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CALX - Q3 2013 Calix, Inc. Earnings Conference Call

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**Simon Leopold** *Raymond James & Associates - Analyst*

**Amitabh Passi** *UBS - Analyst*

**Simona Jankowski** *Goldman Sachs - Analyst*

**George Notter** *Jeffries & Company - Analyst*

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## PRESENTATION

**Operator**

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

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

Thank you operator, and good afternoon, everyone. Before we begin the call, I want to remind you that this conference call contains forward-looking statements regarding future events including but not limited to our expectations for the next quarter, our development of new products that will continue to help our customers transform their networks, 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 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 quarterly report on Form 10-Q for the period ending June 29, 2013, 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 conference 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 are meaningful in evaluating our financial performance, including stock-based compensation expense, amortization-related expenses if any, 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 our earnings press release. All numbers 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, we have posted financial data on our Investor Relations website which you may want to review in conjunction with our press release and conference call remarks.

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

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

Thank you Dave, and good afternoon, everyone. Joining me on our call today is Michael Ashby, our Executive Vice President and Chief financial Officer. Michael is in California, while I am in Las Vegas at the Tenth Annual Calix User Group Meeting.

Q3 was a record quarter for Calix, driven by strong strategic execution by the entire Calix team. Record revenues, strong gross margins, allied with disciplined investments in OpEx, yielded strong earnings performance.

After Michael discusses the details, I will come back and share with you what I've heard from our customers here at the user group. Michael?

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**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 Relations 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 fourth quarter of 2013.

As a reminder, the guidance we provided in July for the third quarter called for revenue between $102 million and $106 million, gross margin between 46% and 47%, operating expenses in a range of $41 million to $42 million, and a resulting EPS between $0.11 and $0.15 per share.

Actual revenue for the quarter was a record $103.6 million, in the mid range of our guidance. Gross margin was 48.1%, significantly ahead of our guidance. Operating expenses came in at $40.3 million, below our guidance. We had a benefit to our tax revision, which I will explain later, and the resulting EPS was significantly ahead of our guidance at $0.20 per fully-diluted share.

We had another strong cash flow generating quarter, and ended the quarter with total cash of $80.1 million.

Putting it all together, it was another very solid quarter for us with revenues over $100 million for the first time, another strong gross margin quarter, operating expenses under control which resulted in operating income climbing to just over 9% of revenue. We also achieved GAAP profitability for the first time.

Revenue for the quarter was up 27% compared to the same period last year, and on a year-to-date basis revenue is up 21% from the prior year. Our international revenue was 10% of total revenues and we had one 10% customer this quarter.

Gross margin at 48.1% was better than we had expected. Gross margin strength was across the board, both in product mix and customer mix.

Operating expenses at $40.3 million was lower than anticipated and increased by less than $400,000 in the prior quarter. As I mentioned, we had a benefit of a tax credit this quarter which was the result of an AMT offset that Occam was granted, prior to our acquisition of Occam.

We have told you at investor conferences and meetings over the last three quarters that our objectives for 2013 and 2014 were to return to revenue growth while continuing to improve gross margin percent, control our operating expenses and increase our operating profit. We have shown steady improvement in each of the first three quarters of this year and are very pleased at the progress that we have made. Improving our operating income has been a major area of emphasis for us this year, and we are pleased to have seen steady improvement with operating margins this quarter at over 9% of revenue.

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 a part of our ongoing activities or are not meaningful in evaluating our financial performance as a company. These charges, the amortization of intangibles, and the amortization of stock-based compensation, are both non-cash items.

As I mentioned earlier, Calix was profitable this quarter on a GAAP basis for the first time.

Turning to the balance sheet, we continue to manage our working capital and ended the quarter with total cash of $80.1 million, an increase of $10.7 million. DSO was 46 days down from 56 days in the previous quarter. Inventory levels increased a little this quarter to 39.4, and inventory turns improved to 5, up from 4.4 in the previous quarter.

Deferred revenue amounted to $63.4 million, down $7.7 million from the prior quarter as expected, reflecting the completion of a number of BBS projects.

Let me now move to our guidance for the fourth quarter of 2013.

