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CALX - Q1 2013 Calix, Inc. Earnings Conference Call

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CORPORATE PARTICIPANTS

David Allen *Calix, Inc. - Director IR, Treasurer*

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

Michael Ashby *Calix, Inc. - EVP, CFO*

CONFERENCE CALL PARTICIPANTS

Mark McKechnie *Evercore Partners - Analyst*

George Notter *Jefferies & Co. - Analyst*

Sanjiv Wadhvani *Stifel Nicolaus - Analyst*

Ehud Gelblum *Morgan Stanley - Analyst*

Amitabh Passi *UBS - Analyst*

Simon Leopold *Raymond James & Associates - Analyst*

Simona Jankowski *Goldman Sachs & Co. - Analyst*

PRESENTATION

Operator

Greetings, and welcome to the Calix First Quarter Fiscal Year 2013 Financial Results Conference Call. (Operator instructions) It is now my pleasure to introduce your host, David Allen, Director of Investor Relations and Treasurer for Calix. Thank you, Mr. Allen. You may now begin.

David Allen - *Calix, Inc. - Director IR, Treasurer*

Thank you Operator, and good afternoon, everyone. Before we begin, I'd like to remind you that this conference call contains forward-looking statements regarding future events including but not limited to our development of new products that will continue to help our customers transform their networks, the ongoing expansion of our total addressable market, the future of business and financial performance of the company, and our expectations of revenue, gross margins, earnings per share, stock-based compensation, and amortization of intangibles.

These forward-looking statements are based on our expectations, estimates and judgments and current trends in market condition, and involve risks and uncertainties that may cause actual results to differ materially than those contained in the forward-looking statements. I would encourage you to review the Company's various SEC reports, including our Annual Report on Form 10-K, for the Fiscal Year ended December 31, 2012, available at www.SEC.gov in which we discuss these risk factors. All forward-looking statements are made as of the date of this conference call and, except as required by law, we do not intend to update this information.

Also on this call we will be discussing GAAP and non-GAAP results. We are providing the non-GAAP estimates to enable interested parties to evaluate our performance in the same manner in which we evaluate our own operations. These non-GAAP measures exclude certain charges and benefits which we do not consider to be part of our ongoing activities or meaningful in evaluating our financial performance, including stock-based compensation, acquisition-related expenses if any, and amortization of acquisition-related intangible assets. To help you better understand these results, we have included a reconciliation of our GAAP and non-GAAP results in our earnings press release. All numbers that are discussed in today's conference call are non-GAAP unless otherwise noted.

This conference call will be available for audio replay in the Investor Relations section of the Calix website at www.Calix.com. In addition to our earnings press release which has been posted on our website, we've also posted supplemental financial data on the Investor Relations section of the Calix website, which you may want to review in conjunction with our press release and our conference call remarks.



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

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

Thank you, Dave. Good afternoon, everyone. Joining me on the call today is Michael Ashby, our Executive Vice President and Chief Financial Officer. Before I turn the call over to Michael, I would like to give a brief review.

We have begun 2013 with strong execution of our strategy. Our record results for a first quarter are indicative of improving clarity for our customers and improving performance by the Calix team. We saw strength across all of our product offerings and customer account tiers and geographies.

While uncertainties remain around the USF ICC reform, many of our Tier 2 and Tier 3 customers are moving forward, strengthening their broadband infrastructures while offering valuable new services, and we continue to make solid progress in our international business and are encouraged by the interest that we saw in the quarter.

After Michael discusses our results in more detail, I will come back to provide some more comments. Michael?

Michael Ashby - *Calix, Inc. - EVP, CFO*

Thank you Carl, and good afternoon, everyone. If you've not already done so, I would encourage you to go to the Investor portion of our website and download the financial slides that we posted concurrent with our press release earlier today. My prepared remarks will provide an overview of our financials and their related business trends. I will close by providing guidance for the second quarter of 2013.

As a reminder, the guidance we provided in February for the first quarter called for revenue of \$90 million, gross margin of just over 44%, operating expenses of \$39.5 million, and break-even EPS. Actual revenue for the quarter was \$90.5 million, slightly above our guidance. Gross margin was 48.1%, significantly ahead of our guidance. Operating expenses came in at \$39.7 million, in line with our guidance, and as a result EPS was well ahead of our guidance at \$0.06 per fully-diluted share.

