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CALX - Q4 2014 Calix Inc Earnings Call

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CORPORATE PARTICIPANTS

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

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

William Atkins *Calix, Inc. - EVP, CFO*

CONFERENCE CALL PARTICIPANTS

George Notter *Jefferies & Company - Analyst*

Tim Quillin *Stephens Inc. - Analyst*

Doug Clark *Goldman Sachs - Analyst*

Sanjiv Wadhwani *Stifel Nicolaus - Analyst*

Amitabh Passi *UBS - Analyst*

Simon Leopold *Raymond James & Associates, Inc. - Analyst*

Paul Silverstein *Cowen and Company - Analyst*

Christian Schwab *Craig-Hallum Capital Group - Analyst*

PRESENTATION

Operator

Greetings and welcome to the Calix Q4 2014 earnings 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)

It is now my pleasure to introduce your host, Mr. David Allen. Thank you, Mr. Allen. You may begin.

David Allen - *Calix, Inc. - Director of IR and 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, the size of the funnel of our sales opportunities, the long-term growth prospects for Calix, expectations for the next quarter, development of new products that will continue to help our customers transform their networks, the future business and financial performance of the Company, and expectations for revenue, gross margin, operating expenses, earnings per share, stock-based compensation, and amortization of intangibles.

These forward-looking statements are based on estimates, judgments, 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 period ending December 31, 2013, and our Form 10-Q for the period ending September 27, 2014, 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 or meaningful in evaluating our financial performance, including stock-based compensation expense, acquisition-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 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, along with supplemental financial data, has been posted in the investor relations section of the Calix 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 President and CEO, Carl Russo. Carl?

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

Thank you Dave, and good afternoon, everyone. Joining me on today's call is William Atkins, our Executive Vice President and Chief Financial Officer.

I am happy to again report that the Calix team performed well, achieving fourth-quarter revenues that were up 19% year over year. In addition, the excitement in the market around fiber-based, high-capacity service offerings continued to accelerate this quarter. I will come back with some thoughts on the market and our progress.

However, I would now like to turn the call over to William to review Q4 in detail and then share our guidance for Q1. William?

William Atkins - *Calix, Inc. - EVP, CFO*

Thank you, Carl. We last provided you with guidance regarding Q4 on October 29. And in that guidance, we called for revenues of between $107 million and $111 million, a gross margin of between 46.5% and 47.5%, and operating expenses in a range of $44 million to $45 million, thus resulting in an EPS of between $0.10 and $0.14 per share.

Actual revenue for the quarter was $111.6 million and EPS was $0.13 per share, with revenues above the top end of our guidance and earnings per share towards the upper end of the guidance. Gross margin was 48.1% and operating expenses came in at $46.8 million.

Product and customer mix contributed to our outperformance of the gross margin level. The increase in operating expenses relative to guidance was caused by larger payments for commissions resulting from customer bookings outperformance and by increased personnel and related costs, amongst other factors.

Q4 was particularly cash generative, with a $23.9 million increase in the aggregate balance of cash and marketable securities. We ended Q4 with a total of $111.7 million, up from Q3's $87.8 million figure.

Revenue for the quarter was $111.6 million, an increase of $17.6 million or 19% from last year's fourth-quarter level of $94 million. International revenue was $11.8 million in Q4, down from $13.6 million in Q4 2013. We had one 10% or greater customer again this quarter.

As I noted earlier, at 48.1%, Q4 gross margin was above guidance and reflected the impact of changes in customer and product mix, with deferred and recognized revenues coming in line with expectations. This gross margin in Q4 was up from Q4 2013's 45.2% level.

Q4 operating expenses at $46.8 million were up $5.8 million from the same quarter a year ago, with this year-over-year increase primarily due to additions in year-over-year headcount and to annual compensation adjustments.

Turning now to the balance sheet, as noted earlier, we ended the quarter with total cash and marketable securities of $111.7 million, an increase of $23.9 million from Q3 and an increase of $28.9 million over last year's Q4 level. We expect to continue to be cash flow positive for the totality of 2015, with a seasonal dip in Q1 resulting in negative cash flows for that quarter.

Receivables DSOs were a very healthy 34 days compared to 39 days in the previous quarter and 41 days in Q4 2013, reflecting both a more even distribution of revenues within the quarter and strong collections performance.

Inventory levels increased to $46.7 million in Q4, an increase from Q3's $43.8 million level, and were down from $51.1 million in Q4 2013. Inventory turns increased to 4.8 times in Q4 from 4.6 times in Q3 and from Q4 2013's 4.1 times.

The deferred revenue balance was $32.1 million, down from $38.9 million in the prior quarter and down from $53.3 million in Q4 of 2013. We closed out deferred revenue in line with our expectations and we have now completed the bulk of our remaining broadband stimulus projects.

We saw the vast majority of the remaining balance of the BBS-related deferred revenues recognized in our P&L in 2014, and while we will continue to have some small residual BBS revenues in Q1, these projects will no longer be a discernible component of our revenues in 2015.

