These are line cards that are built by the OEMs in China. But this is not like a full-scale national deployment that we all drew about it and dream of the day when all of a sudden, we're going to have to be expanding the capacity of our Wavelength Selective Switch production.

So we're right now there's a lot of decisions they have to make about their ROADM network. They have never operated ROADM networks on any scale.

And so learning how to manage them, learning how to control the software interfaces, how to switch wavelengths from one network to another and then deal with the changes that, that causes are some of the serious learning that is going on in China right now. But that will all need to full-scale deployment at some point in the future.

Operator: Your next question comes from Alex Henderson with Needham & Company.

Alexander Henderson: Jerry, Kurt, could you talk a little bit about whether you've committed to purchasing additional new gear to ramp your VCSEL capacity beyond what you currently have in place?

What sort of the maximum you have on say a monthly or quarterly basis of the VCSEL capacity expressed in a revenue basis?

What is the maximum, if you were to get your yields to where they need to be fully qualified and things were running smoothly that you could do what you have today?

Jerry Rawls: Let's see. That mostly has to do with yields. And if our yields are very high, we got more obviously, have more capacity. So we're looking at every possibility of how we might expand that capacity.

But right now, I'd say we're focused mostly on yields. And if I think I'm on most optimistic view right now of the yields is that we can potentially ship $30 million a quarter, maybe something like that.

Alexander Henderson: That's helpful. Looking at the ramp and given that it's pushed out a quarter, it's obviously causing a pretty significant impact on the October gross margin guide. How would you think about the trajectory of gross margins as you get that volume ramp up?

So if we do, say, $30 million in the January or April quarter for VCSELs, do we get two points of margins back as a result of that? And also, as you continue to ramp the next plug of QSFP28 production, can we get some margin back here?

Kurt Adzema: Well, of course, there's a lot of factors that go into margins. I think, all other things being equal, I think, we expect this VCSEL opportunity to be accretive to gross margin.

How accretive will be highly dependent on volumes and on yields. And so, I don't think we're at the position yet where we can say, does it add 50 basis points or 200 basis points to the overall number.

And, obviously, that also depends on, again, how big it is. So I would say we expect it to be gross margin accretive, all other things being equal. But obviously, there's a lot of moving parts in our business, both ups and downs, that happen over time.

Alexander Henderson: I guess, what I'm trying to get at -- if you look at the margin coming down a couple of hundred basis points in your guidance, that's a pretty steep decline from the 37 percent you were doing in FY '17.

What is the trajectory that we should be thinking about? Should we think about it as flat or will it improve as we go forward over the next couple of quarters?

You're obviously, absorbing a lot of costs here for ramping a product that's doing no revenues. What should we be thinking? Should we expect margins to rebound into the mid-30s, [upper 30s] or stay down here in the lower 30s?

Kurt Adzema: Well, again, Alex, we're not going to provide guidance. We never provide guidance more than the quarter we're in and there's a lot of factors out there. So clearly, we need to get revenue growing again, that's the #1 factor. We've had 2 quarters in a row now where revenue is declining, that's problematic for us.

I think the other thing, obviously, is, like you say, we got to get the 3D opportunity ramped so that we can start absorbing all these costs that we have there.

And then, obviously, the third thing is just continuing to take cost out of our products. But there's too many moving parts to forecast beyond the existing quarter and I'm just not going to do it.

Alexander Henderson: If I could ask one last question, then I’ll (concede) the floor, can you talk a little bit about the pricing in LR, in CWDM4 and in short reach for the data center products?

Are pricing relatively stable sequentially, declining 5 percent or 10 percent, declining more than that? Can you give us some gauge of what the pricing environment looks like?

Jerry Rawls: Well, CWDM4 is obviously, priced at a lower level than LR4. And, in this calendar year, prices actually are pretty stable. The thing that we expect though is that sometime in 2018, there's going to be more capacity online and the prices are going -- likely to drop when there's more productive capacity than there is demand.

Now there are -- there's a debate among people in this industry, customers and suppliers, as to actually when that crossover point will occur and if it really will occur, so we're waiting to see.

Alexander Henderson: So sequentially prices are fairly flat in those 3 classes?

Jerry Rawls: Yes. In this year, prices are relatively stable.

Operator: Your next question comes from Patrick Newton with Stifel.

Patrick Newton: Good afternoon, Jerry and Kurt, and Jerry, congratulations on your eventual retirement. Following up on that last QSFP28 question, do you have, you said there's varying opinions of when the supply-demand equilibrium will be reached. I'd love to know what your opinion is.

