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CALX - Q4 2012 Calix, Inc. Earnings Conference Call

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PRESENTATION

Operator

Greetings, and welcome to the Calix fourth quarter and fiscal year 2012 financial results conference call. At this time, all the participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation.

(Operator Instructions)

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

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

Thank you operator, and good afternoon everyone. Before we begin the call, I want to remind you that this conference call contains forward-looking statements regarding future events, including but not limited to, our acquisition of fiber access assets from Ericsson and the global reseller agreement between the two companies, our development of new products that will continue to help our customers transform their networks, the ongoing expansion of our total addressable market, the future business and financial performance of the Company, and our expectations of revenue, gross margins, earnings per share, stock-based compensation, and amortization of intangibles.

These forward-looking statements are based on our expectations, estimates and judgments and current trends and market conditions, and involve risks and uncertainties that may cause actual results to differ materially from those contained in the forward-looking statements. I encourage you to review the Company's various SEC reports, including our annual report on Form 10-K for the fiscal year ended December 31, 2011, and our quarterly reports on Form 10-Q for the quarters ending March 31, 2012, June 30, 2012, and the September 29, 2012, 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 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 our evaluating our financial performance, including stock-based compensation expense, acquisition-related expenses, and amortization of acquisition-relation intangible assets.

To help you better understand those results, we have included a reconciliation of our GAAP and non-GAAP results in our earnings press release. All numbers that are discussed in today's conference call are non-GAAP, unless otherwise noted.

This conference call will be made available for audio replay in the investor relations section of the Calix website at www.Calix.com. In addition, our earnings press release has been posted on our website, along with supplemental financial data, on the Calix investor relations website, which you may want to review in conjunction with our press release and conference call remarks.

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

Carl Russo - *Calix Inc - President and CEO*

Thank you Dave, and good afternoon, everyone. Joining me on the call today is Michael Ashby, our Executive Vice President and Chief Financial Officer. Before I turn the call over to Michael, I would like to give a brief review.

As you are aware, 2012 was a challenging year for our industry. The macroeconomic concerns impacted capital projects in the Tier 1 service providers, and at some of the Tier 2 service providers. Furthermore, Tier 3 US service providers were concerned over the USF/ICC reform, and the implementation of the Connect America Fund. All of this led to uncertainty and overall weakness in the industry. That being said, I am proud of the team here at Calix, as we finish the year with two solid quarters. After Michael discusses our results in more detail, I will come back to provide some comments on the year ahead. Michael?

Michael Ashby - *Calix Inc - EPV & CFO*

Thank you, Carl, and good afternoon, everyone. If you've not already done so, I would encourage you to go to the investor portion of our website and download the financial slides we posted concurrent with our press release earlier today. My prepared remarks will provide an overview of our financials and their related business trends. I will close by providing guidance for the first quarter of 2013.

As a reminder, the guidance we provided in October for the fourth quarter called for revenue of $87 million, gross margin of around 44%, operating expenses in the $36 million range, and EPS of $0.05 a share. In November, we held a conference call following the closing of our acquisition of certain assets from Ericsson, and we updated guidance for the fourth quarter.

The revenue guidance was increased to $91 million, gross margin guidance was lowered to around 43%, because of lower-margin revenue expected through the Ericsson channel, and operating expenses to increase by $2 million to around $38 million, reflecting adding 50 employees and a new facility in San Jose for just under two months. The resulting EPS guidance was adjusted to $0.02 per share.

Actual revenue for the quarter was $91.4 million. Gross margin was 43.2%. Operating expenses came in at $36.7 million, and EPS was $0.06 per fully diluted share. As anticipated, we generated cash during the quarter, excluding the purchase of the Ericsson assets, and ended the quarter with $47 million of cash on hand. As a reminder, the Ericsson asset purchase was a $12 million cash payment.

We attended several investor conferences and meetings during the fourth quarter, and talked about the fact that we believe we are well-positioned in our Tier 1 and 2 customers, and that the Tier 3 accounts were slowly beginning to invest again after the precipitous drop in the second quarter. As you are aware, our third-quarter results did show some improvement from the second quarter. And I am pleased to report that fourth-quarter revenue was up 12% sequentially, a very solid performance.

