

FINISAR CORPORATION

**Moderator: Jerry Rawls
December 4, 2014
4:00 pm CT**

Operator: Please stand by, we're about to begin. Good afternoon, ladies and gentlemen. And welcome to the Finisar Corporation Announces Second Quarter Results Conference Call. Just a quick reminder, today's call is being recorded. And now at this time, I'll like to turn things over to Jerry Rawls, Executive Chairman.

Jerry Rawls: Thank you, Kevin and good afternoon, everyone. We appreciate you taking the time to listen to our conference call today. A replay of this call should appear on our Web site 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 you should enter the ID number 1607677.

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 Web site at www.finisar.com, click on Investors, then scroll down to Webcast Archives and click. You'll see a listing for today's second quarter 2015 earnings call.

Revenues for our second fiscal quarter were \$297 million, an increase of \$6.3 million compared to the second fiscal quarter of 2014, but a decrease of \$30.7 million or 9.4% from the first fiscal quarter of fiscal 2015.

The second quarter was challenging. During the quarter we experienced decreased demand from both the telecom and datacom markets. Telecom suffered from sluggish carrier capital expenditures and datacom saw decreased sales of transceivers for wireless applications. In addition, datacom revenues declined, due to lumpy orders from a few large customers.

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

Kurt Adzema: Thanks Jerry.

The sale of products for datacom applications decreased by \$25.3 million or 10.5% compared to the preceding quarter.

The sale of products for telecom applications decreased by \$5.3 million or 6.2% compared to the preceding quarter.

In the second quarter, we had one 10% or greater customer.

Our top 10 customers represented 55.8% of total revenues, compared to 57.7% in the preceding quarter.

Non-GAAP gross margin decreased to 31.1% from 32% in the preceding quarter, primarily driven by decreased revenue levels and an increase in depreciation.

Non-GAAP operating expenses decreased by \$2.1 million, primarily due to lower legal costs related to ongoing patent litigation. During the quarter, the company resolved one of its outstanding patent litigation cases.

Non-GAAP operating income decreased \$10.4 million to \$25 million or 8.4% of revenues, compared to \$35.4 million or 10.8% of revenues in the preceding quarter, primarily as a result of lower revenue and gross margins.

Non-GAAP income was \$23.5 million or 23 cents per diluted share, compared to \$33.3 million or 32 cents in the preceding quarter.

Average diluted shares for non-GAAP purposes totaled \$105.3 million. This includes the impact of converting the outstanding principal amount of our 5% convertible notes to equity for a purpose of calculating EPS. Therefore you need to add back approximately \$533,000 of interest expense and other costs associated with the 5% convertible notes to calculate diluted EPS.

Towards the end of the quarter, the company announced its intent to redeem the remaining \$40 million of outstanding principal of our 5% converts due 2029. Prior to the scheduled redemption the holders voluntarily converted such notes into shares of Finisar common stock.

The notes were converted in accordance with the existing terms of the notes. \$3.4 million were converted for approximately 314,000 shares on the Friday during the last week of the quarter. The remaining \$36.7 million were converted during the first week of the third quarter for approximately 3.4 million shares.

For non-GAAP purposes, for our \$258 million of 0.5% convertible notes due in 2033, the interest expense associated with these convertible notes was approximately \$323,000 in Q2.

This interest expense is the only impact of these converts on our non-GAAP diluted earnings per share. For purposes of calculating non-GAAP diluted earnings per share for Q2, no shares are added as the result of the issuance of the 0.5% convertible notes.

Non-GAAP taxes are estimated at 6% for the remainder of fiscal 2015.

Weighted average fully diluted shares for fiscal third quarter are expected to be approximately 105.7 million for non-GAAP purposes.

Second quarter capital expenditures totaled \$28.4 million. This was less than our prior forecast of approximately \$45 million, primarily due to an approximate one quarter delay in the completion of the second building of our new Wuxi, China factory, as well as the delay of certain planned capital expenditures due to lower than expected revenue levels.

Capital expenditures are expected to be approximately \$40 million in the third quarter, primarily driven by the continued construction of the second building of our new Wuxi, China factory.

We now expect the second building to be completed by March 2015 and we expect to have all volume manufacturing moved from Shanghai to Wuxi and re-qualify with customers by October 2015. We will continue to perform R&D and NPI manufacturing in Shanghai, as well as some corporate functions at that site.

Depreciation increased \$1.3 million in the second fiscal quarter. Third quarter depreciation is expected to increase approximately \$1.5 million.

Cash equivalents and short-term investments decreased \$20 million to \$477.4 million at the end of the second quarter compared to \$497.4 million at the end of the preceding quarter, primarily the results of capital expenditures of \$28.4 million increased inventory of \$14.7 million and legal settlement and associated expenses of approximately \$13.7 million.

