

**FINISAR CORPORATION**

**Moderator: Jerry Rawls  
March 10, 2016  
2:00 pm PT**

Operator: Good afternoon, ladies and gentlemen, and welcome to the Finisar Corporation Announces Third Quarter Fiscal 2016 Results Conference Call. As a reminder, today's call is being recorded. At this time, I would like to turn things over to Mr. Jerry Rawls, CEO and Chairman. Please go ahead, sir.

Jerry Rawls: Thank you, (Sarah), and 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 by calling area code 888-203-1112 for domestic or area code 719-457-0820 for international, then enter the ID number 1574347.

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 statement. In addition, the company undertakes no obligations to update any forward-looking information presented today. In addition, unless otherwise indicated, all results are discussed 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 and you can view them by connecting to the Investor Relations page of our

website at finisar.com. Click on Investors, then scroll down to Webcast Archives and click. You'll see a listing for today's third quarter 2016 earnings call.

I am pleased to announce revenues for our third fiscal quarter were \$309.2 million. This was close to the midpoint of our guidance for the quarter which was \$300 million to \$320 million. Due to a favorable product mix, gross margins were a bit better than expected at 30.3%. In addition, we benefited from lower than expected expenses to produce 25 cents in earnings per fully diluted share which was at the upper end of our guidance.

And now with that, I'll let Kurt review the rest of the number. Kurt?

Kurt Adzema: Thanks, Jerry. Revenues decreased to \$309.2 million, a decrease of \$11.9 million or 3.7% from \$321.1 million in the preceding quarter.

Telecom revenue increased by \$2.6 million or 2.9% compared to the preceding quarter, primarily driven by growth in wavelength selective switches.

Datacom revenue decreased by \$14.5 million or 6.2% compared to the preceding quarter, primarily driven by a decline in the sale of 40 gigabit transceivers. We attributed this decline primarily to reduced levels of capital spending by Web 2.0 and hyperscale data center customers in anticipation of the rollout of the next-generation 100 gig QSFP28 transceivers.

In the third quarter, we had two 10% or greater customers.

Our top 10 customers represented 58.4% of total revenues compared to 58.2% in the preceding quarter.

Non-GAAP gross margin was 30.3% compared to 30% in the preceding quarter, as favorable product mix more than offset the impact of one month of annual telecom price negotiations which typically take effect on January 1.

Non-GAAP operating expenses were \$67.3 million compared to \$68 million in the prior quarter.

Non-GAAP income was \$26.6 million or 25 cents per diluted share compared to \$26.9 million or 25 cents diluted share in the preceding quarter.

Average excluded shares for non-GAAP purposes totaled 108.1 million.

For non-GAAP purposes, interest expense for our \$258 million of 0.5% convertible notes was approximately \$323,000 in the third quarter. This interest expense is the only impact of these converts on non-GAAP diluted earnings per share, as no shares are added to the fully diluted share count.

Third quarter capital expenditures totaled \$26.8 million, lower than our forecast of approximately \$35 million as some final expenditures associated with the fit out of the second building in Wuxi, China rolled into the fourth quarter. Capital expenditures are expected to be approximately \$33 million in the fourth quarter.

Cash, cash equivalents and short-term investments increased \$10.3 million to \$531 million at the end of the quarter.

Non-GAAP taxes for the third quarter were approximately \$1 million and are estimated for the fourth fiscal quarter to be approximately \$1 million. Non-GAAP taxes for fiscal 2017 are estimated to be approximately 7%.

Weighted average fully diluted shares for the fiscal fourth quarter are expected to be approximately 109 million for non-GAAP purposes.

Excluded from our non-GAAP results, a number of charges or benefits that were either non-cash, what we consider outside of our core ongoing operating results, this totaled \$14.5 million last quarter. If we include all these items as required under GAAP, we generated net income of \$12.1 million or 11 cents per diluted share compared to net income of \$6.6 million or 6 cents per diluted share in the preceding quarter.

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

Jerry Rawls: Thanks, Kurt. We expect revenues for our fourth fiscal quarter to be in the range of \$307 million to \$327 million. We expect both datacom and telecom revenues to grow relative to the third quarter.

We are seeing strong growth from China, due to the continued long haul and wireless buildouts at China Telecom, China Unicom and China Mobile, as well as strength in North America from the expansion of next generation metro networks. We also expect telecom revenue growth in Q4 from Europe and the Middle East.

