FINISAR CORPORATION

Moderator: Jerry Rawls
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4:00 pm CT

Operator: Good afternoon, ladies and gentlemen and welcome to the Finisar Corporation Announces Third Quarter Results conference call. Just a quick reminder, today's call is being recorded.

And now, at this time, I will turn things over to Jerry Rawls, Executive Chairman.

Jerry Rawls: Thank you, Matt, 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. And then enter the ID number 3629508.

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. In addition, 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, then scroll down and click on Website Webcast Archives. You'll see a listing for today's third quarter 2015 earnings call.

Revenues for our just completed third fiscal quarter were $306.3 million, an increase of $9.3 million over the prior quarter. Revenue growth was primarily driven by the demand for 40 gigabit and 100 gigabit transceivers for datacom applications, as well as transceivers for fourth generation wireless base station installations.

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

Kurt Adzema: Thanks, Jerry.

Datacom revenue increased by $18.5 million or 8.5% compared to the preceding quarter.

Telecom revenue decreased by $9.2 million or 11.3%, compared to the preceding quarter, primarily due to the impact of one month of the annual telecom price reduction that typically takes effect on January 1 and and a decrease in demand for transceivers for telecom applications driven by sluggish carrier CAPEX levels.

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

Our top 10 customers represented 56.1% of total revenues compared to 55.8% in the preceding quarter.

Non-GAAP gross margins decreased to 30% from 31.1% in the preceding quarter, primarily driven by the impact of one month of the telecom price reduction and the impact of substantial yield loss for a new optical engine product for supercomputing applications that we started to ramp into production during the quarter.

Non-GAAP operating expenses decreased $2.2 million to $65.1 million from $67.3 million in the preceding quarter.

Non-GAAP operating income increased $1.9 million to $26.9 million or 8.8% of revenues compared to $25 million or 8.4% in the preceding quarter, primarily as the result of higher revenue and lower operating expenses.

Non-GAAP income was $26.7 million or $0.25 per diluted share compared to $23.5 million or $0.23 in the preceding quarter.

Average diluted shares for non-GAAP purposes totaled 106 million.

For non-GAAP purposes, the interest expense for our $258 million of .5% convertible notes was approximately $323,000 in the third quarter. This interest expense is the only impact of these converts in our non-GAAP diluted earnings per share, as no shares are added to the fully diluted share count.

Third quarter capital expenditures totaled $31.7 million. This was less than our prior forecast of approximately $40 million.

Capital expenditures are expected to be approximately $35 million in the fourth quarter primarily driven by the continued construction of the second building on our new Wuxi, China factory.

We expect the second building to be completed by the end of the fourth quarter and we expect to have all remaining volume manufacturing move from Shanghai to Wuxi and re-qualified with the customers by the end of our second quarter of fiscal 2016.

We will continue to perform R&D and NPI manufacturing work in Shanghai as well as some corporate functions.

Cash, cash equivalents and short-term investments increased $11.4 million to $488.9 million at the end of the third quarter.

Non-GAAP taxes are estimated at 6% for the fourth quarter and 6% to 7% for fiscal 2016.

Weighted average fully diluted shares for the fiscal fourth quarter are expected to be approximately 107 million for non-GAAP purposes.

There are a number of non-cash or infrequently occurring charges and benefits which we exclude from non-GAAP results. These totaled $25 million last quarter. To include all these items as required under GAAP we generated net income of $1.7 million or $0.02 per diluted share compared to a net loss of $11.4 million or $0.11 per diluted share in the preceding quarter.

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

Eitan Gertel: Thanks, Kurt.

We expect revenues for our fourth quarter will be in the range of $310 to $330 million. Please note that the fourth quarter of fiscal 2015 will have 14 weeks compared to 13 weeks in prior quarter. However, the positive benefit of the revenues for extra week in the quarter will be partially offsetted by the impact of the Chinese New Year, which occurred in February.

We expect non-GAAP gross margins to be approximately 30%, primarily due to the impact of full three months of the annual telecom price reductions.

Non-GAAP operating expenses are expected to increase primarily due to the extra week relative to the prior quarter.

Non-GAAP operating margins are expected to be approximately 8% to 9%.

Non-GAAP earning per diluted share are expected to be in the range of $0.22 cents and $0.28 per share.

As a reminder, our first quarter of fiscal 2016 will once again have 13 weeks relative to 14 weeks in the fourth quarter of fiscal 2015.