It is worth spending a bit of time reviewing our full-year performance. As has been the pattern at the beginning of most years, 2014 started off slowly. A number of our service provider customers only complete their annual capital expenditure budgets well into the first quarter.

Beginning in Q2 and continuing throughout the year, we saw a number of service providers announce plans and begin to upgrade their network capabilities and speeds. Calix clearly benefited from these investments by our Tier 1, Tier 2, and Tier 3 operators, including many utility cooperative and municipally owned networks.

We ended the year with over 60 announced service provider gigabit networks enabled by Calix, with many more networks beyond this number that have not been publicly disclosed.

For the full year, we recorded revenues of $401.2 million, up 4.9% from 2013's $382.6 million level and produced gross margins of 46.7%, down slightly from 2013's 47.3% figure, with the 2014 gross margin affected by, amongst other items, consumer and product mix and inventory write-downs taken during the year.

Revenue growth was broadly balanced between domestic and international customers, with international comprising 12% of revenues in 2014. We also took important steps to position Calix for further growth by hiring additional systems and software products personnel as well as by increasing the number of international sales people and value-added resellers to address international markets.

Operating expenses were $171.8 million in 2014, up 7% from 2013's $160.9 million number, with this increase largely comprised of personnel-related costs stemming from the headcount increases and annual compensation adjustments, which I discussed earlier. Net income for 2014 reflected these movements in gross margin and operating expenses and was $15 million or $0.29 per share versus 2013's $19.6 million or $0.39 per share numbers.

Before I provide Q1 guidance, let me also comment on the current regulatory environment. While issues such as net neutrality and the debate over Title II regulation are topics of much discussion in our sector, we do not see our service provider customers slowing down their broadband investments in response. And we see any likely scenarios as being neutral to positive for Calix.

As you might know, in January, President Obama visited Cedar Falls Utilities, an Iowa-based Calix customer, and had a first-hand demonstration of a gigabit network. Last week, the FCC commissioners voted in favor of upping the broadband threshold from its previous level of 4 megabits per second downstream and 1 megabit per second upstream to a new level of 25 megabits per second down and 3 megabits per second up.

To put this into perspective, the average American home broadband connection today pulls down around 11 megabits per second. After the FCC's recent decision, some 17% of Americans technically don't have broadband access speeds anymore.

In terms of guidance for the first quarter of 2015, we expect revenues to be above last year's Q1 levels, reflecting the overall improvement that we have seen in our sector relative to last year. Due to the book, bill, and ship nature of our business, our visibility can generally be limited to the next 90 days, with Q1 being the most difficult quarter to project, given that many of our customers are still finalizing their budgets.

Our guidance for Q1 is as follows. Revenues for the first quarter are expected to be a range of between $89 million and $93 million, with a midpoint of $91 million, which is up 6% from the $85.8 million level of Q1 of 2014.

Gross margins are expected to be broadly in the same range as they were in Q4. We are guiding to a 47.5% to 48.5% range for Q1, up from last year's Q1 level of 45.9%. Operating expenses are expected to be in the range of $46.5 million to $47.5 million, up from last year's Q1 level of $40.7 million.

The expectations that I've just finished taking you through result in a guidance range for Q1 earnings per share of minus $0.09 to minus $0.04.

At this point, let me hand the call back over to Carl.

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

Thank you, William. 2014 was a year of significant progress for Calix. First, we committed to improving the predictability of our business. An example of this is how we set guidance. We have achieved four straight quarters of meeting guidance and we remain committed to this pursuit.

Second, we committed to build a solid foundation from which to grow our business. An example of this is cash generation, which resulted in the strongest balance sheet in our history.

Third, we committed to improved execution. An example of this being our product development process, which yielded significant new solution offerings over the course of 2014.

And that brings me to our singular focus for 2015: growth. We are seeing the early signs of strong growth opportunities for Calix and we intend to invest to achieve them.

One example is our new fiber-enabled GigaCenter offering. Introduced in September, the GigaCenter achieved orders from more than 100 customers in just its first quarter of availability.

While this is the highest customer take-up for a Calix product that I can remember, please keep in mind that these are mostly early deployment pilots, and thus, we anticipate unit volumes to grow materially over time.

In closing, we are now addressing markets that afford us significant opportunities for growth and our focus for 2015 is to win them.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) George Notter, Jefferies.

George Notter - *Jefferies & Company - Analyst*

Carl, I wanted to ask you about your comments on Title II and the new classification of broadband services to 25 megabits. Can you kind of walk through sort of the logic? I think you said that you thought it was neutral or even positive for the Company.

Can you just give us a little bit more on why that is positive? And I guess I bring up the Title II discussion, because I think there is an argument that says that, theoretically, Title II can get challenged, that the forbearance aspect of Title II can get challenged.

