

FINAL TRANSCRIPT

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CALX - Q1 2010 CALIX INC Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Calix First Quarter 2010 Earnings Conference Call. At this time all participants are in a listen-only mode. We will conduct a question-and-answer session towards the end of the conference.

(Operator Instructions)

I would now like to turn the call over to Denis Quinlan, General Counsel for Calix. Please proceed, sir.

Denis Quinlan - *Calix Networks, Inc. - General Counsel*

Thank you, operator, and good afternoon, everyone.

This conference call may contain forward-looking statements. These forward-looking statements include the statements regarding our beliefs about the transformation of communication service providers, our beliefs that the access portion of the network is increasingly strategic, our beliefs about our value proposition, our plans to leverage our Unified Access portfolio to increase our market share and our ability to do so, our beliefs about deployment momentum and that we are changing the economics of advanced services deployment, our expectations of revenue and earnings per share, our estimated effective tax rate, our plans to invest in new products and continue to innovate, our ability to help our customers move fibre forward, our belief that demand for bandwidth intensive services continues to expand at an accelerating rate and beyond the network's ability to meet this demand, our belief that our vision of a Unified Access Infrastructure will allow our customers to be in the

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best position to meet this demand and win in the market, and the impact of the current macroeconomic climate and the Company's ability to manage its business.

You are cautioned not to place undue reliance on these forward-looking statements which are based on Management's expectation, estimates and judgment, and current trends and market conditions and involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements.

More information about potential factors that could affect the Company's business, results of operations and financial condition is contained in the Company's final prospectus related to the Company's initial public offering filed pursuant to Rule 424b under the Securities Act with the SEC on March 24, 2010, available at www.sec.gov and from time to time in the Company's periodic reports, including the Company's quarterly report on Form 10-Q for the fiscal quarter ended March 27, 2010.

All forward-looking statements are made as of the date of this conference call and except as required by law we do not intend and undertake no duty to update this information to reflect new information, future events or circumstances or otherwise. Although this call may be replayed as of a later date, its continued availability does not indicate that we are reaffirming or confirming any of the information contained in the live conference call today.

In addition, on this conference call we will be discussing GAAP and non-GAAP results. These non-GAAP measures exclude certain noncash charges and benefits, including stock-based compensation expense, amortization of intangible assets, change in fair value of preferred stock warrants and preferred stock dividends, as we do not consider these items to be part of the Company's ongoing operating activities or meaningful in evaluating the Company's financial performance.

To help you better understand our results, we have included a detailed reconciliation between our GAAP and non-GAAP results in our earnings press release. This conference call will be available for audio replay in the Investor Relations section of the Calix website at investor-relations.calix.com. In addition, our earnings press release has been posted to our website.

I would now like to turn the call over to Calix President and CEO, Carl Russo.

Carl Russo - *Calix Networks, Inc. - President, CEO*

Thank you, Denis. Good afternoon, everyone and welcome to our earnings conference call for the first quarter 2010. Joining me on the call today is Kelyn Brannon, our Executive Vice President and Chief Financial Officer.

I will provide a brief overview of the business and marketplace and then turn the call over to Kelyn to walk through the financials in detail. After that, I will come back to summarize and take questions.

As this is our first earnings call as a public company, allow me to start by offering a refresher about what we develop and market, how we deliver it and to whom and the success that we are seeing in customer deployments. We are focused solely on developing systems for the access network infrastructure of communications service providers.

To clearly delineate, let me state what we do not do. We do not build equipment for the home or enterprise, such as set-top boxes or modems. Nor do we build equipment for deeper in the network such as routers, soft switches or transport systems. We also do not sell to enterprises or consumers.

What we do believe is the access network has unique requirements. And furthermore, we believe communication service providers currently composed of wire line, wireless, cable and satellite companies are undergoing a multi-decade transformation and that the winning communication service providers of the future will look quite different than the service providers of yesterday. It is this belief that guides us as we develop our systems and hone our business model.



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In short, we believe the portion of our customers' network that connects to their customers is increasingly strategic and, therefore, must be architected with a very different long-term view in mind. As such, Calix is distinctly not a box manufacturer for the last mile. Rather, we are a systems supplier for the first mile and we believe this thinking brings our customers an entirely different value proposition, one founded in CapEx efficiency and operational simplicity.

We believe this approach allows our customers to use their CapEx to provide new services and attack new markets, all the while building upon their previous investments. And as the rate of change across the access network accelerates, this long life approach only raises the value of a Unified Access Infrastructure.

Our architectural approach, Unified Access, enables service providers to provide a wide range of revenue generating services from basic voice and data to advance broadband services of a legacy and next generation access networks. Specifically, our Unified Access portfolio consists of two core platforms that leverage the same standards based, Ethernet expandable architecture, the EXA Powered C-Series, multiservice, multiprotocol access platform and our EXA Powered E-Series Ethernet service access platform, along with our complementary P-Series optical network terminals and our Calix Management System.

Together this broad and comprehensive portfolio reaches from the service provider's central office, or equivalent, to the subscriber premises and allows service providers to evolve their networks and service delivery capabilities at a pace that balances their financial, competitive and technology needs.

Our target markets are North America, the Caribbean and Latin America, and we sell to these markets through our own direct sales force. Our customers today include more than 500 North American and international service providers, including large and small incumbent exchange carriers, competitive local exchange carriers, cable operators, municipalities and international carriers.

I trust that this primer on Calix has been useful and I would now like to take a moment to talk about what information we will share on quarterly earnings calls and how we believe you should look at our business. Despite this being our first public earnings call, we have conducted formal earnings calls with our investors and issued private earnings releases for many years. As a result, we are very comfortable with the information that we share and wish to remind investors that our business stands unique in the industry with regard to its combination of focus, size and customer make up.

Perfectly run, our business is a lumpy business. Given our natural seasonality, it is most appropriate for us to compare our results to year-over-year quarters. That said, even this comparison may not be adequately meaningful as individual projects, initiatives, programs and deals may not allow for accurate comparison.

