

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

CALX - Q1 2012 Calix, Inc. Earnings Conference Call

EVENT DATE/TIME: MAY 01, 2012 / 8:30PM GMT



CORPORATE PARTICIPANTS

David H. Allen *Calix Inc. - Director of IR and Treasurer*

Carl Russo *Calix Inc. - President and CEO*

Michael Ashby *Calix Inc. - EVP and CFO*

CONFERENCE CALL PARTICIPANTS

Simona Jankowski *Goldman Sachs - Analyst*

Blair King *Avondale Partners - Analyst*

Ehud Gelblum *Morgan Stanley - Analyst*

George Notter *Jefferies & Company - Analyst*

Mark McKechnie *ThinkEquity - Analyst*

Nikos Theodosopoulos *UBS - Analyst*

Simon Leopold *Raymond James - Analyst*

Sanjiv Wadhvani *Stifel Nicolaus - Analyst*

PRESENTATION

Operator

Greetings and welcome to the Calix Q1 2012 Financial Results Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. (OPERATOR INSTRUCTIONS.) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, David H. Allen, Director of Investor Relations and Treasurer for Calix. Thank you, Mr. Allen. You may begin.

David H. Allen - *Calix Inc. - Director of IR and Treasurer*

Thank you, operator, and good afternoon, everyone.

Before we begin the call, I would like to remind you that this call contains forward-looking statements regarding future events, including the future 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 management's expectations, estimates and judgments 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. I would encourage you to review the Company's various SEC reports, including our annual report on Form 10-K for the fiscal quarter December 31, 2011, available at www.sec.gov, in which we discuss these risk factors.

All forward-looking statements made -- 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 conference call, we will be discussing GAAP and non-GAAP results. We are providing non-GAAP estimates to enable interested parties to evaluate the Company's performance in the same manner in which Calix evaluates its own operations. These non-GAAP measures exclude certain charges and benefits which we do not consider to be part of the Company's ongoing activities or meaningful in evaluating the Company's financial performance, including stock-based compensation expense and amortization of acquisition-related intangible assets. To



help you better understand those results, we have included a reconciliation of our GAAP and non-GAAP results in the 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, our earnings press release has been posted to our website along with supplemental financial data on the Calix Investor Relations website, which you may want to review in conjunction with our press release and conference call remarks.

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

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

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. The first quarter of 2012 saw continued momentum in every market. After a stumble in the third quarter of 2011, we have had two strong bookings quarters. Product acceptance is at an all-time high, and our improved processes are beginning to have a positive impact on the business.

I will come back after Michael discusses our Q1 results to add some thoughts on the business going forward.

With that, I would like to turn the call over to Michael Ashby.

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

Thank you, Carl, and good afternoon, everyone.

If you have 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 concurrently with our press release earlier today.

My prepared remarks will provide a financial overview and the related business trends, and I'll provide guidance for the second quarter of 2012.

I am pleased to say that we had another solid quarter. Our revenue came in slightly under our guidance; gross margin and EPS were slightly better than our guidance. As a reminder, the guidance we provided in February for the first quarter included revenue of \$80 million to \$82 million, non-GAAP gross margin to be up slightly from our Q4 level of 43.1%, non-GAAP operating expenses to be a little less than our fourth-quarter level of \$35.7 million, with a break-even non-GAAP bottom line. We also expected to have slightly positive cash flow.

Actual revenue for the quarter was \$78.6 million. Non-GAAP gross margin was 45.1%. Non-GAAP operating expenses came in at \$34.7 million. Non-GAAP net income for the first quarter of 2012 was \$0.01 per diluted share, and we generated \$9.9 million of cash, ending the quarter with \$49.6 million of cash on hand.

Customer response to our Unified Access Portfolio remained high, as we had another strong quarter across the board, particularly in bookings. Our major accounts, national accounts and regional accounts all performed strongly during the quarter. We also began to see an up-tick in bookings from Broadband Stimulus wins, and we did begin to ship against some of those orders.

As you are aware, we employ a very conservative revenue recognition policy, particularly when it comes to our US contracts, which include Broadband Stimulus orders.



Revenue was \$78.6 million, slightly under our guidance for Q1. However, you will notice that our deferred increased by \$4.2 million, the majority of which was Broadband Stimulus orders where the revenue will be recognized later in the year. The revenue recorded from Broadband Stimulus orders was less than 10% of revenue for the quarter.