And potentially there is a while, years down the road, where the FCC could actually require tariffing and a new regulatory environment around broadband. Could you just kind of walk us through how you see that and why is this good for Calix? Thanks.

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

Well, and I think William's comments were neutral to positive. So let me give you my view and I will ask William to add a little bit of color.

My view, as you know, George, is focused very simply on the device-enabled subscriber and the content and application cloud. And the demand by the subscribers for access to that information is unrelenting.

So there are momentary things that can affect these things, but as we look at the unmet need -- or the unserved need -- and capital flows, I just don't see what stops it. And I think when you look at the Title II discussions and all of Chairman Wheeler's comments, it is pretty clear that if it goes to Title II, it is going to be a lighter touch.

So there is sort of a fair way down, which I think we can see all where this is going. So sure, can there be puts and takes; might there be momentary disruptions? Possibly. But in the long term -- and by long term I mean not even over the course of years -- all of this have to meet the demand.

William, do you have some comments on the particulars that you would like to add?

William Atkins - *Calix, Inc. - EVP, CFO*

Yes. I think the only comment I would make, I guess there are two ways in which this debate can affect the market more generally. One is just uncertainty. And we can argue that that uncertainty has been out there since the middle of the summer -- early summer. And we haven't seen it affecting our customers' demand for our products.

And then more broadly, the question is will government action lead to a reduction in demand for broadband? And if anything, particularly given last week's decision about the redefinition of what broadband is, we see the government pushing, in fact, in the same direction that the overall market is pushing. So that is why we see ourselves as being neutral to positive.

George Notter - *Jefferies & Company - Analyst*

Got it. Okay. Great. Thanks for the perspective. I also wanted to ask about the international business. Another quarter here where you haven't seen growth there.

I know, Carl, you talked about new customer wins and customer additions there, but it doesn't seem like it is translating yet from a revenue perspective. Can you just talk about where you are and where we might see them be in the curve in terms of revenue on international? Thanks.

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

So that is exactly the right question to ask, George. And what you saw year over year was that international growth was the same pace as North American growth.

Obviously, we are investing to enable international growth to outpace North American growth and we believe we are starting to see the early signs of that. So that it is exactly what should happen in 2015.

You are right. I have mentioned a lot of new customer wins and we are seeing those pins on the map actually accelerate. And it is much the same way we built the business in North America. But it takes time. So my view is that you should see it accelerate in 2015 and we will observe it from there.

Operator

Tim Quillin, Stephens Inc.

Tim Quillin - *Stephens Inc. - Analyst*

I just want to make sure that I am looking at the right numbers in terms of international. But looks like it was $11.8 million, down from $13.6 million a year ago and down from $13.8 million in Q3. So what -- if those are the correct numbers, what is the reason for the decline in that business?

William Atkins - *Calix, Inc. - EVP, CFO*

What I would say, Tim -- it is William here. This business, internationally as well as domestic, is a choppy business. And if you look at the full year at the broadband line last year, we called it at 13% for 2013. We are calling it 12% for 2014.

The actual difference between those numbers is less than a single percentage point. It is rounding. So I wouldn't put too much emphasis on quarter-to-quarter movements there.

Tim Quillin - *Stephens Inc. - Analyst*

Okay. And I guess just to follow on with that line of questioning, though. Is the next six months -- I mean, when is the put up or shut up time, where you either see more growth internationally or you start to think about reducing your expenses overseas?

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

So the answer to your question is, if I am setting your expectations from an investment perspective -- I think I just did on the 2015 over 2014 -- we expect it to outgrow North America. If you are asking us about how we lead the business internally, every day.

So we are looking at the final funnel, the pins on the map, and the leading indicators of what will drive that growth. Every single day. And I am encouraged by the pins on the map and the rate of new customer acquisition.

Having said that, those have to be converted into installations, happy customers, reorders, more new customers. And so that is what we are watching. So the direct answer to your question is, year over year.

Tim Quillin - *Stephens Inc. - Analyst*

Okay. And then a couple questions on the guidance. The midpoint of the guidance represents 6% revenue growth. And just trying to follow the trail of breadcrumbs through 2014 and I think your commentary suggests some momentum, especially on these gigabit networks. And so it didn't seem like a difficult comparison to last year's first quarter.

So maybe is that -- would you -- why is the growth not higher and would you expect that to accelerate through the year? And then the second question is on the operating expenses, which I think at the midpoint are up something like 15%, while revenue is up 6%. When will we see a little more leverage on OpEx? Thank you.

William Atkins - *Calix, Inc. - EVP, CFO*

Okay. I will start with the answers and then I will pass the mic over to Carl. In terms of Q1, I mean, as we were careful to state when we went through our prepared remarks, Tim, Q1 is the hardest quarter to forecast.

And so while we remain optimistic about the prospects overall for our space, when it comes in the Q1, you just simply have got less visibility. But we have sufficient visibility to just call it as a quarter that is going to be higher than last year.

