

FINAL TRANSCRIPT

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CALX - Q2 2011 Calix Inc Earnings Conference Call

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Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

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Simon Leopold

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Michael Kim

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Calix Second Quarter 2011 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will facilitate a question and answer session.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the floor over to Mr. Denis Quinlan, General Counsel for Calix. Please proceed, Mr. Quinlan.

Denis Quinlan - *Calix Inc. - General Counsel*

Thank you, operator, and good afternoon, everyone. This conference 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, merger related expenses, stock based compensation and amortization of intangibles.



Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

These forward-looking statements are based on management's expectations, estimates and judgement and current trends and market conditions, and involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward looking statements.

More information is contained in the Company's periodic reports including our quarterly report on Form 10-Q for the fiscal quarter ended June 26, 2011 available at www.sec.gov. 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.

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

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

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

Carl Russo - Calix Inc. - President and CEO

Thank you, Denis. Good afternoon, everyone and welcome to our earnings conference call for the second quarter of the fiscal year 2011. Joining me on the call today is Michael Ashby, our Executive Vice President and Chief Financial Officer.

I will provide a brief review of the business and marketplace and then turn the call over to Michael to walk through the financials in detail. After that, I will come back and briefly discuss the business and marketplace looking forward.

Our second quarter results exceeded our expectations, and demonstrated that the benefits of our Unified Access architecture continued to resonate with our customers. We achieved record revenues up 37% year-over-year. Strong gross margin performance allied with disciplined OpEx, yielded profits ahead of our expectations.

The virtuous cycle that our Unified Access portfolio creates, continued this quarter with growth across all of our systems. Growth in fiber access was particularly strong, which extended our North American market share leadership. Our EXA footprint continued to grow as well, culminating in a new milestone as we began field trials of the E7-20 Multi-Terabit Ethernet service access platform on schedule. We saw strong sales activity across all theaters, and broadband stimulus has continued to be a significant contributor to that activity.

During Q2, we announced that we had eclipsed the \$1 billion win mark in awards to our customers. In short, in our first full quarter of operations, after closing the acquisition, we saw strong, disciplined execution across every area of the business. I am proud of the Calix team.

And with that, I would like to turn it over to Michael Ashby. Michael?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

Thank you, Carl, and good afternoon, everyone. I am going to take you through our unaudited statement of operations for the second fiscal quarter of 2011, and compare it to the second quarter of 2010. After that, I'll briefly discuss the balance sheet and give some guidance for the third quarter.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

In order to make the results as easy as possible to understand, the earnings press release shows by column the non-GAAP income statement, then merger-related and other expenses; the non-cash expenses related to stock based compensation, the amortization of intangibles, and finally the GAAP income statements. My commentary will follow that format.

Let me start with the non-GAAP income statement. Revenue for the second quarter came in at \$98.0 million, an increase of 37% compared to the second quarter of 2010 and slightly above the guidance of \$97 million that I gave you on our last call.

During the second quarter, we had two 10% customers which compares to one 10% customer in the second quarter of 2010. International revenues comprised 6% of total revenues in the second quarter versus 8% in the second quarter of 2010.

Broadband stimulus revenue in this quarter were still negligible, although we did start to see some orders being booked from previously announced awards. Furthermore, we did start shipping against some of the broadband stimulus orders, but that moves into deferred revenue which I will talk to later. We do expect to start to recognize some broadband stimulus revenue during the remaining quarters of the year.

Non-GAAP gross margin for the first quarter was 44.3% up from 42.3% in the second quarter of 2010 and slightly above the guidance that I gave you on our last call. The increase over the prior year was a result of cost reduction, product mix, and specifically the ramp of new products introduced in the last 12 months. We are pleased with the continued strength of our gross margins, and expect to be able to maintain this as we go forward.

Turning to operating expenses. In total, non-GAAP operating expenses of \$35.5 million up from \$24.0 million in the same period last year. Breaking that down by type of expense, non-GAAP R&D spending was \$17.4 million for the second quarter of 2011; an increase from \$11.4 million in the second quarter of 2010.

This increase was primarily due to additional headcount and other development expenses as a result of the Occam acquisition, and pursuit of OSMINE certification. Non-GAAP sales and marketing spending was \$13.3 million for the second quarter; an increase from \$8.9 million compared to the same quarter of 2010.

This increase was primarily due to the additional employees from the Occam acquisition and commissions on much higher bookings in 2011 versus 2010. Non-GAAP GMA spending was \$4.8 million for the second quarter of 2011; an increase from \$3.7 million in the second quarter of 2010. The increase was driven by the Occam acquisition and additional public company expenses.

Non-GAAP operating income for the second quarter of 2011 was \$7.9 million as compared to \$6.3 million in the second quarter of 2010. With offsetting income and expense and a minimal tax revision this quarter, non-GAAP net income of the second quarter was \$7.8 million or fully diluted earnings of \$0.16 per share. This compares with a non-GAAP net profit of \$5.5 million, or fully diluted earnings of \$0.14 per share in the second quarter of 2010.

