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CALX - Q1 2015 Calix Inc Earnings Call

EVENT DATE/TIME: APRIL 28, 2015 / 8:30PM GMT



CORPORATE PARTICIPANTS

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

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

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

CONFERENCE CALL PARTICIPANTS

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

Christian Schwab *Craig-Hallum Capital Group - Analyst*

George Notter *Jefferies LLC - Analyst*

Doug Clark *Goldman Sachs - Analyst*

Amitabh Passi *UBS - Analyst*

Sanjiv Wadhvani *Stifel Nicolaus - Analyst*

Tim Quillin *Stephens Inc. - Analyst*

PRESENTATION

Operator

Greetings and welcome to the Calix first-quarter 2014 (sic - 2015) earnings conference call. At this time all participants are in a listen-only mode. (Operator Instructions)

I would now like to turn the conference over to your host, Mr. David Allen, Director of Investor Relations and Treasurer. Please go ahead, sir.

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 for the Company; and expectations for revenue, gross margin, operating expenses, litigation 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 most recent annual report on Form 10-K and our quarterly report on Form 10-Q, to be filed shortly after this call and 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 our 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'd now like to turn the call over to Calix President and CEO, Carl Russo. Carl?

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

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 going to say a few words about how the first quarter progressed before handing the call over to William, who will take you through the numbers. I will then spend some time giving you our views on how we see the broadband access space developing in the near and longer-term and on how we are positioning Calix to take advantage of those trends.

Q1 is typically a seasonally slower quarter, and this year has been no exception. Budgets at our largest customers have been late in rolling out; however, driven by strength across our Tier 2 and Tier 3 customers, we delivered revenues for the quarter of \$91 million -- in line with our guidance -- and a 6% year-over-year growth relative to last year's Q1.

Furthermore, we saw continued value being realized by our customers for our Unified Access solutions, reflected in our gross margins of 49.2%, up 330 basis points year over year. On the new product front, and in just its second quarter of the availability, our new GigaCenter solution continues to show strong gain, signing orders from over 200 service providers since introduction.

I will revisit this and other developments after William takes you through the quarter in more detail. William?

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

Thank you, Carl. We last provided you with guidance regarding Q1 on February 3. And in that guidance we estimated revenues of between \$89 million and \$93 million, a gross margin of between 47.5% and 48.5%, and operating expense in a range of \$46.5 million to \$47.5 million, thus resulting in an EPS of between negative \$0.09 and negative \$0.04 per share. Actual revenue for the quarter was \$91 million, and EPS was a negative \$0.07 per share, with revenues at the midpoint of our guidance and earnings per share also at the middle of guidance.

Without the expenses incurred in relation to our Occam litigation, EPS would have been negative \$0.03, \$0.01 better than the top end of our guidance. While there may be quarterly fluctuations in this trend, we continue to expect gross margin to grow over time. And we were pleased with Q1's 49.2% level, above our 47.5% to 48.5% guidance range. Product and customer mix contributed to this outperformance, and Q1 2015 gross margin was also up significantly from Q1 2014's 45.9% level.

Operating expenses came in at \$48.1 million, above our \$46.5 million to \$47.5 million guidance range and up \$7.4 million from the same quarter a year ago, with this year-over-year increase primarily due to additions in headcount, compensation adjustments, and expenses associated with our Occam litigation. It is worth highlighting that we recorded a total of \$1.7 million of Occam litigation-related expenses in the quarter, and that operating expenses would have been \$46.4 million -- below the bottom end of guidance -- had we not incurred these costs.

As expected, Q1 was not cash generative, with a \$13.9 million decrease in the aggregate balance of cash and marketable securities. We ended Q1 with a total of \$97.8 million, down from Q4's \$111.7 million figure.

On a year-over-year comparison, the \$97.8 million level for Q1 2015 was up \$22.6 million from Q1 2014's \$75.2 million equivalent. We expect to return to being cash flow positive in Q2 and for the rest of the year.



Let me give you some more detail on revenues. Revenue for the quarter was \$91 million, an increase of \$5.2 million or 6% from last year's first-quarter level of \$85.8 million. International revenue was \$10.1 million in Q1, down from \$10.6 million in Q1 2014. And we had one 10% or greater customer again this quarter.