While we will share many things on our quarterly calls, we believe that it will be helpful to list some items we will not be discussing on these calls. Items that will not be disclosed include bookings, book-to-bill ratios, new customer numbers or precise total customer count, port shipments or port count and segment reportings, other than geographic. As to guidance, we will provide a one quarter outlook for revenue and non-GAAP earnings per share, market visibility permitting.

With those ground rules in mind, let's take a look at our first quarter of 2010. Our first quarter results were ahead of our expectations and represented a good start to our calendar and fiscal year. Revenues for Q1 2010 were up 30% year-over-year to \$48.2 million. This resulted in a non-GAAP net loss for the quarter of \$4.7 million.

Our financial results reflected both a market and macroeconomic environment that differed dramatically from the turbulence of the first quarter of 2009. Broadband demand among our customer subscribers remains strong and communication and service providers continued to bring fibre forward in their networks, shortening their loop length and deploying fibre access to the premises wherever possible.

Communication services providers continue to face a changing market environment where consumers are consistently craving more broadband services while competition continues to intensify and the regulatory environment becomes increasingly



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unpredictable. In the face of this challenge, our customers are increasingly looking to Calix for the solutions that allow them to become more operationally efficient, flexible and responsive to consumer demands.

Calix continued to innovate in the first quarter across our Unified Access portfolio, which in turn fueled deployment and market share gains. Early in Q1 we announced that our EXA Powered E7 Ethernet Service Access Platform achieved RUF acceptance. A validation of the Calix Ethernet expansible architecture, this acceptance ensured that Calix customers can leverage the E7 in association with the hundreds of millions in dollars in loans distributed annually in the US to assist in communication service provider deployments.

A few weeks later, Calix introduced five new line cards and the 7.0 software release to the newly EXA Powered C7 Multiservice Access Platform, significantly enhancing the platform's capacity and expanding our Ethernet services capabilities across both copper and fibre. These new capabilities included 10 Gbit/s Ethernet ring support, as well as VDSL2 and enhanced GPON support.

The C7 Release 7.0 software and supporting line cards was a watershed moment for Calix and the industry as it marked the first time an access platform, which to date has over 20,000 systems deployed, has undergone a full transformation from a TDM, ATM and SONET platform to one that can be deployed as a natively switched Ethernet services delivery vehicle. This fulfills a promise made to our customers in 2002 that they could continually leverage the C7 to evolve their networks from legacy services to an all IP world without forklift upgrades or wrenching operational changes.

This remarkable evolution has been achieved all while keeping every service card deployed on existing C7s operational, thereby ensuring that a combined customer investment of over \$1 billion is protected and can continue to provide profitable services for many years to come. This compelling value proposition is precisely what we mean when we say we build access systems for the first mile.

We also introduced our 700GE family of optical network terminals. These new ONTs, which currently come in six different models, enable multiple ports capable of symmetrical 1 Gbit/s data speed and can auto detect both GPON and active Ethernet technologies.

These innovative new Calix products, platform enhancements and releases are continually expanding the deployment options available to our customers and in so doing, are fundamentally changing the traditional economics of advanced services deployment. By aligning the Calix Unified Access portfolio with the strategic network and service requirements of our customers, we allow them to transform their businesses efficiently and effectively while simultaneously positioning Calix as a key strategic partner and preferred vendor.

This value proposition is resonating with new prospects as well as our existing customers. In Q1 Calix continued to add new customers across IOCs, developers, NSOs, SELEX and international carriers. For example, we announced that the nation's telecommunications cooperative, Horry Telephone in South Carolina, has chosen to move fibre forward with Calix. We also added our first Latin American customer, Transtelco in Mexico, which we formally announced just this week.

Both of these customers are deploying the Calix Unified Access Infrastructure for fibre-based business and residential services. We believe that these wins, among many others, demonstrate our ongoing effectiveness in securing new customer deployments, which complements continued momentum within our existing accounts.

Moreover, we believe that this success reflects the ideal alignment of the Calix Unified Access Portfolio with the competitive and strategic realities of North American, Caribbean and Latin American service providers. We expect to continue to leverage this advantage and grow market share throughout 2010.

Q1 also marked another milestone for our Company as we saw our first order stemming from a broadband stimulus award, PaulStead Telephone Company, winner of three separate awards from the broadband initiative program. To date, we have



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announced that Calix has been awarded the access business for seven different round one broadband stimulus awards, totaling an aggregate project funding value of over \$56 million, with broadband access being just a portion of that total.

All round one broadband stimulus awards have now been announced by the RUF and NTIA, and vendor selection has just gotten underway. The application deadline for round two of the broadband stimulus program closed at the end of March and we expect award announcements to continue throughout the spring and summer.

Calix customers have shown broad interest in the stimulus awards program and our Unified Access portfolio is well suited to what we refer to as first mile projects and to some middle mile projects, as well. We are encouraged that the vast majority of the projects awarded to date have been for fibre access, and we believe that as our already announced stimulus vendor selections demonstrate, our Unified Access portfolio is an excellent fit for helping these service providers move fibre forward.

Our current customers are increasingly deploying fibre closer to their customers and sharing a common future network vision of an all IT services world delivered over Ethernet via an all fibre and wireless infrastructure. The broadband stimulus notices of funds availability and the National Broadband Plan share this view, and indications are that the stimulus package and National Broadband Plan are just the start of future broadband friendly initiatives to be set forth by the current Administration. We believe that the Calix Unified Access Infrastructure is the perfect vehicle to lead the transformation of communication services provider networks to align with this shared strategic vision.

With that, I will turn the call over to Kelyn Brannon, who will provide details on our Q1 2010 financial performance. Kelyn?

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

Thank you, Carl, and good afternoon, everyone. I will walk through our unaudited statement of operations and compare the first quarter ended March 27, 2010 to the same period in 2009. After that I will briefly discuss the balance sheet.