We are pleased with the progress we have made over the last several quarters and the strength we've seen in our business. While we normally have the benefit of some year-end spend during the final quarter of the year, our Tier 2 and Tier 3 customers have indicated that while spending has been strong so far this year, and activity levels remain very positive, they do not see much additional year-end spend. Accordingly, we are more cautious about our outlook for this quarter.

So while we expect the fourth quarter to be another good quarter for the Company, we are guiding to a more conservative revenue range of between $97 million and $103 million. We expect gross margin to come in between 46% and 47%. This expected decline reflects the completion of several BBS projects that include professional services, where we have lower margins. We believe that this is a one-time gross margin impact, and as we have previously stated, we believe that over any four-quarter period we will see a gradual increase towards our long-term target of gross margin in the low 50% range.

Q4 operating expenses will be in the range of $43 million to $44 million. The increase in Q4 operating expenses reflects expenses associated with our annual user group meeting which we are holding this week, an increase in the payment on our employee bonus plan, as well as some increases in head count as we continue to grow the business. The resulting EPS will be in the range of $0.03 to $0.08 per share.

For 2013, EPS will be between $0.39 and $0.44 per share, a considerable increase from the $0.15 per share achieved in 2012.

DSOs should be in our normal range of around 55 days. Inventories will be flat to slightly up, and once again we plan on being cash flow positive for the quarter.

At this point, I'd like to turn the call back over to Carl.

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

Thank you, Michael. The Tenth Annual Calix User Group Meeting set another record with over 1700 attendees. First, let me echo Michael's comments as our customers have made it clear that we should not expect any year-end spend driven by funds left over in their budgets. While occasionally we have heard this admonition in years past, this time it is widespread and as such prudence clearly dictates our guidance.

However, the level of excitement for 2014 is exactly the opposite. There is huge energy around delivering high value services at gigabit speeds and Calix is well-placed to ride this wave.

So with that, I would like to turn the call over for questions. Operator?

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## QUESTIONS AND ANSWERS

**Operator**

Thank you. (Operator instructions) Our first question is from Tim Quillin of Stephens, Inc. Please go ahead.

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**Tim Quillin** - *Stephens, Inc. - Analyst*

Good afternoon. Could you go through the reasons that you're hearing some caution for 4Q and why you think that changes up to an optimistic outlook in 2014?

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

Tim, this is Carl. So -- and I'll allow Michael to add color afterwards. It's actually, from near as I can determine, pretty simple. I think everyone is now starting to sort out how they want to go and invest. As you may be aware from our previous calls and as we've watched the market, there has been a lot of uncertainty especially amongst the North American service providers about how they are going to deal with government regulations, etc. I believe what we are seeing from our customers is they are now getting clarity over how they want to go and invest, and obviously we're past the build season for many of our customers. And I believe they're looking at this and saying they're going to marshal their capital, and as they approach their programs going into 2014, make their investments.

So, that's the reason as near as I can determine it, and by the way, it is quite widespread.

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**Tim Quillin** - *Stephens, Inc. - Analyst*

And then --

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

Michael, do you want --

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**Tim Quillin** - *Stephens, Inc. - Analyst*

Go ahead.

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

Michael, anything you'd like to add?

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

No, I agree with you, Carl. I think that I might just add that I think the whole movement towards gigabit networks has also had people starting to look at that more closely, and decide where they want to invest that money going forward. And I think there is a movement towards more interest in fiber and gigabit networks. And then you know, who knows whether the government shutdown had some impact, you know? That's very difficult for us to judge.

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**Tim Quillin** - *Stephens, Inc. - Analyst*

Right, but all the drivers of the trend towards fiber networks, you still see and think that CapEx can free up for 2014?

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

Oh, it's much clearer and more so, yes. I mean, look. It's very difficult. It's impossible for me to be pessimistic sitting here with 1700-plus attendees. It's frankly difficult to be even prudent, because the energy is so high. But there's a very clear guidance that resources are going to be marshaled. Going into 2014 I think there's good clarity of where folks are going to invest.

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**Tim Quillin** - *Stephens, Inc. - Analyst*

Okay good, and then Michael, with regards to the deferred revenue on the broadband stimulus work, I think you had maybe $50 million or so in the deferred revenue at the beginning of the quarter, was the $8 million drawdown in deferred -- did that work the total down to $42 million or where exactly is that, and how should we expect that to be recognized over the next several quarters?