We were cash-flow positive for the seventh consecutive quarter, and ended the quarter with \$48.1 million of cash on hand.

We attended several investor conferences and meetings during the first quarter and talked about the fact that we believed we were well-positioned in our Tier 1 and 2 customers, that the regulatory uncertainty that had affected our Tier 3 accounts was slowly beginning to resolve itself, and that our international expansion was continuing. Our results for the quarter do indeed show progress in all of these areas of the business.

Customer interest for our VDSL2 and fiber products remained high and we have strong bookings in revenue from the Tier 1 and Tier 2 accounts, continued recovery in the Tier 3 accounts during the quarter and increased sales and orders in the international arena. As a result, our first quarter revenue came \$0.5 million above our guidance and up 15.3% from the same period in the prior year.

More specifically, we have made very good progress in selling into the former Qwest territories of CenturyLink, a Tier 1 account. Our Tier 2 accounts continue to be strong and as expected, the Tier 3 accounts are starting to get back to business as the regulatory uncertainty dissipates.

On the international side, the combination of our own team's success in building new Tier 2 and 3 customer relationships and our global reselling relationship through Ericsson, targeting international Tier 1 service providers, has allowed us to continue to build that side of the business.

To summarize, revenue was up 15.3% from the first quarter of the prior year at \$90.5 million. We also saw an increase in deferred revenue of \$10.4 million from the prior quarter to a balance of \$65.5 million. Shipments against broadband stimulus orders are once again the primary factor leading to this increase.

Broadband stimulus revenue itself came in at just under 10% as expected.

We had one 10% customer in the quarter.

International revenue was 14% of total revenues, up significantly from 7% in the first quarter of last year and 9% last quarter.

Gross margin was 48.1%, up 3 percentage points from the first quarter of 2012 and up 4.9 points from the prior quarter. We had anticipated gross margin to come in at just over 44%. The increase was primarily driven by a favorable mix of products and customers. Very importantly, we continue to see solid growth in our E-series products, which was stronger than we had expected.

Operating expenses came in at \$39.7 million, in line with our guidance and up \$5 million from the same quarter last year and up \$3 million from the prior quarter. This increase reflected as expected the full quarter of the employees we assumed from Ericsson, our new location in San Jose, the funding of an employee bonus plan, and the absence of the one-time accrual reversal that we recorded in Q4.

The slightly better than anticipated revenue, significantly better gross margin, combined with inline operating expenses resulted in earnings well above our guidance of break-even at \$0.06 per share for the quarter, up from \$0.01 per share for the same quarter in the prior year and equal to the EPS recorded in the fourth quarter of 2012.

Before I turn my attention to the balance sheet, I would like to remind you that on a non-GAAP basis we exclude certain charges that we do not consider to be part of our ongoing activities or are meaningful in evaluating our financial performance as a company. These are two non-cash items - the amortization of intangibles, and the amortization of stock-based compensation. As we mentioned last quarter, we are no longer excluding any expenses related to the acquisition of assets from Ericsson.

Turning to the balance sheet, we continue to manage our working capital and recorded our seventh consecutive quarter of positive cash flow from operations, ending the quarter with total cash of \$48.1 million.

DSO was 56 days, up from 51 the prior quarter. Inventory levels decreased this quarter to \$79.2 million from \$43.3 million at the end of Q4, but inventory turns decreased to 3.7 from 5.3 the previous quarter.

Both the increase in DSO and the reduction of inventory turns are because of the linearity of the quarter. The issue on linearity was not related to bookings, but rather to component shortages in the first part of the quarter due to the changing product mix. This resulted in uneven shipments during the quarter which impacted both the DSO and inventory turns calculations.

The deferred revenue amounted to \$65.5 million, up \$10.4 million from the prior quarter, driven primarily by the broadband stimulus shipments that we expect will be recognized as revenue during the second half of this year.

Let me now move to our guidance for the second quarter of 2013. While we remain cautious about the macroeconomic environment and the regulatory uncertainty associated with USF reform, we are pleased with the strength we've seen in the business over the last few quarters and expect to build on that momentum. Over the last few quarters we have increased the deferred revenue on the balance sheet and as you're already aware, the timing of when we can recognize revenue in these contracts is difficult to accurately forecast.