We did have one specific 10% customer in the quarter, and our international revenue was 7%. International has been at 6% of revenue for the last few quarters, but we are beginning to see that increase as our international presence starts to expand.

Gross margin for Q1 increased to 45.1% from 43.1% in Q4. This increase was primarily driven by mix issues, both customer and product versus service, with services being a lower percent of revenue than in the previous quarter.

Operating expenses came in at \$34.7 million, a little lower than our guidance. Operating expenses actually came in right on our plan number, but we benefited from a \$400,000 business credit on our operations in Nanjing, China, which brought operating expenses in under our guidance.

Improvement in gross margin and reduced operating expenses enabled us to achieve a slight profit on a non-GAAP basis for the quarter versus our guidance of approximately break-even.

Turning to the balance sheet, strong cash collections and our ongoing activities to reduce inventory levels enabled us to generate positive cash flow from operations, ending the quarter with total cash of \$49.6 million, \$9.9 million from the end of Q4. In addition, we continue to have no debt.

First quarter DSO was 49 days, an increase of 6 days from Q4, but still below our target range of 50 to 55 days.

While we reduced our inventory levels by around 17% to \$37.2 million, we remain committed to (inaudible) inventory improvements. Q1 inventory turns were 3.6, and our goal is to increase these to between 6 and 8 turns by the end of this year.

Deferred revenue was \$34.3 million, an increase from \$30.1 million at the end of Q4. This increase was due to shipments on Broadband Stimulus and to extended warranty contracts booked during the quarter.

Let me now move to our guidance for the second quarter on a non-GAAP basis.

We expect to have another solid bookings quarter with another strong contribution from Broadband Stimulus, as the wins we have previously announced turn into orders. We expect revenue to be in the range of \$93 million to \$97 million. That range is fairly large, only because the timing of revenue recognition of Broadband Stimulus orders is difficult to predict. What is not recognized in revenue will be reflected in deferred revenue and be recognized later in the later. So we would expect to see deferred revenue increase by between \$4 million to \$8 million, depending upon the mix of orders.

We expect gross margin to be, again, around 45% and operating expenses to increase to just over \$38 million, reflecting primarily our increased investment in OSMINE, our continued investment in the international infrastructure, increased commissions and, of course, the one-time business credit recorded in Q1 that will not be repeated.

In terms of non-GAAP EPS, we expect that to be in the range of \$0.07 to \$0.11 a share. We expect DSOs to remain within our range, inventories to continue to slowly decline, and to be cash-flow positive once again in the second quarter.

I would like to take this opportunity to remind you that we will be holding an analyst event on June 13 in New York City, and we look forward to seeing a number of you there.

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



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

Thank you, Michael.

The secular trends that are driving our industry remain unchanged, and we are well-positioned to grow our market share and our revenues. We have seen strong interest in Calix products and services across all our addressed markets, which bodes well for Q2 and beyond. While we are excited about the opportunities ahead, we remain mindful of the economic climate.

At this point, I'd like to turn the call over for questions. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you. We'll now be conducting a question-and-answer session. (OPERATOR INSTRUCTIONS.) Our first question comes from Simona Jankowski from Goldman Sachs.

Simona Jankowski - *Goldman Sachs - Analyst*

Hi. Thanks so much. Just a couple of questions. First, I did want to follow up on the source of upside to your gross margin in the quarter, and I know you indicated a different customer mix there. But if you can just give us a little bit more color as far as what surprised you versus your expectation.

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

Sure, Simona. This is Michael. It was a strong quarter from a margin point of view and, as you know, the mix of product has significance there in that our new E-series products have higher margins than the older CMB-series products. So as that -- as those increase as a percent of share, that obviously improves margin. And as I did say in my comments, the service -- as a percent of revenue -- is slightly less this quarter. But we have been working on improving margins, as you know, for a number of quarters and have seen progress over the last 6 or 7 quarters, and we expect that progress to continue as we go forward.

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. Thank you for that. And then just a second question. If you can just update us on the opportunities for share gains that you've discussed in the past that a couple of your bigger customers, Frontier and Qwest -- and it looks like your investment in OSMINE is increasing. So should we read into that that a potential win at Qwest is imminent?