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

Yes, that's basically correct. The deferred revenue balance is now $63.4 million, of which approximately $21 million is extended warranty and so the remainder is product, the vast majority of which relates to BBS projects that we will recognize over the next probably over the next three quarters. I expect by the middle of next year, that will have gone down to its more normal level which is probably closer to the $30 million to $40 million range.

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**Tim Quillin** - *Stephens, Inc. - Analyst*

Okay, and how do you think about that being recognized in the fourth quarter, and does the government shutdown impact the timing of government sign-offs on some of those BBS projects? Thank you.

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

We do expect to see some sign-offs in the fourth quarter. I don't know if the government shutdown is going to change that. We weren't quite sure for a while but it seems now as if that's -- that should be okay. So, we are expecting to see some project completions and sign-offs in Q4, and then the remainder as I said in Q1 and Q2 of next year.

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**Tim Quillin** - *Stephens, Inc. - Analyst*

All right, thank you.

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**Operator**

Thank you. The next question is from Simon Leopold of Raymond James, please go ahead.

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**Simon Leopold** - *Raymond James & Associates - Analyst*

Thank you. A couple of things I wanted to just, very quick clarification, I missed the operating expense pro forma guidance. I think you said that was $43 million to $44 million, is that correct?

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

Yes, that's correct. I did say $43 million to $44 million for Q4, yes.

**Simon Leopold** - *Raymond James & Associates - Analyst*

Okay great, so two things I wanted to check on. One, I certainly can appreciate you're not prepared to give 2014 guidance, but I guess one thing we need to check on is given a lack of your typical seasonality in the fourth quarter, I think it's safe to assume that you do not expect typical seasonality in your March quarter, i.e., you don't expect the typical sequential decline in the first calendar quarter after the less-than-seasonal fourth quarter?

And the other question I wanted to ask is, what you're seeing trend-wise in terms of what looked like hero projects like the work you're doing in Omaha with the 1 Gig service, what portion of the business do you see really moving to 100 meg or 1 Gig-type service? How material is that in the business? Not right now, but in terms of maybe one year out, two years out? How do you see that evolving from where we are today? Thank you.

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

So let me go to the first one, first. Obviously we're not giving guidance for Q1, but let me just color that to your point. Judging by the energy I'm seeing here, I'm expecting very strong things in 2014. Having said that, and listening to the messaging I'm getting in Q4, I'm still going to make sure that we vet Q1 when we get there. So, the likelihood of having the same seasonality is probably not the same, but I'm not sure I would necessarily say that -- I'm not sure what I would say as far as where the number goes, and I'll let Michael speak to that in a moment.

On the second piece, there is no question that this trend is moving at a much more rapid pace than even I would have anticipated earlier this year. It's becoming a much more widespread phenomena, and part of it is driven by the economics of where fiber deployments have started to get to, i.e., lower up-front cost with much better operating economics, versus where continually extending the copper is going if the service provider is in a competitive environment.

That said, basically, it's not that much more expensive and in many cases not more expensive to simply take fiber all the way to your consumer business premises and go forward on those services. So, it is material and it's going to become increasingly material, Simon.

**Simon Leopold** - *Raymond James & Associates - Analyst*

Any order of magnitude you could give us to get some sense of what you mean by that? And I guess what I'm looking for, when you say material, I generally interpret that as in the order of at least 10% of revenue. Is that a fair way to think about it?

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

For sure.

**Simon Leopold** - *Raymond James & Associates - Analyst*

Okay great, thank you.

**Operator**

Thank you. The next question is from Amitabh Passi of UBS. Please go ahead.

**Amitabh Passi** - *UBS - Analyst*

Hi, thank you. Michael, first question for you. I'm a little perplexed about the OpEx guidance, and how should we be thinking about OpEx as we go back into the early part of 2014? It seems like you kept it pretty controlled for much of this year, but again, we're seeing a pretty significant move-up in the fourth quarter.

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

Yes, Amitabh, the -- you know, the guidance is $43 million to $44 million so it's up in Q4. But Q4 is always up, and it's up for one big reason is, I know, the user group meeting, all the expense of which falls into this quarter. And believe me, it's quite an expense. As you know, Carl is in Las Vegas with 1700 people, and that's not cheap. So, that's a big part of it.