Customer interest in our products remained high, and we had strong bookings and revenue from the Tier 1 and Tier 2 accounts, and continued recover in the Tier 3 accounts during the quarter. While we met the revenue guidance we set in November, I would like to point out that the final mix was different than that assumed in our guidance. As you may recall, we said we expected to record about $4 million of revenue from reselling the BLM 1500 back through Ericsson. That was not the case.

While we were aware, of course, that there would not be any backlog or deferred revenue to ship through that channel in the quarter, it has taken longer than we anticipated to understand the installed base and to begin to see what the demand flow might be. As a result, we shipped very little through that channel during the remainder of the quarter, and revenue was less than $1 million, well below the $4 million we had anticipated.

On a more positive note, our business was strong enough across the board to offset that shortfall. We have spent the last few months visiting with the Ericsson channel sales team, and their major customers, and now have a better understanding of the installed base and the opportunity through that channel. We are encouraged by what we have seen and learned, and fully expect the channel to be a source of growth as we go through 2013. I would like to remind you that going forward, we will not be breaking out revenue through the Ericsson channel separately.

Overall, we are pleased with the progress that we have made in the second half of 2012, and believe we have positioned the business for success in 2013. Macroeconomic concerns remain, and as we have talked about over the last couple of quarters, the regulatory changes to USF continue to be a source of concern to our Tier 3 US customers. Nevertheless, we see the situation continuing to slowly improve, and look forward to growing the business from a solid foundation.

Also, we continue to make progress in expanding our total addressable market beyond the 15% of the global access equipment market we have historically addressed. As anticipated, we received internal IT certification from CenturyLink in November on our first set of products into the former Qwest territories, and we shipped and recorded our first revenue on those products in the fourth quarter. We believe we are now well-positioned to grow our business in CenturyLink. We have also had success with the former Verizon lines acquired by Frontier, and expect to continue to grow our business in that account as well.

Our international Tier 2 and 3 business expansion remains on track, growing each quarter, albeit from a small base. Our international Tier 1 business, which is predominately through Ericsson is, as I mentioned, off to a slow start, but we are confident that we will grow throughout the year.

To summarize, revenue was up 12% from the prior quarter at $91.4 million. We also saw an increase in deferred revenue of $9.1 million. Shipments against broadband stimulus orders were once again the primary factor leading to this increase. Broadband stimulus revenue itself came in at just under 10%. We had one 10% customer in the quarter. International revenue was up from 6% last quarter to 9%, and more importantly we continue to grow our international customer footprint and funnel of new international opportunities.

Gross margin was 43.2%, down 1% from the prior quarter. We had expected a declining gross margin based on revenue through the Ericsson channel, but as I mentioned previously, that revenue was much lower than we had anticipated, so the decline was not attributed to that. Instead, a higher than anticipated mix professional revenue service revenue related to broadband stimulus projects and an increase in reserves related to a trade-in program led to this decline.

Operating expenses came in at $36.7 million, lower than our guidance, primarily due to tight control over our operating expenses. We also received a one-time benefit from the reversal of $452,000 liability carried over from the Occam acquisition that is no longer acquired. This resulted in earnings of $0.06 per share per quarter, up from $0.04 from the prior quarter, and well above our guidance of $0.02 per share.

Before I turn my attention to the balance sheet. I would like to remind you that on a non-GAAP basis we exclude certain charges that we do not consider to be part of our ongoing activities, or are meaningful in evaluating our financial performance as a Company. Normally, there are two non-cash items that we exclude, those being the amortization of intangibles and the amortization of stock-based compensation.

This quarter, as a result of the acquisition of certain assets from Ericsson, we have two additional items that were excluded from our non-GAAP EPS of $0.06, namely acquisition-related expenses and a gain on bargain purchase. The acquisition-related expenses are comprised of a one-time item related to the acquisition and amount to $1.4 million in the quarter. The vast majority of this is a one-time retention payment made to the Ericsson employees who transferred to Calix as a result of the transaction.

We also realized a one-time gain of $1 million, resulting from the acquired Ericsson assets that were valued in excess of the purchase price. We do not expect there to be any more acquisition-related expenses going forward.