And to Carl's point about the overall take up, for example, of the GigaCenter, we are seeing customers take it into their networks to evaluate it, et cetera. But that doesn't translate immediately into large scale shipments of those units.

In terms of OpEx, ultimately, obviously, OpEx is a very important factor in the operating leverage -- the point that you have made. Revenue being the other factor that we are very focused on, which is why Carl was very careful to emphasize the word growth in his remarks. And on OpEx, what we are doing is we are basically investing in resources that are going to help position us for that growth in the future.

I don't know, Carl, if you want to comment on either one of those topics.

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

Yes. The way I think about it is the following. If you look at Q4 this year over Q4 of last year, we saw 19% [revenue] (corrected by company after the call) growth and 14% growth in OpEx. With the seasonality of the business and what we are seeing as sort of an increasing return to that seasonality.

And as William commented in his remarks, this is the first year working through our new process and see what is going on, we are going to call Q1 at a revenue level that looks to us to be. Again, we are committed to our achieving what we set out to do. You wouldn't take OpEx down to get underneath that revenue number in first quarter, as I am sure you know.

But that is not a good answer to your question because in fact, what we have done is sort of almost take OpEx straight across into Q1 from Q4. And the reason we are doing that is because of the opportunities that we see in front of us to drive growth. And that is what we are focused on in 2015.

Tim Quillin - *Stephens Inc. - Analyst*

Okay. Thank you.

Operator

Doug Clark, Goldman Sachs.

Doug Clark - *Goldman Sachs - Analyst*

Just a quick follow-up clarification to that OpEx question. Is it fair to assume, then, that OpEx -- this is a new run rate for OpEx at these levels, if you are continuing to invest for growth?

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

What I would say, Doug, as I am sure you are aware, I mean, headcount is essentially -- personnel-related costs are essentially the largest single component across the board of our OpEx. And so inherently, while that can be a flexible resource, you tend not to model it that way and I wouldn't model any adjustments in that number going forward.

So in terms of it being a new threshold, we're going to have some puts and takes, but overall, as I say, we are just investing for the growth that we see around the corner.

Doug Clark - *Goldman Sachs - Analyst*

Okay. Thanks. And then looking at the quarter itself, kind of breaking down your various customer constituencies between your largest 10%, Tier 2, and Tier 3s, where was the source of outperformance, if it wasn't deferred revenues? Or if deferred revenues came in roughly in line with expectations?

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

Appreciate the question, Doug. As you know, we would demur and not answer it in that way. The way I would answer it would actually be that there wasn't a remarkable source of growth. So I don't mean to sidestep the question, but there is nothing that I would necessarily call out as disproportionately the driver of that growth.

William Atkins - *Calix, Inc. - EVP, CFO*

Yes. I mean, just to take a few what ifs, we wouldn't, for example, call out CAF as being a source of growth. We wouldn't call out any specific tier of a customer. It was genuinely broadly balanced.

Doug Clark - *Goldman Sachs - Analyst*

Okay. Okay, that makes sense. And then I just want to understand again on the guidance and I think it was suggested in an earlier question. But this is well below kind of normal seasonality for the first quarter.

Is that in any way related to the wind down or the roll off of deferred revenues? Or if not, what, again, is driving the below seasonality in the first quarter?

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

We have actually seen seasonality in the first quarter, I think, low single digits down all the way up to 20% down. So to your point, it is at the low end of what we have seen. It is actually not outside of the range of what we have seen in history. So William, you may want to add to that.

William Atkins - *Calix, Inc. - EVP, CFO*

No, I think you have answered it. I mean, there is this classic variability. We have gone back and looked at our Q4 to Q1 numbers to discern a pattern apart from them to being, shall we say, flat to down. The variant can be as much as 20%. So that is pretty much all I can answer.

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

And the other thing I would echo was William's comment in his prepared text around budgets and budgets being finalized this year. There are many of our customers that, as we sit here today, have not finalized those numbers.

And what that means is not necessarily that they will or will not invest in this quarter, but calling it at this moment, not a good idea.

Doug Clark - *Goldman Sachs - Analyst*

Okay. Thanks.

Operator

Sanjiv Wadhwani, Stifel Nicolas.

Sanjiv Wadhwani - *Stifel Nicolaus - Analyst*

Carl, I had a question on CAF. I think in mid-December, both Century and Windstream argued that the new 10/1 requirement for CAF wasn't realistic. I think that is up from 4/1. And these new requirements would require longer deployment cycles.

I am just curious, has this requirement to raise required speeds for CAF to funding altered your pipeline or made any changes in terms of how your customers are looking at projects? Thanks.

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

Nothing material that I can see. I certainly understand and remember the comments. But I think that that is, in essence, between some of our customers and the government.

From a demand perspective, we see an unrelenting demand. In essence, bits moving across the access infrastructure, and so we haven't seen any changes in that dimension.

William Atkins - *Calix, Inc. - EVP, CFO*

Yes. We have seen CAF and similar programs as being substitutive sources of capital rather than incremental sources of capital. We may be proven wrong in the upside, in which case we will see that in the rearview mirror. But we are not calling it going forward.