Unless otherwise indicated I will be discussing non-GAAP financial measures. A reconciliation of GAAP results to non-GAAP is provided in our earnings release. To arrive at non-GAAP results we adjust for noncash expenses which include stock-based compensation, amortization of intangible assets, changes in the fair market value of preferred stock warrants and preferred stock dividends.

Revenue for the first quarter came in at \$48.2 million, a 29.8% increase from the \$37.1 million reported in the first quarter of 2009. Note that the year ago quarter was impacted negatively by the uncertainty surrounding the broadband stimulus initiative and the overall macroeconomic environment.

Non-GAAP gross margin for the quarter was 37.7%, an improvement of 560 basis points from the 32.1% in the year ago quarter. The year-over-year improvement was primarily due to cost reductions in raw materials, customer and product mix and leveraging our fixed costs over our higher revenue run rate.

As Carl mentioned, our business perfectly run is lumpy and on a quarter-to-quarter basis we would expect our gross margins to fluctuate. However, our long-term goal is to improve our overall gross margin.

Turning to operating expenses, I will be discussing non-GAAP operating expenses which include stock-based compensation which is detailed in our press release within the condensed statement of operations. Non-GAAP R&D spending was \$11.3 million for the first quarter, an increase from the \$9.7 million in Q1 of 2009. The increase compared to the year ago quarter was primarily due to an increase in headcount within our R&D organization, an increase in consulting and prototype expenses and the impact of belt tightening efforts during Q1 of 2009, such as mandatory vacation.

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The year ago quarter was a period when we felt the impact of delayed decision making and uncertainty within our customer base as a result of the initial announcement of broadband stimulus. We plan to continue investing in new products and we will continue to innovate with our development organization in 2010.

Non-GAAP sales and marketing spending was \$8 million for the first quarter, an increase from \$6.8 million in Q1 of 2009. The increase in 2010 is primarily the result of an increase in commissions, higher booking levels and increased headcount, as well as our belt tightening of efforts in Q1 of 2009.

Non-GAAP G&A spending was \$3.1 million, an increase from the \$2.8 million in the year ago quarter. The increase was driven by an increase in headcount, consulting expenses and by our belt tightening efforts, offset by a reduction in bad debt expense.

Non-GAAP operating loss for the first quarter was \$4.2 million, as compared to \$7.3 million in the year ago quarter. Given our net operating loss carry forwards in excess of \$300 million, we do not anticipate incurring meaningful income tax expenses for the foreseeable future, and therefore we estimate a non-GAAP effective tax rate of between 5% to 10%.

Adjusting for these items and assuming the conversion of preferred stock to common stock as of the beginning of the period, non-GAAP net loss for the first quarter was \$4.7 million or a loss of \$0.15 per share, compared with a non-GAAP net loss of \$8.2 million or a loss of \$0.32 per share in Q1 2009.

With regard to the balance sheet, I will be comparing our balance sheet at March 27, 2010, sequentially to December 31, 2009. However, due to the seasonal nature of our business, I will compare a handful of metrics such as day sales outstanding, or DSOs, and inventory turns to the year ago quarter.

At March 27, 2010 cash and restricted cash was \$117.8 million, up from the \$68.7 million at December 31, 2009. During the quarter we closed our Initial Public Offering which yielded net proceeds of \$46.2 million.

One item of note, subsequent to the close of the first quarter our underwriters exercised our over allotment option on April 8, 2010, and we also elected to pay off our term loan. The net effect of these two transactions was to reduce our cash by \$8.9 million.

Net accounts receivable decreased by \$21.8 million, sequentially, from Q4 2009 as a result of the timing of collections on strong new business activity we experienced in Q4 2009. Average DSOs on accounts receivable were 54 at the end of Q1, versus 65 in the year ago quarter.

Inventories were \$26.3 million, up from \$18.6 million at December 31, 2009, yielding inventory turns of 4.5, as compared to 3.5 in Q1 2009.

Deferred revenue was \$32 million, a decrease of \$4.5 million over the prior quarter, primarily as a result of fewer deferrals due to new revenue recognition rules. Calix elected to early adopt ASC Topic 605-25, effective January 1, 2010.

Now turning to guidance for Q2 2010, we expect revenue to range between \$66 million to \$71 million. We expect a non-GAAP EPS range of a loss of \$0.06 per share to earnings of \$0.08 per share, calculated on basic weighted average shares for the quarter of approximately \$37.3 million, and our effective tax rate of approximately 5% to 10%.

With that, I will turn the call back over to Carl.



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Carl Russo - Calix Networks, Inc. - President, CEO

Thank you, Kelyn. As you have heard, we executed well in Q1 and we believe we are well positioned to execute in the quarters ahead. We believe that consumer and business demand for bandwidth hungry services continues to expand at an accelerating rate, much faster than the network's ability to meet this demand.

Thus, we have a special urgency to execute on our vision of a Unified Access Infrastructure so that our customers may be best positioned to meet this demand and win in the market place. We anticipate that many of you will be interested in our perspective on broadband stimulus, the National Broadband Plan and the CenturyLink combination with Qwest.

We believe the questions regarding broadband stimulus and the National Broadband Plan may be quite diverse and better left for the question-and-answer session. However, I would like to say a few brief words about the CenturyLink Qwest combination.

Clearly, we are not in a position to speculate on the plans of this new entity as it works its way through the merger process. In the short term, we plan to continue to address this new customer in the same way we approach all of our customers, which is to earn their business every day.

I will say that Mr. Post has consistently demonstrated a long-term vision for the future of CenturyLink, its customers, employees and shareholders. We too take a long-term view of industry evolution as we focus on the transformation of the access network for our customers, and thus we look forward to working with the CenturyLink and Qwest teams as they complete this exciting combination.