We continue to believe in the long-term growth prospects of the company. Finisar revenue is driven primarily by growth in the worldwide demand for bandwidth with the ever increasing distribution and use of video, images and digital information.

In addition, Finisar continues to benefit from growth in cloud services, which drive networking hardware upgrades of existing data centers and build outs of new hyperscale data centers.

And now with that, I'm going to turn back over the call to Matt to open it up for questions.

Operator: Thank you. Ladies and gentlemen if you'd like to ask a question please signal by pressing star one on your telephone keypad. If you're on a speakerphone please make sure your mute function is turned off to allow your signal to reach our equipment.

Again, that is star one for questions. And at this time we will take a question from Joseph Wolf with Barclays. Please go ahead.

Joseph Wolf: Thanks, guys. Question about the guidance, the range implies a broad range of revenues very little on the margin side. Is there a large order in there that you're factoring into that guidance or is there some sort of mix that I'm not seeing in the - on the margin side of the guidance?

Kurt Adzema: Well, again, the guidance is reflective of the fact that we'll have the one extra week offset by the impact of Chinese New Year.

The gross margin guidance is reflective of the fact that we will have 14 weeks of expenses as well as we'll have the full three months of the telecom price reduction.

Joseph Wolf: So there could be some variability in the mix that's the kind of ((inaudible))

Kurt Adzema: There's always variability of mix.

Joseph Wolf: Okay, it's not one big contract out there that's providing us with that big range?

Kurt Adzema: No, we typically provide a range about that wide. We widened it up a little bit this quarter just to reflect the fact that we've got 14 weeks instead of 13 weeks.

Joseph Wolf: Okay, understood. I wanted to go in a little bit more detail into the 40 gig side. It sounds like the hyperscale data centers are still doing well. And I was hoping if you could talk to us a little bit about the pricing dynamic and the competitive forces going on in that market in terms of other players given now the growth prospects there.

Jerry Rawls: Well, as you point out, that market is still going strong. There are an awful lot of 40 gig transceivers in the QSFP form factor that are being consumed by a number of the big cloud services operators. And it's competitive market.

It's like all the markets that we participate in. It has a number of competitors and it's all about performance, it's all about economics. So, I don't know how to describe it much differently than that.

Joseph Wolf: Is there similar pricing pressure to the telecom side of the business right now?

Jerry Rawls: Well, the telecom pricing pressure comes mostly at the end of the calendar year where we have negotiations with the big equipment companies for prices that go for a yearly for 12 months.

There’re a few exceptions to that, but for the most part, we negotiate sort of 12-month agreements in the telecom business. So, that's behind us now.

Joseph Wolf: Okay. Thank you.

Operator: At this time, we'll take a question from James Kisner with Jefferies LLC.

James Kisner: Hi, guys, thanks for taking my question. So, just want to start with gross margin impact from the yield loss. Can you quantify that a little bit for us and does your guidance for the coming quarter assume that yield loss?

And I guess relatedly, like maybe you could talk about the revenues associated with this opportunity if they're coming in next quarter or did you see any this quarter, how big is it, et cetera.

Kurt Adzema: Well I'd say the impact this quarter of that yield loss was probably about 75 basis. Certainly, we're working on improving that yield, but as of today we haven't made as much progress as we'd like.

So, I think we will continue to be challenged this quarter, but hopefully by the time we get into Q1 we'll start to see some of the benefits. In terms of the revenue opportunity, I think the revenue opportunity right now is still relatively small versus our overall business.

But certainly it's a business that we hope once we improve the yield that we'll be able to ramp and sell a lot more. But it's still a pretty small part of our business even though it's having a big impact on our gross margins.

James Kisner: Great. Okay, 100 gig strength in Datacom. Is it fair to say that’s driven by the ramp of CFP2? Is that becoming a more substantial revenue contributor?

I guess I'm assuming it's a lot bigger than the ((inaudible)) 100 gig. Could you give us any kind of texture on whether or not CFP2 is contributing? Perhaps you can tell us kind of the rough proportion of 100 gig revenues coming from CFP2?

Jerry Rawls: Let's see, our crossover for CFP2 to CFP is - we're not quite there but we're almost there. And we had substantial growth in CFP2 but we also had - we had a very good quarter for the CFPs.