Sanjiv Wadhwani - *Stifel Nicolaus - Analyst*

Got it. And just one quick follow-up. Carl, I mean, I understand that in Q4, you pointed out there wasn't one big source of outperformance, but when I am looking at 2015, is CAF going to be an important portion of what is going to drive revenue growth year on year?

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

No. I don't believe so. I think it is an important source of funding and I specifically think it is an important source of trying to make sure that we don't have, in essence, an Internet divide in rural and urban environments. That is a societal statement.

But as William stated, then I will hearken back to before William was here, we learned a lot from going through BBS, which, when William joined, he is now on the tail end of. And what we learned was that what was viewed as potentially being either accelerative or incremental turned out to be potentially accelerative, but really what it was a substitution for CapEx.

Look, we monitor it, we watch where the projects are going, and we will certainly go compete, but to us, it is competing as if we were competing for normal business, because it feels to us like it is inside of the CapEx budgets, not additive to it.

Sanjiv Wadhwani - *Stifel Nicolaus - Analyst*

Got it. That's helpful, thanks.

Operator

Amitabh Passi, UBS.

Amitabh Passi - *UBS - Analyst*

I was hoping you would clarify for me again. I apologize to go back to this point. But I'm still unclear where exactly are you spending the incremental dollars, particularly in OpEx? Is this part of your international expansion initiative?

And when do you expect to see the fruits of these investments? Is that a 2015 event or do you think it takes longer?

William Atkins - *Calix, Inc. - EVP, CFO*

In terms of where we stand, I think as I noted in my remarks, Amitabh, we are spending it on systems and software product development resources as well as on international sales resources. I mean, obviously, there are other increases and decreases around the Company, but if you were to highlight areas which were having investment, as it were, in heads, that is where it would be. Carl, do you want to take up any?

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

Yes. I would say sales in general. In the past, that has been driven more by international, but as we go forward, we're going to look for opportunities to invest in sales to drive growth. And product development. Those are the two areas that drive, in essence, the growth of the Company.

Amitabh Passi - *UBS - Analyst*

And then the 100 service providers that are procuring your GigaCenters, I don't know if you are able to give us a sense of just unit volumes. Are we talking thousands, tens of thousands?

And again, do you expect to recognize revenues in 2015 or, again, given the certification cycles, this is probably a longer time frame before you recognize revs?

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

Great question, Amitabh. So here is what I said in my prepared comments and let me tie it together to answer your question. In the first quarter of its availability, we actually received orders from over 100 customers. And if I had my druthers to have lots of orders that were small from lots of customers versus a few customers giving us big orders, I would take the former any day of the week, because that speaks to market penetration.

And that is exactly what we are seeing is we are seeing broad market acceptance. Now those orders, to your point, are typically going to be small pilot deployments as folks get used to what is a new technology and they will typically deploy it in their lab and in a few houses and then a neighborhood. And then they will start to roll out the programs.

And the vast majority of those orders are of that ilk. And the customer sets are broad and varied, so there is no one timeline that any one customer is on. So some of them are on shorter approval cycles and some of them are on longer.

To your question about rollouts, clearly, this is a 2015 event. This is not something that goes outside of the year as far as waiting for it. This is happening and will happen relatively quickly. But you are going to see it happen over the course of the beginning part of this year.

Amitabh Passi - *UBS - Analyst*

And just one final one for me. Assuming GigaCenter ramps for you this year and assuming international comes back a little more strongly, how should we think about the impact to your gross margin line?

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

Look, our gross margin line has, in a statistically predictable way, gone up. There are some quarters where it is down; some quarters where it is up. But actually, I am encouraged by the progress on gross margins. And William mentioned some inventory that was addressed in last year.

So if you put all that together, I don't see anything in our business model that does anything other than goes forward on gross margins at some rate. And are above -- to finish that out, are greater than 50 points of gross margin is the model that we anticipate we will achieve.

Amitabh Passi - *UBS - Analyst*

Okay. Thanks.

Operator

Simon Leopold, Raymond James.

Simon Leopold - *Raymond James & Associates, Inc. - Analyst*

A couple of things. First on the housekeeping side, are you going to make us wait for the Form 10-K for the 10% customer details for the year or can you give us that metric tonight?

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

If you are asking me, Simon, and thanks for asking. We had one 10% customer and, yes, we will make you wait. Otherwise, it would remove all of the surprise and you wouldn't actually read the Form 10-K and it is such a wonderful document. So yes, we will make you wait.

Simon Leopold - *Raymond James & Associates, Inc. - Analyst*

Okay. I will read it cover to cover. I swear. (laughter) Anyway, I wanted to ask about the gross margin trends. I have tended to think that there is a seasonality that we haven't observed, but I thought there would be seasonality where the December-March would have higher gross margins with more central office equipment and construction season, sort of June-September, would have lower gross margins on more outside plant, more equipment in households.