There are number of non-cash or frequently occurring charges and benefits which we excluded from non-GAAP results. These totaled \$34.8 million last quarter. If you include all these items as required under GAAP, we generated a loss of \$11.4 million or \$0.11 per diluted share, compared to net income of \$14.2 million or \$0.14 per diluted share in the preceding quarter.

That concludes my comments and I'll turn it over to Eitan.

Eitan Gertel: Thanks Kurt. Our R&D spending in the second quarter was about \$45 million, down slightly from Q1. Our project and technology centers are spread around the world, US, China, Australia, Israel and Europe. We are pleased with our new product development efforts in devices, ICs and modules and our ability to ramp those new products into production volumes at our manufacturing sites.

At ECOC in September we demonstrated our next generation ROADM Technology, including our low profile dual 1 by 20 wavelength selective switch and a new high-resolution optical channel monitor.

In Q2 Finisar also demonstrated a 100 gigabit QSFP28 active optical cable, the first of several new products in the QSFP28 form factor.

We continue to make excellent progress on our development of our 100 gigabit CFP2 coherent module. Industry analysts forecast 100g coherent transceiver markets to be approximately \$400 million in calendar year 2016.

We expect our overall product development to be maintained at similar level as Q2, so that our R&D investments will be about \$46 million for our third quarter.

Now I'll turn the call back to Jerry for some final comments.

Jerry Rawls: Thanks Eitan. We expect our revenue to grow sequentially in the third fiscal quarter. This growth will primarily be driven by the demand for 40 gigabit and 100 gigabit datacom transceivers, as well as transceivers for wireless applications. We expect revenues for our third quarter will be in the range of \$297 million to \$312 million.

We expect non-GAAP gross margins to be approximately 31% as the benefit from growth in revenues is offset by the impact of one month of the annual telecom price reductions that typically take effect on January 1st. In addition as Kurt pointed out earlier, depreciation will increase by approximately \$1.5 million over Q2.

As a reminder our fourth quarter will have a full three months impact of the annual telecom price reduction.

Non-GAAP operating expenses are expected to be approximately flat with Q2, except for potential increase in sales and marketing due to higher revenue levels.

Non-GAAP operating margins are expected to be approximately 8.4% to 9.4%.

Non-GAAP earnings per diluted share should be in the range of 23 cents to 27 cents per share.

We continue to believe in the long term growth prospects of the Company. Finisar's revenue is driven primarily by the growth in worldwide demand for bandwidth, the ever increasing distribution and use of video and other digital information.

In addition Finisar continues to benefit from the growth in cloud services, which drives network hardware upgrades of existing datacenters and the build out of new hyper scale datacenters. These large datacenters need more high-speed optical connections.

Over time we believe datacenters and carriers will spend more money on optics to meet their needs for increased bandwidth and we believe Finisar is uniquely positioned with our broad product line, extensive customer engagements, profitable vertically integrated business model and strong balance sheet to capitalize on these market opportunities.

And now with that, I'm going to turn it back over to Kevin and open it up for questions.

Operator: Thank you. And if you would like to ask a question please signal by pressing star 1 on your telephone keypad. If you're using a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment. Once again press star 1 to ask a question.

And we'll take our first question from Mark Sue with RBC Capital Markets.

Mark Sue: Thank you. I'm trying to get a sense of the duration of the downturns, considering the weakness that we're seeing from of the carriers. Jerry you pointed out the growth in bandwidth, the growth in video, which is been a consistent theme for many years, but I'm just trying to get a sense of how long you think this current downturn that we might be in.

And a subsequent question would be how do we think about finding the business, moderating CAPEX or are we still adding capacity, particularly in the 100gig? Thank you.

Jerry Rawls: Well we think our revenues are going to increase in our third quarter and we're very optimistic about the future beyond that. So we had some rough water in this last quarter. It was a

tough quarter for us. But we're still very optimistic that strength in particular in the datacom sector is going to drive our revenues higher. Telecom, - Eitan, you want to talk a little bit about metro upgrades and some of the spending we expect to come in 2015 and 2016 there?

Eitan Gertel: In the telecom, the actual strength of metro is -- we expect it to be in the mid-2015. So right now we expect significant growth in telecom. We have some new products going into the market on a regular basis. So we moderate growth and fluctuating with the market but the significant growth we expect to happen when metro upgrades will be a reality.

Mark Sue: In '15.

Jerry Rawls: You asked about CAPEX...

Mark Sue: And then perhaps on your plans of just CAPEX, is it full speed ahead? Do we throttle that back a little bit near-term or it seems -- I'm just trying to get a sense of your expansion into your new plant and facilities.

Kurt Adzema: Sure, so again you saw last quarter, we did throttle it back some, based on revenue expectations for that quarter. But it's really on a product by product basis and there are definitely products where we need to add capacity and certainly there is CAPEX spent on ramping newer products.

So I still think until we finish the second Wuxi building, it's going to be high and I think that's going to go through, as we talked about, now it's probably going to go through the end of at least the fourth fiscal quarter and probably a little bit into Q1.