Turning now to some of the other items on our balance sheet: receivables DSOs were a very healthy 37 days compared to 34 days in the previous quarter and 43 days in Q1 2014, reflecting both a more even distribution of revenues within the quarter relative to last year and strong collections performance. Inventory levels decreased to \$40.6 million in Q1 2015 from Q4's \$46.8 million level and were down from \$45.1 million in Q1 2014. Inventory turns decreased to 3.6 times in Q1 from 4.8 times in Q4, but increased slightly from Q1 2014's 3.4 times.

The deferred revenue balance was \$28.5 million, down from \$32.1 million in the prior quarter and down from \$47.5 million in Q1 of 2014. We closed out deferred revenue in line with our expectations, and we now have very little remaining from broadband stimulus projects.

Earlier in this call I broke out that \$1.7 million Occam litigation-related expenses for 2015 in order to give you a perspective on what our expenses would have been without that litigation. It's worth pausing here and describing both where we are in this process and the current level of our non-GAAP Occam litigation-related expenses.

The litigation is more fully described in our various SEC filings, but essentially it consists of a group of former Occam shareholders seeking damages related to the purported failure of Occam's directors and management to obtain the best purchase price for Occam when we purchased the Company in 2011. The litigation is taking place in Delaware, and the last hearing before the Delaware judge was in March of this year.

No trial date has yet been set. And although we can't predict the outcome with certainty, we remain confident that this litigation is without merit. The litigation expenses that have been occurred in the Occam situation include, amongst other things, legal fees and expert witness fees incurred by Occam and Calix and by parties indemnified by Occam, including by an outside advisor previously retained by Occam. The majority of Occam litigation-related expenses have been reimbursed to us by Occam's insurers, but we note that Occam's insurance carriers have advised us that there are certain expenses that they believe they should not cover, including Occam's indemnification obligations to that outside advisor. Nonreimbursable items comprise the bulk of the Occam litigation-related expenses that we have recognized on our books.

On a non-GAAP basis in 2014, we recognized a total of \$0.5 million of Occam litigation-related expenses for the full year. Total Occam litigation-related expenses recognized in Q4 of 2014 were \$0.2 million, with no expenses being recognized in Q1 of 2014.

In Q1 2015, and as noted earlier, we recognized another \$1.7 million of Occam litigation-related expenses. Taking into account the expenses that we expect to continue to incur in this litigation, we expect that unreimbursed Occam litigation-related expenses will continue and that they will exceed the remaining balance of Occam's insurance before the end of 2015. As the Occam legal process unfolds, and subject to the constraints of that process, we intend to continue to highlight our Occam litigation-related expenses to allow you to gain a better understanding of the movements in our operating expenses.

Turning to guidance: in terms of guidance for the second quarter of 2015, as Carl mentioned, budgets got off to a slow start in our largest customers. And while we are seeing orders beginning to pick up, we expect revenues to be in line to slightly down from last year's Q2 levels, reflecting a year that is going slowly in the first half relative to last year's first half. Taken together with our Q1 results, our guidance implies 2% overall revenue growth for the first half of 2015 relative to the first half of 2014.

Our guidance for Q2 is as follows -- revenues for the first quarter are expected to be in a range of between \$94 million and \$98 million, with a midpoint of \$96 million, which is down 2% from the \$98 million level recorded for Q2 of 2014. Gross margins are expected to be broadly in the same range as they were in Q1. We are guiding to a 48% to 49% range for Q2, up from last year's Q2 level of 47.7%.

Operating expenses are expected to be in the range of between \$48 million to \$49 million, up from last year's Q2 level of \$41.6 million. Occam litigation-related expenses that will not be reimbursed by its insurers are expected to be approximately \$0.7 million. The expectations that I have just finished taking you through result in a guidance range for Q2 earnings per share of negative \$0.06 to negative \$0.02, or negative \$0.05 to negative \$0.01 after taking possible Occam litigation expenses into account.

Please note that litigation expenses are inherently unpredictable, and I am providing you with this guidance in order to help you with your assessment of Calix. But I must emphasize that these numbers can change.

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

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

Thank you, William. Our sole focus at Calix is to address what we see as a coming transformation in the access infrastructure. While nothing in the outside plants changes quickly, that change is now being driven by the device-enabled subscriber obtaining their content and applications from the cloud.