Just wondering if that trend exists within your business and just gets masked by other things or how to think about trending a gross margin in terms of mix?

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

Boy, I wish I could give you insight into that. As I said, it is somewhat noisy, but it is quite predictable over time. I would have to think about that, Simon.

The only way I can answer your question is to say you are going to see it continue to go up over time. And I don't think it is driven by the installation cycles so much as it frankly is delivered more by individual situations or particular orders.

William Atkins - *Calix, Inc. - EVP, CFO*

Yes.

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

I'd have to go back and look at that. I don't think there is any trend like that, that I can identify.

William Atkins - *Calix, Inc. - EVP, CFO*

I have taken a stab at it to see whether there is predictable seasonality in gross margin, Simon, and frankly, I can tell you from the inside we don't see it. Obviously, with a migration from copper to fiber in broadband, given the fact that we sell products that are at both ends of the pipe, as it were, in a fiber environment versus one end in a copper environment, that can help us overall in terms of revenue mix.

And over time, as we get better at manufacturing stuff, inherently the margins in those products will grow. Then you have to balance that against new customer acquisition, where inherently chassis sales are footprint oriented and we are going to have lower margins on those initial sales. So this gets sort of, in a sense, polluted, if you will, or skewered by all of the other activities that we are engaged in. And therefore, you cannot discern a seasonality to the gross margin trend.

Sorry -- a long-winded answer to your question. Just wanted to make sure that you heard where we were coming from.

Simon Leopold - *Raymond James & Associates, Inc. - Analyst*

Yes. No, no. That is very helpful. If you can't see it, I sure can't see it. So you have certainly got better data than I do.

And then just the last thing, I wanted to go back to the 1 gig projects. You did give us some metrics on progress there. If you could just repeat where you are this quarter versus last in terms of these 1 gig and whether you have reached a threshold or neared a threshold of those projects contributing 10% or more of revenue? Thank you.

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

So here is my answer. It continues to grow at a significant pace. As William mentioned in his prepared remarks, actually, President Obama visited Cedar Falls, Iowa, and saw one of those deployments.

There are many that have been publicly announced and many that are not, but we actually don't look at it internally in the way you are asking. Because we don't look at the speeds tied to the network. Clearly, there is an increase and a continued growth in fiber-based access infrastructure and that is something that we have continued to innovate in, but we don't look at it as a percentage of revenue. William, I don't know if you have any additional comments.

William Atkins - *Calix, Inc. - EVP, CFO*

No, we don't. The only additional comment I would make would be to answer one element of your question, which was regarding the number of announced gigabit deployments that were out there that had a Calix tag on them, as it were.

In the prepared remarks, I stated that there were over 60 -- in fact, I think the number for this past quarter was 65. And in Q3, I think the number was 43. But these are directionally helpful numbers, but the fact of the matter is, as I did state, there are many networks out there that have not been announced. Because our policy, as you know, is not to announce deployments unless our customers do.

Simon Leopold - *Raymond James & Associates, Inc. - Analyst*

Okay. Thank you very much.

Operator

Paul Silverstein, Cowen.

Paul Silverstein - *Cowen and Company - Analyst*

I have got several questions. I'm going to apologize to you and others on the call if any of this is replicative of previous questions. If they are, I can take them off line, but here goes.

First off, I think I saw where you all had 35 new customers this quarter, which looked like it was a pickup from previous quarters. Are any of those new customers meaningful by size, if not by the order?

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

Yes. I mean, some of it -- they are of all different sizes. And so sure, some of them will become meaningful customers over time. But I would caution you on as they become new customers, they typically are not significant drivers. They are becoming new customers, they are starting new deployments, they are testing, they are doing whatever.

Paul Silverstein - *Cowen and Company - Analyst*

Carl, I understand that, but maybe I should frame the question in a better manner. In terms of putting aside the dollars to you today or even tomorrow, in terms of how you would bucket or classify those new carriers, those new customers, are any of these Tier 2s, if not Tier 1s? As opposed to Tier 3 and below?

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

Yes. So I have to be careful here, because we have different terms for different things. So let me -- especially when you go globally.

William Atkins - *Calix, Inc. - EVP, CFO*

Yes, so international Tier 1s versus domestic Tier 1s, et cetera.

Paul Silverstein - *Cowen and Company - Analyst*

Understood.

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

So a Tier 1 is, by definition, the largest service provider in its country. So sure, some of them could be Tier 1s. But I think your question is the size in an absolute sense compared to other large service providers. So there are service providers that run the gamut in these new accounts. And again, that's the best I can do for you.

Paul Silverstein - *Cowen and Company - Analyst*

But Carl, to the point in terms of the way you framed it, some of this -- one or more of the service providers you would deem to be meaningful in terms of the size and thereby, the potential revenue benefit to the Company over time.

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

Oh, sure. Absolutely.