James Kisner: That's interesting. Are you seeing any - and I assume this is the CFP2s are going to systems that are not with your largest datacom customer. Are you seeing the CPAK module out there, any kind of competition from that?

Jerry Rawls: I don't really have a lot of good data on that one. We don't see much of it but I know that they're being sold. So I don't - and I couldn't comment on the volumes, I couldn't comment on the impact if there is, an impact on our business because I just don't know.

James Kisner: Okay. Last question, just telecom, obviously it's very challenging around for everybody here so you are not alone. But any thoughts on the outlook for the year? Fourteen percent year-over-year decline, I mean, is that how we should think about telecom sort of through this year or is there a reason to think that telecom could get significantly better? Thanks.

Eitan Gertel: The way we're guiding telecom for next quarter we say it's pretty much flat with this quarter and maybe with the 14 weeks, it's slightly up, but no significant change quarter-over-quarter.

There are some new products that have come into the market right now from us. And as they ramp through the year, we should see an improvement. But, most improvement like we were talking before what will be the driver for telecom will be the metro. That still has few quarters to go before it becomes meaningful for the revenue in that segment.

James Kisner: All right. Thanks, guys, I'll pass it. I appreciate it.

Operator: At this time we will take a question from Mark Sue with RBC Capital Markets.

Mark Sue: Thank you. Gentlemen, you made some really strong improvements in operating expenses reduction during the quarter and then I'm trying to get a sense of what part of that is actual changes that you've taken out in OpEx or is it really rather expenses moving from quarter to quarter.

Kurt Adzema: Well, I think there are several factors. Certainly we are focused on trying to keep OpEx relatively flat given the decline in gross margins so that we can improve our operating margins. So there’s certainly a lot of focus on that.

We did benefit some this quarter based on the continuing strengthening of the dollar. So I think that's part of it. And we did have some expenses that we thought we'd spend this quarter on R&D project materials that got pushed into next quarter.

So, I'd say it's a combination of all three of those things.

Mark Sue: Okay, that's helpful. And, gentlemen, on the gross margins, recognizing the telecom price reductions, the mix in the volume, are you also starting to see intensifying competition on 40 and potentially 100 gig? If so, is there some preemptive thought to kind of maintain your market share in these two transport speeds implied in the gross margin?

Kurt Adzema: So, I think as Jerry mentioned, 40 gig datacom side and 100 it continues to be a very competitive space. And obviously we're working hard to maintain our margins despite any pricing pressure that we see.

Mark Sue: Okay. And lastly, as it relates to competition and industry structure. Jerry, now that you've had a chance to look at the Form 10 from JDSU, what are your thoughts in terms of consolidation and you're more interested, less interested as to say your thoughts on just going at it alone or offsetting some price competition with greater scale?

Jerry Rawls: Well, we continue to believe that consolidation is important in our industry and it would be attractive to achieve consolidation. But with respect to JDSU or any other company, I don't think we have any particular comments to make.

Operator: Mr. Sue, did you have anything further?

Mark Sue: Thank you.

Operator: This time we'll take a question from Kent Schofield with Goldman Sachs.

Kent Schofield: Great, thank you. Just one from me. Around the web scale guys and I guess in particular kind of the Web 2.0, guys, can you just talk a little bit structurally about your visibility there?

And then just kind of the activity that you're seeing on the go forward as we look at some of the CAPEX estimates going forward. They are slowing some but just want to get a sense for how you're thinking about that and how your visibility is - has evolved over time?

Jerry Rawls: Well, one of the frustrations of that Web 2.0 sector is that all of the revenue that goes into it, at least from our end, is sort of dependent upon construction projects. And the construction projects have many facets.

There's physical structure, there's electrical distribution, there's air conditioning, there's the wiring, there's all of the hardware that goes in. And if any one of those runs late, then the whole project runs late and you get our optics after you got all the stuff in place get plugged in and now you connect everything.

So, forecasting has been a challenge because our customers in these construction projects have been challenged with having predictable schedules. And so the business is strong. The market has still a lot of demand. Percentage growth may be slower in the future than it has been in the past, I've read predictions like that.

But the absolute magnitude of the growth is greater than it has been in the past and - or we expect it to be. So, I'm - it's a big market becoming a much bigger market. So we're still paying a lot of attention there. And we just wish that there was a little less volatility, if that's the right word, in the shipment patterns that we have with the big 2.0 operators.