Datacom revenue growth during the quarter is expected to be primarily due to increased sales of 100 gigabit Ethernet transceivers and CFP, CFP2, CFP4, and QSFP28 form factors.

Telecom revenue growth during the quarter is expected to be primarily due to continued strong demand for wavelength selective switches and ROADM line cards. In addition, we expect growth from 100-gig and 200-gig line side product, such as CFP2-ACO.

Given the strong demand for our 100-gig client side modules as well as our wavelength selective switches, wavelength selective switch-based line cards and our CFP2-ACO products, we are capacity constrained on all of these products, and we are actively adding capacity to meet customer demand.

We expect fourth quarter non-GAAP gross margins to be approximately 30%, as the positive impact of favorable product mix is offset by the impact of three months of the annual telecom price reductions.

We expect operating expenses to be relatively flat at approximately \$67.5 million.

Non-GAAP operating margins are expected to be between 8.2% and 9.2%.

Non-GAAP earnings per diluted share are expected to be between 22 cents and 28 cents per share.

We continue to believe that the long-term growth prospects of our company and the optical communications industry are positive. In fiscal 2017, we expect to benefit from the increased sales of many new products driven by both data center construction and upgrades and increased deployment of ROADMs and the 100-gig, 200-gig coherent transceivers in telecom long-haul and metro.

Finisar's revenue is primarily driven by growth in the global demand for bandwidth from the increasing distribution and use of video, images and digital information. In addition, Finisar continues to benefit from the growth in cloud services which drives networking hardware upgrades of existing data centers and the construction of new hyperscale data centers.

Now with that, I'm going to turn it back over to Sarah and open it up for questions.

Operator: Thank you. And if you'd like to ask a question at this time you may signal by pressing star 1 on your telephone keypad. If you're joining us using a speakerphone today please check your mute function, make that is turned off to allow your signal to reach our equipment. Once again that is tar 1 for questions at this time. And we'll pause for just a moment.

We'll hear first from Patrick Newton with Stifel.

Patrick Newton: Yeah, Jerry, Kurt, thank you for taking my questions. Good afternoon. Jumping right in, I think gross margin was definitely a positive surprise especially on the outlook perspective, and I think you talked a little bit about some of the key demand drivers from a mix perspective that are benefiting it.

But if we look out longer term, I think you talked about an uptick or a sustainable uptick in gross margin, largely being driven by your forthcoming new product ramps and 25-gig portfolio. I'm curious if you can talk a little bit about the timing of QSFP28 hitting the market in volume and just your confidence that you'll be able to drive some margin accretive business over the next several quarters from that 25 gig portfolio.

Jerry Rawls: Well, we're shipping our QSFP28 in - I consider it to be volumes because in previous quarters, we shipped hundreds; and now, we're shipping thousands. So I think that's good progress. And we expect that the impact throughout the rest of this calendar year is going to be - well, let's see. The growth rate will be very impressive for us and probably the highest growth part of any of our product lines that we sell.

Patrick Newton: Kurt, can you wrap any numbers around the gross margin potential of those products?

Kurt Adzema: Well, again, we only provide one quarter of gross margin forecast. As we talked in the past, our hope is always that new products carry higher ASPs and better gross margins. But obviously, it depends on our ability to ramp and to yield them efficiently. But certainly, we hope that these products are positive on the gross margin perspective.

Patrick Newton: Okay. And then Jerry, you talked about strength on WSS and the ROADM business currently and being capacity constrained across a number of products. Could you help us understand the relative size of that WSS business and perhaps quantify the amount of capacity that you're planning on expanding at this point?

Jerry Rawls: Well, our WSS business today in total is pretty close to 30% of our telecom revenues, and we expect it to grow. Demand is very strong.

Patrick Newton: Great. And then just one last one if I may. Jerry, we're about another quarter removed from that Avago-Foxconn transaction. I'm just curious if you could provide any thoughts around implications to Finisar. Could this be an opportunity for you to improve your market position, or have you seen any changes in the competitive dynamics?

Jerry Rawls: From our standpoint, I couldn't point to a single market segment or a geography or a large customer where I think it's had any impact at all. So obviously, when there's any change like that taking place, our hopes would be that it's beneficial to us. But I have no data to indicate that yet.

Patrick Newton: Great. Thank you for taking my questions.