Before I discuss the merger related expenses, I would like to highlight two key points. First, the integration of Occam was fully completed during the quarter, which means that we no longer track Occam separately. Second, and most importantly, when we announced the acquisition, we stated that it would be accretive in the quarter immediately following the close and as you can see from the results, we achieved that goal.

Turning next to the merger related and other expenses. Since these are difficult for anyone to estimate, as I go through each category, I will give you estimates for the third and fourth quarters of 2011. On our April 4th call, we had told you that in the second quarter total merger related expenses would amount to \$7.3 million in cost of goods sold and \$4.7 million in operating expenses.

As you may recall, in the first quarter we booked a smaller amount than we had forecasted in cost of goods sold and I told you that would mean booking a larger amount in the second quarter. That is indeed correct and we recorded \$9.7 million in cost of goods sold this quarter. We don't anticipate any further merger related expenses in cost of goods sold in future quarters.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

In the category of operating expense, we booked \$4.4 million in merger related expense, slightly less than forecasted. The majority of the remaining merger related expenses, approximately \$2.4 million I expect to amortize in the third quarter with only a small residual of approximately \$600,000 to be recorded in the final quarter of the year.

Amortization of stock based compensation amounted to \$5.3 million. This amount decreased considerably from \$8.1 million in the prior quarter, reflecting full amortization of the RSU grant from the prior year. However, it was more than we had forecasted because in finalizing the purchase accounting for the Occam acquisition, some changes in the final calculation of goodwill have been offset in stock based compensation. On the going forward basis we expect stock based compensation to decline to just over \$4 million each quarter for the remainder of the year.

The final item is the amortization of intangibles, and this amounted to \$6.0 million in Q2 as compared to our April 4th estimate of \$9.9 million. As I mentioned on the Q1 earnings call, we were in discussion with our auditors on the amortization periods to be used.

These have not been agreed with the exception of in-process technology, since this is subject to periodic impairment testing. We expect to amortize about \$5.4 million excluding in-process technology in the third quarter followed by approximately \$4.6 million in the fourth quarter. We currently do not expect to be amortizing the in-process technology until the start of 2012.

Now, let's turn to the balance sheet. Cash, marketable securities and restricted cash amounted to \$28.6 million down from \$39.6 million at the end of the first quarter, but considerably better than our April 4th guidance of \$16 million. Some of this improvement was a carryover from the improved first quarter cash flow, and the remainder came from better than planned income from operations and management of our working capital as you will see in the following comments.

Net accounts receivable was \$57.9 million at the end of the quarter. Our average DSOs on accounts receivable were 47, down from 56 in the prior quarter and better than planned. Net inventories amounted to \$38.5 million, down from \$49.4 million at the end of the first quarter. Inventory turns were 3.6, up from 3.4 in the prior quarter, but still well below our target of eight turns. We expect to continue to see improvement in inventory turns in each of the remaining quarters of this year.

Deferred revenue was \$35.1 million, up from \$29.7 million at the end of the first quarter. This increase was almost entirely due to shipments against broadband stimulus orders, and we expect to see this number increase in each of the remaining quarters of the year.

Finally, let's move to guidance on a non-GAAP basis. On our April 4th call, we gave you some specific non-GAAP guidance for each quarter of 2011. For the third quarter of 2011, we had given you guidance of \$104 million in revenue, gross margin percent of between 42% and 44% and earnings per share of \$0.19. We are comfortable with the revenue guidance and as such reaffirm \$104 million for the third quarter.

Although gross margin can fluctuate from quarter to quarter it continues to be strong. Accordingly, we are raising our range a full percentage point to 43% to 45%. Using the middle of that range, and assuming a small increase in operating expenses over Q2, that leads to EPS guidance of \$0.20 per share, up from our previous guidance of \$0.19 per share.

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 continue to accelerate, speeding broadband adoption while driving the demand for more capable internet services ever higher.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Competition, technology, and deregulation serve to pressure communication service providers to provide these new services all the while shifting to lower cost business models. Thus, we continue to have a special urgency to execute on our vision of Unified Access.

As we look to Q3 we see a clear path to achieving our goals, but remain mindful of the macroeconomic climate and therefore we will keep our hands close to the levers as we manage our business.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

And our first question is coming from the line of George Notter, from Jefferies. Please, proceed.

George Notter - Jefferies and Co. - Analyst

Hi guys. Thanks very much. I wanted to ask about broadband stimulus specifically it looks like a deferred revenue increase here of about \$5 million sequentially. You know, last quarter we kind of suggested that you could do something like \$60 million to \$70 million in broadband stimulus revenue this year. And I think the comment something to the effect of you didn't really disagree with those kinds of numbers.

Would a \$5 million increase in deferred revenue be supportive of a significant amount of stimulus revenue this year?