We've also -- are increasing our accrual for employee bonus in the fourth quarter, and that is something which we'll attempt to continue to maintain during 2014. And then we have some head count growth. So, generally speaking, I think we are capable of and comfortable with keeping tight control over our OpEx expenses, but we always see a bump in Q4 followed by somewhat of a decrease in Q1.

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

And if I may add, Amitabh, when we set out the planning for this year's users group, given what we thought was going to be a modest 2013, we actually were planning on struggling to get back to the numbers we had last year in attendance and in fact we're up over 20% and just blew away every plan that we had. So look, it's great news and it's exciting news, but it obviously also raises the OpEx a bit from an investment standpoint.

**Amitabh Passi** - *UBS - Analyst*

Just as a follow-up, I apologize if you talked about this. I missed what your commentary was on international versus domestic revenues, and if you could give us a sense of just how the international opportunity set and funnel is developing for you?

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

Maybe I'll start with that one Carl, and just say that international is 10% of revenue in Q3. For the first three quarters of the year it is at 12%, so up from 7% in the prior year. So, we've had a good increase in international revenue and I think as you've said before, that increase is primarily -- we've added a lot of new customers. You know, small orders to begin with, but you start with small orders and then build from there. So, we're very pleased with, with I think the number of new customers we've added and the reach that we've added internationally. And I don't know, Carl, if you want to comment a bit more on the funnel going forward?

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

Well, there's a number of observations, and let me start with those. As I promised, I would try to give you as much color as I could directly here from the user group. Last year, you know, was really a North American user group with some international attendees. This year is clearly a global conference. We have folks from around the world in virtually every region here, and a much larger international contingent. The interest level is very high. The funnel is building. But as you remember, Amitabh, we've talked about this before. Building out the products and the things we need to do to bring our products through the Ericsson channel are starting to come to fruition at the end of this year and early next. We are beginning marketability this quarter on a number of those efforts for basically order taking next quarter.

So actually, we see a lot of good excitement, a lot of good partnering, and as a matter of fact Ericsson is here obviously at our user group, participants in the show, presenting some pieces, etc., and lots of co-marketing going on.

So, I think we're very well situated for 2014, as we go forward.

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**Amitabh Passi** - *UBS - Analyst*

Okay, I'll jump back in the queue, thanks.

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

Well thanks, Amitabh.

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**Operator**

Thank you. The next question is from Simona Jankowski of Goldman Sachs, please go ahead.

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**Simona Jankowski** - *Goldman Sachs - Analyst*

Hi, thanks very much. Just first on the near-term guidance, could you just help us understand if more of the decline is coming from the Tier 2 or the Tier 3 customer base?

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

You mean the decline as far as the budget flush, lack of spending?

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**Simona Jankowski** - *Goldman Sachs - Analyst*

Exactly yes, so just as far as kind of the near-term caution and the sequential decline in their expected revenue?

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

It's widespread. I wouldn't make comment on what percentage of it. It's across the board, Simona.

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**Simona Jankowski** - *Goldman Sachs - Analyst*

Okay, and then as you talked about the energy you're seeing, and clearly with 20% increase in attendance I can see what you're referring to there, what is your sense of the funding forces for gigabit projects into next year? You know, a lot of the Tier 2s have been reducing CapEx quite significantly this year, and for the Tier 3s it's a bit unclear as well. You know, are people thinking about tapping into CAF or what other sources do you see for potential CapEx increases next year?

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

Good question. I mean look, the whole government piece, you know, we see it influencing it. But I'll tell you, the vast majority of these folks, to be truthful, are looking at it from funding it out of operations. There's a -- you know, there's a little bit of jaundice if you will amongst a lot of these service providers around the government programs, and many of them have just sort of pulled themselves up by the bootstraps and have convinced themselves that they ultimately have to build an enterprise that's bereft of government financing, and they best get on with it. So most of it is actually internally driven.

**Simona Jankowski** - *Goldman Sachs - Analyst*

And do you see some of these fiber-to-the-premise projects into next year, coming from the Tier 3 customer base? Or are you mostly looking at the Tier 2 base?

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

More so in the Tier 3 base, actually. We see them globally. We see them from many different areas. I would say when you think about clinically, the Tier 2s, we would see less from the Tier 2s than we would from the other segments, actually.