Jerry Rawls: Thank you.

Operator: We'll hear next from Alex Henderson with Needham.

Alex Henderson: Thank you very much. Great to have you guys back on the growth curve here. A couple of quick questions. Just following off of Patrick's comment, could you talk a little bit about the 10-gig pricing environment, particularly relative to VCSEL-related short-range optics stuff which obviously is where that Foxconn event happened, but it's also where you've been seeing a lot of competition from low-grade Chinese competitors otherwise.

Jerry Rawls: Well, it is a competitive business and we have, in some segments of the business, seen competition from companies that we never had to compete with before. But that's life in the Web 2.0 space. They control their environment. They control both ends of the network. They don't have to be interoperable with anybody but their own equipment. They don't have to sell these products to anybody else. It never gets too hot, it never gets too cold in those data centers, and it never rains in there. So they don't have to worry about Bellcore qualification. So we are competing with companies that we have never competed against before in that Web 2.0 space.

But overall our business has held up really quite good in 10-gigabit. It's still our largest product segment of them all. And we're not predicting strong growth in the future, but 10-gigabit in the enterprise is still the workhorse data rate.

Alex Henderson: Just the question was really around pricing. I mean it come down pretty hard last year. Has it finally stabilized, or is it still coming down at that same steep rate?

Jerry Rawls: It's not coming down at that same steep rate.

Alex Henderson: Oh, good. That's great. The second question is can you just tell us what the greater growth was in the ROADM/wave selected switch segment? And when you gave the 30% number, I assume that's both wave selective switches and blades, right?

Jerry Rawls: Yes.



Alex Henderson: So, what was the rate of growth there?

Kurt Adzema: The growth quarter-over-quarter in that area was about 25%.

Alex Henderson: Good job. And then the last question, just on a sizing issue, if I were to take the CFP2, CFP4, and QSFP28 and compare it in size to the 40-gig and CFP older product, 100-gig product, how does the relative scaling of those compare because obviously, there's very different growth rates between those two?

Kurt Adzema: I'm sorry, so you want to compare CFP, CFP2, plus QSFP28 to 40-gig?

Alex Henderson: CFP2, CFP4 and QSFP28 to 40-gig and CFP which is the much older 100-gig piece?

Kurt Adzema: The way I'd answer the question is that CFP versus CFP2/CFP4 are approximately the same size at this time. And we expect as QSFP28 ramps, obviously that's going to start shifting things even more in that direction.

Alex Henderson: But have you crossed over against 40-gig is really the crux of it?

Kurt Adzema: So, well, right now, 100-gig CFP, CFP2, CFP4, and QSFP is still a little bit below 40-gig, but not much.

Alex Henderson: I'll give the floor. Thanks.

Operator: And moving to our next question, that comes from James Kisner of Jefferies.

James Kisner: Thank you for taking the question. So, I don't think you commented publicly on ZTE. I guess I can infer here that you don't have much revenue exposure there and don't see much downside from the restrictions that have been imposed. But could there potentially be some upside here given your strong relationship historically with Huawei? And I'm also kind of wondering if that's the comments in the Middle East if that's going to be through Huawei as well?

Jerry Rawls: First of all, we don't think the ZTE situation is going to have a meaningful impact on us. They have not been anywhere near a 10% customer in the past. My hope is that whatever these restrictions that finally come out from the government on shipments to ZTE that they don't extend that to Huawei or to other companies in China, it's - anyway, I would hate to see that happen. Let's see.

And will it benefit any of our business at Huawei? No, I doubt it. Maybe it benefits Huawei. And if Huawei's volume is up because ZTE can't ship to some of the customers that they compete with Huawei for, it might increase demand from Huawei. So I guess it's possible that it could benefit our relative volumes that we do with Huawei.

James Kisner: Okay. And then just quickly on the last quarter here in the declining datacom, I recall I think you expected 40-gig to be the big driver of that. But I'm just wondering could you confirm that? Is it mostly 40-gig, and 10-gig also decline?

Kurt Adzema: Yeah. It was primarily 40-gig but also a 10-gig declined a little bit.

James Kisner: All right. Thank you. I'll pass it.

Operator: Mr. Kisner, do you have anything further?

James Kisner: I said thank you, I'll pass it.

Operator: Thank you. And we'll go next to Joseph Wolf with Barclays.