As we look to Q2 we see a clear path to achieving our goals, but remain mindful of the macroeconomic climate, and therefore we will keep close to the levers as we manage our business. At this point, I would like to turn the call over for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question comes from the line of Ehud Gelblum of Morgan Stanley. Please proceed.

Ehud Gelblum - Morgan Stanley - Analyst

Hey guys, how are you? Thank you very much. A couple questions, first of all, Kelyn, on the guidance range on the EPS guide of negative \$0.06 to \$0.08, I haven't done the entire math on that, but it would seem to be a relatively wide range versus the revenue. I wanted to get a sense, first of all, at what gross margin we were looking at. There is a range of gross margins that get us into that range. And why is it so wide?

And the share count, clearly the share count is more to tend to run the GAAP EPS than it does on the regular EPS, oh, I'm sorry, the form EPS, but for the negative \$0.06 would we be looking at the 37 million shares, but for the positive \$0.08 we would be looking at a more fully diluted share count, closer to 42 million or so, given the way that works? Or is it one share count for both, just understanding that EPS guidance?

Carl Russo - Calix Networks, Inc. - President, CEO

And was there a second question, Ehud?



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Ehud Gelblum - Morgan Stanley - Analyst

Oh, there will be a lot more questions, Carl, but yes, from that I would love to get -- I would love to just be able to understand a little bit more the, if you can, a little bit more on the Qwest CenturyLink merger what your -- what you understand as to the going forward way that the two companies will operate and how you will be able, how you will take your position, essentially, over into Qwest and what are the pressures that you will be seeing and how you kind of navigate through that to ensure that you end up on the winning side of that merger?

Carl Russo - Calix Networks, Inc. - President, CEO

Okay. So, let me start with your first question on the guidance range. As we said in the opener, we don't give guidance other than revenue and non-GAAP EPS, but with further color on that range, Kelyn, would you like to address that? And then I will come back and address your question on the Qwest CenturyLink combination.

Ehud Gelblum - Morgan Stanley - Analyst

Great.

Kelyn Brannon - Calix Networks, Inc. - EVP, CFO

Certainly, Carl. So, Ehud, on the gross margin our bottom line guidance takes in to account several assumptions. One, our gross margins, as you know, are subject to variations based on things like cost of materials, whether there is cost reduction, also based on customer and product mix, which feeds into our seasonality.

In addition, we are projecting in that higher range of revenue run rate Q2 over Q1, so would expect things like higher commissions. There is a little bit of play in -- not much, but a little play in the other kind of OpEx lines as move into now being a public company, when you look at the G&A line, talked a little bit about commissions in the sales and marketing lines.

As to the share count, we are expecting Q2 on a GAAP basis, because of the stock-based compensation, will be still at a GAAP net loss which means both basic and fully diluted as the same number, which we are expecting to be about, as we mentioned, about 37.5 million.

Ehud Gelblum - Morgan Stanley - Analyst

But, Kelyn, if I could just rephrase that question, the range of the revenue guidance was \$5 million and if I were just to take that \$5 million and apply a high 30s gross margin, I don't care what the number is, but something similar to what you have now, and then divide that by your share count, I don't get a range of \$0.14 from top to bottom. I only get a range of \$0.05, \$0.05 or \$0.06 from top to bottom, so it seems that the EPS range is just much wider than the revenue range. So that is why I was wondering if the gross margin has -- would be moving around based on the top or the bottom of that revenue.

Kelyn Brannon - Calix Networks, Inc. - EVP, CFO

And that would be correct. So when you take the low range you basically look at the worst case scenario. You have a lower range of revenue and perhaps a lower gross margin, versus going up to the high range with a higher revenue number and a stronger or higher gross margin number. And that is what is giving that variability in the bottom line. And then again, the basic share count is the same for in Q2 at 37.3 million.

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Ehud Gelblum - Morgan Stanley - Analyst

Okay.

Carl Russo - Calix Networks, Inc. - President, CEO

Okay. So stated differently, just add some color to that, Ehud, this is our first quarterly conference call. And we will continue to with an eye towards narrowing up these ranges as we go forward. But right now we feel it is prudent to go with this approach.

To your question about Qwest and CenturyLink, let me sort of go down that sequence. How will they operate as they go forward? As you know, Qwest and CenturyLink held a joint conference call at the time that they announced the combination and I think in that Glen Post outlined how he was going to go forward at least at a high level from a structure standpoint.

And I don't believe anything else has been made public at this point in time on the rest of the plans. And as you know, it will take quite a few months to work through this process.

As to how we intend to go about approaching the account, the same way we have approached both accounts to date, and I stated that earlier in my comments, as well, which is we are going to go earn the business on every day, in and out. We take nothing for granted. There is no fair share.

And the way we approach them is the same way we approach all of our customers which is we stay focused on the long life CapEx approach that Unified Access allows our customers to bring to market. And as we go forward we also believe as they unify their access infrastructure, they end up in a lower operational expense environment.

And that is the approach that has bode us well so far and that is what we will continue to focus on. Other than that, in the meantime we are going to address Qwest -- that's Qwest CenturyLink, at CenturyLink and continue to go forward.

Ehud Gelblum - Morgan Stanley - Analyst

Great. I will give the conference a little bit and will come in a little -- I may come back in later, but appreciate it. Thank you.

Carl Russo - Calix Networks, Inc. - President, CEO

Thanks for the questions, Ehud.

Operator

Your next question comes from the line of George Notter of Jefferies. Please proceed.

George Notter - Jefferies & Co. - Analyst

Hi. Thanks very much. Back to the share count, so assuming that pro forma adjusted net income is a positive number, what would the share count be?

Carl Russo - Calix Networks, Inc. - President, CEO

George, hand on one second. I thought you were going to have a sparkling question for me, but it seems that share count is commanding everybody's attention. Is there some reason for that?

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George Notter - *Jefferies & Co. - Analyst*

Yes, right. I thought I would ask the sparkling questions later.