As we have said over the years, we see this is becoming one Unified Access network. In the last two years we have begun to make deliberate investments in new solutions meant to address this opportunity and expand our addressable market.

The GigaCenter is a direct result of this investment approach. And based upon the number of customers who have ordered this product, it is the fastest-growing product launch in our history. The GigaCenter, coupled with our Compass software application, enables our service provider customers to deliver a superior subscriber experience at dramatically lower cost.

We believe the unlicensed wireless spectrum will redefine the subscriber edge of the active infrastructure. And we are investing to lead this convergence.

We have a history of bringing innovative solutions based on interoperable standards to our customers. Our unrivaled E-Series systems continue to lead that charge with industry-leading fiber and copper densities, all delivered in an easy-to-deploy, pay-as-you-grow platform.

As service providers evolve their networks to meet burgeoning subscriber demand for new services, new fiber and copper technologies are coming to the fore. This next generation of industry-standard technologies gives our customers the ability to deliver the capacity the services require. And it gives us the opportunity to again expand our addressable markets.

G.fast is one such technology. Designed to deliver speeds of up to 1 gigabit per second over short copper loops, we see this technology as an ideal solution for bringing the next generation of Internet services to subscribers residing in multi-dwelling and multitenant environments.

Next-generation PON is another such technology. With speeds up to 100 gigabits per second, these next-generation PON technologies hold out the promise of true convergence in the access infrastructure, a Calix pursuit since our inception.

These are exciting times. And as such, we are investing in both research and development, to innovate in these areas; and in our sales and marketing, to reach a larger set of customers. Over the years we have built a company that has an excellent reputation with our customers allied with continuing innovation. We have built a strong balance sheet, and it is time for us to invest in Calix to expand and serve a much start larger set of markets and customers.

We are confident in our future. As such, we announced earlier today that we are investing up to \$40 million in a program to repurchase our stock.

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

QUESTIONS AND ANSWERS

Operator

Simon Leopold, Raymond James.

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

Thank you. A couple things that I wanted to see if we could touch on. First one is: you are highlighting the GigaCenter platform. I just want to get a sense of materiality. I think you talked about a very high number of customers, but my presumption is we are still well below 10% of revenue. If you could just give us some kind of foundation to understand how to put that into perspective within the business?

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

Simon, this is Carl. So to answer your question, the GigaCenter is off to a very fast start on a number of customers. As you know, when service providers deploy technology that is new, they typically will order a few and then put them into the lab; do first office applications; and begin to think about whether or not the technology applies, and if they like it.

So the two things that we monitor are the number of new customers growing -- and we are trying to give you a feel for that. And then, obviously, the second thing we monitor is the earlier customers -- are they reordering as they like the technology?

Both are occurring at a very rapid rate. However, for that to flow all the way through to something that you would refer to as material is still yet in front of us.

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

Okay. Great. That's helpful. And then getting back to the, I guess, slow start to the budget release -- and I'm not trying to set you up for excuses, but I want to understand sort of the -- what are the drivers that are affecting your customers slower release? And what comes to my mind could be factors such as weather, the pending CAF II funding?

So I'm just looking for a little bit of the rationale as to why the release was slower. And then, to follow that up, why aren't we seeing a more rapid recovery in the second quarter in terms of catch-up spend, given the late release of budget?

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

Okay. So let me start with the first one first. The effect that we've noticed was from large to small, so it's largest, really. And I think one of the drivers actually is around the whole net neutrality, Title II, and discussions of that nature, and looking at where they have clean line of sight to invest.

CAF II could potentially be part of it as well, but we have clearly seen perturbations such that that have people's interest. So with that in mind, the second piece is -- and I think you heard William alluding to it in his comments -- we are actually starting to see orders picking back up. The question is right now what feels prudent to us to make sure that we guide and as we are guiding in Q2 -- because even though they pick up, converting into revenue in that time frame -- let's just say it's a little gnarly.

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

Okay. And I'll make one attempt at -- you had one 10% customer. Do you care to give us a little bit more color on how big that 10% customer was in the quarter?

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

(laughter) Appreciate the attempt, Simon. We had one 10% customer in the quarter. That's correct.