Turning to the balance sheet, we continue to manage our working capital and generated an additional $1.6 million of cash before the payment to Ericsson of $12 million. We ended the quarter with total cash of $47 million. DSO was 51 days, down from 58 the prior quarter, and within our expected range of between 50 to 55 days. Inventory levels increased this quarter, primarily because of the acquisition of certain assets from Ericsson, the largest component of which was inventory.

Inventory turns improved to 5.3 from 4.7 the previous quarter.

Deferred revenue amounted to $55.1 million, up $9.1 million from the prior quarter, driven primarily by broadband stimulus shipments.

Let me now move to our guidance for the first quarter of 2013. We remain cautious about the macroeconomic environment and the regulatory uncertainty associated with USF reform, which we expect will continue to impact a portion of our Tier 3 accounts for the next couple of quarters.

Typically, we would expect normal seasonality for the first quarter to result in a decline of around 20% from the fourth quarter. However, external factors have had a strong influence since the second quarter of 2012, and we do not believe that we are operating in a normal seasonal environment. In addition, we expect to benefit from a full quarter of sales from the Ericsson sales channel, compared to only part of the quarter in Q4.

Accordingly, we anticipate revenue to decline only slightly in the first quarter to approximately $90 million, instead of the large drop in Q1 typically expected. We expect gross margin to increase to just over 44%, driven by changes in product mix.

Operating expenses will increase by around $3 million to approximately $39.5 million. The increase in expected operating expenses reflects the expenses associated with additional employees acquired from Ericsson for the entire quarter, as well as funding for the 2013 employee bonus plan, our nominal increases, and adding back the one-time accrual reversal that reduced Q4 operating expenses that I mentioned earlier.

As a result of the slight sequential decrease in revenue and the increase in operating expenses, we expect to break even in the first quarter. DSOs should remain in our targeted range between 50 to 55 days. Inventories will come down slightly, and once again, we plan on being cash flow positive for the quarter. With that, I will turn the call back over to Carl.

Carl Russo - *Calix Inc - President and CEO*

Thank you, Michael. 2013 looks to be a better year for the industry, and we are better positioned than we have ever been. Our existing customer relationships are strong. Our competitive position continues to strengthen, and we have several market expansion opportunities now within our reach. While our opportunities through the Ericsson channel have started off more slowly than we expected, I am confident that it will build over time, and the partnership gives us the opportunity to greatly expand our international reach.

As evidence of our improving position, our 2012 user group set another attendance record, as has each and every user group before it.

Our unified access architecture inserts easily into our customers' existing infrastructure today, while positioning customers to provide ever more compelling service offerings into the future. The execution of our strategy continues to improve and accelerate, and thus I am excited for our prospects as we step into this new year.

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

QUESTIONS AND ANSWERS

Operator

Thank you. We will now conduct a question-and-answer session.

(Operator Instructions)

To allow everyone time during the Q&A session, please limit yourself to one question and one follow-up. One moment, please, while we poll for questions. Thank you. Our first question comes from the line of Simon Leopold with Raymond James Financial.

Simon Leopold - *Raymond James & Associates - Analyst*

Great. Thank you. I wanted a quick clarification on the OpEx guidance. I think the $39.5 million, just want to verify that that was a pro forma number and not a GAAP number?

Michael Ashby - *Calix Inc - EPV & CFO*

Yes, Simon, that is correct. That's the pro forma number.

Simon Leopold - *Raymond James & Associates - Analyst*

Great, Then I noticed in the slide deck you talked about the long-term growth rate being double digits, which certainly a respectable number. But previously you had talked about 20%. While I am aware that that's also double digits, I just want to get an understanding of how you are thinking about the longer-term trends here, and then I have a follow-up after that.

Carl Russo - *Calix Inc - President and CEO*

Yes. Simon, we have often discussed numbers around 20% to use for planning the Business, et cetera. At the end of the day, the way I would look at it is we are now placing ourselves in front of market opportunities with product market fit and exposing ourselves via channels and others to the global marketplace that will afford us the opportunity to grow greater than double digits.

We don't know where that is. We just think it's going to be greater than double digits. If you look at, for example year-over-year, if we meet or exceed our guidance for Q1, then we will probably be in the 15% range, and we will continue from there. I don't know that I can shape it any better than that. I don't know if Michael wants to add any color.