Joseph Wolf: Hi. Thank you. Just a couple of questions. The CAPEX number that you gave, the \$26 million, could you kind of give us a little bit of color on how much is left to build up the plant and how much capacity or how much CAPEX you're using to relieve some of the capacity constraint you're having? Are those go hand-in-hand and we can't isolate the two right now?

Kurt Adzema: Well, again, I think the building is slightly different on the CAPEX associated with test and - final test and assembly equipment for the constraints that Jerry is talking about. So those are two separate items. And again, we expect the CAPEX associated with the final buildout of the last couple floors in Wuxi to be finished in Q4. So, what we're forecasting for Q4 is about \$33 million of CAPEX. And as I've said in the past, I hope that that declines in FY 2017 to something more around \$30 million per quarter.

Joseph Wolf: Okay. Okay. But there's an acceleration there at the end after a slow spend.

Kurt Adzema: It's just timing. Often with construction projects, the timing of CAPEX can be lumpy, and it just so happens that some of the expenditures that we thought would happen in Q3 are actually going to happen in Q4 for that building.

Joseph Wolf: So, is there additional tests - I guess is there - how can we think about the incremental for where there's capacity constraints and how many quarters do you think it takes, or how are you addressing the long-term versus short-term capacity constraint issue within your spending plan?

Kurt Adzema: Well, again, I think when you're looking at capacity, there's obviously - the test and assembly equipment tends to be relatively short-term. When you're relieving capacity constraints, depending on the equipment, they can take anywhere from three months to six months to get that

equipment in. In terms of longer-term capacity, that has more to do with capacity in fabs or big facility buildouts which is what the Wuxi CAPEX is related to.

Joseph Wolf: Okay. That's helpful. And then I guess, we've touched on it in a couple of different ways, but if you look at the progression of revenues and margins, it's been fairly tight over the last five quarters in the same range on EPS, margins and revenues.

When you think about that product mix and the new building, is there a product category that will drive sustainable revenues? Is there an inflection point where you think you can get to a \$320 million level and sustain there for a few quarters, or is it really just a question of timing across a broader portfolio of product?

Kurt Adzema: Well, as Jerry mentioned, in terms of revenue growth, our hope as the biggest driver for revenue growth in the calendar year that we're in or fiscal 2017 is QSFP28. And we're counting on that to grow meaningfully over the coming quarters, and that should drive overall revenue growth for the company.

Joseph Wolf: Okay. Thanks. That's all I got now. Thank you.

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

Doug Clark: Hi. Thanks for taking my question. The first, I just want to talk geographically about China as an end market. How large is that maybe in the most recent quarter versus the past few quarters? And then kind of a question that I think has been relevant across a number of different companies. But what is your visibility into that region especially considering there is some products that may be capacity constrained right now?

Kurt Adzema: Are you talking in terms of the OEMs that are located in China or deployments in China?

Doug Clark: China and demand to deployments in China.

Jerry Rawls: One of the things that's a little hard for us to size is exactly what we sell to China, we sell to OEMs. And about 20% of our revenue today goes to China. And how much of that stays in the country versus is exported from China from those OEMs varies some from each one of the OEMs to the other OEMs. I mean some export more than others. So it's really hard to say exactly what stays in the country and what doesn't.

Generally, one of the things that I think I would tell you though, that's pretty exciting is that heretofore, everything that we have shipped in wavelength selective switches to China have been exported. But now in the last quarter, we shipped wavelength selective switches to China that were actually used in networks in China in a deployment. And so we think that is a way for the future that is going to be very positive for that whole ROADM segment.

Doug Clark: That's an interesting point. Thanks for that detail. Maybe following up on the WSS and kind of ROADM deployments, how do you view your competitive position? Do you see kind of opportunities for share gains or share opportunity in North America and generally your exposure to kind of Verizon which is the most public of the known kind of metro network builds?

Jerry Rawls: Well, we think our product position is great. We think we have a very competitive high-performance wavelength selective switch. We invented this concept of flexible grid spacing of the wavelengths. And a number of the carriers - most of the major carriers in the Western world now all demand that. And we're being told that the Chinese carriers are demanding that.

So, that plays to our strength. And we expect that product line to be very strong for - our expectations are it could be a real boom in that product line for a couple of years, maybe longer.