Accordingly, we are guiding to a range of revenue for the second quarter of between \$94 million and \$98 million. Gross margin is likely to come in at between 45% and 46%. This is down from the 48% recorded in Q1 but up from our prior average gross margins and continuing in the right direction. Specifically in the second quarter, we do not expect the customer and product mix to be as favorable as we experienced in the first quarter. As we have repeatedly stated, our gross margin can fluctuate from one quarter to the next and we believe that over any four-quarter period we will see a gradual increase towards a long-term target of gross margin in the low 50% range.

Q2 operating expenses will increase by around \$1 million to approximately \$40.7 million at the low end of the revenue range and \$41 million at the high end of the revenue range. The increase in expected operating expenses is primarily the result of across-the-board salary increases that came into effect in April after two years of no general increases, and variable commission expense. The resulting EPS will be in the range of \$0.02 to \$0.06 per share.



DSO should remain in our targeted range between 50 to 55 days. Inventories will be essentially flat and once again we plan on being cash flow positive for the quarter. With that, I'll turn the call back over to Carl.

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

Thank you Michael. As we said last quarter, 2013 looks to be an improving year for the industry and we are better-positioned than ever. With our first quarter in the books, we believe that 2013 will be a strong year for us. Our unified access portfolio continues to be valued by a growing set of customers and prospects, allowing us to grow our market share.

In February, the FCC issued its sixth order on reconsideration of its USF ICC transformation order. While slightly more favorable to service providers, we believe it has now removed most of the uncertainties and the result is we are seeing customers making decisions and beginning to move forward. Our international efforts are bearing fruit as our number of new customers is growing at a healthy rate and our opportunities with Ericsson continue to grow.

Finally, and perhaps most importantly, our team's execution of our strategy continues to improve. At this point I'd like to turn the call over for questions. Jesse?

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first question comes from the line of Mark McKechnie with Evercore. Please proceed with your question.

Mark McKechnie - *Evercore Partners - Analyst*

Great, thanks. It looks like a pretty good quarter, guys. I wanted to ask, maybe for Michael, on the stimulus revenue, the blocking and tackling around that. Can you give us a sense of how much came in on this quarter, and how much you think you're including in your guidance for next, and how you see it kind of rolling out throughout the year?

Michael Ashby - *Calix, Inc. - EVP, CFO*

Yes Mark, we don't specifically give out broadband stimulus numbers, but what we -- we have said is that most of the broadband stimulus orders came in last year. There are some trickling orders still coming in, but generally speaking most of them were booked last year. We are recognizing the revenue on those as we go through 2013 and 2014. It has been and was last quarter, and has been for the last few quarters, just about under 10% of revenue and we expect that to continue until probably sometime through mid 2014, when it should all be recognized.

Mark McKechnie - *Evercore Partners - Analyst*

Okay, got you, and then maybe Carl if you could give us a bit of an update on how the efforts with Ericsson are going on? Not so much with the products that you acquired, but with getting your products qualified, and on their systems, and set up to be sold through their sales force?

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

So, as we stated last quarter, and it's tracking the same, we continue to go down a pretty methodical integration of systems, management systems. As you know, the EntriView system that Ericsson used is owned by us, and so I'm actually quite encouraged with the amount of activity that we are seeing through all of our channel partners, and specifically not only around the BLM1500 but also around the E7 family.

Mark McKechnie - *Evercore Partners - Analyst*

Great, thank you.

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

You bet Mark, thank you.

Mark McKechnie - *Evercore Partners - Analyst*

Thank you. The next question comes from the line of George Notter, with Jeffries. Please proceed with your question.

George Notter - *Jeffries & Co. - Analyst*

Hi, thanks very much, guys. I guess I was trying to better understand the Ericsson situation as well. If I go back there was some disappointment in terms of the amount of revenue that you guys were going to generate through the Ericsson channel. I mean, can you give us any sense for how much revenue you got from the Ericsson channel this quarter, and then I think you guys had looked at doing \$5 million to \$6 million per quarter on a go-forward basis. Is there an update to that number now? Is that still appropriate, or do you think you can do better than that going forward? What's the view, there? Thanks.