Carl Russo - Calix Inc. - President and CEO

George, I think we are going to spend a reasonable amount of time broadband stimulus on this call. And I think what I'd like to do is start by maybe framing again the size and scope of broadband stimulus, and maybe I'll ask Michael to do that. And then, Michael, after you've framed it, I want to come back and talk about competition and timing. So, Michael, can you frame it?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

Sure. I can indeed, Carl. So there are a number of variables in broadband stimulus that we need to bear in mind. Starting with the total award value of \$8.6 billion; we've always said that about half of that is going to be last-mile awards. So, divide that by two you get to \$4.3 billion approximately.

We have also said that that high single digit percent of those are not taken for a variety of reasons -- not taken up for a variety of reasons. So lets assume you take \$400 million off that number, so you get down to about \$3.9 billion -- \$3,900,000 of actual value of last mile awards.

And of those awards -- of the \$3.9 billion, approximately \$300 million are wireless only, an area in which we don't compete. So that leaves you with \$3.6 billion, which is the addressable value of the market that we compete in. We have always said that between 10% to 15% of that is actual access equipment.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

In analyzing awards to-date, we come up with around 12% and we use 12% therefore as the number is actual access equipment. 12% of the \$3.6 billion is about \$430 million. So, the addressable access equipment market for us is around \$430 million.

Now when we analyze that, the power of incumbency is extremely important in these, and on the basis of incumbent, Calix will win 43% of that total. And as we've told you, we are competing on every one of these deals. And we certainly hope and expect to win more than the 43% that we would get from incumbency, but nevertheless based on incumbency 43% of \$430 million would be the addressable number.

Then there is another variable which is obviously the timing of revenue, and that can vary enormously from a rapid 90 days to up to at least three years. And, Carl, do you want to elaborate on those?

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

Yes, So, a couple of things there, George, one, on the win percentage. Keep in mind that we've been committed to keeping track of awards that are announced. And so we've been announcing them as, in fact, situations occur, the customers allow it, et cetera. And our tracking of awards announced is quite high. So I want -- trying to create some brackets here.

On the timing, as an example, we have a couple of orders that we've had in house since Q4 that still have not met our bookability criteria because there is still some documentation that needs to be driven through the government, filled out by the customers, et cetera. So these things are taking longer than everyone thought and we thought, and we've been consistent in saying that.

So now, let me go back to your question. Does that amount of deferred revenue lead to the \$60 million or so that you had cited before? Still could do, but you sort of have to frame this into a we don't know until we continue to crank through these.

And I thought we would be at a point where we would have a very clear view, and things are still taking, in some cases, longer than we thought and for different than we thought. So that's not an answer directly to your question, but I think to your point, I think the \$60 million would be a higher risk than a lower risk at this point.

George Notter - *Jefferies and Co. - Analyst*

Got it. Okay, one of the things you mentioned interest the analysis was the 43% market share you are associating here with the stimulus program. I guess, given the Occam deal, I got the sense that your market share was quite a bit higher. Does that 43% number include Occam, or exclude Occam?

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

So the answer is it's Calix today. So, it's all included. But keep in mind that these are by names across the award winners, not necessarily by share, right? So this is pressed up against our customer lists. So, we're sharing with you some analytics to give you a sense for sort of the puts and takes.

George Notter - *Jefferies and Co. - Analyst*

I'm sorry -- so, your market share is 43% of the total value of awards that have been announced to date? I guess I'm trying to understand what that number is.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

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

No. So in other words, take the pie of all the award winners -- right? And then, go look at that pie and see which ones we are incumbent in and which ones we are not. We are incumbent in some 43%.

George Notter - *Jefferies and Co. - Analyst*

Got it. Great.

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

To your market share question that number could be and is in fact different from what market share might be because it depends on who won awards and where.

George Notter - *Jefferies and Co. - Analyst*

And those include announced and unannounced awards that you are aware of.

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

That's correct. So Michael's analysis that he's sharing with you is a top down analysis based upon that. Now going back to the earlier point, we have been driving north of 80% of the announced awards at this point in time. That may change, it may stay the same. Who knows? But you start to realize there is a pretty big spread between the incumbent number and potentially the awards, and the timing is also quite interesting.

So I think what Michael was doing was simply doing the fundamental analysis to help everybody sort of get a shape or the size of the box. The timing to me is still the biggest variable.

George Notter - *Jefferies and Co. - Analyst*

Got it. And the last thing on stimulus. There have been concerns raised among some folks in the independent Telco area that fiber is harder to come by these days. Any sense for whether or not that is slowing stimulus projects down or not?

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

So first of all, the answer is -- in the objective the answer is yes. But from a material standpoint, the answer is no. So just like any other situation where in any market you get a rush of orders, the first thing you see are some shortages, lead times stretch out, and then the suppliers attenuate from a supply standpoint. And we are already starting to see the lead times come back in. So there is some effect, George. I'm not going to say there is not. But is it material in nature? That's not a big factor here.

George Notter - *Jefferies and Co. - Analyst*

Got it. Fair enough. Thank you.