But then starting in Q2 we could get a more normalized CAPEX rate. But as Jerry, mentioned we expect growth in this business and in particular in areas like 40 gig and we're going to continue to add capacity there.

Mark Sue: Lastly, just competition wise, it seems the traditional fixed line telecom are now moving into datacom. If you're seeing any change in terms of dynamics in the datacom business competition wise? Thank you, gentlemen.

Jerry Rawls: Well datacom is competitive. We have a number of competitors there. And has it really changed? We see a few more Chinese competitors than we've probably seen -- if we see about this year versus last year. But one of the things that has occurred over the last several years is that we had a lot of success in terms of revenue growth in the datacom sector.

And therefore I think there's a number of competitors who here before had revenues mostly in telecom, that are now trying to build products that can be sold into the datacom sector. So we expect competition to stay vigorous, but I don't think it's going to be dramatically different than what it has been in the past.

Mark Sue: Thank you. Good luck, gentlemen.

Operator: We'll take our next question from Subu Subrahmanyam with The Juda Group. Please go ahead.

Subu Subrahmanyam: Thank you. I have two questions. The first one is on revenue. You mentioned in the commentary that there was some lumpy demand from some datacom customers. And I just wanted to understand if those were OEMs or the Web 2.0 players.

And on gross margin, I wanted to understand, given that April has a full quarter of telco price reductions, if you feel that trends with revenue growth and the price reductions, do you think gross margins could tick down from current levels.

My other question is on consolidation. Jerry, we've seen several moves in the last few months from different players in terms of consolidation at this space. And I wanted to get your thoughts on that.

Jerry Rawls: Let's see. Consolidation, I think it's a good thing. We have thought for a long time there's more companies in our industry that are doing research and development on the same products and I don't think that's very efficient. And I think the industry in general would benefit from having a fewer number of competitors. So if we could consolidate or if this industry could consolidate into a more efficient sector, it would be good for all of us I think.

Kurt Adzema: I'll take the gross margin question. We don't provide guidance for Q4 gross margin and that's highly dependent on revenue growth and mix. But as you point out, traditionally the fourth quarter gross margin is lower than third quarter gross margin, given that there is the full three months of the telecom price reductions baked in.

Jerry Rawls: The other thing you asked about Subu was revenue being lumpy and where was that? Well it was from customers who have construction projects that consume a lot of optics.

Subu Subrahmanyam: So these would be more end customers, kind of operators rather than the OEMs.

Is that right?

Jerry Rawls: Yes.

Subu Subrahmanyam: And final question, if you think about kind of the revenue trend, you talked about optimism growing into calendar '15. Do you think we're from a revenue perspective bottoming out in the October quarter and you expect quarter-over-quarter growth to continue? Do you have visibility for that going into 2015?

Kurt Adzema: Well again we don't provide guidance for Q4. I would say traditionally Q4 has been relatively flat, again because you've got all things else being equal, because you've got the full three months of the price erosion. But obviously each Q4 is very different if you look back at history. So again we're not providing guidance.

But in terms of long-term, certainly we think the business is going to continue to grow. It goes back to the prior question about capital expenditures. We wouldn't be spending the money we're spending to make sure we can make the products that our customers demand if we didn't think there was going to be growth. So we are still very confident about long-term growth.

Subu Subrahmanyam: Got it. Thank you.

Operator: We'll go next to Alex Henderson with Needham and Company.

Alex Henderson: Thanks. A couple of just very targeted questions and then a broader one. First, would there be growth in the guidance that you're giving for the upcoming quarter if we were to strip out the contribution to the quarter-to-quarter growth from China wireless sales?

Kurt Adzema: Are you saying if we excluded wireless? As Jerry mentioned we expect 40 gig and 100 gig to grow in the quarter. So even without growth in wireless we would expect the business to grow.

Alex Henderson: And can you give us any quantification of qualitatively what the relative contribution of that piece is, because it's such a big swing. It's so different from the rest of the business, particularly on the margin front?

Kurt Adzema: Well, I think it depends on where we are in the range of revenue guidance. It's a \$15 million range of revenue guidance. So depending on if we're at the high end or the low end, I think that that is going to drive it. But we think there is going to be meaningful growth in 40 gig and also 100 gig in a quarter, it's not just all wireless.

Alex Henderson: Is that China wireless piece the predominant variance between the high end and the low end or is it other factors?

Eitan Gertel: I don't think we can actually predict exactly if we're at the high end of the range, what products get us there. I mean, it's possible if we're at the high end of the range that it's driven by wireless but it's also for possible for the high end of the range that driven by 40 gig.

So I think is a lot of variables but I think when you take all those variables, product mix into account, revenue growth and the one-month of the price erosion, that's how we got our estimate of approximately, 31% gross margin.

Alex Henderson: The second question is on the CFP product line, to the CFP2 product line in the datacom segment. Can you quantify or give us some sense of what the trajectory of the combined revenues of those are? Is the erosion in the older CFP still a greater factor than the ramp in the CFP2 or has that started to stabilize and nose up? Where are we on that? It was sort of the impression that would be in the June July timeframe when that went positive.