Doug Clark: Okay. That's helpful. And then one final one. Just on new product, so the QSFP28 and kind of the CFP2 coherent ACO product. Wanted to get your views on competitive differentiation or unique attributes that you believe your product may bring to the market relative to competition.

Jerry Rawls: Well, we believe that we have a CFP2 module that will be very competitive at 100-gig but will be superior in performance to any of the offerings that we have seen in the market so far at 200-gig and 250-gig and for 16QAM transmission. I think we'll be - obviously, we will be competitive at 100-gig, but I think we're going to be tough to match at the higher data rates.

Operator: Next, we'll go to Simon Leopold with Raymond James. Please go ahead. Mr. Leopold, your line is open.

Simon Leopold: Just a couple things I wanted to follow up on. One is sort of both a short- and long-term question on the Chinese end market question. First of all, in terms of the quarter you're in right now, your April quarter, did you experience the normal seasonality during the month of February around Chinese New Year?

And is it behaving historically normal, or is the China demand particularly strong in defying your past years of seasonality. And then following up on that in China, what is your expectation for the duration of such healthy spending trends from the Chinese end market?

Jerry Rawls: Well, first of all, Chinese New Year always has a seasonal impact because things just shut down over there for a week. But nevertheless, demand continues to be strong out of China. And the answer to the question about how long can the demand stay strong or even increase is all related to government spending. It's government stimulus. It's infrastructure spending.

So, our expectations, at least from what we are being told by the equipment companies anyway, is that they expect it for, I don't know, a couple of years at least. But even then, I think everybody is speculating. All the policies of spending are determined really by the government.

Simon Leopold: Okay. And then I wanted to follow up on your position in the North American opportunities around ROADMs and blades. I believe you were in a position where you were getting certifications from the OEMs last time we spoke. Just wanted to get a better sense of what your timeline might be for when you would expect to receive your certifications and start to see more material contributions to your revenue from North American buildouts featuring your ROADM products.

Jerry Rawls: We expect qualifications to be received this quarter, and we're building line cards right now for delivery.

Simon Leopold: Great. And then just one last one. A little bit more granularity I'm looking for in terms of gross margin drivers. I've made the assumption that as 100-gig increases in the mix, your datacom gross margins are increasing and that WSS and ROADMs increasing in mix drive up the telecom gross margin. So as we make assumptions about mix, each of those segments should see gross margins trending higher through the balance of fiscal 2017. Is that a fair assumption?

Kurt Adzema: Well, again, I don't think we provide guidance again beyond one quarter. But we certainly believe that WSS is higher than our average gross margin. And so, to the extent we sell more and that becomes a higher percentage of our telecom revenue, then that certainly should help and I think the same thing on the datacom side for the 100-gigabit product. So, I think the mix could be helpful there, and that will help offset other factors that are obviously always existing in the market.

Simon Leopold: Great. Appreciate that. Thank you for taking my questions.

Operator: Next, we'll hear from Troy Jensen with Piper Jaffray.

Troy Jensen: Hey, congrats on a nice quarter and guide, gentlemen.

Jerry Rawls: Thanks.

Troy Jensen: Hey, Jerry, for you, on the QSFP28, could you let us know if you are shipping all three flavors of the product?

Jerry Rawls: Wow. I bet we're shipping more than three flavors.

Troy Jensen: Well, specifically, PSM4, LR4 and...

Jerry Rawls: We're not shipping PSM4. That flavor we're not shipping, not yet.

Troy Jensen: Okay.

Jerry Rawls: We're shipping, SR4. And we're shipping a few of short wavelength multiplex devices.

Troy Jensen: Okay. Understood. In the QSFP28 market, do you feel like it's crowded? And if I just think back when 10G and 4x10 took off it seemed like, it seemed like you and Avago have. Do you have any concerns that there's just kind of more competition here at the front end of this 110-gig datacom cycle?

Jerry Rawls: Yeah. I think there's a few more competitors in the 100-gig cycle than there were in the 40-gig cycle.



Troy Jensen: Okay, fair. One last one for Kurt. Just when you look at the April quarter guidance, are you expecting both datacom and telco to grow sequentially, or is telco going to be significantly stronger?

Kurt Adzema: We expect both to grow sequentially.

Troy Jensen: All right. Perfect. Congrats, gentlemen. Keep up the good work.

Jerry Rawls: Thank you.

Operator: As a reminder if you would like to ask a question today please press star 1 now. And we'll hear next from Tim Savageaux with Northland Capital Markets.