Operator

Your next question is coming from the line of Nikos Theodosopoulos. Please, proceed.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Nikos Theodosopoulos - UBS - Analyst

Thank you. Maybe just a couple of follow ups on this topic, and then another one. If you look at the change in deferred that -- correct me if I'm wrong, but does that not reflect your actual shipments against broadband stimulus, your actual cumulative orders would be higher than that? Or, is that an incorrect assumption?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

Nikos, it certainly doesn't mean that the actual cumulative orders are higher than that. But it is not just -- it doesn't reflect only the shipments against broadband. We shipped more than that, recognized some amount of revenue during the quarter and the balance, which wasn't recognized, has gone into deferred revenue.

Nikos Theodosopoulos - UBS - Analyst

Okay. Got it. So you're recognizing some revenue, but the vast majority is going into deferred.

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

That's correct.

Nikos Theodosopoulos - UBS - Analyst

Okay. If I look at the \$1 billion in aggregate awards that you are associated with, how does that compare -- how does the percentage of total awards announced, yours and other vendors, compare to the 43% that you are expecting at a minimum?

Carl Russo - Calix Inc. - President and CEO

Nikos, sorry you had me confused on -- I got confused on denominators and numerators there. Rephrase that question, if you would, so I can understand it.

Nikos Theodosopoulos - UBS - Analyst

Okay. Calix has announced \$1 billion -- has announced stimulus contracts associated with \$1 billion dollars of awards, right? So if I look at all the awards announced, what percentage does \$1 billion represent so far?

Carl Russo - Calix Inc. - President and CEO

So \$1.2 billion, I think, which is what we are about running at, we are 85% of what we've seen announced to-date. So, more than 80%.

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

(Inaudible) question is that the total awards will be about \$3.9 billion. So, \$1.2 billion announced to date, so there is still another \$2.7 billion to be announced.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Carl Russo - Calix Inc. - President and CEO

Is your question, what percentage does the \$1.2 billion represent of the \$3.9 billion that we believe --

Nikos Theodosopoulos - UBS - Analyst

No. My question is you expect 43% share, how does the amount that has been announced so far -- how are you tracking verses the \$1.2 billion that has been announced so far? Is that 43% of all announcements? Higher or lower?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

I think you are confusing things, Nikos. The 43% is if you take all of the awards, then the incumbency on those awards, the ones which are announced and not announced, so the \$3.9 billion we are incumbent in 43% of those.

Nikos Theodosopoulos - UBS - Analyst

Okay, fair enough. I'll follow up later. It's probably getting lost in the translation here, but not that important. I'll follow up later. My other two questions real quickly -- the 10% customers I'm assuming those were the same that you had in the first quarter.

Carl Russo - Calix Inc. - President and CEO

You should make no assumption other than, as I think I stated last quarter, you wouldn't be surprised by the names.

Nikos Theodosopoulos - UBS - Analyst

Okay. And then, finally, just on gross margin, you've been doing a good job improving that. What has led to the slight increase in the guidance going forward here? Are some of the factors that have let to the improvement sustainable, or how would you characterize the rationale behind it?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

I think the answer is some of the factors that have let to the increase are sustainable going forward, and those include some cost reduction work that we have been doing, some value engineering. And we are comfortable now that those are going to continue in the future.

Nikos Theodosopoulos - UBS - Analyst

All right. Great. Thank you.

Carl Russo - Calix Inc. - President and CEO

Thanks, Nikos.

Operator

You're next question comes from the line of Simon Leopold from Morgan Keegan. Please, proceed.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Simon Leopold - Morgan Keegan - Analyst

Thank you very much. There are two things I was hoping to ask about. One was in concern to Qwest CenturyLink closing on that merger early in the quarter. Just wondering if you can give us some sense of how their behavior changed or didn't change, and how that compares to your expectations.

The question is really coming from the idea that often when carriers merge we see a pause in the quarter. So, I'm just trying to get a sense of what you observed in their behavior, and then I've got a follow up after that.

Carl Russo - Calix Inc. - President and CEO

So, Simon, as we've stated we've observed CenturyLink to have a relatively consistent behavior in their acquisitions, which is they to evaluate markets where they want to invest and they invest, and they sort of continue along on that CapEx trend of investing in the territories that they believe they can win and they go about doing that.

We haven't seen any change in behavior and we haven't seen anything that takes us off of our nominal plan with them. So as we've been clear, if there is something that is off nominal, we will let you know, but everything is going according to plan.

Simon Leopold - Morgan Keegan - Analyst

Okay. And then, in terms of the follow up, I wanted to see if we could get a status update on your E-Series product. I think in past calls you've indicated that revenue has been negligible, but it's been in favor in terms of some of the contract awards particularly under stimulus. I'd like to kind of get a refresh of how you are thinking about that product in terms of contributions and trends. Thanks.

Carl Russo - Calix Inc. - President and CEO

I don't think I would have chosen the word negligible other than to say it was young and growing, and then we stopped talking about it. You may remember some number of quarters ago we were at least giving folks a sense for customer count and penetration. And once we reached 100 customers, we stopped talking about it because it has become part of the mix.

What's my best way to characterize it? It's growing like a weed, and it continues to be the most successful product in our history. The E7-20, which is the two terabit per second platform for the data center, is in trials on time, and those trials have been frankly nothing short of right according to plan. We are up and running in under two hours from out of the cardboard box into the shelf, racked up and in production.