Kent Schofield: Thank you Jerry for the color.

Operator: And at this time we'll take a question from Subu Subrahmanyan with Juda Group.

Subu Subrahmanyan: Thank you. I have two questions. First, on the 13 weeks versus 14 weeks, I know you mentioned that there is some benefit in the 14 weeks partially offset by Chinese New Year.

If we look out to July and if you just look historically, if you return back to a 13 week quarter, has that traditionally meant kind of a revenue decline or less of an increase? How has that worked out historically and how do you expect it to play out this year?

Kurt Adzema: Well, Subu, we changed our fiscal year two years ago in fiscal '13. And so for most fiscal years, we have 13 weeks in every quarter. And it's only once every four years to five years that the fourth quarter will have 14 weeks.

So we've never had this experience before. But as you think about Q1 given the fact that Q1 will have 13 weeks and Q4 will have 14 weeks, then I would expect revenues would decline just based on the pure number of weeks in the quarter.

Subu Subrahmanyan: And is it linear, Kurt? I mean, 13 weeks and 14 weeks, this is 7% difference, should we think about that or is it not that linear?

Kurt Adzema: Well, again, I think in this quarter you've got the benefit of 14 weeks and some partial offset as the result of Chinese New Year. So, you have to take that delta and then apply it.

And then if there was a 13 to 13 week basis, certainly we would expect some level of growth going from Q4 to Q1. So then you should once you've adjusted for 13 weeks versus 14 weeks you should layer in a little bit of growth.

Subu Subrahmanyan: Understood. And then gross margin, I think you mentioned that the impact of the low yield was about 75 basis points, you have some ongoing impacts.

So, if I look past April, you don't have the telco price reductions going into July. The CAPEX starts to level off. Hopefully the yield issues which still continue to impact this quarter start to lighten. How should we think about gross margin trend line past the April quarter?

Kurt Adzema: I would say we obviously don't provide guidance but typically the first quarter gross margin is higher than fourth quarter gross margin. So, hopefully that pattern continues.

Subu Subrahmanyan: And then how should we think about the impact of if the yield issues are fixed and the CAPEX declines, just those two factors, what kind of a swing factor do those create on gross margin?

Kurt Adzema: It's hard to break that down because obviously if the yield improves then we're also shipping more units and so some of that offsets each other. But certainly we've seen in the past - again, we could look at historically meaningful improvement in the first quarter gross margin over the fourth quarter.

Subu Subrahmanyan: Understood. And final question on telco. Jerry, Eitan, this quarter the level of telco revenues is the lowest revenue in five years since you started breaking it out.

And I know, I understand the carrier CAPEX challenges and still waiting for metro. But how do you think about this business in terms of investing in telco, given it continues to decline as a percentage of revenue and hitting kind of multiyear lows at a time where the market's not healthy but for your competitors it's not as challenging as it seems for you as well?

Eitan Gertel: Currently, Subu, we're investing in the most strategic products that we think is going to have the growth. And obviously in the product that's not going to give us the return on investment we're reducing the level of R&D.

Obviously we have big investments going in coherent and some level of wss and tunable. So, we choose our products and we try to match what we expect from the growth and what we expect the best return to be.

Subu Subrahmanyan: I understand, just we've been in that 70, I mean, 70 - $80 to $90 million for a long time now. We're closing, probably closer to $70 million. I'm just wondering from a run rate perspective as things get better, should be - should this be 30% of revenues, I mean 40%? Is it a $100 million run rate?

Just trying to understand given the steep declines we've seen in telecom, what the real run rate of this business is as you start getting back to some growth areas.

Eitan Gertel: Well, I think if you look at the long-term I'm still hoping that this thing will be coming back to the $100 million level. I can't tell you exactly when that will happen.

It's actually it's all the ramp-up of new product, it's the impact of all the upgrades in the metro and actually some of the telecom products spreading to - and going into non-telecom application with telecom type product.

So, all those combined together should help grow the revenue. But on the long-term, I expect that to be in the $100 million level.

Subu Subrahmanyan: Okay, got it. Thank you.

Operator: And at this time we will hear from Simon Leopold with Raymond James.

Simon Leopold: Thank you very much. I wanted to just check on this, just keep our lives simple, in terms of the OpEx trend with the extra week. You're suggesting April would be around 70-ish million, 69, 70 million and then July operating expenses should be similar to the January level. Is that the way we should think about it?