Michael Ashby - *Calix Inc - EPV & CFO*

No, I agree. That's fine, Carl.

Simon Leopold - *Raymond James & Associates - Analyst*

Okay. Then just a quick follow-up. In the past, you've talked quite a bit about the OSMINE process and what it took to succeed in ramping that performance coming into the Qwest footprint of CenturyLink. I'm just wondering if you could talk to what the delta would be for you in order to be prepared to basically win business at a carrier like AT&T, given that you have done some OSMINE work, but maybe not what is necessary for them?

Carl Russo - *Calix Inc - President and CEO*

I want to make sure I understand your question. Are you asking me a financial question, as in what it would take for us to do it from an OpEx R&D standpoint?

Simon Leopold - *Raymond James & Associates - Analyst*

Both financial, as well as what the deltas might be. In other words, the answer may be as simple as, we are completely ready to be deployed at AT&T, to no, we need to do the following activities that could raise our operating expenses by several million dollars.

Carl Russo - *Calix Inc - President and CEO*

I think those two answers are good range, Simon. All kidding aside, let me see if I can address it directly. Prior to the Ericsson transaction, the answer would've been more of the latter, i.e., we are not ready. We are going to have to exert a lot time and additional dollars. Part of what the Ericsson transaction brings to us is, in essence, the systemization into the back office systems of a large number of service providers around the world. That gateway allows us to go bring our equipment into that gateway in a much faster fashion than we would if we had gone through the entire selling process to begin with to get approved.

And then you have to go through the entire operationalization process, as you watched us go through to a good deal of time and effort at CenturyLink/Qwest, when CenturyLink was a customer and Qwest was about to become one. It has now been accelerated through that transaction, and in some cases we will be quickly ready. I would not say immediately ready, but in some other circumstances where there is no relevant footprint or experience, then you will likely in a larger carrier go through the entire cycle.

Simon Leopold - *Raymond James & Associates - Analyst*

Great. That is helpful. Thank you.

Operator

Our next question comes from the line of Simona Jankowski with Goldman Sachs.

Simona Jankowski - *Goldman Sachs - Analyst*

Thanks so much. I actually just had a couple of follow-ups to Simon's questions. Just first specifically to 2013. I think you had indicated at some of the conferences that you might be returning to a 20% growth rate for this year. Is that something that you don't feel like you have visibility into. And then regardless if it is 20% or double digits, what would you say would be the three biggest drivers of top line growth for you this year?

Carl Russo - *Calix Inc - President and CEO*

I will answer the first one the way I think I sort of just did with Simon. Again, look. I think we can grow in double digits, and we have such big changes in our ability to reach the market now with a global product platform, a global partnership, our own on the street sales folks around the world. I don't know what that number is but we are, I think, both comfortable, Michael and I, of saying it's double digits. And again, if you look at Q1 year-over-year, it is some 14% to 15% up, and we will see how we can do from there. As far as the big drivers, well, there's a number, and it's a great question. If you come down inside at 2013. So I think your question's a bracket, just the next year.

Simona Jankowski - *Goldman Sachs - Analyst*

Yes.

Carl Russo - *Calix Inc - President and CEO*

Those drivers are going to be more what is in front of us and expansion through the channel partnership with Ericsson. So, specifically growing our Business inside of some Tier 1s and Tier 2s in the United States and North America, number one. Number two, expanding our channel presence through the global partnership with Ericsson. And number three, obviously newer products that we bring out over the course of the next year. Those would be the three drivers. Michael, any color you would like to add?

Michael Ashby - *Calix Inc - EPV & CFO*

I would like to, I think, say what I said at the last conference. The three -- there are really four things that form a great opportunity ahead of us that we can take advantage of. One is, obviously, the CenturyLink and the Qwest where we now have products approved going into that, which is a great opportunity for us. Second is the Frontier Verizon States, and third, the Tier 3 regional accounts that have been depressed and they expect to slowly come back. So they represent growth in 2013. The fourth, as Carl mention, is the resale channel through Ericksson. So I think we have four identified opportunities that we're going to be monitoring during the year.

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. That is clear. Then as far as the potential opportunity at AT&T, is that something that you are considering in your plan? Is that something that you have a shot at at the moment, or is that just kind of more upside, above and beyond what you are currently planning for?