Jerry Rawls: We're starting to ship more of the CFP2, but our revenues are still a lot more in CFP than they are in CFP2. And our revenues overall in the 100 gig Ethernet are growing and we expect them to continue to grow.

Alex Henderson: Okay. So the last question is just, can you give us some sense of what you think your long-term growth targets might look like at this point and what you think the long-term gross margin and operating margins might look like? What is your thought in terms of what the Company should be delivering under reasonable conditions in terms of growth, gross margins and operating margins?

Kurt Adzema: Well, again I think as you look at what industry analysts have, I think for the industry it's relatively low teen's revenue growth, but we traditionally have gained market-share. So and our hope is overall revenue to grow in the mid-teens over time.

In terms of where we want to get the business, obviously as we talked about last time, we're at lows of traditionally where gross margins have averaged. We've been as low as 30 and as high as 37. Our goal was to get them closer to the mid-30s but we got a long ways to go.

In terms of OpEx, our goal is to try to drive that closer to being 20% of revenue but again we've got a ways to go to that. We're continuing to invest in R&D as Eitan talked about but at the same time we're trying to show some leverage on the operating expense line as we expect to do this quarter.

Alex Henderson: Good. I'll cede the floor. Thanks.

Operator: We go next to Troy Jensen with Piper. Please go ahead.

Troy Jensen: Good afternoon, gentlemen. Just a follow-up on the datacom 10G and that was down. 40G and 100G was up. I'm curious, the declines in 10G, is it more just the lumpy aspect to the transition of 40 to 100 going faster than anticipated or is it ASP reductions? I'm just trying to get a sense for where are we in that 10G upgrade cycle in the data center?

Jerry Rawls: My guess is you've got some of everything that's rolled in there. We've got some that's lumpy because we sell a lot of it into the big data centers. We have some that goes into wireless, and as we said wireless was weak in the quarter and our prices never go up. So they always come down little bit. So there is always some impact of pricing in there.

Troy Jensen: So, Jerry, I know there's - you're expecting growth for the business and growth in datacom. Do you think we can get growth in 10G next year or is it the transition to the other speeds that are going to provide that growth?

Jerry Rawls: I think 10 gig will continue to grow for several years. Ten gigabits will be for the enterprise datacenters, will be the predominant speed for all the new switches that are going to be in used in enterprise networking. Now 40 gig is predominantly used by the Web 2.0 mega datacenters or hyperscale datacenters, and I think, the growth rate 40 gig is clearly going to be faster on a percentage basis than 10 gig will.

Troy Jensen: Fair, okay. And then last question, can you just talk about the range of ASP reductions for the Telco business? I'm assuming it's in the 10 to 15 but, you know, what end of the range would we have?

Kurt Adzema: It was the higher end of the 10% to 15% range again this year.

Troy Jensen: Okay perfect. All right, good luck guys.

Operator: We will go next to Joseph Wolf with Barclays. Please go ahead. Once again, Mr. Wolf, your line is open. Please check your mute button at this time, we're unable to hear you. Once again, Mr. Wolf, your line is open. Please check your mute button. Due to no response we will be moving on to the next question. At this time we'll go to James Kisner with Jefferies LLC.

James Kisner: So thanks for taking my questions. Just -- I just want to hit on industry consolidation again. I know you guys can't comment on any specific things in the works. So I'm wondering is there anything that would keep you from doing a large deal like conceptually or I guess sort of philosophically.

And if there were large an opportunity that were around, is that something you guys would be willing to participate in, given, if it was the right fit?

Kurt Adzema: I don't think there is anything conceptually or philosophically. As Jerry mentioned we're big believers in consolidation. We think the space needs consolidation. And, as he mentioned, there's a lot of activity going on in this space right now and we'll continue to evaluate it. But as always, there's a lot of factors that go into M&A deals and whether or not they get done and it can be challenging.

James Kisner: Great. So, I am just wondering you guys talked about a 100 gig QSFP28. I'm just wondering do you have any more visibility to just switching a 100 gig cycle, when things finally kind of go from the edge to the top of rack switches or I should say the aggregation switches, you know, for 100 gig? Do you see that - I'm hearing sort of middle of next year you kind of start, you know, researching 100 gig switching systems. Like what are your thoughts on that?

Eitan Gertel: It depends on the timing of the switches. I think lot of people are talking about deploying the IO, 25 gig IOs. And, our module is going to be ready between next year to the next two years

depending on the module specifically. But it's -- more of that is driven by the time of deployment of the 25 gig IOs.

James Kisner: Okay. Just one final one housekeeping. I know you guys didn't show your datacom and telecom trend; you kind of just give us some change in numbers of quarter-over-quarter. Is your intent to stop disclosing that details?

Kurt Adzema: No that detail is in the earning slides and I mentioned it in the script.