And then previously, I think you talked with to the goal of bringing on $15 million a quarter roughly, plus or minus, in sequential QSFP28 growth through the remainder of the fiscal year, is that still the goal, and are you tracking to that?

Jerry Rawls: I don't know exactly when in 2018 that supply will equilibrium -- and supply-demand will be in equilibrium. I honestly just don't know.

Obviously, it's better for consumers if it happens earlier and suppliers if it happens later, but it really depends on it if the Web 2.0 consumers of these products continue to have the incredible appetite for 100-gig that they have, it may be later. So, don't know. What was the next one you asked?

Patrick Newton: I think you'd previously been targeting $15, plus or minus, million in sequentially growth through the fiscal year. Are you on track and is that still the goal?

Jerry Rawls: The goal is roughly $15 million. I think this last quarter, we increased about $10 million. But if we hit everything, we'll do better than that next quarter. So we're going – we're continuing to add capacity throughout this year.

Patrick Newton: OK. And then, kind of, I think you had said earlier in 3D sensing with the push out that you're recognizing a few million that's embedded into this guidance. Can you give us just an exact range of relative to high and the low end of the guidance of what is 3D sensing this quarter?

Kurt Adzema: We're expecting low single-digit millions of dollars.

Patrick Newton: And then just one more multipart question on China is, what is China as a percentage of revenue currently? You said it was low teens last quarter.

Kurt Adzema: Yes. It's still low teens at this point.

Patrick Newton: OK. And then if we think about the China Mobile tender, do you guys have any thoughts or view of the mix of 100-gig? Is it percentage of ports? And any thoughts on timing as to when rollouts in general can help your Chinese business return to growth?

Jerry Rawls: I don't know. I mean, it's going to help a bit. But there was an analyst report that went around that said this was the biggest tender that the China Mobile had ever issued.

Wow, well, we got very different information from the OEMs that it was not the biggest by a lot, it was relatively small. So, I don't know. I expect we'll see some impact. But we're not expecting a boom in China.

Patrick Newton: Any thoughts on when China could return to growth?

Jerry Rawls: Well, I'll tell you. There's a bunch of guys in China that say that the People's Congress in October is going to be -- some important announcements will be made that will affect capital spending and infrastructure builds by the government. So we'll all be watching.

Operator: Your next question comes from Dmitry Netis with William Blair & Company.

Steve Sarver: This is Steve Sarver in on for Dmitry. So on 3D sensing, I guess two pieces. Are you guys planning just to, at this time, produce the high-power VCSEL array?

Or do you foresee trying to go to low power as well? And then for the -- right now you're using 4-inch fab for the production, will you go to a 6-inch fab? Or is that in the process now? Are you working on yields for the time being?

Jerry Rawls: Well, we expect to be able to supply VCSEL arrays and many configurations of how many VCSEL and emitters there are on a single die. So we don't -- we hope our business is not limited to just the one product configuration in the future and we got enough potential customers right now, we think that's a very unlikely event.

And 4-inch versus 6-inch, we're a disadvantage when we operate only at 4-inch. We thought it was an advantage for us to being able to scale production and being able to produce quality product because that's the fab that we run and that's the fab that we know.

But in the future, if we're going to be competitive in this business, we're going to have to expand our capacity to 6-inch. So we're planning on that.

Steve Sarver: OK, great. And then on, I'm not sure if this has been asked already, but it seems like your CapEx expectations for the rest of the year seemed to be higher than your previously set by maybe $10 million to $15 million as you previously said last quarter. Is this -- what is this being attributed to, is this QSFP28 ramp or fiscal ramp or CapEx higher-than-expected?

Kurt Adzema: I would say it's a combination of two things. I think, number one, it's continued investment in our laser fabs.

So we think having adequate capacity in all of our 3 laser fabs is vital to be successful in this business so we're continuing to invest there, perhaps more aggressively than we had thought into the last conference call.

And then I think the other thing is, again, just trying to accelerate maybe some of the fit out in the third building in Wuxi. So we talked about building the building, creating the shell.

I think we want to make sure we're ahead of the game and start to fit out that space a little bit earlier than before just because we do expect demand to come back and we want to be ready for when it goes.

Steve Sarver: Great. And then one last question if I may. On the China ROADM opportunity, I know you guys alluded to sometime in 2018, do you expect that full scale deployment to be first half or second half? And I guess, how large of an opportunity can this represent for Finisar?

Jerry Rawls: Well, it could be gigantic. If they really did full-scale deployment on a national basis, and I have no clue as to whether it will be first half or second half.