So in every dimension I can think of, everything is executing extremely well. But we just don't talk about it anymore as a specific platform.

Simon Leopold - Morgan Keegan - Analyst

Maybe I'm underestimating the contribution. Is there any kind of color you can give us to help us understand the actual revenue contribution getting beyond being over 100 customers but trying to get a sense of materiality within your overall sales?

Carl Russo - Calix Inc. - President and CEO

I've heard a good word to use is it's meaningful.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Simon Leopold - *Morgan Keegan - Analyst*

To me, meaningful tends to indicate over 10%. Is that applicable here?

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

Meaningful sounds like it has some level of common understanding then.

Simon Leopold - *Morgan Keegan - Analyst*

Okay. I appreciate it. Thank you very much.

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

Thanks, Simon.

Operator

Your next question comes from the line of Mark McKechnie from ThinkEquity. Please, proceed.

Mark McKechnie - *ThinkEquity - Analyst*

Great. Thanks, Carl, and Michael. I wanted to ask, can you give us an update on your international plans upon the hiring on Andy Lockhart? What's he been there about three months or so -- anything to report on that front?

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

The good news is he's still employed. He has done exactly what we expected him to do. We've been through our analysis, the (inaudible) of what we're about to go do and are doing. We are hiring according to plan. He's building his organization. And we're entering those markets that we want to enter in the order that we want to enter them in. He's literally right on plan.

Mark McKechnie - *ThinkEquity - Analyst*

Can you give us any detail as to what markets you are prioritizing?

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

We could. We won't. But let me put it to you this way; when we have news to announce in those markets we will share it with you, and then I think you'll get a pretty good sense of how we've approached it.

Mark McKechnie - *ThinkEquity - Analyst*

So right now he's staffing up, he's got feet on the street, and he's hiring people in countries, establishing customer contact. Orders out of international, is that something we'd see this year, or we'd probably start seeing those next year?

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Carl Russo - Calix Inc. - President and CEO

Well, I mean there are orders in international, so that is occurring today. But, again, things that we would go after and say are noteworthy, we will announce when they are noteworthy.

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

I think we did say before that we would be -- while we have the expenses planned for this year, we do not have revenue planned from international for this year.

Carl Russo - Calix Inc. - President and CEO

That's correct.

Mark McKechnie - ThinkEquity - Analyst

Got you. Great. Then, just housekeeping -- I don't know if you'd give us this number. The -- you gave out this 50 million subscriber lines for your overall footprint of your customers. Is there an update on that, and how many of those ports or lines are served by your gear?

Carl Russo - Calix Inc. - President and CEO

Mark, the answer is yes. I'd have to go digging for it. Would you mind if I went digging for it and came back to you off line?

Mark McKechnie - ThinkEquity - Analyst

No problem, Carl. That would be fine.

Carl Russo - Calix Inc. - President and CEO

Thanks, Mark.

Mark McKechnie - ThinkEquity - Analyst

Great. Thank you. Congrats.

Operator

Your next question comes from the line of Sanjiv Wadhvani from Stifel Nicolaus. Please, proceed.

Sanjiv Wadhvani - Stifel Nicolaus - Analyst

Thanks so much. Carl, quick question on broadband stimulus. There was a stipulation by the government that the majority of the build-out gets done by September, 2012. Do you think that still stands, or they are becoming a little more flexible on that?

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

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

It does not still stand, and they are becoming more flexible on that.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

But you are still expecting the majority of the dollars to flow through next year, or any sort of color on 2012 versus 2013?

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

There's clearly going to be -- as we messaged before on last quarter's call, it's clear that there will be flow over into 2013. Don't know how much. The rules on the drawdown of funds and the closing of funds is that the clock starts when they start to draw down funds and then goes from there.

So if you start tacking all these things through and it's a three year window, clearly 2012 is going to be an important year, but I think just as clearly now we would say 2013 is also going to be an important year.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

Got it. And then, Michael, a question on deferred revenues for you. I'm guessing you're expecting Q3 and then Q4 deferred revenues to rise greater than the sort of the \$5 million that you've seen coming out of Q2.

Michael Ashby - *Calix Inc. - Executive VP and Chief Financial Officer*

Yes indeed. I think on the April 4th call I said we expected them to more than double before the end of the year, which I think they were at about \$25 million at that point. So, we do -- expecting this to up by more than that in both the next two quarters.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

Got it. Fair enough. Thanks so much, guys.

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

Thanks, Sanjiv.

Operator

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

Simona Jankowski - *Goldman Sachs - Analyst*

Hi. Thanks very much. I think you've mentioned before that about 20% of your customers had received broadband stimulus funds, and I was just curious on the remaining 80% if you can just comment a bit on the trends there that you're seeing. Are you seeing any strengthening or weakening in terms of their order patterns? What are the main things driving those customers?

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Carl Russo - Calix Inc. - President and CEO

I would say that the order patterns for the most part, Simona, are pretty constant with what they have been, keeping in mind as we talked about four quarters ago, there is a lot of discussions around USF and ICC and all of those things that are being discussed inside the beltway.