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

Thanks. I'll yield the floor with that.

Operator

Christian Schwab, Craig-Hallum Capital Group.

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

The increase in investment dollars that we are making to focus on some new opportunities -- is there any way to quantify the size and impact to the business? I mean, since we've gone public, we've never lost money for two quarters in a row. And depending on how big the September uptake, it could be three. So I'm just trying to think what this Company looks like a couple of years from now, as it may benefit from the increased investments we are seeing today?

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

Christian, I think if we go back and look at my comments -- the first piece is GigaCenter and that subscriber edge. The subscriber edge is being redefined. And if you think about the subscriber edge as that area of the network where service providers provide their services from to all of the devices that we are carrying and are growing at an explosive rate -- not only in count, but in bandwidth and surface richness -- it is clear that this is a significant opportunity.

How large? I mean, you are looking at the confluence of several large markets. It's a big opportunity. But I don't want to play short shrift to the other two that I spoke about.

G.fast is actually a significant opportunity on its own, as it probably represents sort of the last iteration in DSL technologies on short loops in multitenant and multi-dwelling units. It opens up a significant opportunity for us from an addressable market standpoint, as well. And the last are the converged next-generation PON standards that are being worked on and what they imply for the access infrastructure. Each of those represents a significant opportunity.

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

I appreciate that. Could you define what that word means -- significant?

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

Significant?

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

Yes. I mean, everybody means that word differently. Are we driving this business to be \$110 million a quarter, \$150 million a quarter, if we are successful in these initiatives?

I guess the question I get most asked is: what does this business model look like a year or two from now, if the investments are successful? So significant is great. But I'm wondering if you can quantify a range in which you would view the investments as a success.



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

Okay. So we don't guide more than 91 days, obviously. So let me put it into my parlance, and then I'm going to ask William to add some color.

You know, I could quip that too much is never enough, but I want to put it into this perspective: we worked long and hard to craft the Company to bring us to this point. We see big opportunities for us going forward, and we are making these investments. They are disproportionately not incremental, but we have to go execute against them.

So let me leave it at that and ask William for color.

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

Yes. I think that, Christian, as Carl noted, we don't guide; so I'm not going to give you any numbers. But what we have been careful to stress in this call and in our answers to this question is that in a way -- we haven't said this, but one way you could look at that is there is I would regard as evolutionary R&D spend, which is on, for example, technologies like G.fast; or, you can argue, the next generation of PON.

But we're also highlighting the subscriber edge as being somewhere where we definitely want to play, and where we are playing with the GigaCenter product, and where we are seeing traction. And while we have always played at the subscriber edge, we see that as being an area where there is going to be some meaningful change in the broadband access space going forward.

So that's how I would try to characterize it in terms of incremental versus the simple sort of logical continuing R&D spend that you would see. Does that help?

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

Yes, I understand. I appreciate that. Thank you.

Operator

George Notter, Jefferies.

George Notter - *Jefferies LLC - Analyst*

Gross margin -- 49% this quarter. I heard your guidance, certainly, for Q2, also elevated relative to the margins you have been printing.

Can you talk about how sustainable that margin is? Can you give us some more flavor as to what's driving that margin? Is it more software content? The products? Is it GigaCenter? Is it the higher mix of chassis -- or line cards, rather, relative to chassis? Just any more flavor there would be great.

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

It all boils down, ultimately, to product and customer mix. And I'll let William add comments to the extent that he would like.

But for me it's about the solution and the value that it drives for our customers. And I believe, as we watch our customers and how they behave, the value of our solutions is continuing to go up -- based on a Unified Access infrastructure with Compass applications that enable our customers to extract more value from their network.



Typically, when you enable a customer to do that they are more willing to share that value with you. It manifests itself as products and customer mix, but that's what's driving it. And to your sustainability question, you know our long-term goals and where we think they can go, which is over 50 points. And since our IPO you've watched us steadily march up and to the right. It's noisy from quarter to quarter, but the trend, in our view, is inexorable. William?

William Atkins - Calix, Inc. - EVP and CFO

I think Carl summarized it very well. The only comment I would make is on the underlying -- the cost of goods side. As Carl has noted, we are seeing strong customer interest in our product, which helps with one part of the gross margin calculation.