**Simona Jankowski** - *Goldman Sachs - Analyst*

Yes.

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

Does that make sense?

**Simona Jankowski** - *Goldman Sachs - Analyst*

And -- yes, I mean, it's just a little interesting to kind of see how they would actually be able to fund it in the Tier 3 space just given that I don't get the sense there is a lot of excess cash flow generation there.

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

They funded, I'll tell you exactly what drives it is, they typically do a pretty good job of intimate marketing and they get very good take rates. And so, in their -- in the programs they've done in the past whether they be pilots or experiments, they seem to be able to drive to strong take rates in the community with much lower churn. And so, it makes them feel much, much better about making that investment than making sort of an incremental, I'm a little bit better at broadband than you are, investment.

**Simona Jankowski** - *Goldman Sachs - Analyst*

Got you, got you. And then another question just on the margin side, I think you mentioned that the dip in the fourth quarter is likely to be one-time in nature. Can you just go a little bit into what is driving that dip? I think you commented on professional services, but if you can just maybe break down for us the components, you know, like fixed cost absorption, services, or anything else that may be causing the dip?

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

Yes Michael, can you take that one please?

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

Sure. Yes, Simona, that is -- relates primarily to broadband stimulus projects where we have contracted to do professional services for those customers and we did not run our own professional service organization. We have professional services people and we outsource a lot of that work. When we outsource it, obviously we don't get a particularly high margin on that. So, there are some projects remaining from BBS where we have a fairly high percentage of professional services, and the margin on that is lower, and there's those -- those have been in deferred revenue so as those come back into recognized revenue that has a negative impact on margin momentarily.

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**Simona Jankowski** - *Goldman Sachs - Analyst*

And are those professional services just a one-quarter phenomenon, or is there some kind of a mismatching when the costs are flowing through the P&L versus when you're actually delivering the services?

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

No, it's only just when we recognize the revenue, at the point we recognize the revenue. So, in Q4, we have some projects that are completed where we expect to recognize the revenue, and those have a high percentage of professional services. So it all gets recognized at the same time.

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**Simona Jankowski** - *Goldman Sachs - Analyst*

I see, got it. Okay, thanks very much.

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**Operator**

Thank you. The next question comes from George Notter of Jeffries, please go ahead.

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**George Notter** - *Jeffries & Company - Analyst*

Hi, thanks a lot. I guess I wanted to ask about you know, the guidance in the context of, it feels like you've got some moving parts here, right? You've got some lumpiness of revenue recognition around the broadband stimulus program. I get that sense just given the decline in deferred revenues and the movement on gross margins. At the same time, I think what you're saying is that some of the smaller operators spent more of their budgets earlier in the year than maybe they had in the past, and so you're getting a softer Q4. I guess I'm just trying to understand the different kind of pieces at work here and how that funnels into the guidance for Q4. I'm a little bit confused.

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

So let me address the last piece first, George, and Michael, feel free to chime in. There are clearly moving pieces, as there are always, George. But you said something related to a number of folks who are giving us guidance to don't expect the year-end spend that's driven by budget flush. If you think that through, it's actually not that they had actually overspent early in the year. It's actually that I think they're getting more strategic in their investments. They're starting to get better clarity around where they want to go and invest, and they're starting to realize okay, so, why are we -- why do we need to spend it in Q4? Let's marshal those resources to go invest in the building season into 2014.

And that's what lines up for us when we listen to what their aspirations are for 2014, the plans they have, the programs they're looking at, the markets that they're looking at building out and "CELC-ing" into. That lines up better with that fit. Does that help you on that side?

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**George Notter** - *Jeffries & Company - Analyst*

Yes, I mean, okay. I mean, the pushback would say look, you know, these operators historically I presume, this isn't the first time they thought more strategically about their business, and you know, what you're suggesting is just so significantly contrary to the seasonality you guys have put up in years past. I mean, if I look at March quarters last five years, I think you've averaged at 20% sequential decline. But in December, it's been roughly a 20% sequential growth, right?

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

Yes.

**George Notter** - *Jeffries & Company - Analyst*

And so this is a really big spin on what you guys have seen historically, and I guess I'm just trying to understand that.