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

Simona, hi. This is Carl. So let me go backwards forwards, if you will. The increase in OSMINE -- you're going to see OSMINE be noisy. It'll go up and down from quarter to quarter depending upon the specific timing of (inaudible) and other things. So I don't know that I would read anything into that. As for penetration in the two accounts that you're referring to, we expect late-in-the-year penetration in the former Qwest properties in CenturyLink as we go through both the OSMINE process and then the internal IT integration at CenturyLink. So nothing has changed there from last update. And then towards the Frontier/Verizon lines, as I think we've stated before, they have rotated off of base and onto the Frontier IT systems, and as that has happened, we have begun taking orders. And so we are actually now active in those properties. And interest funnel, etc. continues to build so we expect that to build methodically throughout the year.



Simona Jankowski - *Goldman Sachs - Analyst*

Oh okay. Got it. So as far as Frontier then, are revenues from that going to be recognized in the second quarter?

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

I believe there were some revenues that were recognized in the first quarter and it will grow from there --

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

There will be some revenues in the second quarter and they will grow each quarter as we go through the year, Simona. Yes.

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. Terrific. Thank you.

Operator

Thank you. Our next question comes from Blair King from Avondale Partners.

Blair King - *Avondale Partners - Analyst*

Yes. Hi. Thanks for taking the question. I guess the first one is just broad. It may be for you, Michael. Just in regard to annual revenue growth, is a 20% revenue target still something that's on the table this year for you guys?

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

Yes, Blair. It is indeed. I think what we said on the last conference call was that our goal was 20% revenue growth this year.

Blair King - *Avondale Partners - Analyst*

Okay.

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

And that hasn't changed. That is still our goal.

Blair King - *Avondale Partners - Analyst*

Okay.

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

And still something that we fully expect to be able to achieve.



Blair King - Avondale Partners - Analyst

Perfect. And then the follow-up question to that is CenturyLink's put out some pretty aggressive spending plans with regard to IPTV builds and fiber-to-the-node deployments for this year -- both, I believe, within the Qwest properties, but also within the legacy Embarq and CenturyTel properties together. And it would seem that you guys would have an opportunity to grow business at CenturyLink this year. I was wondering if you could just comment on what your thought process there is with regard to that CapEx budget and whether you feel your revenue contribution from that particular account can grow this year versus last.

Carl Russo - Calix Inc. - President and CEO

Blair, this is Carl. The answer is we do believe it can grow, obviously, but I don't know that I would make any specific comment on their plans as they've alluded to where they're heading, but I'll let them speak for themselves. Very clearly, we believe we have a good set of technologies that fit where CenturyLink is heading, but we'll see over the quarters how that progresses.

Blair King - Avondale Partners - Analyst

Okay. Alright. Thank you.

Operator

Thank you. Our next question comes from Ehud Gelblum from Morgan Stanley.

Ehud Gelblum - Morgan Stanley - Analyst

Hi, guys. Thanks. Appreciate it, Mike and Carl. A couple quick questions. Did you see any disruption from your largest customer in the first two months of the year as they did the provisioning system move-over? Any more than normal and can you compare kind of like what March looked like -- the linearity from that customer as you went through the quarter?

Michael Ashby - Calix Inc. - EVP and CFO

Ehud, this is Michael. No, we did not see any perturbation in that customer during the first quarter of the year. So no change in the way we were seeing business or in our dealings with them.

Ehud Gelblum - Morgan Stanley - Analyst

So as they moved their provisioning system over onto the Qwest properties, they continue to spend in line with expectations on the primary legacy CenturyLink properties?

Michael Ashby - Calix Inc. - EVP and CFO

Yes. Yes. That's correct. And as you know, we're not as yet able to sell into the Qwest properties, so if there was an effect on that side, we wouldn't be aware of it.

Ehud Gelblum - Morgan Stanley - Analyst

Right. I just wanted to see if it affected the entire business or just --

Michael Ashby - Calix Inc. - EVP and CFO

No. No it did not.

Ehud Gelblum - Morgan Stanley - Analyst

The (inaudible) going in. Kind of a -- sort of an adjunct follow-up question to the 20% question from before. You, I believe -- both Mike and Carl -- have talked about a 90-ish million number for Broadband Stimulus for this year. Correct me if I'm wrong, but is that still the angle that you're looking at for Broadband Stimulus? And is that orders or actual recognized or both?

Michael Ashby - Calix Inc. - EVP and CFO

The number that we have talked about, Ehud, is \$80 million to \$100 million, we've said --

Ehud Gelblum - Morgan Stanley - Analyst

Right. (Inaudible.)