And so, we expect as those things get resolved that folks will probably see a clearer view and go back to actually what had been historically higher levels of spending, but it's been flat for the last four quarters in the way it's gone on.

Simona Jankowski - Goldman Sachs - Analyst

Okay. Got it. So when you say flat you mean just in an absolute dollar sense?

Carl Russo - Calix Inc. - President and CEO

Yes. The buying behaviors have been pretty consistent along the last four quarters. So, in other words, the level of spending and what the folks are focused on has not changed.

Simona Jankowski - Goldman Sachs - Analyst

Okay. So then in terms of the growth that you'd be looking for here for the rest of the year, is it fair to say that pretty much most of it at this point would come from the 20% that are receiving the broadband stimulus funds?

Carl Russo - Calix Inc. - President and CEO

No. Don't forget you have historical buying patterns and seasonal buying patterns et cetera. So, we see growth from share gain, from BBS, from market share expansion from the same three rings that we've talked about before, from our existing customers, from converting prospects into customers, so in essence gaining new customers and then also from opening new addressed market.

So I don't know if that's changed actually in any manner, shape, or form in our view, now that I think about it.

Simona Jankowski - Goldman Sachs - Analyst

Yes. I mean, it seems that the guidance that you're giving, for the September quarter is basically in line with the historical seasonality you've had in the business, as opposed to seeing a more noticeable bump or above seasonal growth because of broadband stimulus.

And I know it's tough to gauge seasonality with your short history -- or at least publicly known short history, but is it intended to be an above seasonal number?

Carl Russo - Calix Inc. - President and CEO

I thought you were referring to me, and I was going to say thank you. So, I think when Michael laid out the guidance back on April 4th from a four quarter perspective, I think he did so with a whole set of views in mind and I think we are holding to those views.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

I think you'll see deferred revenue grow as Michael referred to, but I think all-in-all we are going to continue to run the business and grow the business. And there will also be broadband stimulus and it will occur into the revenue column whenever it occurs.

Simona Jankowski - *Goldman Sachs - Analyst*

Got it. And then just a change in topics a bit for one last question. Nut on the E7-20, since you just started shipping that, given it's such a higher capacity product, are you seeing any kind of different competitors there than before? And should we see it meaningfully nudge up your margins here in the next few quarters?

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

So it's early in its product cycle, right? So we are in now field trials, so that would mean not revenue. But over time, as we've messaged, the E-Series is typically above corporate average gross margin. So, we have said that. So, as it comes online it will clearly add to that.

From a competitive standpoint and to be blunt, I mean, you have a multi-terabit, all IP over all glass system. There is nothing like it in the marketplace. And what we're concerned about is making sure that our customers can put it into service in as easy a fashion as possible, as they go forward and continue to ship their business models.

And so far, the early trials have literally been right on plan. It's quite exciting.

Simona Jankowski - *Goldman Sachs - Analyst*

So you are not seeing more of say an Alcatel or a Cisco or something like that, as opposed to traditionally seeing an Adtran more?

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

No, again, you've got -- maybe we should spend some time off line so I can better shape this for you. But, in essence, you have the access edge of the network which has certain characteristics which you want in a system. If you then look at that set of requirements and then you also then start looking at all IP and all glass, it's in you section of set that makes it sort of unique.

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. Terrific --

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

If we get a chance I'll take you through it, Simona.

Simona Jankowski - *Goldman Sachs - Analyst*

I appreciate it. Thanks, Carl.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

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

You bet. Thank you.

Operator

Your next question comes from the line of Blair King, from Avondale Partners. Please, proceed.

Chris Glancy - *Avondale Partners - Analyst*

Hey, guys, this is Chris Glancy in for Blair King. I hate to go back to the broadband stimulus again, but kind of on a different level here. I know you guys were originally expecting mostly [BRUS] awards are coming from the Rural Utility Service fund, but I've noticed that you got a couple NTIA awards in those announcements that you've got.

I was just wondering is that -- is included in your \$3.9 billion number that you gave, or are NTIA wins just kind of icing on the cake? And if not, what do you think your opportunity is for those awards?

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

Chris, that's a very astute question. We'll have to talk to Blair about getting you promoted.

Chris Glancy - *Avondale Partners - Analyst*

I appreciate it.

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

The answer is no, it is not included in the number. And as -- if you go back to our previous calls we have said we thought we would be able to compete in some awards outside of the last mile access RUS, and that is in fact the case. So we have been able to do that, but we do view it as icing on the cake.

Chris Glancy - *Avondale Partners - Analyst*

Okay. That helps. And then, just one last one. Back to the international realm, if you will, I know you announced a win with LIME fairly recently. And I think a couple years ago you had a pretty good contribution from some Caribbean customer. I don't recall who it was, but I believe it was north of \$30 million for the fiscal year. Just wondering, is that a similar sized opportunity or smaller?

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

Specifically, you are referring to LIME?