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

So, George, basically we are still forecasting a GAAP net loss. When you think about stock-based compensation in Q2, as we went public on March 24, you will notice in our statement of operations we have stock-based comp in Q1 of about \$2.8 million.

We are looking at that kind of slightly more than doubling in Q2 because of the additional stock-based compensation that we will need to take on the increased value of the RSU exchange that happened in September 2009. So we are expecting a net GAAP loss, and therefore, the share count will be, we are estimating around 37.3.

George Notter - *Jefferies & Co. - Analyst*

Okay, got it. So just for my purposes, if I am going to adjust your results to get a pro forma and back out stock compensation expense, assuming I come out with a positive number, what would the fully diluted share count be?

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

Ehud, I don't believe when you back that out you are going to come out with a positive number on a pro forma basis. It is still going to be at 37.3, George, excuse me.

George Notter - *Jefferies & Co. - Analyst*

Okay, okay, that's fine. We can follow back up there. How about on [coogins]? I was trying to figure out when you have got a lot of moving parts here in terms of the products, you have got to the 7.0 Version of the C7, newer line cards coming out, obviously the E Series, I presume is ramping as a percentage of the overall mix.

I believe you guys have a new FC product coming out as well. There are some other kind of moving parts, but can you walk us through what your long-term picture on gross margin looks like and are there other factors we should be thinking about and mash it all up. What do you think?

Carl Russo - *Calix Networks, Inc. - President, CEO*

George, let me take a cut at that and then if we want to dig deeper financially, I will try and do that with Kelyn. But, as you know, our, if you will, our long-term model is a 42 point gross margin model. And as we have always cautioned, and will continue to caution, ours perfectly run is a lumpy business.

So I would dissuade anyone from trying to linearly extrapolate margins as we go forward because it will noisy. It will take at least a lee square's fit to figure it out, and I think if you go back historically and did that you would see that in our historical financials in the S-1.

As far as the factors, you are absolutely right. There are a lot of factors. There is product mix. There is customer mix. There is all sorts of things that go on and that, by the way, is what genuinely makes it something that we wouldn't want to go out and try and give guidance going forward.

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So is your question more related to why we are margins ahead of expectations, for example, in this quarter?

George Notter - *Jefferies & Co. - Analyst*

Yes, certainly I -- very curious about that as well. Obviously the revenue line was down a fair amount, sequentially, naturally given the normal seasonality in the business. But obviously, gross margins were up. So I certainly wanted to pitch on that one as well.

Carl Russo - *Calix Networks, Inc. - President, CEO*

Yes. So, again, compare year-over-year to get a better view of what is going on. And let me just lead off my comments and then I will turn it over to Kelyn.

There has been a disciplined approach inside the business for quite a number of quarters now, more than a year on deliberate cost reductions, both in how we go about manufacturing, negotiating and engineering our products. And we have continually gotten better at that.

So I could state simply that we are reducing our costs faster than market erodes price. So that is an easy one to figure out. Kelyn, is there any color you want to add to that?

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

The only thing that, as I mentioned earlier in the script, the three major reasons is, one, we, as Carl just mentioned, we had cost reductions in our raw materials. Secondly, if you look at the higher revenue base Q1 2010 over Q1 2009, we are leveraging our fixed costs on a higher revenue number and that impacted our gross margins. And then lastly, again, it is just customer and product mix.

George Notter - *Jefferies & Co. - Analyst*

Got it. What percentage of sales was CenturyLink in the quarter? Were there any 10% customers?

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

There was one 10% customer in Q1.

George Notter - *Jefferies & Co. - Analyst*

Okay. Can you disclose who that is and what the percentage was?

Carl Russo - *Calix Networks, Inc. - President, CEO*

I won't let Kelyn do either of those things.

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George Notter - Jefferies & Co. - Analyst

Fair enough. That's fine. Okay and then just last question I just wanted to ask about the stimulus plan. So if you look at the round one awardees, I was wondering what mixture of those customers, what percentage of those customers were Calix customers? Do you have a sense for that? And then, also, if you look at the round two applications, same question, any sense for what mix of those applications were from your customer set?

Carl Russo - Calix Networks, Inc. - President, CEO

Yes. So, George, I wouldn't address it with a direct answer. I want to address it sort of indirectly with two different approaches. Number one, obviously we have a lot of customers in the market space and so you can sort of think about market share and it is generally falling down over top of that market share.

But I also want to emphasize and reemphasize our approach to this and our belief. It is our belief that given a large award of funds to go build a significant piece of network infrastructure, all our customers and all of those that are not our customers are going to use it as an opportunity to look around and look at different vendors.

And so, I think maybe we will be advantaged with our customers. We certainly like to think so, but we think with all customers looking around, when they get a chance to look at Unified Access, that we have the opportunity to win more than we currently have share of. So that is our focus.

George Notter - Jefferies & Co. - Analyst

Got it. Okay, great. Thanks very much.

Carl Russo - Calix Networks, Inc. - President, CEO

George, this just in. I think we may have more precise numbers on the share count. We were actually counting them here as we were discussing. Hold on a moment.

Kelyn Brannon - Calix Networks, Inc. - EVP, CFO

So, George, because we were not expecting GAAP profitability we didn't calculate the unexpected fully diluted share count for Q2. However, on kind of back of an envelope as I looked at it that said, if you include outstanding options, RSUs and common stock equivalents, the additional amount for Q1 would have been about 5.2 million shares. So you add it to the 37.3 and that will get you around your 42.5.

George Notter - Jefferies & Co. - Analyst

Great. Okay. Thank you.

Operator

Your next question comes from the line of Simona Jankowski of Goldman Sachs. Please proceed.

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Simona Jankowski - *Goldman Sachs - Analyst*

Hi. Thank you so much, just wanted to ask about the guidance range. Obviously it is understandable that it is quite wide, given the nature of the business. But I want to ask about the midpoint of it which seems a bit below earlier expectations. Is there anything that has happened in the last couple of months that causes you to be more cautious about that? Or is that just conservatism on your part?