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

George, I appreciate the question, but as we said, we're not going to call out any particular channel partner, and as a proxy the best place to look would be into the international numbers. I would just merely characterize this as, I am very encouraged by what I am seeing in all of our efforts there. Michael, if you want to add from an international perspective, any percentages, feel free.

Michael Ashby - *Calix, Inc. - EVP, CFO*

No, I think you said it, Carl. I mean, the international is growing, and one of the reasons for that is the Ericsson relationship, so I think we're very pleased with that relationship and it has the potential George, as you know, to be quite large over time.

George Notter - *Jeffries & Co. - Analyst*

Just qualitatively, what's the feedback from customers that you know, were EDA 1500 customers, are they still buying that platform? Are they happy to see Calix owning those assets now? Are they looking at buying the E-series as a potential copper-based solution? Any sort of feedback you can have, give us, on the customer side would be great.

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

Yes, I'll give you the qualitative feedback George, and that's a good question. When we acquired the platform, obviously Ericsson had been messaging into their customers for some time as to what they might or might not be doing, and so as you might imagine, customers get a little bit nervous. And so right now, I would characterize us in the following stage -- to make sure that we get out to all of their customers and help them understand that the level of commitment we have to the platform, and also help them understand our other wares, if you will. But, our first concern is to make sure that everything is stabilized, and everybody feels good, and I would say that we are right in the middle of that now.



And the feedback from that has actually been very positive, but you've got to go work through it just as we did when we acquired Occam or acquired OSI.

George Notter - *Jefferies & Co. - Analyst*

Got it, and then could you just give us any sense for what the environment is like internationally? In terms of RFQs, or RFP processes, for broadband infrastructure, is it picking up, staying the same, slowing down? What's the view?

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

So, you know, we've heard all sorts of different things and the only way I can answer your question, George, is to put it into a perspective of where we are coming from, which is, all the world's an oyster. The global expansion for us is all new, so I can't tell you whether the tide is up or down, way up at the top. All I can tell you is, we've got lots of opportunities for us and I don't know how to comment on the rest of it.

George Notter - *Jefferies & Co. - Analyst*

Great, thank you very much.

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

You bet, George. Thank you.

Operator

Thank you. The next question comes from the line of Sanjiv Wadhvani with Stifel. Please proceed with your question.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

Thanks so much. Michael, just a quick question for you on gross margins, I know you said product mix helped, but there's also a customer mix element over there. I was wondering if you could just give some more details on the customer mix aspect of it? And then on broadband stimulus, obviously it looks like it's been trending slightly below 10% of revenues. You kind of alluded to that you're expecting it to remain at that same level, perhaps through the middle of 2014. I'm just curious. I mean, there's no sort of visibility in that, getting bigger? Obviously as the revenues expand and it sort of hovers at about 10% it just gets bigger, but just curious, sort of what the expectations are for the next year or so, for that piece of business? Thanks.

Michael Ashby - *Calix, Inc. - EVP, CFO*

Okay. On the customer mix, that's related to the fact that we have, we've seen the Tier 3 customers, the regional customers, as I said starting to stabilize and grow again, and we have pretty good margins in the regional and Tier 3 accounts because of the type of products we're selling. And so, that helps, that helps improve the overall margins. So, in this particular quarter we had a good mix of customers that are buying a fairly, you know, good products at reasonable margins, high margins. That helped us out for the quarter, that and the product mix relating to the overall increase in the E-series, as a percent of total product being sold.

As far as broadband stimulus is concerned, I expect it to just chug along at basically the same rate. I don't think it's going to change very much. It hasn't for the last two or three quarters. It's going to remain at under 10% and will slowly decline. I expect the majority of it to be recognized in the



second half of 2013, with some going through into 2014, but it is not going to increase. The majority of it is either in deferred revenue or not shipped yet, and as I say, it's going to go along at roughly the same level for the next few quarters.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

Got it, that's helpful. Thank you.

Operator

Thank you. The next question comes from the line of Ehud Gelblum with Morgan Stanley. Please proceed with your question.

Ehud Gelblum - *Morgan Stanley - Analyst*

Thanks. Hey guys, it's Eddie. A couple of questions. First, I want to go back to the international revenues and Ericsson, I'm just a little confused. So, is the growth international this quarter, is that related to the Ericsson acquisition and the products that came from there, or is it complete legacy? And if you hadn't closed Ericsson last year, you'd still be up in internationals? I wanted to confirm that.