Chris Glancy - *Avondale Partners - Analyst*

Well, it seemed like it had potential to be a sizable win. I didn't know if that was a large customer in the past that contributed to that one year where you had meaningful revenues.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Carl Russo - Calix Inc. - President and CEO

Now I understand your question. I apologize for stepping over you there. So, look, all these customers potentially have the opportunity to be significant, LIME certainly does. But in the specific case of what was announced, I mean this is a backhaul-focused initiative. So, it would not be the size of something larger that you are referring to.

Chris Glancy - Avondale Partners - Analyst

Okay. That's all for me. I appreciate it. Thank you.

Operator

Your next question comes from the line of Michael Kim from Morgan Stanley. Please --

Michael Kim - Morgan Stanley - Analyst

Hey, guys. This is Michael Kim calling in for Ehud Gelblum. I had a question on the guidance. With the revenue guidance I reiterated from the April 4th call, are there any different drivers that went into maintaining that revenue guidance?

Carl Russo - Calix Inc. - President and CEO

If I understand your question, if there were some puts and takes will it enable us to maintain it?

Michael Kim - Morgan Stanley - Analyst

Exactly. From the April 4th call -- or compared to the April 4th call.

Carl Russo - Calix Inc. - President and CEO

I don't know that there is anything that I would materially go point out. I mean, Michael, any color you'd want to add?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

No I don't think so. I think it's just been all proceeding as we had expected.

Michael Kim - Morgan Stanley - Analyst

Okay. On a different question, in terms of the broadband stimulus, in terms of the revenue recognition, you mentioned that the majority that you're seeing in on 397 paper. Is there any change to that, particularly post the Occam acquisition?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

No, no change. The majority is still 397 paper.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Michael Kim - Morgan Stanley - Analyst

Okay. Great. One additional follow up question. In terms of the eight times for the inventory turns, can you talk about the drivers and getting to that eight times for the longer term target?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

Sure. We are slowly -- some of the inventory increase was a result of the acquisition of Occam and in particular the purchase accounting. We tried to write up the value of the Occam inventory. That has now been taken out of the equation (inaudible) all amortize by the end of the second quarter.

And I think we told you before we had more inventory from Occam than we have expected, so we are working our way through that. And our inventory turns this quarter 3.6 are not as high as we would have liked, but that's because we started out -- we used average inventory over four periods, and we started out with a very high inventory and then it got much lower. So, the impact on turns is minimal. I think we'll see a big increase in turns in the third quarter.

Michael Kim - Morgan Stanley - Analyst

Great. Thanks. One more quick follow up. In terms of the guidance for the Q4, is there any kind of color you can give in terms of other drivers that may impact that in terms of tracking to the Q4 given on the April 4th call?

Michael Ashby - Calix Inc. - Executive VP and Chief Financial Officer

No change in anything on this side.

Carl Russo - Calix Inc. - President and CEO

Yes, and keep in mind, Michael, when we did the April 4th call, we made it clear that we would -- Michael would lay out four quarters and then each quarter we would go back to just simply one quarter out.

Michael Kim - Morgan Stanley - Analyst

Okay. Great. Thanks a lot.

Carl Russo - Calix Inc. - President and CEO

By the way, Ehud, never gets this many questions in. Thanks, Michael.

Michael Kim - Morgan Stanley - Analyst

Thanks a lot.

Operator

We have a follow-up question coming from the line of George Notter from Jefferies. Please, proceed.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

George Notter - *Jefferies and Co. - Analyst*

Hi. Thanks, guys. I'm still noodling on this 43% number. So if I heard what you said correctly, 43% of all the awardees interest he stimulus program happen to be Calix customers. And I know that there were around 300 awards in total in stimulus and I think some of them were duplicative, but maybe 270, 280 unique awards I'm guessing.

It sort of seems like your customers have a very, very low hit rate on winning stimulus projects, where if you look at the rest of the marketplace. And, I think in times past you guys have told us you have around 900 customers with Occam in the fold. It looks like other peoples' customers in the aggregate have a huge hit rate on winning stimulus awards. Am I misreading that, and why might that be if that's accurate? Thanks.

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

No, you're not misreading it in type, George. I'm sitting here thinking we've got to sort of take time to take you through the numbers. And I don't think we are going to get that done - I mean, we'll be here for a little bit. So, can I just grab you off line and we'll take you through it, since you've done a lot of that work?

George Notter - *Jefferies and Co. - Analyst*

Fair enough. That would be great. Just so I'm clear, the 43% is not a number -- it's number of customers, not a dollar value associated with your customer base?

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

The answer is yes, but it is being used as a bit of a throw of thumb, so to speak. So, we'll take you through it.

George Notter - *Jefferies and Co. - Analyst*

Great. Fair enough. Thank you.

Operator

Your next question is a follow-up question from the line of Nikos Theodosopoulos. Please, proceed.

Nikos Theodosopoulos - *UBS - Analyst*

Thanks. Hey, Carl, I wanted to follow up on the international topic. We have seen some large awards issued like in Australia and Canada and maybe one or two in Europe. And we've heard from companies like Corning and Tyco Electronics that FTTX business is really doing well overseas.