Carl Russo - *Calix Networks, Inc. - President, CEO*

So I would -- I will answer that one straight away, Simona. I don't know that the midpoint represents the good statistical descriptor, first of all. And secondly, no, there is nothing that is causing us to be more conservative.

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. As far as the gross margin upside versus expectations, it sounded like one of the things you were citing there, and again, more focused here on the sequential incremental change versus the year-on-year, but one of the things you are citing is the lower cost of raw materials than you expected. Would just give a little more color, because obviously commodities have been generally strong and chips have been tight. I am just curious if you can give us more detail there.

Carl Russo - *Calix Networks, Inc. - President, CEO*

Yes. Frankly, hats off to the operations team from a negotiating standpoint. I think we are making a concerted effort in how we manage our supply chain and, again, it goes back to both cogs after the design, as well as cogs targets before the design is complete and also cost reduction efforts of designs that already exist.

So that is what is driving it. It actually is not a statement. I think you are looking for sequential volumes up and down and what we were able to do. It is actually simply much more of just internal process focus of the culture that is here.

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. Another question is earlier this week we had Windstream reporting, another one of your sizable customers. Their CapEx seemed to be quite a bit below what we had expected. Is there anything to kind of read into that? I know they are not more than 10% for you guys, but just anything we can read into that as far as that particular customer more broadly?

Carl Russo - *Calix Networks, Inc. - President, CEO*

I would make no comment on it. Obviously that question is better directed Jeff Gardner and his team, but if you were to try and extrapolate it more broadly, I think what we see is the continued demand for bandwidth on the part of consumers continuing to accelerate faster than the network can keep up, and so there is sort of a general trend.

And then there is going to be short-term trends in any one segment or with any one customer. So I would have no comment on that other than to say I would respectively ask you to ask Jeff and team.

Simona Jankowski - *Goldman Sachs - Analyst*

Fair enough and just last quick one here on your recent win in Mexico with your first one in Latin America. Can you just comment on how the dynamics there differed from what you are used to, whether in North America or the Caribbean as far as the

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competition, pricing and just how your value proposition resonated there in Latin America as kind of the first precedent to look to?

Carl Russo - *Calix Networks, Inc. - President, CEO*

Actually, I would say almost identically to how it is manifested itself in the markets that we are currently in, in North America and the Caribbean. As you know from reading the press release, it was a fibre forward application where they were using fibre access technologies, and the value proposition of Unified Access, the Company business model that we bring to bear resonated with them almost identically to our -- the rest of our customers, so actually no differences.

Simona Jankowski - *Goldman Sachs - Analyst*

Great. Thank you.

Operator

Your next question comes from the line of Nikos Theodosopoulos of UBS. Please proceed.

Nikos Theodosopoulos - *UBS - Analyst*

Thank you. I had a couple of quick questions, just some quick number questions. Do you have the headcount at the end of the current quarter and compared to the end of the fourth quarter?

Carl Russo - *Calix Networks, Inc. - President, CEO*

Is that -- do you want to give me all your questions, Nikos, or do you want me to do these one at a time with Kelyn?

Nikos Theodosopoulos - *UBS - Analyst*

If you have got the numbers one at a time is easier. If not I can keep going.

Carl Russo - *Calix Networks, Inc. - President, CEO*

Now, okay, because I may have to ask Kelyn to run out. We were doing a share count earlier. Maybe we need to do a headcount count too.

Nikos Theodosopoulos - *UBS - Analyst*

Okay, no problem. I will move on to the next one. I'll see --

Carl Russo - *Calix Networks, Inc. - President, CEO*

No, no, no, got it. Kelyn has those, Kelyn.

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Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

Okay, so thank you, Nikos. Good to hear from you. We actually ended March 27, so Q1 at 416 heads and that is up from the 407 that you would have noted in the S-1.

Nikos Theodosopoulos - *UBS - Analyst*

Okay. And, Carl, back on CenturyLink Qwest, that merger I think they have said will not close until sometime in the first half of next year. So do you in your discussions with CenturyLink since they have announced that, do you anticipate any changes in what they plan doing this year? Clearly, what they may do afterwards is a different story, but do you see any changes in the current business that you were planning with them for this year?

Carl Russo - *Calix Networks, Inc. - President, CEO*

So you're right. It is going to take quite awhile to work through. It is quite a large combination, and to your point, I think if you go back and actually listen to the comments that were made on the conference call with Qwest and CenturyLink and Mr. Post and Miller, they actually made it very clear that it is not a CapEx synergy play and they, as such, intend to continue to invest in CapEx.

And as a matter of fact, if you listen to CenturyLink's earnings call from yesterday, they have continued to grow their broadband subscriber base by greater than any expectation. So I don't -- from my perspective I don't see any change.

However, let me just caution everyone that anytime you have a combination of this type, especially one where it is both large companies, people inside of those companies tend to spend some amount of head time talking about what do you think is going to happen? And so, there is going to be those sorts of "nerviosities," to use Woody Allen's term, going on. But outside of that we don't see anything programmatic other than business as usual for the next few quarters at both companies.

Nikos Theodosopoulos - *UBS - Analyst*

Got it, okay. And just moving on to a couple other quick ones, back on the balance sheet of the deferred revenue declining, you kind of explained what happened there. Is that a onetime adjustment and would we expect the deferred revenue to continue to grow as the Company grows?

Carl Russo - *Calix Networks, Inc. - President, CEO*

So your question is to Kelyn's comment about the shift as we have approached deferred revenue, is a onetime shift and then we will continue to build down that path? Is that --?

Nikos Theodosopoulos - *UBS - Analyst*

Yes. The way I heard it was that deferred revenue declined sequentially due to the moving to the new accounting revenue rec rules, so I understand that. And my question is, now that you have done that, going forward should we expect deferred revenue to start increasing in the balance sheet as the Company grows?

Carl Russo - *Calix Networks, Inc. - President, CEO*

Kelyn, why don't you take that, please?