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

The answer is, again, we're not going to break out the pieces, but you can assume it's parts of both. We're seeing strong success in what we were doing, and we're seeing strong interest and success with Ericsson, as well.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay, so it would be safe to assume that Ericsson that last quarter had issues, had fewer issues this quarter, and probably was -- that revenue stream was up this quarter?

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

Yes, that cloud is lifting.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay, that's positive. Now, is that related to the E-series strength you saw, or was the E-series strength you saw that pushed the gross margin related more to CenturyLink?

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

Well, so. The E-series as Michael said, was stronger than anticipated, but I would tell you that that was stronger than anticipated across all segments and customers not related to any one channel or segment, actually. Michael?

Michael Ashby - *Calix, Inc. - EVP, CFO*

No, that's correct. That strength was across the board, primarily in North America, but across the board across all customer segments.



Ehud Gelblum - *Morgan Stanley - Analyst*

Okay. I mean, the Ericsson product obviously, BLM, is not the E-series, but what I meant was whatever you're getting internationally through Ericsson, etc., you're selling E-series as strong internationally as you are in the US? But it sounds like now, what Michael said, is much more of a US thing than it is an international thing?

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

Well --

Michael Ashby - *Calix, Inc. - EVP, CFO*

My response --

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

Sorry Michael, you go ahead.

Michael Ashby - *Calix, Inc. - EVP, CFO*

I'm saying North America, because obviously that's the larger part of our business, but we are -- we sell the E-series product to the Tier 2s and Tier 3s internationally as well, and through Ericsson. So, that is also contributing to the growth of E-series. But it's only, you know, it's still a relatively small amount of the total revenue, obviously.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay, and then when you look at the -- I always kind of in the back of my mind, I always thought that when we move from the C7 to the E-series, do that more in Ethernet it became more of an international type of thing because Ethernet is kind of an internationally-liberating standard as opposed to more SONET-based products, that are not. So, in the back of my mind I always thought that E-series would help expand international, and so that's why I was kind of wondering if they were --

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

Well, hold that thought for a moment, if I can Ehud, because you're partially right but I want to make sure that we're clear. The C7 is a multi-service multi-protocol system, so it does SONET and Ethernet, not just SONET.

Ehud Gelblum - *Morgan Stanley - Analyst*

Correct, but if you're international and you can't do --

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

And so the C7, the C7's been deployed across all of those transformational networks, however, what you are correct in saying is it's an ANSI product. So, for the most part it either goes into North America or North American-like markets, and therefore to your point, as we go international we are likely carrying the E-series or the B-series into those markets but not the C-series.



Ehud Gelblum - *Morgan Stanley - Analyst*

Correct, okay.

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

Yes, you got it.

Ehud Gelblum - *Morgan Stanley - Analyst*

I didn't say it exactly right, but that's sort of where I was going. And then finally, when you look at your Tier 1, it seems like Tier 1 actually grew this quarter and was a nice part of the revenue. You were flat total top line, quarter-to-quarter, so international grew, Tier 1 grew, what shrank on a quarterly sequential basis?

Michael Ashby - *Calix, Inc. - EVP, CFO*

I'm sorry, I don't think, I don't believe anything shrank, Ehud. I think we had some strength across the board. I mean, there are some customers that increase more than others from any one quarter to the next, but there's no area of the business that saw any particular weakness during the quarter.

Ehud Gelblum - *Morgan Stanley - Analyst*

Well I know, I mean, generally on a relative basis you didn't because Q1 is always obviously seasonally weak. Putting that aside, and so whatever did shrink probably shrank from a seasonal perspective but did seem from an absolute perspective that international was strong and Tier 1 I would imagine was up? Or maybe I was mistaken to mention it?