Carl Russo - *Calix Inc - President and CEO*

As we said in the past, we are calling directly on all Tier 1 service providers in North America, and have been now for more than a year. We are addressing individual opportunities inside of them. I would not speak to any individual opportunity at any of those accounts currently. Michael?

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. I had two more quick ones. One is, did you say what offset the $3 million or so shortfall from the Ericsson channel in the fourth quarter, as far as delivering inline revenues despite that?

Carl Russo - *Calix Inc - President and CEO*

Did we speak to the particulars of it?

Simona Jankowski - *Goldman Sachs - Analyst*

Yes. What was better than expected?

Michael Ashby - *Calix Inc - EPV & CFO*

I'm not sure I understand the question, Simona. I'm sorry.

Simona Jankowski - *Goldman Sachs - Analyst*

Sorry. I thought in the fourth quarter you said that because the Ericsson channel came in closer to $1 million and you thought you would have been in $4 million, but even with that you came pretty much inline. So it implies that something else did about $3 million better than you expected, and I was just wondering if you could expand on what that was?

Michael Ashby - *Calix Inc - EPV & CFO*

Yes, absolutely. That was actually across the board. I think we had growth in each area of our business from the -- from the Tier 1 accounts, Tier 2s, the regional Tier 3 accounts coming back, international across the board. So I think we saw strength not in any one area, but across all areas of the Business.

Simona Jankowski - *Goldman Sachs - Analyst*

Okay. Thanks very much.

Operator

Our next question comes from the line of George Notter with Jefferies.

George Notter - *Jefferies & Company - Analyst*

I guess I wanted to ask about the disconnect on the Ericsson business. I think you guys were talking about a $12 million to $15 million quarterly run rate looking out into 2013, and certainly based on what you've said today, it feels like it will be somewhat below that. I mean, can you talk about how you were surprised by the whole analysis around how much revenue Ericsson can generate this year? What was the disconnect there? Thanks.

Carl Russo - *Calix Inc - President and CEO*

George, the disconnect is, and let's be blunt. Shame on us. The disconnect is, I was looking at their internal forecast and run rates, if you will, adjusting them, the play for conservativism, but not really understanding just how large an organization Ericsson is, and to take their sales organizations, their specific regions through this change throughout, and make the calls, get through the customers, get to the funnel, all of the steps. It is simply taking longer than we had anticipated. While ultimately I believe the relationship actually as we dig more into can be everything we think and more, the ramp of it is going to be different than we had thought.

That being said, as you know, what we have acquired is a forward-looking footprint that is growing. I'm not sitting here worrying about any vestigial revenues that are holding us down. It's just a matter of getting access to that footprint, growing it in, and bringing our additional products through the channel. So, the ramp is different, but not the ultimate affect.

George Notter - *Jefferies & Company - Analyst*

Got it. Then how do I think it about sort of the steps involved towards operationalizing that channel and getting product flowing through there? I mean, can you walk us through, or give us a sense for what is involved? Is it a training issue, is it more about operationalizing the E-Series products so they can fit underneath the management umbrella for the Ericsson product? I mean, walk us through what is required and how long that takes.

Carl Russo - *Calix Inc - President and CEO*

I'm going to bucketize those into three categories, the short-, the mid-, and the long-term. Let me start by the long-term. As you know, and we've spoken about this. The long-term for us is driven by the excitement of being aligned with the leader in the wireless space. We believe very much in wireless/wireline integration in the future, and having that partnership, we believe, brings tremendous strategic value to us over the course of time as we develop new products, et cetera. In the midterm, it's bring our products through the channel into the global market space, and the reason I say midterm is there's always things like OSS integration and making sure everything works together, and that just takes some time.

For example, while we made material steps with the Occam acquisition in the first quarter, it went over the course of two years. It was about eight quarters before we were fully integrated on everything. Across that time period, things ramped up, just as we expect to happen here, but that would be the midterm goal. In the short-term, in the next few quarters, it's about working with the channel, making sure that we have systems integrated, training done, marketing programs tied into our demand flow, funnel process, et cetera. Does that sort of frame it for you?