Kurt Adzema: I would say operating expenses, most of it is variable. So, if you looked at that I would say you're probably going to increase about 3.5 million or so this quarter.

And then, that 3.5 million would go back down the following quarter. But then there is obviously kind of a normal growth rate of operating expenses. And in the third quarter we just finished, we were at a pretty historically low level given some of the push out in the project material on the R&D side.

So I'd say there will be some growth in fiscal Q1 versus fiscal Q3.

Simon Leopold: Okay. Thank you. And then, you talked about the web scale, guys. I haven't heard much mention of submarine exposure and a number of the OEMs, your customers on the systems side have been taking about submarine opportunities both literally under ocean or opportunities at landing sites.

I'm wondering if you could give us some sense of how big an opportunity that is for your business and what the growth trends are?

Eitan Gertel: I think, Simon, the answer to that is I don't know, because a lot of equipment that goes in the edge of the submarine line is the regular equipment we sell to other telco applications.

So we know there are some submarine lines looking at equipment from us but we don't know how much of it is going to either one of the applications. Some of them are starting to look at the high data rate coherence and things like that. But there is still time to go for that to be meaningful. But the rest of it I wouldn't know how to break it down.

Simon Leopold: And does that fall in your telco or your datacom segment?

Eitan Gertel: Well, I think majority of it is in the telco side. But, again, I don't have the visibility to that.

Simon Leopold: Okay and then several quarters back, the increased exposure to China and China backhaul affected your gross margin. I'm just wondering where those projects are in light of what looks like flattening CAPEX in calendar '15 in China as China Mobile slows and maybe Telecom and Unicom ramp.

Can you talk a little bit about the dynamic of China and how that affects your business?

Eitan Gertel: Well, the backhaul equipment which we talked to wireless, we talked about China, was slightly up this quarter. Not much and we predict it to be slightly up again but not any significant, so the level is flat to slightly up over the prior quarter and the quarter looking forward.

And the margin impact of those is the same as it was before, it's below our corporate average.

Simon Leopold: Okay, and then you've talked about long-term targets particularly the gross margin trending towards the mid-30range. I just want to do a check on how you feel about those targets.

And whether we should think about trending towards the mid-30s over a period of couple of years or whether you feel like you can exit fiscal 2016 significantly higher.

Just want to get an idea of what kind of slope we should think about towards the longer-term targets.

Kurt Adzema: Well, certainly we've got a ways to go, given our guidance in Q4 of approximately 30%. But certain we're certainly aiming to get back to the mid-30s but I think we've got a couple of years to get there.

So we should see some improvement from the 30 range in FY 16 we hope. Obviously, it depends on revenue growth and mix. But, we've got a couple of years where we need to continue to prove it to get to where we really want it to be.

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

Operator: And at this time, we'll take a question from Patrick Newton with Stifel.

Patrick Newton: Yes, thank you for taking my questions. I wanted to dive a little bit into the OpEx slightly. In your prepared remarks you talked about significantly decreasing operating expenses but then during this kind of Q&A you talked about that January's at historically low levels, getting some push outs of R&D projects.

So, should we think about Finisar as being in a period or perhaps exiting a period where they've invested aggressively in R&D and we should start to see that line item growth be below the revenue growth rate?

And that you're in somewhat of a harvest mode or conversely should we tend to think that OpEx should relatively pace the revenue growth rate over in the intermediate term period?

Kurt Adzema: We're hoping to keep operating expenses relatively flat so that we get some leverage to that extent. And our goal is to ultimately drive that close to 20% of revenue over time.

That'll obviously depend on when we get there, will obviously depend on pace on revenue growth. But certainly we're looking to get some level of leverage on the operating expense line realizing that some quarters are going to lumpy and some are going to be up and some are going to be down.

So it's not going to necessarily be a straight line. But we certainly are driving towards getting some operating leverage at the operating expense line.

Patrick Newton: Great, that's helpful. And then I guess, Jerry, I wanted to dig into datacom mix in the quarter and how we should think about on a go forward base. You did talk about hyperscale being up a little bit, I think, wireless, you did talk about some sequential growth.

Can you give us a little bit on your thoughts on the enterprise business on the fiber channel storage side of the business? And then also, any thoughts that you have on the transaction between Avago and Emulex and does that change the competitive landscape or impact your customer rates at all?