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

No, Ehud, you're correct. I mean, international was up as a percentage and revenues were roughly flat from quarter to quarter, so therefore North America was down. That's a correct statement, but I think to Michael's point -- and again, when we think about it seasonally and obviously the seasonal trends are changing here -- we feel very good about the quarter, but to a mix standpoint, we clearly saw strength in international. But, when we look at it against what we traditionally have seen, North America was quite strong but as a percentage of mix it was less because of making room for international. That's correct.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay, and then finally, when you look at your guidance into Q2, how did you come up with that? Did you look at regular seasonality? If so, what types of seasonality did you apply to each part of the business, or is this based on your sales funnel, or how do you get comfortable with the move up into Q2 versus perhaps staying larger, and how does that fit in with last quarter on the conference call -- you kind of danced between a 20% growth rate for the year and a 15% growth rate for the year. I think you answered one of the questions in saying that if you were to be in line to build better in Q1, then you'd probably be doing the 15% growth for the year, but 20 wasn't out of the question. How does Q2 kind of dovetail with that? Do you still kind of believe in that?



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

Yes, so let me give you just the shaping and then I'll turn it over to Michael for more details or color, if you would like, Michael. Real briefly, Ehud, as you know, if you look back at our numbers, we used to see the first quarter, then a step up to the second, sort of a sideways to Q3 and then a step up to Q4, and then you go into Q1 and you take a step down, and repeat. What we think we are seeing is something that looks much more linear and up and to the right throughout the year, so that's what we think we are seeing. So Michael, any color you'd care to add to that?

Michael Ashby - *Calix, Inc. - EVP, CFO*

No, that's exactly right because the first quarter was flat with Q4, which is most unusual. We're looking, we've seen differences now, because this year for a number of reasons, so the process we do is to see growth each quarter as we go through and as you go through this year.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay, so you think it could grow throughout the year. I'll let someone else tackle the full-year question. Thanks.

Operator

Thank you. The next question comes from the line of Amitabh Passi with UBS. Please proceed with your question.

Amitabh Passi - *UBS - Analyst*

Hi, thank you. I had a few questions. Michael, can you give us any sense what the E-series did, either or both sequentially and year-over-year? Maybe just in percentage terms, like how much growth?

Michael Ashby - *Calix, Inc. - EVP, CFO*

That's not a number that we give out, Amitabh. That's not something that we talk about. The only comment we make is that, we have made in the past, is that it's the fastest-growing segment of the business, and obviously that continued in this quarter.

Amitabh Passi - *UBS - Analyst*

Okay, maybe another question for you then Michael, and I think I asked you this last quarter, but wanted to ask again, if I look at your year-over-year revenue growth it's roughly 21% for the June quarter. You're guiding OpEx to grow 21% roughly as well. When do we start to see greater leverage in the model where OpEx growth can sort of start to be slower than your revenue growth?

Michael Ashby - *Calix, Inc. - EVP, CFO*

Well, our plan on OpEx which I think we talked about before is to hold OpEx as flat as we can for the next few quarters. There is going to be an increase as I said of around \$1 million in Q2 which reflects the variable compensation and then the increase, the general increase, for the population, the employees that went into effect in April. But, from a head count point of view, we are holding things essentially flat, so I expect to see very sort of low growth in OpEx as we go through the remainder of this year, and as we just mentioned, we do expect to see the revenue continue to go each quarter. So, we'll start to see that leverage improve each quarter as we go through the remainder of the year.



Amitabh Passi - UBS - Analyst

Okay. You previously have also talked about double-digit growth for the full year. I was curious, if I looked at your 10%-plus customer, would you expect them to grow in line with your total company growth rate this year, better, lower?

Michael Ashby - Calix, Inc. - EVP, CFO

Well, that's difficult to answer, but we are as you know, now selling into the what was the former Qwest side of CenturyLink, so the potential is certainly there for that to grow faster than the average.

Amitabh Passi - UBS - Analyst

Okay, and then I just want to -- sorry, go ahead?

Carl Russo - Calix, Inc. - CEO, President

We expect it, we expect it to grow.

Amitabh Passi - UBS - Analyst

Perfect, and one final question for you Carl. I'm just curious, you know last year when Google started the rollout in Kansas City, everybody perceived that to be an experiment. Since then we've seen them announce a couple other cities. I'm curious -- as you have your conversations with your customer base, your Tier 1, Tier 2, Tier 3s, I'm curious, are people starting to know what Google is up to? Are you starting to sense maybe a increasing need to up their capital investment plans? Just any sense of just kind of the reaction to what Google is doing in the marketplace?