And then in terms of the underlying cost of goods element, obviously, as -- you know, we get better at manufacturing things the longer we manufacture them; but more importantly, as you move to fresher product families, you are going to have the greater ability to use components across a family of devices, perhaps more easily than you have before. And you can have a common set of hardware that can be reconfigured essentially into new product sets. So that tends to be what drives a lot of our underlying cost performance, in addition to the top-line stuff that Carl has been talking about.

George Notter - Jefferies LLC - Analyst

Got it. Okay. And then I also wanted to ask about the buyback program you are announcing here of \$40 million. I guess if I sit back and look at the balance sheet, one observation would say that the balance sheet at this point is not that liquid yet. The stock, I think, suffers to some degree from relatively thin trading volumes. Can you kind of walk through why the buyback here, why that amount, and what you hope it gets you?

William Atkins - Calix, Inc. - EVP and CFO

Sure. I'll take that, and then I'll let Carl sort of finish off. First of all, the business has got strong underlying cash generation. So we feel comfortable spending money not only on our own business in terms of the underlying R&D spend that we are talking about -- in terms of that form of investment. And we have sufficient strength in our balance sheet and sufficient cash generation to allow us to go out and also purchase our shares at a time when we see them being good value.

Carl Russo - Calix, Inc. - President, CEO, and Director

Yes. So, George, I would just add one other item. First of all, I think it's a good investment. But also, one of the uses of cash would be a significant inorganic undertaking. And as we look at the business right now -- and you can take from my comments -- we see significant opportunities for growth focusing on our organic execution. And as such, we believe we have a strong balance sheet; and there's cash that we can invest otherwise. That's what we are choosing to do.

George Notter - Jefferies LLC - Analyst

Got it. Great. Thank you.

Operator

Doug Clark, Goldman Sachs.



Doug Clark - *Goldman Sachs - Analyst*

So one quick clarification, first. Within the first quarter guidance that was initially given, was there any expectation for expenses related to the Occam litigation? So what was the delta versus original expectations?

And then my brother question is: given second-quarter guidance, do you think that growth is still achievable in 2015 overall? And then I have a follow-up as well.

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

Okay. Let's see -- taking the litigation question first, yes, we did have a much smaller amount of litigation expenses embedded in our guidance. But Doug, the reason why we called it out is the actual litigation expenses that we recognized in the quarter, which were much, much higher than what we had budgeted for the reasons that I've outlined in my remarks. So that was why we chose to call it out.

And then, of course, once you do that, you want to make sure that analysts and investors have an ability to look at your numbers with and without across a span of time, which is why I went into some detail in my comments. And then turning to the whole year, the short answer is, yes, we do continue to believe that the year is going to show strong growth relative to last year.

Doug Clark - *Goldman Sachs - Analyst*

Great. Thanks. That's helpful. And then, actually, drilling down into perhaps your largest customer -- this is a bit retrospective, but revenues from that largest customer actually came down in 2014 despite kind of overall flat CapEx for that customer and a period of investing in kind of gigabit fiber deliveries. Wondering if there is anything going on within that customer that kind of led to not seeing more growth? And then your expectations for this year associated with any potential architectural shift.

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

None that I would comment on. I believe that their strategy moving forward and our strategy moving forward are quite well aligned. And you're going to have momentary pieces -- year-end, budgets, pieces of that nature. But everything that we see is still quite aligned.

Doug Clark - *Goldman Sachs - Analyst*

Okay. Great. Thanks.

Operator

Amitabh Passi, UBS.

Amitabh Passi - *UBS - Analyst*

Carl, I guess my first question for you was on G.fast. I think it's the first time I've heard you speak about it quite optimistically. I just wanted to get a sense for -- is there some shifting dynamic in the market that's getting incrementally more excited about G.fast? Where are you seeing the best opportunities? If you could just maybe give a sense of the landscape and the lay of the land?

Carl Russo - Calix, Inc. - President, CEO, and Director

So what has us excited about G.fast is that there are very clear use cases that, as fiber moves closer and closer to the subscriber edge, there are places where G.fast is clearly the right way to try and bridge that last few-hundred-foot gap. So what first has me excited is that it has a very clear use case.