Jerry Rawls: Let's see, datacom in general, I would say, the enterprise part of the business is mostly 10-gigabit Ethernet and 10-gigabit Ethernet continues to be a good product and revenues we expect for the quarter will be up a bit in that sector.

It's not, the 100-gig and 40-gig have pretty specific targets but they're not really enterprise. They tend to be hyperscale or the client sides of routers.

But overall enterprise seems to be doing well with moderate growth rates. The fiber channel sector, I mean, it's again not a rapidly growing sector overall. But one of the things that we're seeing now is much more rapid take of 16-gig fiber channel.

Most of our shipments for several years now have been 8-gigabit fiber channel. And the 16-gig was sort of limited to the switch makers. But now we're starting to ship 16-gigabit fiber channel to a number of the equipment suppliers of the storage arrays and host bus adapters, et cetera.

So we expect that 16-gig will be greater than 8-gig shipments here probably within the next year.

Patrick Newton: Any comments on of Avago, Emulex?

Jerry Rawls: Oh, Avago, Emulex. I don't really have a view of that one. Emulex has been a good customer of ours for a long time. On the other hand, Avago is a competitor in that datacom space. And so my guess is there’s going to be some decisions that have to be made there.

But in general, any customer, any one of the equipment companies wants to have at least two sources of supply even if one is internal. So, I would expect that we will still have an ongoing relationship with Emulex.

Patrick Newton: Great. Thank you for taking my questions, good luck.

Operator: Just a reminder that is star one for questions. At this time, we'll move to Troy Jensen with Piper.

Troy Jensen: Hey, thanks for taking my question and congrats on the quarter gentlemen. A quick one for Jerry. One of your competitors in datacom had a problem with the 40-gig components in the quarter.

So, I was wondering if you saw a benefit in your - the January quarter revenues by the April quarter guidance due to share gains at this Web 2.0 company.

Jerry Rawls: We think so but nobody told us exactly. There is an element of security and maybe you can even say secrecy that goes with some of the Web 2.0 competitors.

I mean the competitor - guys that are in the Web 2.0 business building out these data centers and they're trying to protect information about their business and their activities.

So, it's not always that we have very specific information about why is our business going up or why was our business going down. In this case, it was going up.

Troy Jensen: All right, that's fair. Maybe a follow up for Eitan, can you just give an update on how the samples of the 100G coherent CFP2 modules have been received and just also, on the timing, when you think that ramps?

Eitan Gertel: I would say we're shipping samples to customers. Customers have received our sample have very good response, they're very happy with our performance. In some cases, they're surprised of the performance, but it's early days, it's really at alpha stage.

And as far as the program versus our schedule, I would say, plus-minus couple of weeks we're on schedule. So, we expect to continue with the program, continue with our ramp. It's a significant product - program from us and again we're excited about the performance and the level we can achieve from this module.

Troy Jensen: All right, perfect. Good luck, gentlemen.

Operator: At this time, we'll move to Jorge Rivas with Craig-Hallum. Please go ahead.

Jorge Rivas: Good afternoon. Thanks for taking my question. So, you know, a complicated question but I will ask it anyway because your datacom mix is as high as it's ever been.

So, if we were to exclude the impact from the yield loss on the optical engine and it sounds like the impact on the mix from the wireless transceivers it's been the same as in the past couple quarters this would suggest that your rest of the business gross margins are not even close to what you did about a year ago which was about 37%. So, I wonder you can walk me through, you know, what's going on in the rest of the business.

Are you seeing more pricing pressure in datacom or is it just that telecom given the lower base of revenues you're experiencing a probably one time pretty low gross margins for this quarter.

And we would eventually expect that to go back to where it was once telecom picks up. If you can just walk me through what's going on with the gross margins it would be great.

Jerry Rawls: Well, the biggest change over that period when our gross margins have gone from 37% to 30% has been in the 100-gig Ethernet. If you recall, if we go back year and a half ago, we had virtually - I don't know, if we didn't have 100% of the market, we had 85% or 90% of the market.

We were an early entry. We had a CFP 100-gig LR4 device that was fully functional. It contained an IC set that we designed here at Finisar and there was no other functional ICs in the industry.

And so, our sales were growing very rapidly. Our margins were exceptionally high. We were on allocation for several quarters and - but all that came to an end as merchant semiconductor companies were able to correct the errors in their chips and produce functional chips.