Carl Russo - Calix, Inc. - CEO, President

Yes, I think there's multiple reactions. Let me just boil it down to our perception of it, which is any time you have people talking about a richer portfolio of services provided at speeds that frankly require fiber to either get right to the premises or very close, we think it advantages us, our unified access architecture, and a whole fiber-forward stance that we've had since the inception of the company. So, truthfully I think it's wonderful.

Amitabh Passi - UBS - Analyst

Okay, thank you.

Operator

Thank you. (Operator instructions) Our next question comes from the line of Simon Leopold with Raymond James, please proceed with your question.

Simon Leopold - Raymond James & Associates - Analyst

Great, thanks a lot. A couple of things I wanted to clarify. I know you don't like to give a firm breakdown of products, but I'd like to try to get a ballpark idea of the E-series contribution and I'm assuming we're now above 25% of revenue. Is that a reasonable assumption for the March quarter?



Carl Russo - Calix, Inc. - CEO, President

So, I appreciate your asking, Simon, but we won't break it out. Let's go down a different path. Clearly, it's going to Michael's point, faster than any product that we have seen. By the way, the reason it's growing faster than any product we've seen, is it's architected in the E7-20 to be a two-terabit architecture. So, when customers are looking not just at higher speed copper but through that to fiber, broad services, video, wireless-wireline integration, that architecture is we think just a killer architecture.

So, it's going to continue to be pulled through. Suffice it to say that if you remember way back when, we said we would comment on it up until it became sort of a greater-than-10% contributor. It's well passed that many quarters ago.

Simon Leopold - Raymond James & Associates - Analyst

Okay, so let's go back to the Qwest progress. So, last quarter you only really had a few weeks of contribution into that Qwest footprint. Is there anything you can give us that would help us quantify the deployment in this quarter, and maybe a way I'd like to see if you could help us is, if you were to linearize the contribution in the fourth quarter, basically so you get a quarter-over-quarter pro forma. I'm assuming you were up sequentially in the March quarter? If that question makes sense?

Carl Russo - Calix, Inc. - CEO, President

I understand the question, but again, I would just harken back and say we anticipate growing this business, as we settle along. The barriers to entry into those properties come down, which they have, because of all the work on OSMINE and IT integration, etc., and we anticipate it growing And that's exactly what it has done. Beyond that, I would not care to comment.

Simon Leopold - Raymond James & Associates - Analyst

Can I, let me ask a slightly different question that maybe is easy. Do you feel as if you're gaining market share at that customer?

Carl Russo - Calix, Inc. - CEO, President

I don't -- you know, you'd have to look at their CapEx investment, etc. I feel we are strategically aligned and that we continue to demonstrate that with the customer, and that we continue to grow our business. I can't speak to the other part of it.

Simon Leopold - Raymond James & Associates - Analyst

Okay, and let's shift gears, then. International, good quarter, nice percentage of revenue, but I'm conscious that that could be lumpy. How do you think about international contributing in the June quarter? Should we think about that as being lumpy, or is this a new level that we should see as more sustainable?

Carl Russo - Calix, Inc. - CEO, President

Well, I think as we said to your point, we expect it to slowly but surely go up and to the right. It will do so in a noisy fashion. So, it's more like a "least-squares" fit on a dotted line. I would characterize Q1 as a very encouraging quarter, and we are encouraged as we look through into the funnel and the opportunity that this will continue. But, I would be hard pressed to plan it out on a linear basis. Michael?

Michael Ashby - Calix, Inc. - EVP, CFO

Yes, I agree, Carl.



Simon Leopold - *Raymond James & Associates - Analyst*

And is there any color you can give us in terms of the level of customer diversity or concentration of that international business?

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

I'm not sure I follow the question, Simon.

Simon Leopold - *Raymond James & Associates - Analyst*

I guess what I'm trying to get a sense of is, is the growth we saw in this quarter led by let's say one large project, or many small ones?

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

A mix of all of the above. We're seeing more pins on the map as we alluded to in our prepared comments from a new customer basis, as well as some larger pieces, as well. It's actually a good mix.

Simon Leopold - *Raymond James & Associates - Analyst*

And so for the full year, you expect international, certainly could be over 10% then if we sort of take that commentary into perspective for the year?

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

Michael?