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

And by the way, I reserve the right to be wrong. I mean, there's a part of me that sit here and says you know, yeah, yeah, yeah, we've heard this before. And then you end up with the spend, right? So, the reason I'm saying, I think we need to be prudent, is because we are seeing it widespread. This is not something where you know, it's you pulled me aside and said hey, you know, for next year we're not going to spend money. It's all across the table, here.

**George Notter** - *Jeffries & Company - Analyst*

Got it, okay. So it's just the buildup of the sales funnel based on conversations with customers and hence down sequential Q4?

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

That's one piece, and the second piece again, if I look at it and then look forward as to what their plans are, you know, we spoke about this last year, George. You and I specifically, about the cloudiness around people's clarity as to what they were going to do. I'm not seeing that this year. I'm seeing a lot of folks focused on how they want to go deliver the next generation set of services, how they're going to go to market, and what their infrastructure's going to be. So, there's a great deal of excitement around 2014. I'm not talking about my excitement, I'm talking about the people that I'm in the building with.

**George Notter** - *Jeffries & Company - Analyst*

Okay, great.

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

That's the only way I can put it. Michael, any additional comments?

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

No comment. I agree with you. I think there is just, just would like to emphasize, I don't think we had any, any additional spending in the first three quarters of the year. I think that spending was normal, and what we've just seen is that they are making their decisions as to how to spend in the future and not going to rush into spending it in Q4.

**George Notter** - *Jeffries & Company - Analyst*

Got it. And one last thing. You were talking about the Ericsson relationship and how there are a number of milestones or triggers that were getting put in place here such that you could start taking orders in Q4. Could you remind us what those pieces are? Is that -- is that integration of the E-series products into your, interest for your element management system, or what exactly is driving that?

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

Well, it's a -- so good question, and it's a set of things. But it's all around the E-series through the Ericsson channel. So, part of it are the BLM systems, part of it is bringing through their productization processes. They are a big company. Part of it is expanding the premises portfolio. Part of it is expanding the VDSL2 portfolio. So there were just a set of factors that in essence ready us for global footprint. Some of them have directly to do with Ericsson, some of them are just frankly things that you have to do to be global. But because Ericsson is our partner, we sort of put them into that -- all that same bucket. Does that make sense?

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**George Notter** - *Jeffries & Company - Analyst*

Got it yes, great. Thank you very much.

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

Thanks, George.

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**Operator**

Thank you, ladies and gentlemen. (Operator instructions) The next question comes from Sanjiv Wadhwani of Stifel, please go ahead.

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**Sanjiv Wadhwani** - *Stifel Nicolaus - Analyst*

Thanks. Carl, I wanted to ask you a question about 2014. I think you've used the words about modest expectations coming into 2013 and it looks like the environment for 2014 seems to be much more favorable. Qualitatively, could you talk about what we should be thinking about growth in 2014 as it relates versus 2013? Thanks.

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

You know, I'll leave this one to Michael, but the best I could tell you is, we've sort of stuck to -- we expect to be able to deliver double-digit growth given the markets that we are playing in and focusing on, and I don't know that there's anything that's actually changed in my view of 2014. Michael?

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

No, I agree with you, Carl. I think what Carl is saying is that in meeting the customers and discussing their view of 2014, I think we see a lot of activity and we see a lot of positive things happening. I don't think we're prepared to guide obviously to 2014 now, except to say that we still believe we will grow the business at double-digit revenue, we can continue to improve the gross margin up towards the 50%, we can continue to hold operating expenses at reasonable levels and improve our operating income.

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**Sanjiv Wadhwani** - *Stifel Nicolaus - Analyst*

Got it, all right, thanks.

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

Thanks, Sanjiv.

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**Operator**

(Operator instructions) It appears we have no further questions in queue at this time. I'd like to turn the floor back over to Mr. Allen for any closing remarks.

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

Thank you operator, and thank you everyone for joining us once again. This quarter we'll be participating in three investment conferences. We hope you can join us at one of those conferences, including the Needham Second Annual Next Gen Networks Conference on November 5 in New York, the Goldman Sachs US Emerging Growth Conference on November 14, also in New York, and the UBS Global Technology Conference this year in Sausalito, California, on November 20. Information about these conferences is available on the Investor Relations section of Calix.com. Thank you again for joining us. 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.

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**Operator**

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

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