Paul Silverstein - *Cowen and Company - Analyst*

Okay. All right. Let me move on. Going back to the -- well, in light of Adtran's commentary about Tier 2s and Tier 3s, as well as your own commentary tonight, I know historically, you have pointed out that Tier 2s and Tier 3s are not identical in terms of the drivers of their spend.

So that being said, as you look forward, if you could help provide some incremental insight in what you are seeing from those two particular classes of customers from 50,000 feet up.

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

At the end of the day, I would be consistent with what we were seeing last quarter. The smaller customers clearly are looking forward and saying, okay, we have got to go address these opportunities and we are going to invest.

It does not mean all of them. But it is clearly continuing to improve as an attitudinal statement. Some of the Tier 2s, same bucket. Some of them are on strike. Okay? So that runs the gamut as well. Am I answering your question?

Paul Silverstein - *Cowen and Company - Analyst*

Carl, does that represent a change from what you have seen previously or what you have said previously?

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

It is in the Tier 2s. I think we are seeing a little more favorable environment in the Tier 2s.

Paul Silverstein - *Cowen and Company - Analyst*

Notwithstanding that some are on strike, when you net it out, you are saying you see a more favorable environment.

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

Yes. And yes, it does represent a change.

Paul Silverstein - *Cowen and Company - Analyst*

Okay. And I will ask, although I am sure I know what the response is, but with respect to your large Tier 1, where your friends in Huntsville have said they expect to stabilize or regain share, any comment that we can get from you in terms of your expectations?

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

No, other than we are encouraged by the relationships that we have and the business that we do with our largest customer. I don't know that I would make any more comments.

William Atkins - *Calix, Inc. - EVP, CFO*

Yes. I mean, basically, when the Form 10-Ks come out, you can compare the numbers. The issue is whether they are going to be comparable, given the slightly different -- well, not slightly, but different revenue mixes that we have.

Paul Silverstein - *Cowen and Company - Analyst*

William, I understand about, but obviously, I am asking a forward-looking question as opposed to market share, which is backward-looking. But a couple more, if I may.

On gross margin, any insight you can share with us on how much of the gross margin benefit, how much of the upside was from the decrease in non-US revenue relative to US as a percentage of total?

William Atkins - *Calix, Inc. - EVP, CFO*

I wouldn't, frankly, hang anything on that. I mean, I understand why you're asking, because you perceive it as being an area where we are acquiring new customers, so I get it. But I wouldn't pin that at all.

As I think I noted earlier in the call, the actual difference in percentage terms between the two numbers year to year is less than a single percentage point. Frankly, we are just rounding it. And it ends up being this way. I wouldn't read anything into that.

Paul Silverstein - *Cowen and Company - Analyst*

All right. And I have got two additional questions, if I may. I want to challenge you all. Simon being a much more nicer and more politically correct guy that I am, he let you guys off the hook, but I am not going to do that. On the 10% --

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

That is called damning with faint praise, Paul. (laughter)

Paul Silverstein - *Cowen and Company - Analyst*

On the 10% customers, seriously, you're really going to make us wait for the Form 10-K and not tell us who and how much? We are going to find out eventually. You know the numbers now -- why not just give it to us?

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

Didn't I say that you wouldn't read the Form 10-K, then, and it is packed full of all sorts of things/ By the way, I am not going to go speak to those numbers. So (multiple speakers), it's up to you.

But I think we stay on the course. It has been our -- the approach that we have had and I think you just let it come out in the Form 10-Ks and then we will go have the conversation. So yes, seriously, appreciate the question.

William Atkins - *Calix, Inc. - EVP, CFO*

And I am trying to wear Carl down, Paul, but it takes time.

Paul Silverstein - *Cowen and Company - Analyst*

Good luck. On -- one other thing, if I may. Coming back to -- I think it was George's question on international. If my numbers are accurate, it looks like for the year -- and I appreciate it. I think we all understand there was lumpiness in your business in total on a regional basis. I get it.

But if I look at the numbers for the year, I am surprised that there was no growth. Your non-US revenue was flat. You have been in customer acquisition mode. There has been a clear positive trend in terms of new customers added.

And yet, notwithstanding that the numbers are small, you're non-US revenue is flat for the year, notwithstanding your characterization of it earlier. And I am just trying to understand.

I'm not trying to give you all a hard time, but I am trying to understand why we are not seeing the corresponding growth, smoothing out the lumpiness, putting aside quarterly volatility, and looking more importantly, looking forward, what is going to change going forward? Why haven't we seen more predictable growth, even taking into account the lumpiness? Again, your revenue is flat on a year-over-year basis for 2014 for non-US. What is going on?

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

So when you look at it from a micro perspective, the way I would try and set your expectations is we are seeing good new account activity. Those new accounts add revenues at a certain rate. As you add them, that builds up. They deploy, they get satisfied, they order more. That is an underlying uplift on the revenue.