Michael Ashby - Calix Inc. - EVP and CFO

For Broadband Stimulus this year. And I did say originally that we thought there'd be revenue of \$80 million to \$100 million. Since then, when I've been talking to investors, I have somewhat changed that and said we expect \$80 million to \$100 million between revenue and deferred revenue, because it's a little difficult to predict exactly when these contracts will come to revenue. So we're still confident that we'll get between \$80 million to \$100 million Broadband sort of revenue and deferred revenue. Having said that, we also think that the 20% goal that we've set is achievable, even if more ends up in deferred revenue than we had perhaps originally thought. So it doesn't change our outlook.

Ehud Gelblum - Morgan Stanley - Analyst

Okay. So you can easily clear that with just an \$80 million -- or lower revenue number and the rest in deferred. When you look at where your visibility -- your visibility looks like now versus three months ago, can you give us a sense as to how far out can -- are orders coming in now versus where they were three months ago? And do you have the same visibility at your largest two customers as you do at the rest of your customer base? And -- or is it stronger than tier 3s than it is perhaps in the tier 2s or -- kind of throwing CenturyLink into that tier 1/tier 2 category -- or do you see different levels of visibility as you look across the industry?

Carl Russo - Calix Inc. - President and CEO

There's a lot of sub-questions in there, Ehud. This is Carl. So let me see if I can just sort of address it broad-brush. I don't know that I would give you a time answer to your question. I would tell you that I believe our visibility is improving and I think it's improving for a couple of reasons. One is there's better visibility in general for our customers starting to show up now as we're going through all of the (inaudible) USF/ICC stuff that's starting to clean up. Secondly, there were -- as you know from last, the fiber shortage piece has started to mitigate. So that's removing some of the cloud from a visibility standpoint. But the other pieces, frankly -- and the mea culpa we gave two quarters ago in the third quarter of 2011 -- we clearly have utterly revamped our sales forecasting data gathering process, and I think that has significantly improved our visibility as well. So I think



there's three reasons why we're seeing improved visibility, and I would not restrict it to any one set. I believe we see it across all of our market (inaudible).

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay. Great. One last thing. Just a trend type of thing. Are you seeing more business with -- I know you had some -- several years ago, and you still do, have business with some fiber-to-towers and mobile backhaul. Are you seeing any difference or pick-up in either a fiber-to-the-tower-type build or mobile backhaul-type build, whether it be high-order DSL or fiber versus wire line broadband access build? I guess what I'm going at is wireless backhaul versus broadband access to homes and businesses -- are you seeing an acceleration in the wireless side or is it still -- is it growing somewhat in line with the Broadband Access base?

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

Yes. There's so much broadband being built out in different directions. I don't know that I would segment it that way. I would tell you that -- I'll answer your question, unfortunately, orthogonally to the way you're asking it -- is we are clearly seeing that the trend to the tower is now fiber -- that the traffic volumes that are coming off of those towers are dictating that you just have to be on fiber. But I don't know that I would tell you that it's -- one is outgrowing the other, per se.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay. Very helpful. Thanks, guys.

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

Thanks, Ehud.

Operator

Thank you. Our next question comes from George Notter from Jefferies & Company.

George Notter - *Jefferies & Company - Analyst*

Hi. Thanks very much, guys. I wanted to ask you about your largest customer and the process there. My understanding is that lab trials on OSMINE were Q1. I guess I just want to confirm that you're through that phase now. And I believe you're going to go to field trials in Q2 and you were looking for revenue in the second half. I just want to make sure that that was the expectation. And then from what I heard you say earlier, it sounded like potential revenue on the Qwest side of that account would come late in the year. So I'm wondering if there's a delay there that I'm sensing or is there -- I just -- kind of parsing some of the commentary here too finely. Thanks.

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

No. I think you're parsing them and they're -- that -- your parsing and sensing is aligned. So -- and I think Michael has been speaking to this when he's been out on the street. Most of what you just said is accurate. So going through OSMINE, doing those things, etc. The piece that moved was internal IT integration to CenturyLink/Qwest. So that comes sort of after OSMINE and before deployment. And that stretched out a couple of months. So it's still second half, albeit -- I think, Michael, you've been signaling a little bit that you expect it to be later in the second half than previously expected.

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

Yes. I think we had originally thought that we would be sort of equipped to start selling in Q3, and I think we have another (inaudible) I think it's really Q4 is when we're going to be ready and -- because of this delay in the internal IT Qwest process.