George Notter - *Jefferies & Company - Analyst*

Yes. That is very helpful. Thank you very much. Okay. Then just stepping back. I also wanted to ask about some of the guidance that in the presentation. I think you guys were talking about high teens, or even low double digit, I'm not sure if I read that right, low double digits to high teens operating margins longer term. Is that the right level, and can you walk through some of the pieces that kind of get you there? Is it mostly volume driven, is there a software aspect to this? Any sense for that would be great. Thanks.

Carl Russo - *Calix Inc - President and CEO*

Well, from my perspective, it's about growth and making sure that we keep a disciplined control on our operating expense, but I will let Michael elaborate.

Michael Ashby - *Calix Inc - EPV & CFO*

Yes. The elements of that, George, are, as Carl said, obviously, the top line. We expect be able to continue to improve gross margins each year. Our longer term goal, which is three to five years, is to five in front of the gross margins, and we see that happening as we grow margin each quarter and each year, and it's primarily through mix of product. Not so much through volume, a little bit of volume, but it's basically product mix that's helping us there.

At the same time, we are holding operating expenses down to a much lower growth rate. We haven't done that in the last two years, and I think I have really explained in the last quarter, that's our objective for the next two years, is to hold operating expenses relatively flat. There will be small increases in dollars and small increases in headcount, so we grow that at a much lower rate. We expect operating expenses as a percent of revenue for the next three to five years will enable us to get into the low 30%, and that will enable us to get operating income into the high teens.

Carl Russo - *Calix Inc - President and CEO*

Got it. Great, thank very much.

Operator

Thank you. Our next question comes from the line of Amitabh Passi with UBS.

Amitabh Passi - *UBS - Analyst*

Thank you. Just a clarification. In your first quarter guidance, is the 15% growth largely organic, or are we expecting a better than expected performance from the Ericsson business in the first quarter?

Carl Russo - *Calix Inc - President and CEO*

From my perspective again, you're going to see a lot of organic growth and some additional Ericsson growth. I don't know that I would parse it out in any one fraction. Amitabh. I guess the way I would guide you is over the long term, since we are not going to be speaking about quote, unquote Ericsson or the channel or other pieces. We do, however, respond to questions around our Domestic and International business.

As you might imagine, the largest percentage of what will become the Ericsson channel business will show up in international, and while on any one quarter I would caution you, because remember the Caribbean and other places where we have done business are in International. Over the long term, you should expect to see that percentage grow. Michael, is that fair?

Michael Ashby - *Calix Inc - EPV & CFO*

Yes, it is. I think it's is as Carl said, I think it's growth across all aspects of the business.

Amitabh Passi - *UBS - Analyst*

I just wanted to clarify, Michael, a point you made about OpEx growth versus revenue growth. It looks like for the first quarter you're guiding OpEx growth about 14%, revenue growth 15%. Should we expect to see more leverage, then, in the back half of the year as we trend through the year, particularly in the OpEx, Mike?

Michael Ashby - *Calix Inc - EPV & CFO*

Yes, very definitely. (Technical difficulties) OpEx, and then within a small range, small increases each quarter, but relatively small as we grow the revenue. We expect revenue to grow each quarter and OpEx to grow very slightly, and we'll see much better leverage each quarter as we go through the year.

Amitabh Passi - *UBS - Analyst*

Just a final one from me. Can you give us any help, how we should think about the ramp at CenturyLink, and what exactly is the opportunity for you at AT&T? I know you don't want to talk specific customers, but I feel there is a lot of confusion out there with respect to whether or not the spend will occur at AT&T, and would like to get your thoughts in terms of what the potential opportunity is there.

Carl Russo - *Calix Inc - President and CEO*

Let me address the last one first. I would direct all questions, and please don't take this as an affront, but vis-a-vis AT&T, I think the questions are best addressed to them. We are calling on AT&T, and have been responding to various things at AT&T for the last year or more, but I do not want to speak about any one particular situation, as I think it is highly speculative. At CenturyLink/Qwest, the opportunity at CenturyLink has been customer of ours. We are now past the barriers to entry into the legacy Qwest properties. We believe our unified access infrastructure is something that enables us to help CenturyLink win in the marketplace, and now that those barriers are down, we expect to continue to grow our business at CenturyLink.

Amitabh Passi - *UBS - Analyst*

I appreciate it. Thank you.