And so then a number of competitors were empowered, they entered the market at substantially lower prices and so we had to - our prices had to come down to be competitive. So that has been the largest impact on our margins over the last year, year and a half.

Jorge Rivas: Thank you, Jerry, really appreciate it. And then just going on the business, if we split it out by speeds, has it changed from last quarter, meaning that 40-gig is the fastest growing part of the business, and 10-gig remains the largest portion of revenues?

Jerry Rawls: Yes.

Jorge Rivas: It's still the same?

Jerry Rawls: It's still the same.

Jorge Rivas: Okay. All right, thanks all from me. Thanks guys.

Male: Thanks.

Operator: At this time we'll go to Ted Moreau with Barrington Research.

Ted Moreau: Great, thank you guys. Just wanted to follow up on the 100-gig CFP comment that you just had Jerry. Given some of your competitors or many of your competitors are out may be a little bit earlier competing in the CFP2 versus what they were on the CFP4 and the original CFP, can you just talk about what are going to be the dynamics of winning opportunities?

Is it going to be time to market, performance, price? And then how do you see a more competitive CFP2 business impacting your overall business?

Jerry Rawls: Let's see, CFP2 is going to be an exciting product area. It is exciting for us right now in that we are shipping everything we can build. If we could double our output, we could sell double our output. But we are increasing our capacity.

Demand is strong. The equipment companies are designing blades that have CFP2 ports because they can double the density on their blades. And I think it's an exciting market.

Now, the margins there will never be as high as they were with our original CFP because we have competitors and in CFP we were the only game in town.

So - but the margins are quite good. I mean it's not like it's a bad product. It's a good product and we think the demand is going to be strong as equipment companies convert their boxes to having these high density blades.

I mean there's still a lot of ports for CFP, there’s a lot of ports even that are being shipped from the OEMs, but there's a lot of ports in the field that are - that where shipped where blades were not fully populated and for the expansion of networks at - in central offices.

They continue to buy CFPs and plug them in the CFP slots. So we're going to see CFP revenue for quite some time. But CFP2 is clearly growing faster.

Ted Moreau: Okay. And how does CFP2 margins compare to corporate average?

Jerry Rawls: Higher.

Ted Moreau: Okay.

Jerry Rawls: CFP2 is higher than the corporate average.

Ted Moreau: Okay, great. And then, one other question. You were talking about - there was a question about consolidation in the industry. And if you were to play a role in consolidation, what would you be looking for?

I mean, would you look to just to gain scale? Would it be to eliminate a competitor, to make it less challenging competitive environment? Would it be to pick up a technology? What are your thought process there.

Jerry Rawls: All of the above.

Jerry Rawls: Any consolidation move could accomplish any one of those things or multiple of them. And, the more of the factors that you could make a positive contribution through some acquisition, I mean, that makes it more attractive. That means there is more value there.

Ted Moreau: Okay, thank you very much.

Operator: Moving forward, we'll hear from Michael Genovese with MKM Partners.

Michael Genovese: Great. Thanks. I just have one question. You've already indicated somewhat how we should think about 1Q revenues. So, if we look beyond the quarter - the current quarter, two quarters out, on the gross margins two quarters out, are you willing to say that 4Q should mark the bottom and then we should be up in 1Q sequentially a bit?

Kurt Adzema: Well, again we're not providing guidance for that. But, historically, Q1 has had better gross margins than the Q4.

Michael Genovese: That's all I have. Thanks.

Operator: Dmitry Netis with William Blair has the next question.

Dmitry Netis: Thank you for squeezing me in, a couple of quick ones for me. I was just wondering, the depreciation expense that was going through the gross margin due to construction of the facility in China, when does that, Kurt, begin - begins to alleviate? And is that a multi-year effect? is that a couple of quarter effect?

Kurt Adzema: Well, I'll answer it two ways. I think capital expenditures after this quarter should start to decline. As I mentioned, the second building should be done this quarter. And so I would expect capital expenditures to start to decline as the result of that.

In terms of depreciation, I expect depreciation to continue to increase because again you're comparing current CAPEX levels with what's rolling off five years - that you spent five years ago.

So depreciation will continue to increase but CAPEX should come down and the rate of change of the depreciation should start to be less.

Dmitry Netis: And how much basis points did that contribute in the quarter, that effect of depreciation expense in the gross margin?

Kurt Adzema: Well again, in this quarter, depreciation went up, I think, about $400,000.