George Notter - *Jefferies & Company - Analyst*

Got it. Okay. And then as I step back and look at it, it sounds like there are some questions now about how quickly you're going to be able to take deferred revenue for Broadband Stimulus. It sounds like the Qwest situation's maybe pushed out a little bit, at least a few months. I guess you guys are also kind of reinforcing this 20% growth idea for this year. I guess I'm trying to figure out what parts of the business have improved fundamentally relative to what you were thinking before.

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

I think, George, the business is strong across the board and I think that was what we said in the comments, that each area of the business is actually quite strong. We do have very conservative [rev reg] policies with regard to these RUS contracts, so the timing of those becomes difficult to predict. We don't know exactly when it's going to go to revenue. And in those cases -- I think we've been through this before -- we don't take revenue until, in some cases, it's signed off by the board or the CEO of the company, and that's frequently not easy to get. So it's very tough to predict those and, in some cases, that they -- if we've been delivering and the network is up and running perfectly and there may be some other vendor whose product isn't working properly and we don't get sign-off until it's all complete. So those things can delay it, but they don't change our overall outlook for the strength of the business that we've seen.

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

Well, and -- George, to add -- just to come at it a little bit differently, new platform penetration and new accounts -- so as we have our platforms available, as we address new accounts with them or existing accounts with new platforms, that's moving at a very rapid rate. So the business is doing better, I think, than we had originally thought, which gives us, I think, the room to say 20% is still the goal and we believe it's achievable.

George Notter - *Jefferies & Company - Analyst*

Great. Thanks a lot.

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

Thank you, George.

Operator

Thank you. Our next question comes from Mark McKechnie from ThinkEquity.

Mark McKechnie - *ThinkEquity - Analyst*

Oh great. Thanks and congrats on the outlook, guys. So -- hey, Michael, have you -- I guess you said your Broadband Stimulus revenue was about 10% this quarter. Trying to figure out what's the range, do you think, will come in in June in your guidance for Broadband Stimulus?



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

Hi, Mark. Actually, I said Broadband Stimulus was less than 10% in Q1, so it is not past that 10% mark. And I don't think it will in Q2 either. I think it's -- I think we've always said that it's going to be heavily loaded towards the second half of the year and some of it will -- which will ship this year will not become revenue until 2013. But it's -- the first half of the year, we've always said, is going to be relatively small and then it'll ramp up in the second half.

Mark McKechnie - *ThinkEquity - Analyst*

I mean, it's interesting. Your guide then -- it's not -- the sequential growth is really not incremental Broadband Stimulus. It sounds like it's just your core business. Can you give us a sense for what some of the bigger drivers are -- what -- is this the Verizon/Frontier lines really kicking up for you or what's driving the majority of the up-tick there in June?

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

Well, Mark, it's really -- just to finish off on the Broadband Stimulus. You can track the Broadband Stimulus to a certain extent by seeing what goes into deferred revenue, and we'll give that number each quarter. So you'll see that that could increase, and then obviously, eventually, that moves into the top line. As far as the overall business, I think, as I just said, it's pretty strong across the board. There's nothing -- there's no one area that's -- that is any -- that's been a surprise to us or anything that's been sort of out of line with what we had expected would happen.

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

No, and in my opening comments, Michael, as I said, we've seen strong bookings over the last two quarters. We expect that to continue. So again, we think that we're getting good clarity now across all of our segments so that folks can make decisions. In the past, you've heard us share with you that there were times when the clarity didn't exist, and that has a tendency of slowing decisions down. So the best -- spring is in the air. How's that?

Mark McKechnie - *ThinkEquity - Analyst*

Good enough. Okay. Thanks. Great. Congrats.

Operator

Thank you. Our next question comes from Nikos Theodosopoulos from UBS.

Nikos Theodosopoulos - *UBS - Analyst*

Thank you. Just a couple of quick questions. On the bookings, was the Broadband Stimulus under 10% of bookings as well in the quarter?

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

Hi, Nikos. This is Carl. So obviously you know we won't answer that question, but I appreciate your asking.



Nikos Theodosopoulos - UBS - Analyst

Okay. I didn't know you wouldn't answer it, but that's okay.

Carl Russo - Calix Inc. - President and CEO

(Inaudible) as you didn't know, I wasn't going to answer it.