The second piece is we believe that we have the opportunity to create significant value-add for our customers in the way we go about innovating and interoperating in network environments. So it's a combination of those two items that has us quite interested in what's happening in the space. And the last, obviously, is the standard was ratified late last year. Until then, as you know, we do things only based upon interoperable standards.

Amitabh Passi - UBS - Analyst

And is most of the opportunity set international? Or are you seeing just as much interest domestically as well?

Carl Russo - Calix, Inc. - President, CEO, and Director

This is a global interest.

Amitabh Passi - UBS - Analyst

Okay. I also wanted to just clarify on the comment you made pertaining to your Tier 1 customer and being late in releasing budgets. You attributed part of that to issues surrounding net neutrality. The debate on net neutrality seems quite complex and convoluted, so I'm just wondering, what gives you the confidence that that gets resolved in the next quarter to two to really get spending sort of normalized and back up in the second half?

Carl Russo - Calix, Inc. - President, CEO, and Director

Yes. So to be clear, our largest customers were the ones that were more affected than not. And what gives us the confidence is we've seen those budgets released, and we are seeing order flow start to pick up. So frankly, what gives us confidence is we are seeing the orders. And the only issue is one of timing inside of Q2.

Amitabh Passi - UBS - Analyst

Okay. Cool. Thank you. I'll step back in the queue.

Operator

(Operator Instructions) Sanjiv Wadhvani, Stifel.

Sanjiv Wadhvani - Stifel Nicolaus - Analyst

Carl, I just had a quick follow-up on net neutrality. I think last quarter you had suggested that your service provider customers are not slowing down in response to net neutrality, but it looks like this quarter they might have had some reaction to net neutrality. So I just wanted to see what might have changed in the last sort of three months? And then I had a quick follow-up to that. Thanks.

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

So I think net neutrality -- and I'll be the first to say I may have been misperceiving some of the subtleties that were going on here. And let me give you a teaching moment that I just went through in how much the underlying currents of net neutrality matter. And I would cite not our largest customers or service providers; I would actually cite the withdrawal of Comcast's takeover of Time Warner -- which, as you know, when it was announced, there were many concerns about video and things of that nature.

But as it went through time, it really rotated into a discussion around broadband access and access to the Internet and net neutrality. So I think there have been a lot of undercurrents around this discussion that, frankly, I may not have really fully understood were going on. So I hope that answers your question.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

That's helpful. Thanks. And then a quick follow-up: do you think that this year, in terms of budgets and CapEx, is sort of unusually back-end loaded at the second half? Or sort of this is pretty much normal, where you see a little bit of a slower start first half and then pick-up in the second half? Just wanted to get your take on that. Thanks.

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

Well, my best take on it is it seems to be -- I think William could make comment on other things that you are seeing in the industry from different financial reports, etc. So there seems to be some data points that indicate that it is, and what we are seeing personally makes it that way. William, any thoughts?

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

Yes. I think as Carl noted in his remarks, our largest customers -- you saw them coming out of the gate a little bit more slowly than the rest of our customer base. And it may be -- and I'm now speculating, because nobody said this; but as I look at industry observers' comments on the space and just based on my own experience, it may well be that -- you know, you referred to net neutrality, the whole Title II debate. I think those issues become perhaps more resonant with the larger carriers than they do with the smaller guys. And that may have contributed to it. But as Carl noted, that's sort of how we are seeing it skewed a little bit in terms of how the year is panning out.

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

And let me add one other piece if I may, Sanjiv, to William's earlier comment, and to just make sure that I reemphasize it. Based upon what we are seeing, we believe we are going to have good growth this year, which means it's a second-half event.

Sanjiv Wadhvani - *Stifel Nicolaus - Analyst*

Got it. That's helpful. Thanks so much.

Operator

Tim Quillin, Stephens.



Tim Quillin - *Stephens Inc. - Analyst*

I think when we've discussed the higher operating expenses this year, you focused on product development. But I wonder if we could shift to the sales and marketing spend and maybe the longer-term trends that we've seen.

So if you dial back a few years to 2010, I think sales and marketing expense was something like 13% of revenue. You are touching 20% of revenue with sales and marketing expenditures now. Can you kind of break the expense structure down there? Why is it necessary, and has it been necessary to grow your sales expenditures faster than revenue?