James Kisner: Okay. Thanks.

Kurt Adzema: Yeah.

Operator: Thank you. And we will go back to Joseph Wolf with Barclays. Please go ahead.

Joseph Wolf: Thanks. Can you guys hear me now?

Kurt Adzema: Yes.

Joseph Wolf: Okay great, thank you. Jerry you touched about this in one of the last answers, but I wanted to go back to 40 gig, which seems according to the numbers on the Ethernet side to be really ramping -- it looks with the Web 2.0 vendors, including Microsoft.

And I'm wondering if you see activity across all those big players and what you can tell us about the applications it is being used for and how quickly it should have been deployed across more than just Microsoft, who has talked about it publicly.

Jerry Rawls: Well, we sell our 40 gig QSFP products to a number of companies, but mostly they are in the Web 2.0 space as opposed to the OEM space. And the typical uses are for top-of-rack switch to the aggregation switch connections. So you're coming out with multiple -- but it's about density, in that you've got 10 gig lanes but in a single port you now can put four 10 gig lanes in a single plug-in, whereas before it was one 10 gig lane per plug-in. So it's increasing the density -- the bit density of the switch and it's mostly switch-to-switch connections.

Joseph Wolf: Okay, and is everybody moving in the same pace or is there opportunity for this to be a pretty good ramp as we move through calendar 2015?

Jerry Rawls: I think it's going to be a very healthy ramp as we move through 2015. And there is -- not everybody in this space has made the move from 10 gigabit to 40 gigabit yet. So there are still others yet to move.

Joseph Wolf: Okay. And also a follow-up on a consolidation, just a specific question, we've seen I guess Koch Industries with the Molex and then going out and buying Oplink, which I guess traditionally was more of a telecom player.

Can you talk about where you think that strategically is going and what that means for the industry; because it feels like there had been changing of the names of some of the companies but the actual number of companies competing hasn't shifted that much yet as we talk about consolidation.

Jerry Rawls: I think you are right on. Consolidation occurs when you have the number of participants actually decrease in number, and in this particular case with Koch Industries acquisition, we're not decreasing the number of participants. They just have a different ownership. But I do think it's very exciting that a deep pockets investment group like Koch Brothers would choose the optics industry as a place to put billions of their dollars at work.

Joseph Wolf: All right, thank you, guys.

Operator: And we'll go next to Bill Choi with Janney.

Bill Choi: Hey guys. A couple of questions. First, can you just talk a little bit about the \$2 million excess in obsolete inventory? And looking at -- the total inventories did go up quite a bit sequentially last quarter. Some of the increase was due to an acquisition this quarter. Can you talk about what you saw from the hub pull from the OEM companies and perhaps the linearity of that?

And lastly, what you guys are thinking when -- given your guidance, what you are thinking about the hub pull on that guidance? Thanks.

Kurt Adzema: Well, I think inventory going up is not a surprise when revenues were meaningfully were lower than expected. Obviously, we're working hard to reduce our inventory levels and adjust those accordingly based on our current forecast. So we'll continue to work on that. But that was not a big surprise.

In terms of CMI, inventory hubs, I don't think we saw anything unusual in the quarter. And again, our forecast typically is based on what our customers are telling us they're going to pull from those hubs in a quarter, which may end up being different. But it's our best estimate based on what's been pulled through this quarter so far and what our customers are telling us.

So, I don't think there was a lot there. In terms of your comment about E&O, again that is an accounting exercise and it is a non-cash charge. And so it's not a big deal.

Bill Choi: But could you say what the products were that was in that \$2 million?

Kurt Adzema: No, it's a mathematical exercise where we basically look at backward-looking usage versus the current inventory out there. So, I'm not going to get into all the details of what those products would be.

Bill Choi: Okay. And then the OEM pull. So the pull -- at least looking back in Q2, it was as forecasted predominantly. Because the reason I am asking is, you know, a number of OEMs have, you know, missed their September quarter numbers and guided down. So I'm just curious whether you saw any kind of deviance versus forecast maybe OEM and any linearity of that?

Kurt Adzema: Well, again, I think as we've talked about, if you assume our revenue is down then our CMI pulls were down. But as Jerry talked about, some of that was driven by some participants that don't necessarily use hubs. So, it's hard to parse that.

But I would say that, we expected revenues to be higher, which means probably hub pulls were a little bit less than expected. But, our forecast for the third quarter takes into account, you know, what we're seeing in terms of current trends of hub pulls.

Bill Choi: Okay. Last question, Eitan, can you talk about the timing of the 100 gig coherent in terms of first revenue? The \$400 million market number sounds interesting. Who else do you see really modularizing the 100 gig and do you think you will be first to market? Thanks.

Eitan Gertel: For us, our schedule as we said, I think even in the last call, we said by the end of the year, we're sampling our customers and by mid next year we expect to be in full production. We are dealing with a large number of customers. So we expect this transformation into the pluggable devices to be a pretty wide industry and a big opportunity for us.