Your question is, hey, that uplift's happening. Sounds like good things. Why aren't we seeing it at the top line? So there might be some other things that might be going on from a systems footprint product shift and things of that nature.

So let me give you an example. Many of our customers internationally are evaluating the E7 platform that might have had other platforms installed prior. And we are seeing a lot of interest around the E7.

But when you get into that mode, it slows things down. And potentially, all you have to have is one or two orders move from one quarter to another. And on a lower revenue number, it has a material impact on that number.

So the underlying buildup we are seeing and it is encouraging us to continue to bang away at it because there is more and more countries where Calix now has customers.

Paul Silverstein - *Cowen and Company - Analyst*

Okay.

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

Which is why I said earlier, it is a 2015 over 2014 piece. We grew at the same rate. That is not what we want to grow at. We want to accelerate our international growth. And there is the investment that we are making.

But there are some other pieces that relate to our strategic products going forward, customers evaluating them, all good news takes some time.

Paul Silverstein - *Cowen and Company - Analyst*

Okay. And one last question, if I may. Any impact from foreign currency?

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

Not material to us. Are there discussions around it? Are there the same articles that you read in the paper that we read? Et cetera. Sure, but right now, it is not affecting what we are doing. It could, but it is not currently.

Paul Silverstein - *Cowen and Company - Analyst*

All right. I appreciate it. Thanks, guys.

Operator

Christian Schwab, Craig-Hallum Capital Group.

Christian Schwab - *Craig-Hallum Capital Group - Analyst*

My question is about growth. What growth rates, if you don't want to talk about this year, maybe you want to talk about a CAGR for the next three years that you are anticipating you are going to get at this current OpEx level?

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

We are focused on quarter in and quarter out, Christian. I appreciate the question, but there is no way I would be able to answer that.

Christian Schwab - *Craig-Hallum Capital Group - Analyst*

I guess I am confused, because we talked -- a lot of questions about OpEx and what maybe you don't believe is elevated, but slightly higher than obviously a lot of us analysts on Wall Street assumed you would remain at.

And you guys said you were investing for growth. You are investing for growth. You are investing for growth. Systems, products, international sales. I think it is probably a fair question to be answered what that growth rate that you are investing to do to hold you accountable for that OpEx.

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

I appreciate the question. And what we are seeing and what we are trying to indicate is there are green shoots that are driving customer interest. But we have got a cycle to get through of pilots and approvals before we can start to speak to more accurately what we might see in the growth rate in just a quarter or two out. But we are not going to drive towards a longer term, set the model sort of number.

Christian Schwab - *Craig-Hallum Capital Group - Analyst*

Okay. That's fair. Thought it was worth asking. Thanks.

Operator

(Operator Instructions) Tim Quillin, Stephens Inc.

Tim Quillin - *Stephens Inc. - Analyst*

Let me take another shot at that same question. But if you just annualized your first-quarter anticipated operating expenses, you end up with operating expenses for the year, 2015, that are up something like 9.5% versus 2014 OpEx.

And I am just wondering, just philosophically, should your investors believe that you will grow faster than your OpEx? In other words, should we be thinking that you are targeting faster than OpEx top-line growth?

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

So long term, my answer is yes. Is yes. But you have momentary times, given markets that you are addressing, where the answer is no. And so we have a bit of a surge to go address the growth opportunities that we think are significant in front of us, but there is going to be a surge in that where the answer to your question would be no. Long term, the answer is absolutely yes.

Tim Quillin - *Stephens Inc. - Analyst*

Okay. And then it is a high quality problem, but cash is starting to build up on the balance sheet. What would be your preferred uses of cash? Thank you.

William Atkins - *Calix, Inc. - EVP, CFO*

Tim, we do from time to time look at the traditional mechanisms of returning cash to shareholders, whether they be buybacks or dividends. And we weigh those against the advantages of having a stronger balance sheet as we go out and compete for new business, for new customers in particular.

And as we look at the opportunities that are out there, we think that we are better advantaged by retaining the cash and keeping it on our balance sheet. So that is essentially why we are retaining the cash and why we are quite pleased with having this large cash balance.

Tim Quillin - *Stephens Inc. - Analyst*

Thank you.

Operator

Thank you, ladies and gentlemen. There are no further questions at this time. I would now like to turn the floor back over to David Allen for closing remarks.

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

Thank you, operator. Calix will be participating in three investor conferences in the first quarter: the Stifel 2015 Technology, Internet, and Media Conference on February 10 in San Francisco; the Goldman Sachs Technology and Internet Conference 2015 on February 11, also in San Francisco; and finally, the Stephens West Coast one-on-one conference on March 19, again in San Francisco.

Information about these investor events is posted on the events page of calix.com. We remain focused on executing against the opportunities ahead of us and we look forward to meeting with you at one of these upcoming events. Thank you for joining us today and goodbye for now.

Operator

Thank you, ladies and gentlemen. This now concludes our teleconference for today. You may disconnect your lines at this time. Thank you for your participating and have a wonderful day.