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

Well, without commenting on the numbers themselves -- and if, William, you want to comment, you can feel free -- anytime you move off of getting to a stable place -- so I want to take you back to the time period that you are talking about. We were very focused on making sure that we had a robust footprint, defensible market share. And we were very focused inside of a market segment.

Two years ago we began some very deliberate, measured investments in both R&D and in channel. And when you do that, your productivity per head immediately starts to go down, because you are investing in areas where you have, obviously, zero productivity per head, because they are brand-new areas, new customers, whatever.

We are going to continue doing that, but it is allied with technology investments as well that we think allow us to expand our total addressable market as we are expanding the addressable market that we serve. We have a reasonable single-digit share of the global market. By the way, for a long time we only addressed a single-digit share of the global market.

And so for us to start to grow at the rate that we would like, we believe that these investments are correct and prudent. William, anything you want to add?

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

Yes. This is possibly an overly detailed comment, because as we look at sort of the sequential quarterly performance of sales and marketing expense as a percentage of revenues, there is a little bit of a spillover of some commissions-based compensation into Q1 of this year. It was based upon year-end accelerators being achieved, but payouts not being made, because some of those payouts were made on shipments that actually occurred in Q1.

So there was a little bit of a spillover into Q1, which nudged the sales and marketing expense up a little bit higher than you might otherwise think. That's a relatively minor point. But if you are crunching your numbers, it's worth highlighting that.

Tim Quillin - *Stephens Inc. - Analyst*

Would you be able to break down the sales expenditures internationally, or maybe address the sales productivity internationally versus domestically -- what the trends look like there? Obviously, we are not seeing the growth yet on the international side. I think we have discussed the point where maybe you don't have infinite patience with international sales efforts. But how should we think about that?

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

Okay. First of all, we don't break down the specific cost elements of our international efforts. Obviously, we do give you the revenue number. But in terms of productivity, as Carl noted -- as you would expect, given the fact that we are investing, and putting salespeople out there, and establishing channel relationships, we are going to have lower productivity per head, per a salesman who is located in the rest of the world versus a salesman who is located in North America.



So inherently, taking a snapshot, it must be the case that our sales force is less productive than -- our rest-of-world sales force is less productive than our North American sales force. That would be natural. That's what you would expect for us at this stage of our investment in that activity.

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

Well, 10 years ago our North American sales force was considerably less productive than it is today, because we built the regions the same way.

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

Yes.

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

So it's simply a forward-looking investment that we now have to go execute against. And it will move quarter on quarter, but we believe that the trend long-term is relentlessly up and to the right.

Tim Quillin - *Stephens Inc. - Analyst*

And I guess maybe the smarter question is what do you -- it's this notion of infinite patience. What do you do to improve productivity if sales don't develop? And so far sales have not developed.

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

So, obviously, as we have discussed, we did a little bit of refocusing our international efforts as we grappled with the Ericsson installed base -- Ericsson as a channel partner as opposed to the channel partner. And we've continued to invest in the channel, etc.

Literally last week was -- we just had our international partner summit -- largest summit yet. So the forward-looking indicators are actually very encouraging. Obviously, you are hearing a ton of optimism on our part. But it takes a while for those things to flow through.

Tim Quillin - *Stephens Inc. - Analyst*

Okay. And then just last question for William: so the cash flow was meaningfully negative in the first quarter. You said that cash flows would be positive for 2Q through 4Q. Do you expect the full year to be a positive cash flow generative year?

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

Yes, we do.

Tim Quillin - *Stephens Inc. - Analyst*

Okay. Thank you.

Operator

Ladies and gentlemen, there are no further questions at this time. I'll turn it back to David Allen for closing remarks. Thank you.



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

Thank you, operator. Calix will be participating in three investment conferences in the second quarter: the Jefferies TMT Conference on May 13 in Miami, Florida; the annual Craig-Hallum Institutional Investor Conference on May 27 in Minneapolis, Minnesota; and the Stephens 2015 Spring Investment Conference on June 2 in New York. Information about these future investor events will be posted on the events page in the Investor Relations section 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. Once again, thank you for joining us today, and goodbye for now.

Operator

This concludes today's conference. All parties may disconnect. Have a good day.

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