As far as the actual timing and how they ramp, we roughly say it's the second half of next year. But from what we see is, it's not only new customers who are -- it includes customers who are

actually building line cards before and want to transfer to pluggable devices. So the opportunity is pretty sizeable.

Bill Choi: Okay, thank you.

Operator: We'll go next to Kent Schofield with Goldman Sachs.

Kent Schofield: Great. Thank you. On the telecom side of things, I was wondering if you could talk about a little bit geographically as we look into the next quarter and then any sort of commentary you may have on the previous quarter if you think that's helpful?

And then second question, just around the datacom side of things as we look into 2015; Jerry do you think there has been enough kind of competition that's come into the fray that we should think about you guys as more growing with the market or do you think that there is more, you know, share taking to be had in 2015?

Eitan Gertel: I think for geographic comment, it's hard to for us to see where the demand is because we have customers who are located geographically but they deploy their equipment in other geographies. But we didn't see substantial difference from what was in the last few quarters. So the behavior was not substantially different. But overall if you see, the softness in the telecom came pretty evenly across the geographies.

Kent Schofield: Thank you.

Jerry Rawls: With respect to datacom in 2015 and beyond, I think that the good thing about growth is that it happens at the highest speeds. And yes, though, there may be some competitors who appear in the market that weren't there a couple of years ago, most of them offer products that are not cutting edge.

And so when we gain market share and historically have gained market share, most of that comes not because we were knocking off new equipment companies in the industry and mostly became -- because as the speeds move higher we were there with products and we actually had fewer competitors at the higher speeds. So I think it's very possible that we would continue to gain market share in datacom.

Kent Schofield: Thank you.

Operator: And we'll go next to Patrick Newton with Stifel.

(Robert): Good afternoon. Thanks for taking my question. This is (Robert) in for Patrick today. Just kind of a house keeping question in a way. Kurt did you mention what the top 10 customers as a percent of revenue was number of 10% customers were in the current quarter?

Kurt Adzema: There was one 10% or greater customer and top 10 represented 55.8% versus 57.7% in the prior quarter.

(Robert): Great. Thank you for that. And then, I guess, Jerry, if we shift back to datacom, and I'm thinking kind of more with the wireless transceivers, was kind of the weakness in there derived from any geography? Was it China driven or from somewhere else?

Jerry Rawls: Well yes. I mean, China is the big market and so that's where most of the volume is.

(Robert): So if you think about that, so my understanding was that's pretty dilutive product to overall corporate average gross margin. Just kind of wondering, what kind of played into the margin in the quarter, if you saw kind of that weakness in the wireless transceivers, would expect maybe little better gross margin. Just looking for some thoughts on that.

Kurt Adzema: Sure, so you're right. From a product mix perspective, it was relatively favorable given the fact that the wireless stuff carry lower gross margin than our average. But at the same time you need to remember there was a pretty dramatic drop in volume because we're a vertically integrated manufacturer. We're got a fair amount of fixed costs. So I would say it was, favorable mix, but then, offset by the drop in volume.

(Robert): And then I guess kind of one last question if I may. So just want to make sure I understood expectations for the next quarter, thinking about the split between datacom and telecom, are we thinking datacom should be up year-over-year or telecom down to possibly flat or is there, what's kind of the mix or your thoughts on that?

Kurt Adzema: Do you mean quarter-over-quarter?

(Robert): Sure, quarter-over-quarter.

Kurt Adzema: Yes. So I think for the third quarter for telecom I would think it's going to be flat to slightly down given the one month of the telecom price erosion and the growth would primarily as Jerry mentioned be from 40 gig Ethernet, a 100 gig Ethernet and the wireless switch we've talked about, we include in our datacom product area.

(Robert): Got you. Great. Appreciate the answers.

Operator: We'll go next to Simon Leopold with Raymond James.

Simon Leopold: Great. Thank you very much for taking my question. Just a quick number, I missed in the prepared remarks with the actual CAPEX in the quarter?

Kurt Adzema: It's about \$28 million, \$28.4 million.

Simon Leopold: Great. Okay, appreciate that. And then just following up on the commentary around the datacenter in the 40 gig and lumpiness, it does sound that you're pretty confident about that business coming back.

And so I'd like to try to get a better understanding of the dynamic of the weakness in the reported quarter and the recovery in the coming quarter, how much of that is simply a single customer or few customers and project delays versus dynamics regarding either competition, pricing or production.

Essentially I'm trying to get a sense of whether this is pure lumpiness of activity and concentration or whether this a bigger picture trend, given that one your competitors talked about pause in 40G in the coming quarter, whether it's the sort of ebbs and flows. Sorry for the long winded question.

Jerry Rawls: Well we think 40 gig overall is going to grow for quite a while. So we're very positive on the sector. We're adding capacity. Some of that CAPEX, as Kurt talked about is headed in that direction. In the quarter the lumpiness had to do with project pauses.