Tim Savageaux: Good afternoon. And I apologize in advance for what is likely a little background noise here. I have a couple of questions really following on that competition question on 100-gig QSFP. I wonder as you kind of look at where price points appear to be shaking out early on, are they kind of coming in in line with what you would have expected and what would support the notion of maintenance or even expansion of gross margins?

And then somewhat related on the growth side, when you talked about that as a major growth driver, some of your peers are seeing double-digit type growth; in some cases, much greater than that. Your guidance still calls for a year-over-year decline. I wonder if you could sort of take us through the metrics in terms of kind of newer products versus legacy in terms of what's going to kind of tilt the balance with Finisar to grow heading forward on a year-on-year basis. And I'll leave it there.

Jerry Rawls: Well, let's see. First of all, let me talk about QSFP28. It's a good product. Gross margins are above our company average. We expect it to be additive to our gross margins. And now, will they

be quite as high as what 100-gig was back in the introduction of our first CFP 100-gig or back in the early days of 10-gig? Probably not quite. But like all new product cycles it appears that pricing is still attractive there and it will be.

Kurt Adzema: Was your second question about year-over-year datacom overall growth?

Tim Savageaux: No, overall growth for the company. I mean, mid-range, you're still talking about sort of a 1% decline. And I thought you were getting ready to give us some growth expectations for fiscal 2017, or maybe you did and I missed them, but feel free if you would like to. But I'm just trying to understand the dynamics between what is growth in new products versus decline in legacy products and what sort of growth rate that kind of might sort out to if the growth rate at all.

Kurt Adzema: Sure. So, I think first of all, when you're comparing FY '16 to FY '15, I'd say first you got to adjust for the fact that FY '15 had one extra week. So, that's one of the things. But I think in general, we've been saying for a while that FY '16 was going to be a challenging year top line basis, and it's been a relatively flat year.

But then we do feel better about FY '17, and that will be driven by the growth of new products like QSFP28 and CFP2 coherent as well as wavelength selective switches. So I think Jerry had said that we are optimistic for growth in FY '17.

Tim Savageaux: Okay. If I could do maybe one quick follow-up and I think heading forward, I'd be interested in trying to bracket expectation for that growth. Obviously, there's a wide range of - that could imply a lot of different things. Can you comment on your expected share in 100-gig datacom transceivers versus where you think you are in 40-gig?

Jerry Rawls: I can't predict that it would be any different honestly. I think we are more competitive in the early stages of the 100-gig QSFP28 than we were in the early stages of the QSFP 40-gig. So I

think that bodes well for us. But to predict market share and how it's going to shake out, I don't have any data today that would say it would be any different.

Tim Savageaux: Okay. Thanks, guys.

Jerry Rawls: Thanks, Tim.

Operator: We'll take our next question from Jorge Rivas with Craig-Hallum Capital Group.

Jorge Rivas: Good afternoon, gentlemen. Thanks for taking my questions. So first, I wanted to understand your expectations for 40-gig for calendar 2016. I mean how do you see the growth trajectory of 40-gig in calendar 2016? I mean do you think - can you still see growth maybe from some of the Asian customers, or do you anticipate 40-gig falling off a cliff as we move to 100-gig?

Jerry Rawls: We don't expect it to fall off a cliff, but we're not optimistic about strong growth in 40-gig any longer because of the really strong growth in 100-gig. So most of the 40-gig sales went into the Web 2.0 space, and most of the 100-gig QSFP28 anyway is going to go into the Web 2.0 space. So I would say that they're still going to deploy 40-gig, and there's still some of the Web 2.0 guys that are going to buy 40-gig for some period of time.

But we just don't - we just expect that the conversion to 100-gig is going to take some of the impetus out of that. And it will - our expectation honestly is it will decline at some rate but not off a cliff, for sure.

Jorge Rivas: I appreciate the thoughts. One last question for me, it's something that's happening in the industry in the past. Certainly, things have changed over the last five years or so. But we're starting to get questions from investors getting concerned about double ordering. So I want to get your take as far as whether that's - where the things are different this time, whether investors

should now be as concerned since where we are using VMI, something that wasn't there in the past. So if you can provide some context on that, I'd really appreciate it.