Nikos Theodosopoulos - UBS - Analyst

Alright. Fair enough. And a lot of people are asking about the goal of 20%, yet perhaps a slight push-out on when you might be able to recognize revenue with Qwest and the mix of revenue recognition versus deferred on Broadband Stimulus. So do you -- and you mentioned the strength across the business. Do you see a potential second 10% customer in any of the quarters later this year or do you think you could -- it's just so broad-based you'll just have the typical one?

Carl Russo - Calix Inc. - President and CEO

My answer to your question would actually be both. There is a potential for that, but really, when you're thinking about this, I think both Michael and I would say the same thing, that we are simply seeing strong support across all the products in all the segments. So I wouldn't hang your hat on a second 10%, although that is possible. I would much prefer you to look at the model just in a statistical nature of the broad basis that we have -- obviously north of 1,000 customers.

Nikos Theodosopoulos - UBS - Analyst

Okay. And then just lastly on the gross margin, mix helped this quarter and it obviously changes quarter to quarter. Do you -- the continued shift to the E-series would seem to be something that's ongoing. Do you see the mix that helped you this quarter continuing throughout the year or do you see it kind of lumpy and the gross margin could reverse? What's your sense on that?

Carl Russo - Calix Inc. - President and CEO

I'll look at Michael as I answer this, but I think Michael would say that we expect the trend on GM -- on gross margins to continue to go up. It will not go up necessarily smoothly and monotonically, but it will go up and to the right. And I think there's a couple of reasons for that and, Michael, feel free to chime in. One is, clearly, from a mix standpoint, we're continuing to see accelerating growth in products that have a greater-than-corporate-average margin mix, but the other thing that, I think, Michael, you started to highlight -- there's been a lot of effort inside the company on improved processes and just better execution on the business, which is more of a horizontal statement on improving margin. And we think we can continue to do that as well. So Michael, any other color?

Michael Ashby - Calix Inc. - EVP and CFO

Yes. And I think we have stated before, Nikos, that we have a goal of getting a margin -- gross margin with a 5 in front of it over the longer term, and we're certainly moving towards that and will continue to progress, I think, towards that.

Nikos Theodosopoulos - UBS - Analyst

Okay.

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

So I'd be surprised if -- to see margin drop. It can go up and down slightly, but it's not going to drop significantly, I think, now.

Nikos Theodosopoulos - *UBS - Analyst*

Okay. Great. Thank you.

Operator

Thank you. Our next question comes from Simon Leopold from Raymond James.

Simon Leopold - *Raymond James - Analyst*

Thank you. First, I wanted to just get a quick clarification. The G&A expenses in the quarter took a little bit of a jump. Wondering if there's something one-time-ish going on there or anything you needed to highlight?

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

Simon, you're talking about the guidance for Q2, I guess. Right?

Simon Leopold - *Raymond James - Analyst*

No no no. I'm talking about the quarter we just reported. It looked like about \$5 million, if I'm doing my math right --

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

Oh, you're talking against the prior year?

Simon Leopold - *Raymond James - Analyst*

Yes.

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

Yes. That -- well, that is -- a large part of that is the acquisition of Occam which was not included in Q1 of last year.

Simon Leopold - *Raymond James - Analyst*

Okay. Okay. And then just maybe shifting gears a bit, I wanted to see if you could talk about what's going on in the regulatory environment and what -- how your customers either are reacting or aren't, specifically what's going on with the proposed shift of USF funding to the Connect America Fund -- if you could maybe parse that based on different customer types and what thoughts they have may have and if it's affected their spending patterns.

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

So Simon, at the risk of going down a very detailed discussion, let me see if I can just abstract it to a high level. As you know, the whole USF/ICC Carrier Reform Connect America Fund that's been being driven by the FCC has caused quite a bit of uncertainty in the environment. When the original proposal came out, it caused a lot of, as Woody Allen would say, nervousness in the marketplace. Subsequently, and just recently, there are two categories, as you know, of the smaller telco's. Those are price cap and those are rate of return. And the price cap rules have driven, I think, \$300 million out in phase I, some \$240 million of it directly to our customers. And so that's been -- obviously going to be a big positive over time. But I think more importantly, and through the work of some of the industry trade organizations, the rate-of-return folks -- they went through what is called a quartile analysis. They updated that analysis and it is much more favorable to those folks, but not only is it more favorable, but I think there's much greater clarity. And so we've heard a collective sigh of relief come out of the tier 3s, and so now you -- once you have clarity and a clear view into how you can invest and what the returns are going to be, they will begin their investment again. So if you want to get into a lot more detail than that, we can, but I don't know -- we could spend hours on this subject. So I hope that gives you at least a high-level sense.