And one of the things about the mega datacenter, hyper datacenter market is that they are construction projects and they're subject to construction delays and all of the pieces coming together at the right time and sometimes it isn't perfect.

Simon Leopold: And going back to the China wireless, in your July quarter I think you talked about some component shortages in the supply chain. I believe it was maybe some amplifiers that just slowed down activity in China and I think we had the impression that this problem was getting resolved and that China would ramp for wireless build outs in your October quarter.

And so to what degree were you surprised by weakness in China and what's the cause? Is it that they didn't resolve that supply chain problem or something else?

Kurt Adzema: Well, we had expected wireless to be significantly down in the second quarter and I would say it was even weaker than we had expected. At the time we gave guidance back in September, our hopes were that we'd start to see pick up again in the wireless in our last month of our quarter. It really didn't happen.

But as Jerry mentioned earlier in our Q3 we expect wireless to start growing again. So, we think that's a growth market overall and for us, but it was just one of those quarters. We had a really strong quarter in Q1 and it fell off dramatically in Q2. But we expect it to start to grow again.

Simon Leopold: I guess what I'm trying to get a sense of what was the reason? Is it that the customer is having a supply chain issue or they making a choice to simply spend less because they're trying to control CAPEX or have weaker demand? I'm trying to understand the source of the weakness?

Jerry Rawls: I'm not sure that we could tell you exactly what all the sources of weakness are. There was a supply chain problem with one of the ICs, critical ICs. But we've also heard feedback from China that said, there was inventory correction because there was too much inventory at not only the big carriers but also some of the equipment companies.

So they sound a little bit inconsistent to say wait a minute we've slowdown because we got a supply chain, but also our inventories are too high. So we got a correction. But part -- one of the problems is that there is always a bit of mystery when you're dealing with China. It's just a little different than sort of our traditional business in the US.

Operator: And we go next to Ted Moreau with Barrington Research.

Ted Morerau: Thanks for taking my questions. Getting back to this lumpiness in the 40 gig area, we hear a lot about kind of the pricing dynamics between the various Web 2.0 players. Do you think there has been a change in economics for this Web 2.0 guys, because of the aggressive pricing across that landscape and therefore that's trickling down to your level and causing the projects to move around a lot?

Jerry Rawls: No, I don't think so. I don't think any of the competitive aspects of that business are affecting the projects. Projects are mostly related to construction and sometimes weather, transportation. Lots of things can contribute to that.

And overall I can't -- with respect to the economics of the cloud services business, it's a little difficult for us to understand exactly how lucrative that business is for all of the participants right now.

I mean, it is obviously -- the expectations are very high, but the amount of money that is being spent on the expansion in that industry is unbelievable. So is the spending proportion also the opportunity? I don't know. I think Ted, we're going to have to depend on analysts like you to go and do the calculations.

Ted Morerau: Obviously, hopefully other guys can handle that. Getting into telecom a little bit, what happens -- and we hear a lot about a 100 gig and the customer base, the customer OEMs becoming little bit more vertically integrated. So what are the criteria that are most at risk that you as that happens in 100 gig?

Eitan Gertel: You mean the 100 gig coherent? Is that what you mean?

Ted Morerau: Correct, yeah.

Eitan Gertel: We look at it as opportunity because if you look at the cost dynamics of the 100 gig coherent when it started it was a very expensive solution and as more and more being deployed the cost effectiveness is coming around the DSP and the optics is coming the majority of the cost.

And our efforts in our pluggable CFP2 coherent is to bring more effectiveness, enable the higher density. And basically the people who make the DSP let them optimize their business on their core competency, but we supply an optical module to fit everybody's DSP.

So we think the opportunity here is to help our customers to reduce their costs and help the 100G coherent proliferate much deeper into the network when you enable lower cost and higher efficiency.

Operator: And we'll go next to Dmitry Netis with William Blair.

Dmitry Netis: Yes, gentlemen. Thank you very much for taking my question. I have a couple of ones.

One, on this China business, the wireless transceiver business, is there any visibility into the duration of that deployment? When does that start to roll off? Kind of give us your thoughts to the extent you could see that or hear from the OEM partners you're working with?

Jerry Rawls: Well the forecast that we've read would say, or have said, that there are something in the order of 2 million towers that are acquired to do a 4G upgrade in China. And in the last year they did a 200,000 tower upgrade. And now it's few hundred thousand more.

But at that rate it's going to take another two years at least, maybe three, and it depends a lot on the political winds in China, because a lot of the spending is driven national priorities, and that's little hard to predict sometimes.

Dmitry Netis: Okay, so it sounds like you feel that this business has another two year type run rate. And when it does roll off, what are you hoping to substitute that revenue with? Is it going to be just as you were saying 40G, 100G and maybe some of the telecom starts to ramp? Is that sort of what the strategy is to kind of tack on growth here or is there something else in the pipe?