Jerry Rawls: Well, I think you hit a nail right on the head with VMI, because the last time we had a big inventory correction was back in our Q3 of 2011, our fiscal year 2011, and our wavelength selective switches and our 40 gig transceivers, and all of a sudden what had been enormous demand for a couple years before that, all of a sudden stopped because of inventory correction. Well, since then, most of - I mean those products are now in vendor managed inventory hubs. So we ship to hubs which kind of balance the inventory. We have some visibility as to what that inventory is.

Now, having said that, our customers do what businesses do when they're short in supply of key components. And that is they typically will double order and they will hoard and they will - they try to protect their revenue stream. And I think it is a natural behavior on the part of all the equipment companies.

And, we try to gauge where the shipments need to be to support production as opposed to where inventory builds might be taking place. But I think it's inevitable that they would build some inventory buildup. Now, with having said that though, I still think we'll see less of an impact from a correction than we have seen in the past just because of the inventory hubs that are in existence now.

Jorge Rivas: Okay. Just a quick follow-up with that. You and many other peers in this space are talking in terms of being capacity constrained. So would you think that, you know, your customers are getting close to engaging in that type of behavior at this stage?

Jerry Rawls: I couldn't tell you for sure because they never will admit that they are double ordering. But I would suggest that to the extent that there are limited supplies in the industry, the supply chains of big equipment companies are trying to place orders any place they can and so it's possible.

Jorge Rivas: Okay. Okay. Thanks. Appreciate it. That's all for me, guys.

Operator: And we'll hear next from Dave Kang with B. Riley.

Dave Kang: Yeah. Thank you. Kurt, can I get the depreciation/amortization number first?

Kurt Adzema: I think it was about \$22 million or \$23 million. I don't have it right in front of me.

Dave Kang: Okay, fair enough.

Kurt Adzema: It'll be in the 10-Q we just filed.

Dave Kang: Sure. And then regarding your outlook, you expect datacom to be up. Should we expect - obviously, 100G will be up. Should we expect 10G and 40G to be, what, flat to down a little bit and then 100G more than offset the decline?

Kurt Adzema: I would think that 10G will be flat to down and 40G will be relatively flat with the growth coming from 100G.

Dave Kang: Got it, got it. All right. All right. And then any kind of revenue you left on the table because of the component bottleneck, if any?

Kurt Adzema: Well, every quarter, there's always an amount of revenue that we leave on the table for certain products. But it's not a number we quantify.

Dave Kang: Okay. And then you said WSS was up 25% sequentially. What was the year-over-year growth?

Kurt Adzema: Again, I don't have that number in front of me. That's not a number that we typically break out.

Dave Kang:: Okay. If that is the case, WSS, up 25%. Obviously, something was a drag. Which telecom products were a drag on growth last quarter?

Jerry Rawls: I think it was just some of the legacy products. I think it was relatively flat. I think there was some of the older legacy products. I think amplifiers was a little bit down and some other stuff, but nothing really of note.

Dave Kang: All right. I think that was it. Thank you.

Operator: Next, we'll go to Dmitry Netis of William Blair.

Dmitry Netis: Thank you. Thanks for taking my question. I have a couple questions, more on the channel vertical specific kind of focused on the - in China, the wireless transceiver business, if you guys could comment where you are on that trajectory of exiting that business, have you exited completely? Is there some revenue still and if so, when does that sort of gets out of the model completely?

And then also from Web scale perspective, on the Web 2.0 in that channel, what are you seeing out there demand-wise? Is it healthy as it can be? Do you see some pockets of weakness from that channel? Just kind of a broader kind of look into the Web scale guys and what they're doing out there as far as demand goes.

Jerry Rawls: Wireless, we have not exited the business. We still sell opportunistically into the wireless business where we have capacity and where there is demand for capacity for buildouts, and that sometimes gets business at prices that we find attractive.

Dmitry Netis: Jerry, I just wanted to ask - we're talking about the CIPRI transceiver business for a wireless deployment, not the telco buildout. Okay, got it.

Jerry Rawls: Right. Let's see, the other one you asked about was? Tell me again.

Dmitry Netis: The Web 2.0.

Jerry Rawls: Web 2.0. Web 2.0 demand has been a little slow. It's hard to say because it's never uniform across all of the Web 2.0 cloud services providers, but we have seen, in some cases, demand for 40-gig to be down a little bit in anticipation of deploying 100-gig.