They've got a lot of questions, technically, that they have to answer. And then there are the political overtones of all this, with respect to the investment in infrastructure. So, I'm not smart enough to predict that.

Operator: Once again ladies and gentlemen, to ask a question, please press star and then the number one on your telephone keypad. Again, that's star and then the number one on your telephone keypad. Your next question comes from Troy Jensen with Piper Jaffray.

Troy Jensen: Kurt, if you think about the guidance, I know you talked about datacom being flat and then telecom being down. Are you putting VCSEL into either in one of those categories? Or will you reporting that separately?

Kurt Adzema: Right now, we are including it in datacom. But as we mentioned in Q2, we expect that to be low single-digit millions of dollars.

Troy Jensen: Will you be breaking that out for us in the future or...

Kurt Adzema: Well, we haven't decided that yet.

Troy Jensen: OK, understood. And then just a follow-up question. Can you talk about 40G transceivers? You didn't call them out being down in the current quarter. Were they stable to up? And then thoughts on what that looks like for this quarter?

Kurt Adzema: Yes. 40-gig was relatively stable last quarter. And I would say, the expectation is it will be relatively stable this coming quarter as well. So the declines we're seeing more have been in 10-gig and then also in 100-gig CFP and CFP2 Ethernet.

Troy Jensen: OK. Maybe one last question for me. Just on the CFP re-qualifications at Huawei and ZTE, where are you guys? And when China bounces back, will they return to CFP? Or are they going to move to QSFP28 and CFP2?

Jerry Rawls: We are back on the AVL. And I think that we're expecting that there will be some CFP, CFP2 revenue that comes out of any increase in 100-gig deployment. But we predict that, that will move to QSFP28 over the coming, I don't know, some number of quarters.

Operator: Your next question comes from Michael Genovese with MKM Partners.

Michael Genovese: I want to ask two questions, each separately. But given the delays we've already seen, what are the risks to qualification -- your current expectations for qualification -- both with the 3D sensing customer and with Cisco/Verizon? What are the factors we should be worried about that they could slip again? Or why should we not be worried about those things?

Jerry Rawls: Well, I think the probability is very high that we will be qualified in this quarter in both cases. Now, it is not 100 percent, bad things can happen on the way to the forum, but they would be totally unexpected, because at this point, we think all of the heavy lifting is behind us.

Michael Genovese: OK. Would you be -- I mean, does one of those two carry more risk than the other in your opinion? Or do you have the same level of confidence for each?

Jerry Rawls: No, I have a lot of confidence in both. I think we've had heavy customer engagement on both projects. We've got a lot of feedback from the customers that we are in really good shape. And so we feel good about both of them.

Michael Genovese: OK. And just one more for me, which is, given that you have a lot of cash on the balance sheet, but you also have a fairly depressed equity price right now.

Does that impact the way that you think about M&A? Having your stock here where it is, would you prefer to look at M&A when your stock is higher or does that not really matter?

Kurt Adzema: Well, part of the reason why we did the capital raise back in last December is to give ourselves financial flexibility, in times like these, when there are M&A opportunities and our currency isn't what would like it to be.

So I think we're going to continue to explore those opportunities, and we do believe in continued consolidation in the space. But, certainly, when your stock currency is down, you're more likely to use cash than stock in any sort of transaction.

Michael Genovese: All right, thanks Jerry and Kurt, good luck this quarter getting those qualifications.

Kurt Adzema: Thanks.

Operator: And your next question comes from Tim Savageaux with Northland Capital Markets.

Timothy Savageaux: Hi, good afternoon. I think most of the puts and takes have been covered around the sort of telecom and datacom. But just to be clear, on a go forward basis with regard to kind of non -- well, I guess non-QSFP28 datacom.

Are you expecting sort of an acceleration or a material acceleration declines in the 10-gig side? I think you just said 40 gigs are expected to remain stable. Can you review the dynamics there on the datacom side, assuming that we're continuing to get solid increases on QSFP28 100-gig?

Kurt Adzema: Yes. Well, I think as we've mentioned for last couple of quarters, we've seen declines in 10-gig and lower transceivers. And so we do expect that trend to continue, they've been candidly stronger-than-expected the last couple of quarters.

We also have the other place we've really seen declines is on CFP and CFP2 Ethernet. Now some of that has been driven by declines in the business out of the Chinese OEMs.

And so some of that could bounce back. But as Jerry mentioned, those customers are also considering going to other form factors in the future. So until we see exactly how some of these new tenders play out, it's a little hard to predict exactly where that business is going.