Jerry Rawls: Well by then we hope our 100 gig CFP2 coherent is now a big success in the market and we get a big market share and we think that's going to help a lot. We think that there is still fourth generation upgrades of wireless in the rest of the world. China is leading world right now, but there are still lot of 3G towers in the rest of the world where upgrades are coming.

And I don't know when -- fifth generation is out there ahead of us somewhere. Now that's a few years away I think. But there is discussions, planning, experiments, hardware, lots of things going on where people are planning the next wireless generation, which will be even higher bandwidth.

Dmitry Netis: So it sounds like your footprint in China can help you maybe get into some other, those 4G LTE deployments elsewhere in the world, if they do commence.

Jerry Rawls: Sure.

Dmitry Netis: Got, you. All right. And then just wanted to revisit a few items, kind of old topics if you will. One is maybe to Eitan. On the silicon photonics front, what are you guys doing on that front? JDS recently talked about some partnerships that they are considering or working on; not that I'm expecting you to announce anything, but just kind of walk us through your thoughts there. That will be very helpful.

And then the second one, just on the Cisco relationship, Cisco switch business was actually pretty strong this past October quarter but the softness you had seen, it sounds from the results I'm looking at, it sounds it was more weighted towards that Web 2.0 vertical than maybe one of

your largest customers OEM customers. And just kind of revisit that customer if you will and give us some thoughts around the traction and strength of your business there? Thank you.

Eitan Gertel: Let me see if I remember all your questions. So you started asking me about silicon photonics. For us silicon photonics is just another technology. We have many technologies and we don't intend to specify each technology to each product.

Are we working on silicon photonics? We have projects in silicon photonics, we have demonstrated in ECOG which we think is one of the most advanced module in the market for silicon photonics from 2 by 50 gigabit, and it was a fully integrated transceiver. But the way we look at it is we will match any application with the most cost effective and best performance for our customers.

Silicon photonics for us is just another technology that we can use. The important message here is we have Indium phosphate, we have silicon photonics, we don't need to buy anybody, we don't need to have a major revamp in our operation to use it, and we'll use them as our products need them.

Jerry Rawls: Let's see, with respect to your Cisco question, Cisco is our largest customer. They have been for a long time. And they're a very good customer, a successful company. And as you pointed out, the softness in our datacom business in the last quarter was predominantly Web 2.0.

Operator: We will go next to Richard Shannon with Craig-Hallum.

Richard Shannon: Hi guys. I guess just a couple of questions from me. I'll start in 40 gig datacom. Curious what you think your share is there, whether it's -- like your sales is number one in the market and how that compares to your overall datacom share. And then also are you seeing or do you know of any component shortages searching into that market specifically?

Jerry Rawls: I don't know what our market share is in 40 gig datacom. I guess I'd have to dig up the Infonetics -- our Infonetics or light counting or one of those industry analysts and see what they have to say. But off the top of my head, I don't know what it is.

Eitan Gertel: I don't know what the number is but I think -- we still have capacity issues to deliver the market whenever they want to buy and we still ramp the capacity on that product.

Jerry Rawls: Yeah, I mean, the answer is for 40 gig we have more orders and we were able to deliver. So it's still pretty strong demand.

Richard Shannon: Okay. And to follow up on that question on capacity, is there a restraint on you adding capacity fast enough so you can relieve those constrains or is there equipment or other things that are preventing you from doing that?

Kurt Adzema: It's just test equipment at the end of the day. So, we're continuing to add capital equipment and that's driving some of the CAPEX that I talked about earlier.

Richard Shannon: Got it. Okay, that's helpful. And second question, Jerry, a follow up to your responses in earlier question regarding competition, specifically I think you mentioned some more competitors I'm assuming that are coming from China. A couple -- kind of two part question on that. Are you seeing this coming in as high as a 10 gig speed here? And if so, does this have any impact outside of China?

Jerry Rawls: We have seen historically competition that came from Chinese suppliers, where most of it appeared in the gray market. It was counterfeits, knockoffs, what were known as compatibles, where the security codes from the big OEMs were programmed into these devices, and many of

them even came with counterfeit labels that said they were from big OEMs. So that was the big sale of things from China.

In the last couple of years we have seen more in roads, and if that's the right word, more companies have making sales calls anyway, at least in some of the datacenter users that were, companies from China. So I think that's -- and some of those were 10 gigabit.

So, I don't think that that's really surprising, because most of the Chinese competitors are usually a couple of generations behind wherever our latest product is though, and the 10 gig product has been out there for several years.

Richard Shannon: Okay. That's a fair assessment. That's all my questions. Thanks, guys.

Operator: And this does conclude the Q&A session for today. At this time, I'd like to turn the conference over to Mr. Jerry Rawls for any additional and/or concluding comments.

Jerry Rawls: Well I thank you, Kevin and I appreciate your help and my thanks to everyone for tuning in today. We hope that you will come back in three months and join us again. So all of you have a good day.

Operator: Ladies and gentlemen, this does conclude today's conference. We thank you for your participation.

END