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Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

So, correct. I said in the -- in my earlier comments that deferred revenue was down sequentially due to the change in revenue recognition rules. However, looking at deferred revenue going forward, do I see substantial increases or decreases?

It really depends on the mix of business that we get. So, as you remember, we had mentioned during the road show that in 2009 with broadband stimulus, no one was really -- there wasn't a lot of use of Rast funds in 2009.

What we are going to see is the Farm Bill PACs are going to be, not only with broadband stimulus, but additional Rast funding, so it really just depends on the mix of our business coming in. And I think you are going to see deferred revenue fluctuate, again, as Carl and I have always mentioned, our business is kind of lumpy and it depends on that customer end mix.

Nikos Theodosopoulos - *UBS - Analyst*

Okay. And then, on the revenue breakdown do you have the geographical split or is that something that will come out later with the queue?

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

So the --

Carl Russo - *Calix Networks, Inc. - President, CEO*

Kelyn, do you want to take that, please?

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

Yes. So for our Internet we will disclose, geographically, our international business was 9% in Q1 2010, up 6% from Q1 2009. And that is up both in percentages and in absolute dollars.

Nikos Theodosopoulos - *UBS - Analyst*

Okay, so 6% Q1 last year, 9% this quarter?

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

Correct.

Nikos Theodosopoulos - *UBS - Analyst*

Okay, and, Carl, just one last question. Does the recent articles this week, last week about the FCC potentially reevaluating these broadband rules, broadband policy and net neutrality and depending on how you interpret that it, do you sense any concern from your customers, potential customers that this might open up what was originally agreed post the unity rules several years ago and could make some customers pause spending? Or is it at this point there is no concern, or it is still ambiguous?

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Carl Russo - *Calix Networks, Inc. - President, CEO*

That -- well, you have given me a broad range of multiple choice answers to choose from.

Nikos Theodosopoulos - *UBS - Analyst*

Well, you could pick something else too.

Carl Russo - *Calix Networks, Inc. - President, CEO*

I -- as a matter of fact, I am working up my own words here. So, look, I am record for many years on this discussion and I will say the same thing I have been saying. This is not a particularly difficult problem to think through because of the following.

The midpoint, if you will, between the desires of the content providers and the desires of those that are providing the transport, if you will, of that content is such a clear midpoint. And if you move even an inch to the right or left of that midpoint, one of those parties goes haywire, that where this is going and as FCC Commissioner Jankowski laid out in his document of this morning, a light touch on the rules because the midpoint is so clear.

So I think in the long-term it is not that hard to see where this is going to go. However, because of the politicization of this particular issue, it tends to get noisy in the environment and causes people to go, so what is he saying again? And you have to go back through the discussions around it.

So, and on anytime there is uncertainty injected, it gets people's attention and slows them down. But again, there is a history around this that is going to continue to get people to recognize where this is going to end up which is don't block content, but make sure that we are able to charge for more services or charge less for less services.

So that is my answer to you. More discussion on that would take me an hour and we have probably got about seven or eight minutes left on the call, so happy to chat about it at some point later, but that is my overall view.

Nikos Theodosopoulos - *UBS - Analyst*

Okay, thank you.

Operator

Your next question comes from the line of Mark Sue of RBC Capital Markets. Please proceed.

Joe Longavardian - *RBC Capital Markets - Analyst*

Hi, this is [Joe Longavardian] on for Mark. Just curious as to how the competitive dynamics have changed now that you guys are a public company. It seems as though ADTRAN is very focused on gaining share at your expense.

Carl Russo - *Calix Networks, Inc. - President, CEO*

The competitive dynamics from our perspective remain the same as they always have which is it is a competitive industry. There is a set of competitors that sometimes shrinks and sometimes grows and I have not seen any particular changes in that competitive dynamic.



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Joe Longavardian - RBC Capital Markets - Analyst

Any comments from customers on platform differentiation?

Carl Russo - Calix Networks, Inc. - President, CEO

So I am not sure, are you saying -- when you say platform differentiation, I am not sure I understand what you are asking.

Joe Longavardian - RBC Capital Markets - Analyst

The -- just the product, the offering that Calix has and the differences from many of the competitors in the space right now.

Carl Russo - Calix Networks, Inc. - President, CEO

So, again, it goes straight back to my comments earlier from a Unified Access standpoint. We believe as fibre goes into the access infrastructure it changes dramatically, the ability to build a single Unified Access Infrastructure. And when you do that, you can build systems that have incredibly long life.

And just real quickly, the C7, which we shipped at the end of 2002, with Release 7.0 will live in networks for easily another decade. You are looking at a systems product that our customers invested in and are going to be an 18 or 20 year return on. That is our approach to this market and we will stay on that focus. We don't see anyone else with that same long-term focus. Okay?

Joe Longavardian - RBC Capital Markets - Analyst

Great. Thank you and good luck.

Carl Russo - Calix Networks, Inc. - President, CEO

Thanks. Yes, I appreciate it, thanks.

Operator

Your next question comes from the line of Todd Koffman of Raymond James. Please proceed.

Todd Koffman - Raymond James & Associates - Analyst

Thank you very much. You were talking earlier about the vendor selection process getting started for the broadband stimulus, and I was wondering, generally speaking, on the Calix products a higher price or generally lower price, regardless of the maybe superior features and functions, are they more expensive or generally less expensive than your competitors?

Carl Russo - Calix Networks, Inc. - President, CEO

Todd, you have given me a softball. I would say they rightly priced.

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Todd Koffman - *Raymond James & Associates - Analyst*

Then the follow-up to that would be if they are correctly priced, why does it seem as though some of your competitors seem to be able to make so much more money on competitive, rightly priced products?

Carl Russo - *Calix Networks, Inc. - President, CEO*

That is a great question and it goes back to actually what I was just talking about a moment ago. We have architected these systems to live in the network for two decades. When you do that, guess what? They have more architectural headroom and probably a little more cost to achieve that built in at the start.