Simon Leopold - *Raymond James - Analyst*

It does, and I think your answer's sufficient, but let me just clarify what I think you said was that there was some bit of a pause in the rate-of-return spending in the March quarter, and now, with the clarification, you see that group spending back on normal patterns with maybe some catch-up?

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

Actually, I would tell you that we have felt a lot of that dissonance for the last four quarters and we spoke to it last year, not only in the form of -- remember, we started speaking to this quite a while back, that there was a lot of uncertainty in the tier 3s as to where this was all going to go and it would cause some of the group to sort of stop spending and some of the group that were more aggressive to spend. Now you're getting the clarity and it's starting to free up. But I think you're just starting to see the effects of this going forward, frankly. Secondly, the tsunami in Japan -- if you remember all of that with the fiber shortages, etc. -- that's starting to free up. So there's a set of effects here that I think are basically giving the whole set of our customer base a much clearer view of what the future holds, and now they'll make decisions, by the way, to invest or not to invest. But that's very different than everybody sort of holding their cash to the side trying to figure things out.

Simon Leopold - *Raymond James - Analyst*

Great. No, that's very helpful. And the second thing I wanted to talk about was what you see going on in your addressed markets, specifically North America, in terms of market share. Given what you've described in terms of your growth and looking at your pipeline, how do you see your market share shaping up by the end of this year? Do you have a prediction of what your market share might be?

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

Simon, that's even a longer conversation than the one we just had. So look, there was just a report that came out that placed us as number one in the North American marketplace overall. And that's been a 10-year endeavor for us to get to that point of number one in the North American Broadband Access market space. Having said that, the same thing that got us there, I believe, can continue to bode well for us in the future. So it will grow. The report I referred to, by the way, was just done by Infinetics. So happy to point you in that direction. But I wouldn't even hazard a guess as to where it could go from here. We're just going to sort of keep whittling away at it.

Simon Leopold - *Raymond James - Analyst*

Great. Well, thank you very much.

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

Thanks, Simon.

Operator

Thank you. (OPERATOR INSTRUCTIONS.) Our next question comes from Sanjiv Wadhvani from Stifel Nicolaus.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

Thanks so much. Just a quick question on the international side. It was mentioned a couple of times on the call. I'm curious, are these the traditional Caribbean properties that you've been addressing or is some new stuff happening with Andy Lockhart in there for, I think, 6 [last] months?

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

Sanjiv, this is Michael. The -- no, the answer to that is that the traditional sort of Caribbean properties have been around 6% of revenues and have been for the last few quarters. So the -- any sort of increase -- and we don't expect that really to grow very much. So the increase is from expanding our presence in Europe, Asia, Australia, South America, etc. And while we're only beginning to see small increases at the moment, we are beginning to see increases -- strong increases -- in pipeline, and that's really what we're looking for is to see those pipeline increases, and towards the end of this year, we'll start to see a little bit more significant revenue increases and then really in 2013 we expect to see it grow significantly.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

Got it. Fair enough. Thanks. That's helpful. And then just another crack on gross margins. Obviously, the E-series impacting gross margins positively. As your Broadband Stimulus revenues increase at the back half of the year, I think a lot of those customers are taking an E-series. Should we expect you to start getting closer to that 5-handle or is it a little too soon at the back half of the year?

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

No. I think that's way too soon. That's a longer-term goal -- a 3 to 5-year goal -- and maybe we can get there before that, but it certainly isn't going to be this year. We'll be happy to keep margins for the full year this year in the mid-40's and then continue to rise from there.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

Fair enough. Alright. Thank you.

Operator

Thank you. (OPERATOR INSTRUCTIONS.) We appear to have no further questions at this time. I would like to call back over to David Allen for closing comments.

David H. Allen - *Calix Inc. - Director of IR and Treasurer*

Thank you, operator. We hope you can join us at one of the upcoming investor conferences we are participating in this quarter, including two that will be webcast this month, along with our Analyst Day event in New York City on June 13. Information about these events is posted on our Investor Relations section of our website.



Thank you for joining us today. We remain excited about the opportunities ahead of us and we look forward to speaking to you at one of these events. Good-bye for now.

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time. Thank you for your participation.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2012, Thomson Reuters. All Rights Reserved.