Dmitry Netis: Okay. All right, excellent. Thank you. And then, again, a quick one on telecom side. I know a lot of questions have been asked on that front. But, I'm just curious, like, the competitors - one of the major competitors there had seen their ROADM business actually snapback sequentially.

We - I don't know if you could - be willing to talk about your ROADM business. But it sounds from the numbers that business had declined.

So I don't know why you're not seeing exactly the positive impact of perhaps even the 100G metro deployment with AT&T. Ciena reported this morning and talked about some metro projects already in effect.

I know there’s Verizon metro and that's potentially where you will be playing with the Flexgrid ROADMs. But we were trying - what I'm trying to sort of get to is, is it different architecture on the ROADM side that will begin to give you growth in that business. And you just sort of excluded at the moment from the current metro projects that are going on.

If you could comment on those two major carriers’ deployments, that would be helpful.

Eitan Gertel: I don't think we’re excluded from any deployment. Our ROADM business, we don't break it down, but it's doing fine. It's not growing tremendously, but it's pretty flat quarter-over-quarter.

And we have a significant share in the market. I don't think our share has changed - our share has changed in the market in any meaningful way. And we actually have high expectation for the market going forward for more ROADM playing actually in the metro project that you're talking about.

So I don't think at all we lost any step in this markets and I think our new products are playing very well. But I haven't - we haven't seen growth yet and that's what we're looking for but the product plan itself is working fine.

Dmitry Netis: Okay, thank you. And if I may and I apologize for being that specific. I recall again going back a few years, top three customers of yours were Cisco, Alcatel-Lucent, and Huawei.

And Cisco is sort of hanging in there and certainly had a nice quarter and perhaps you were seeing wind of that this quarter as well and then going into the next quarter.

But, what about the Alcatel-Lucents and Huaweis? I mean, are you seeing other customers replacing them? Are you seeing them snapping back? How are these major customers of yours are performing at the moment? Are you happy with that performance?

Eitan Gertel: The only thing I can say, we can't talk about specific customers, we can't comment on what customer does versus others. All I can say we have share in all of them.

And when everybody wins - when everybody - when each one of them wins, we benefit from one versus the other. It may be in some different weights or ratios, but we do. But, I can't comment on a specific customer versus others.

Operator: We have time for one more question in the queue. We will go to Dave Kang with B. Riley.

David Kang: Thank you. Good afternoon. First of all, regarding your datacom sales increasing 8.5%, I was wondering if you can go over the mix between 40G, 100G, and wireless.

Kurt Adzema: So, 40G grew the most followed by wireless and then 100G.

David Kang: Okay. what about for your - the outlook, should we expect similar dynamics or 40G and 100G to be growing faster than wireless in the first quarter?

Kurt Adzema: It always hard to tell quarter-to-quarter, but I think we think that 40G and 100G are going to be growth drivers next quarter. I'd say, we expect wireless to be slightly up. But our clarity into that business is not perfect.

David Kang: Got it. And then on moving to telecom, I was wondering - Eitan already talked about WSS but what about Tunable XFP and if you can just - if you're not going to break it out specifically, can you just tell us what the rough mix is between WSS plus Tunable XFP in terms of overall telecom sales?

Kurt Adzema: We're not going to break it out product-by-product. I would say, Tunable XFP was slightly down in the quarter.

David Kang: And how much is the 10G telecom and 10G - or 10G and below telecom?

Kurt Adzema: Again, we're not going to break out the details of that, we break out telecom, we break datacom, that's - and we'll talk directionally about every product line. But, we're not going to break it out.

Eitan Gertel: We don't have any meaningful telecom below 10G anyway.

David Kang: Okay. All right. And then, did you talk about price decline, what the actual price decline was?

Kurt Adzema: We said last December and nothing’s changed since then. It was at the higher end of the 10 to 15% range.

David Kang: Got it, got it. And I was wondering if you can tell us Emulex, what their percentage of revenue...

Kurt Adzema: No, we can't tell.

David Kang: You can't? Okay, got it. Thank you.

Operator: That does conclude the question and answer session. At this time, I'll turn it back over to management for any additional or closing remarks.

Jerry Rawls: Thanks everybody for tuning in today. We appreciate your time and your attention and we hope you're going to join us again three months from now. Good day.

Operator: Once again, this does conclude today's conference call. Thank you all for your participation.

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