Timothy Savageaux: OK. And then back on 3D, given the sort of focus on the kind of orders coming out of last quarter. I don't know, I think you might be obliged to maybe provide a little bit more detail on -- in terms of what went wrong beyond stating there was a manufacturing change.

Should we assume this was an execution issue on your part, changes in specs? And to the extent that there's a window with regard to some of these initial builds and launches for this device and kind of harkening back to the last question, is there sort of a risk that you missed it here?

Jerry Rawls: No, I don't think there's a risk that we missed it. But we did have to make a change in one of the processes that we run. And that was an order to improve the performance of the product, the reliability of the product.

It turns out it was a key process parameter. And we have dialed it in a little bit off where it should have been. So, we dialed it back, and the results have been terrific. So we're rolling. And I don’t think that there’s much risk I guess.

Timothy Savageaux: Thanks.

Operator: And your next question comes from Simon Leopold with Raymond James.

Mauricio Munoz: Thank you for taking my question. This is Mauricio in for Simon today. Jumping to your datacom product, specifically the QSFP28, can you guys provide the quarterly growth on the QSFP28?

Kurt Adzema: I think Jerry said it was, I think it was a little under $10 million.

Mauricio Munoz: OK. So basically, in the range of $84 million to $87 million this quarter?

Kurt Adzema: Again, we're not going to give specifics of where we're at. Just, again, I think we had expected, we talked for a while about this roughly $15 million of growth a quarter.

We expected this quarter to be less, and it was less, and we expect next quarter to be more. And our expectations are that we will be over $100 million next quarter.

Mauricio Munoz: All right. Thank you. And then can you give us an update on the current supply and demand as well as the pricing environment for both the CWDM4 and the LR4 designs?

Jerry Rawls: Well, currently there is still a shortage in the industry, there's more demand than there is supply. And so, that means that as long as that stays in place, the prices are relatively stable.

And the real question is, is it going to be in 2018, are we likely to see an equilibrium in that market between supply and demand. And I don't know exactly when that's going to occur.

Mauricio Munoz: One last one on the QSFP28. Do you have an inoperability issue early this year, one of your North American OEMs, which I believe was unique to this particular customer. Was that resolved this quarter?

Jerry Rawls: Mauricio, you’re going to have to say that again because I missed it, the question

Mauricio Munoz: Yes. There was, I believe, an interoperability issue with QSFP28 at one of your North American OEM customers.

Jerry Rawls: Yes, that's true. And that has been resolved and we are shipping to that customer again.

Mauricio Munoz: OK. Thank you. Switching to China, there was a lot of excitement following the tender announced by China Mobile for 42,000 ports.

Even as we lack any details regarding the mix, I guess, my question is, have you heard any further details from your customers regarding the size, timing or product mix of this order?

And do you believe this is incremental to previous expectations? Or this is probably just built in on your previous projections?

Jerry Rawls: Well, I've seen the breakdown. And the breakdown is a combination of a lot of different ports, some of which are 1-gigabit, some are 10-gigabit, some are 100-gigabit, I think some are 40.

So it's a combination of all of those. And the OEMs that receive this tender didn't think it was overly exciting that it was not -- that this was not a huge purchase.

So I think everybody appreciates every bit of business that comes from our – from any customer. But this was -- this one was clearly overhyped by at least one analyst.

Mauricio Munoz: Thank you, and one last question for me. You attributed some of the lower guidance to the telecom segment, particularly as it relates to Chinese OEMs?

Can you give us some color on the specific products that have been affected by this inventory builds in China?

What we're hearing from some of your competitors, it seems that some OEMs build large or some quantities of inventory in client-side equipment, mainly CFP or CFP2 datacom transceivers.

And it looks like inventory builds on ROADMs are not as severe. I guess, I'm a bit surprised that you are not seeing a larger headwind in datacom given the breadth of your CFP sort of family datacom offerings and the large contribution from datacom to your total revenues.

Kurt Adzema: So, first of all, you need to understand both for our CFP and CFP2, we have Ethernet based products and then we have the dual-rate products. And the Ethernet-based products are falling into the datacom bucket and the dual rates product fall to the telecom bucket. And we are seeing an impact in those products as reflected in our guidance.

And so, we did talk in our guidance about telecom being down, which would be partially attributable to declining in the 100-gig dual rate products.

And then we also talked about growth in QSFP28 being offset by declines in CFP and CFP2 Ethernet products. So I would say that is one of the areas where we are continuing to see some weakness.

Operator: Your next question comes from Richard Shannon with Craig-Hallum Capital.