And the way our customers get that return is by adding that kind of headroom and being able to back and provide services without changing anything in the network, without changing, by the way, their operational procedures, you name it. And so, when you look at that and you look at the platforms, that might give you some insight into cost, price, et cetera.

And the second piece I would highlight, and something that we are very proud of, is, as you know, in the fibre access space we are, excluding Verizon, in North America far and away the market leader. And fibre access historically has not been a place where people have run to get the high margin business models.

And so, as you might imagine we have a lot of fibre access business that we do. So actually, I am encouraged by where we are from a corporate average margin standpoint and I am very encouraged by the progress that we are making on the cost reduction efforts and the go to market approaches.

Todd Koffman - *Raymond James & Associates - Analyst*

So just a quick follow-up on that, would it then be fair to assume that the pricing environment from your perspectives, yours and Kelyn's perspective, is not likely to get that much more intense than it has been the last few years?

Carl Russo - *Calix Networks, Inc. - President, CEO*

So I think it is a good point, but as we look at pricing going forward and we look at pricing backwards, there is nothing that would cause me to say it would go nonlinear from what we would extrapolate from the past. So, am I -- I am not trying to use math terms, but I am trying to answer your question. Does that paint the right picture for you?

Todd Koffman - *Raymond James & Associates - Analyst*

It sure does. Thank you very much and good luck.

Carl Russo - *Calix Networks, Inc. - President, CEO*

Appreciate it, Todd.

Operator

You have an additional question from the line of Ehud Gelblum of Morgan Stanley. Please proceed.

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Ehud Gelblum - Morgan Stanley - Analyst

Hi, thanks and a really quick one. One of the things you mentioned that I thought was really interesting, Carl, is that you said that you have received, well, as to say seven, I believe, customers of yours got broadband stimulus funds totally \$56 million.

Do you have a sense of those seven customers and the \$56 total, how much of that \$56 million will eventually end up as equipment, whether it is with you or competitors, but it is that ratio of -- that we have always tried to figure out, how much of the total award ends up as actual equipment? Do you have a sense now that the total was \$56 million of these, how much ends in actual equipment?

Carl Russo - Calix Networks, Inc. - President, CEO

So that I don't mislead you, Ehud, there are seven awards, five customers. One of those customers actually received three awards. To that \$56 million question and, specifically, the percentages, we, after going many, many, many, many RUS awards over many, many years have sort of come to a simple rule of thumb that we serve as a conservative estimate which is 15% of the award typically turns into the optical electronics and the access space. Does that answer your question?

Ehud Gelblum - Morgan Stanley - Analyst

It does. That was the number I had before. I was wondering if we could improve that number with this because we now have an actual bird in hand.

Carl Russo - Calix Networks, Inc. - President, CEO

You wouldn't improve it because I will tell you it is going to look very similar to infrastructure builds that we have done many, many times in the past and I would see no reason why it should change.

Ehud Gelblum - Morgan Stanley - Analyst

Okay. And so if in that \$56 million, that 15% then all accrues to you? Is that what you meant to say? Or can that still end up being split between yourself and competitors?

Carl Russo - Calix Networks, Inc. - President, CEO

Well, in the -- certainly in the customers that have been announced, they are now obviously customers and so we certainly hope that that would since there are contracts come our way.

Ehud Gelblum - Morgan Stanley - Analyst

Okay, and no idea on the timing of that? That still has to happen over the next two years, probably, right?

Carl Russo - Calix Networks, Inc. - President, CEO

Right. And so back to Kelyn's comment, depending upon deployment schedules, are you -- the way you are using 397 or 398 type of paperwork, the -- where this goes to revenue can be a long and winding trail.

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Ehud Gelblum - Morgan Stanley - Analyst

Okay, one last question on that actually now that I have thought about it. Is there any difference now that you have seen these awards in the gross margin profile of those awards, the equipment you will be supplying into those versus your regular business? Shall we see -- ?

Carl Russo - Calix Networks, Inc. - President, CEO

We are not seeing anything that looks different than anything than anything that we have seen in the past.

Ehud Gelblum - Morgan Stanley - Analyst

Helpful. Thanks.

Carl Russo - Calix Networks, Inc. - President, CEO

Thanks. David, I think we have time for one last question.

Operator

You have an additional question from the line of Simona Jankowski, Goldman Sachs. Please proceed.

Simona Jankowski - Goldman Sachs - Analyst

Yes, hi. Thank you for the quick follow-up as well on the deferred revenue comment. Kelyn, not that you are able to provide this, but if you hadn't changed the accounting do you have a sense of what deferred revenue would have looked like in the just reported quarter, just so I can get an apples to apples comparison?

Carl Russo - Calix Networks, Inc. - President, CEO

Kelyn, do you want to grab that and then we will finish up?

Kelyn Brannon - Calix Networks, Inc. - EVP, CFO

I don't think that we are going to actually disclose that.

Carl Russo - Calix Networks, Inc. - President, CEO

I'm not sure that we would -- we -- yes.

Kelyn Brannon - Calix Networks, Inc. - EVP, CFO

For -- and the other thing is, is that what I would also say that when we talk about the impact in the quarter because of the changing revenue recognition rules that I take about deferred revenue, what it allowed us to do was recognize revenue on partial shipments, right, whereas before we had to ship complete because of DSOE on hardware. And so, therefore, as we were coming down to the end of the quarter we would have shipped complete. So that would have changed the deferred revenue.

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Simona Jankowski - *Goldman Sachs - Analyst*

Right.

Kelyn Brannon - *Calix Networks, Inc. - EVP, CFO*

Okay?

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. That's helpful. Thanks a lot.

Carl Russo - *Calix Networks, Inc. - President, CEO*

So, great. If there is no further questions we will go ahead and wrap up the call. Thank you for joining us today and we look forward to speaking with you again after the close of our second quarter. Operator?

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes the presentation.

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