Michael Ashby - *Calix, Inc. - EVP, CFO*

Yes, I would hope so.

Simon Leopold - *Raymond James & Associates - Analyst*

Great, thank you very much.

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

Thanks, Simon.

Operator

Thank you. Our next question comes from the line of Simona Jankowski with Goldman Sachs, please proceed with your question.



Simona Jankowski - *Goldman Sachs & Co. - Analyst*

Hi, thanks very much. I wanted to follow up once again on the source of upside to growth margin in the quarter, and I understand your comment on the E-series increasing as a portion of the mix. Was there also an element of change in the mix of chassis versus blades?

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

So the answer is -- sorry, Michael, do you want to take that?

Michael Ashby - *Calix, Inc. - EVP, CFO*

No, go ahead, Carl.

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

I, obviously I would never break it out in that regard. I think the answer to the question was that we saw a favorable product and customer mix. Michael, any additional things that you want to add on cost reductions or anything else?

Michael Ashby - *Calix, Inc. - EVP, CFO*

No, just that you know, we don't necessarily track blade and chassis mix, and I don't see any changes in what's happened in Q1 versus in the other quarters. But we also did have some, some cost reductions, manufacturing cost reductions, that came and that helped in that line. And so, it was a combination of factors that enabled us to have it, but you know, what pushed us higher than we'd expected was the favorable product mix primarily.

Simona Jankowski - *Goldman Sachs & Co. - Analyst*

Okay. A separate question, is there a sense you can give us at this point of what percent of your business is Tier 1, which I guess would be CenturyLink, versus Tier 2 and Tier 3 customers?

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

(multiple speakers)

Michael Ashby - *Calix, Inc. - EVP, CFO*

(multiple speakers) last year, and they were in the 10-K. Of course, we gave the percent for our largest customer, CenturyLink, which was I believe 19%, 21%, sorry, 21% for 2012. And that's the only Tier 1 customer that we have, obviously.

Simona Jankowski - *Goldman Sachs & Co. - Analyst*

And then between the Tier 2 and Tier 3s?



Michael Ashby - *Calix, Inc. - EVP, CFO*

Again, that's not a number that we give out but I think what we have said in the past was that Tier 3s normally represent, historically represent between 55% and 60% of the total revenue.

Simona Jankowski - *Goldman Sachs & Co. - Analyst*

Okay, got it, and then the last question, kind of a specific on the Tier 2 segment. A couple of those guys, Frontier, Windstream, have indicated CapEx being down this year. Should we think of your business there kind of tracking more or less in line with their overall CapEx trajectory, or do you have any specific projects that you're involved in that you think can help you outgrow that?

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

I don't think we are immune to any gross CapEx changes in our customers where we are well-established, but having said that, we're encouraged by the progress that we're seeing across all of our customers, including the Tier 2 segment.

Simona Jankowski - *Goldman Sachs & Co. - Analyst*

So, in other words, directionally we -- you know, if we were to think about the upside to your business this year, it sounds like CenturyLink because of the Qwest expansion, and then the Tier 3s because of the normalization there of the environment, should be more of a source of upside relative to the Tier 2s given their declining CapEx. Would that be fair?

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

That's likely true. Michael?

Michael Ashby - *Calix, Inc. - EVP, CFO*

Yes, I agree. I think that's probably fair.

Simona Jankowski - *Goldman Sachs & Co. - Analyst*

Okay. Thank you very much.

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

Thanks, Simona.

Operator

Thank you. (Operator instructions) It appears there are no further questions at this time. I would like to turn the floor back over to Mr. Allen for any closing comments.



David Allen - *Calix, Inc. - Director IR, Treasurer*

Thank you, Operator. Once again, I want to thank all of you for joining us today. We hope you can join us at one of the three upcoming investor conferences in the month of May that we'll be participating in. The Jeffries 2013 Global TMT conference in New York on May 7, the Raymond James Semi-Annual Investor Conference in Boston on May 9, and the Cowen and Company 41st Annual Technology, Media and Telecom Conference in New York on May 29. Information about these conferences is available on the Investor Relations section of Calix.com.

Thank you again for joining us today. We remain focused on executing against the opportunities ahead of us, and we look forward to speaking to you at one of these forums. Goodbye for now.

Operator

Thank you. Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

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