Richard Shannon: Maybe two quick clarifications. Kurt, in response to the question regarding revenues from QSFP28. I think you said you expected to be over $100 million referring to the current quarter or the next one?

Kurt Adzema: Referring to the Q2.

Richard Shannon: OK. Perfect. Second question on VCSELs and 3D sensing. I think there's a question regarding the movement to 6-inch, potentially 6-inch size wafers.

Jerry, any sense of whether you've made the decision on how you're going to approach that either in-house or using a foundry basis? And if so, can you comment on what you're thinking there.

Jerry Rawls: No, we're considering a number of alternatives and what we have not pulled the trigger on any of them.

Richard Shannon: OK. Probably two more quick questions for me back on the QSFP28 topic here. Maybe you could give us a sense of how big your revenues are between LR4 and the short-distance products?

Jerry Rawls: Well, our revenue is still higher for LR4 but our units are now higher for CWDM4.

Richard Shannon: OK. That's all for me I'll follow up offline on that topic. And last quick question for me is on the lower speed products 10-gig and below datacom, been a couple of quarters of softness here.

What's your sense of the drivers for this? Is this a software inventory build and burning some inventory, some softness geographically or competitive issues? Or Jerry, what's your sense of what's going on there and when do you expect that to return?

Jerry Rawls: Well, one of the things that's happened is that we sell a lot of 10-gigabit transceivers in the enterprise space, to OEMs and the sell through to the enterprise data centers.

But we also sold a lot of 10-gigabit to Web 2.0 customers, particularly in the times when they were building 40-gigabit interconnects between the switches. If you think about 40-gigabit, it's 4 times 10 gigabits and most of the server ports were at 10 gigabits.

So we were selling a fair quantity, I am mean at a big quantity of 10 gigabits transceivers the Web 2.0. And with the switch to 100-gig by the Web 2.0 guys, they're consumption of 10-gigabit has declined. So that's been -- and we expect that's going to continue to decline.

Richard Shannon: If you were to offset your lower speed datacom grouping for this dynamic with the cloud guys, how would you characterize the trends in your -- in those products? Has that been kind of flattish or kind of growing at kind of GDP kind of growth? Or how would you cap characterize that?

Jerry Rawls: Outside the Web 2.0?

Richard Shannon: Yes.

Jerry Rawls: Well, it varies a bit. I think 10-gig outside Web 2.0 is pretty stable. We have been seeing a decline in gigabit Ethernet, I don't know, for several years, right?

And it's a very, very slow decline and there's some maintenance level there. At 2 gigabit, 4 gigabit, 8 gigabit we still sell a lot of fiber channel parts going to that world. And they are declining as well as most of the customer who are now buying 16 gigabit and 32 gigabit.

Richard Shannon: OK. Thanks for that characterization, that's all the questions from me. Thank you.

Operator: Your next question comes from Joseph Wolf with Barclays.

Joseph Wolf: First off, just add to my congratulations and thank you to Jerry for the work over the years. I guess, on the 3D VCSEL side, could you just give us a little bit update perhaps on timing and the scope of your engagement beyond your lead customer and whether that's baked in revenues you'd see in calendar '18?

Jerry Rawls: Well, we've made no forecast of calendar year '18 revenues. But we're very hopeful that our high-powered VCSEL raise is going to be really important contributor in calendar year '18.

And some of those revenues we -- well, for sure some of those revenues are going to come from other customers besides our lead customer.

Now, the question is, whether they will be any significant percentage of the lead customer's consumption. And that's one that we don't really -- we don't have a clue yet as to when some of these things are going to go into production.

Joseph Wolf: And when you address that, are any of those outside the handset market right now?

Jerry Rawls: Yes.

Joseph Wolf: OK. And then on annual telecom pricing, I'm not asking for guidance beyond the October quarter. But as we think about our modeling going forward, what do you think about the annual pricing declines on the telecom side of the business given the gives and takes in terms of demand but which kind of product mix and product do you expect in 2018?

Jerry Rawls: I don't know. I am always an optimist, and given that our normal price declines are in the range of 10 percent to 15 percent, I always hope that they're going to be closer to 10.

So we've had a few of those years in the last few. But we've had some that weren't. I would hate to even speculate at this point.

Joseph Wolf: OK, thanks. That’s all for me.

Operator: This concludes the question-and-answer session. Mr. Rawls, do you have any closing remarks?

Jerry Rawls: (Sarah), thank you. And thanks to everybody for joining us today. We really appreciate your time and we hope that you'll be able to join us and then 3 months from now. Thank you.

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

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