So the question I want to ask here is, are you guys going to miss the window of these build-outs given the timing of expanding your international opportunities? And if not, can you explain why?

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Carl Russo - Calix Inc. - President and CEO

Sure, be happy to explain why. Certainly, Nikos, one of the things that goes on if you look at our portfolio, you look at our innovation you very quickly come to the conclusion that from a fiber access standpoint both technologically and footprint wise we are a leader in the industry.

So if you're going to go expand new markets and fiber is hot, so to speak, gee, let's go. We agree. And you might imagine that Andy certainly has his eye focused on that as an application.

Having said that, when you say missed, I want to be clear. If we were the fiber provider, the answer is yes, because once the fiber is built, the fiber is there. But from an optical electronics stimulus, from the access standpoint, sort of but not really because the technology continues to development, the speeds keep going up, we believe we have material benefits and differentiable so to sell.

So, some. You're going to miss a little bit, but it's not like you've missed the design win per se. If you were selling the fiber, the answer is yes. Does that make sense?

Nikos Theodosopoulos - UBS - Analyst

It makes sense, but it's I guess in terms of go to market, in terms of customer awareness as they make those decisions, do you have enough people doing -- out in the streets to get Calix recognized for those opportunities?

Carl Russo - Calix Inc. - President and CEO

It depends on which opportunities and what segments, et cetera. As you might imagine we are going to take a pretty disciplined and delivered approach to it, and we'll continue to grow the business underneath it. There are some things that are simply outside of your reach, and the worst thing you can do is go chase them. Right?

Because you were never able to win them in the first place, and by chasing them you ended up missing some things that you could have won. So, there are going to be some things that we will simply a priori say no, we are not going to go chase that. But there is lots of market opportunity and we are very early into the fiber build-out world wide.

Nikos Theodosopoulos - UBS - Analyst

Okay.

Carl Russo - Calix Inc. - President and CEO

To your point, are there going to be some deals that we will miss? Absolutely, but take Fios as an example. We were a no show on that way back when because obviously we couldn't reach it, but as we continue to grow we now are the market share leader in North America. So, plenty of opportunity to go do this. I just want to make sure we don't try and chase things in the wrong order.

Nikos Theodosopoulos - UBS - Analyst

Okay. Thanks.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Operator

Your next question is coming from the line of Mark McKechnie from ThinkEquity. Please, proceed.

Mark McKechnie - *ThinkEquity - Analyst*

Great, thanks. Carl, on Frontier and these Verizon lines, can you give us an update one way or the other as to what kind of progress you are making, and how you feel your position for winning the business that they decide to upgrade there?

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

It's consistent with last quarter, Mark. And just to reiterate, in the properties that are on the Verizon OSS systems, which is -- the acronym is [BASE], we are not in that system. And so in order for us to go address the different states, we follow their sweeping of moving from those OSSs to the Frontier OSSs.

They have a set of conversions that they are doing over time. I won't speak for them. They have spoken to that in the public domain. And as those occur we follow that wheel around, if you will, and begin to address those territories. So in light of that, it's actually continuing right on plan that it has been, so there's been no change.

Mark McKechnie - *ThinkEquity - Analyst*

Great. No, that helps. And then, Michael, a couple of housekeepers here. On your guidance when you gave it back -- the detailed of quarterly guidance you gave an OpEx number for Q3 it was down sequential from where you were for Q2. Do you still expect OpEx down sequential here in the September quarter?

Michael Ashby - *Calix Inc. - Executive VP and Chief Financial Officer*

In the guidance I just gave today I actually just assumed a small increase in OpEx in Q3 over Q2.

Mark McKechnie - *ThinkEquity - Analyst*

Okay. Got you. Great. And then, how about -- again, housekeeping on the tax rate -- what do you see rest of the year, next year and then a long term tax rate?

Michael Ashby - *Calix Inc. - Executive VP and Chief Financial Officer*

Well, the good news is we have \$523 million of NOLs and they don't begin expiring until 2018. So, I am not anticipating paying too much in taxes for the next few years. And we pay obviously state taxes and sales and use taxes, but we're not going to have much more than that. So, our tax revisions are minimal and for planning purposes we just use 1%.

Mark McKechnie - *ThinkEquity - Analyst*

I wish I could say the same about my taxes. Thanks, Michael.

Michael Ashby - *Calix Inc. - Executive VP and Chief Financial Officer*

Me too.

Jul. 21. 2011 / 8:30PM, CALX - Q2 2011 Calix Inc Earnings Conference Call

Operator

At this time, I'm showing we have no time for any further questions. I would like to turn the call back to Mr. Carl Russo for any closing remarks.

Carl Russo - Calix Inc. - President and CEO

Great. If there are no further questions, we will go ahead and wrap up the call. Thank you for joining us today, and we look forward to speaking with you again after the close of our third fiscal quarter.

Operator

Ladies and gentlemen, that concludes today's conference. We thank you for your participation. You may now disconnect. Have a great day.

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