We also always see that forecasting in that space is always an iffy, it's just an iffy subject because they're not very accurate. And I suspect it's because of the construction project nature of their business that construction projects have holes and they have delays and they have other things that go on, and that delays the sequence of all the materials that get delivered to a job site.

So I think the demand - everything we know about the demand for Web 2.0 overall, it remains strong. And I think for the next year, it's going to be strong. It's just quarter-to-quarter, you see variations.

Dmitry Netis: And you guys mind separating that a bit and telling us what exactly - how much revenue is flowing through that channel versus maybe your enterprise business which I would venture to say probably still a fair majority of the datacom revenue you get?

Kurt Adzema: Yeah, I think we said in the past Web 2.0 is probably about 20% plus of datacom.

Dmitry Netis: Okay. Awesome, thanks. And can I ask again on the wireless side what percentage of the business - I know it's opportunistic sale from here on.

Kurt Adzema: As percent of overall or as a percent of telecom - I mean datacom, sorry?

Dmitry Netis: However you like to define it, datacom or overall.

Kurt Adzema: Yeah. As a percent of datacom, you know, it's approximately 10%.

Dmitry Netis: Okay. But do you expect that number to decline as...

Kurt Adzema: Well, we expected it to - again, as Jerry talked about, we're being very opportunistic in that space and playing in the space when we think, you know, it's accretive to EPS. We had expected it to decline last quarter some, it actually was flat. And I'd say right now, as we sit here today, we're expecting approximately flat next quarter as well. But again, it's such an opportunistic situation that, it can vary off of that.

Dmitry Netis: Okay. Okay. Great. All right. And that's very helpful. And if I may, maybe one last question, and this is getting more on the technical, I guess, side of things. As you look into the telecom market, there seem to be new products coming off your conveyor belt, manufacturing belt, if you will.

The ACO is one of them. It also seemed to be a quite competitive market with some new competitors announcing products as of late. There's some folks calling out kind of low cost



options that may have not penetrate the market initially, but over the long haul may benefit from their single-chip transmitter solution, et cetera.

So I'd like to get your perspective there, your two-chip solution today, is the modulators potentially - are they internally sourced that you're buying them externally? How are you approaching this ACO market on the telecom side of things?

And I also ask that in context of maybe Ciena, potentially one of your customers on the telecom side onboarding or buying some of the component companies like Teraxion and bringing some of that component capability in-house on the telecom side. I'd love to get your view there of what you think of that acquisition and how that may impact the overall space. Thank you.

Jerry Rawls: CFP2 coherent is a rapidly growing market, and it's going to be huge for optics. It's going to be huge for optics for the next several years. As all the telecom companies worldwide, as they upgrade their networks, they're putting in ROADM capabilities, and they're putting in the 100-gig and coherent. And it's a combination of the two that makes these networks so capable.

So now, to talk about how any one company that has not yet entered the market but has announced a product, but they haven't built it yet is hard to predict because those products aren't yet available to customers and aren't - at least, we're not running into them. So I hear the announcements. I read the announcements.

I anticipate that there are going to be new entrants that will have real products in the market. I suspect when we go to OFC this year, we're going to see some first-off samples that will be demonstrated there by one or more companies. But I'm not going to predict yet that we won't be very competitive with those, and our solution is an internal laser and an internal modulator.

Operator: We'll move on to our next question from Michael Genovese with MKM Partners.

Michael Genovese: Thanks very much and please excuse the voice. I'm under the weather here today.

So I'm just going to ask one question which is revenue timing expectations on CFP2-ACO. When do you expect to have your initial revenues? Is that going to be off of a pilot line? Would we then expect a couple quarters later that it would start to ramp towards volume? Just some update on the timing there, please.

Jerry Rawls: We'll have our first revenues this quarter off of a pilot line. We'll have and as we - over the next few quarters after that, we will start moving - we will be moving that product into one of our Asian plants for volume ramp.

Michael Genovese: Great. That's all for me. Thank you.

Operator That will conclude our question-and-answer session for today. Mr. Rawls, I will turn the conference back to you for any additional or closing remarks.

Jerry Rawls: Great. Thank you, (Sarah), and thanks to everyone who tuned in today. We appreciate your taking the time to spend with us, and we hope you'll be able to join us again in three months. Everybody, have a good day or a good evening. Thanks.

Operator: Ladies and gentlemen, again that does conclude today's conference. We thank you all for joining us.

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