Operator

Thank you.

(Operator Instructions)

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

Ehud Gelblum - *Morgan Stanley - Analyst*

A couple of questions. Mike, just to start off with. The guidance, you started you guidance preamble talking about seasonally you expect to be down 20% sequentially, and I know that Ericsson, that is coming in, but it's nowhere near the $15 million that you guys were talking about earlier. What were the puts and takes, I'm just confused. What were the puts and takes as to, I think you then said it's are not normal right now. I mean, it is terrific that you're going to be relatively flat in Q1, but what were the puts and it takes to get from the normal seasonally down 20% that you started talking about to your current guidance of relatively flat at around $90 million?

Michael Ashby - *Calix Inc - EPV & CFO*

Yes. If you look at our historic Q1, as I say, it's down about 20%, and so we just -- that is simply a calculation over the last three years, I believe, slightly greater than 20%. You know, what is different in this year is that, one, we have been somewhat -- Q4 was not as strong as the normal Q4. So, therefore we don't expect the Q1 to drop partially for that reason. Two, we are selling, for the first time for a full quarter into the Qwest legacy partnership with CenturyLink, which is, obviously, additive. We are selling into the Frontier Verizon States and we had a great quarter. Our regional accounts, which were depressed, obviously dropped a lot in Q2, effectively stabilized at Q3, slightly better in Q4. Again, we expect to see that continue to increase in Q1 and Q2, et cetera. So, it's really across the board that we're seeing things stabilize and move on.

Carl Russo - *Calix Inc - President and CEO*

There's one other item as you think forward. I think what Michael just spoke about in the history was very true of us being a North American Tier 2, Tier 3 wireline service provider denominated company. As we are exposing the products to much larger customer segments globally now, and continuing to add new products that have good product market fit, I think the nature of that seasonality is going to change, but it is -- as of yet I don't think we understand what the new seasonality will look like.

Ehud Gelblum - *Morgan Stanley - Analyst*

I agree with you, but I was wondering how you got from one place to another, because last year you said the same thing. Your Q4 in 2011 was also up similarly, and yet you still had the down 20% in Q1. I agree with you. It's not necessarily a rule of thumb. I was just wondering how you parse it in your head. Obviously, you should be getting share of Qwest and Frontier, and so that should change the equation a little bit, but I was wondering how you were thinking about that and completing that.

Moving onto the Ericsson deal. Can you explain to me again, so let's just look at it from an international/domestic point of view. Your international grew quite nicely this quarter. It went from a little less $5 million in Q3 to a little over $8 million in Q4. Where does that go in Q1, and how are you looking at that in that in the guidance, as well? How long is it going to take for Ericsson to get to that run rate you were talking about originally, in the $14 million, $15 million per quarter? Is that the end of 2013, or does that take us into 2014?

Carl Russo - *Calix Inc - President and CEO*

Well, a couple things real quick, and I will let Michael take it from there. One is I would be very cautious about factoring in anything on Ericsson in any given quarter. We typically don't do that, and we wouldn't do it here. I would ask you to be cautious as we think about what I said on any given quarter. I do believe absolutely it will go up. There is no question as we are watching the processes internally to Ericsson and how we're working them, rapidly come up to speed. To your second question about over time, I don't think there's any question that we're going to get to that run rate in the planning horizon, but I don't know what the number of quarters are going to be, but it is not going to be two years.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay. Now, from what I understand there are two avenues of revenue from Ericsson. One was the BLM1500 and the other was the what you can put through the distribution channel. The description, I seem to understand, is that the vastness of the distribution channel and working through it was much more complicated. But the 1500, I didn't hear a comment on the 1500. So can we assume that the 1500 did what it was supposed to do, but all of the -- the majority of the $4 million that you've been looking forward for was going to come from the distribution channel, and that was the piece that hasn't come through, but the BLM is still doing fine?

Carl Russo - *Calix Inc - President and CEO*

So actually, and again, I applaud Michael for calling out in the results that while we made the results, they were different than we originally thought. To this case, it is actually quite different from what you just said. It's the exact opposite, actually. If you remember in my comments to George's question, in the middle bucket as we begin to bring our E-Series through the channel, that will ramp over time. We actually expected the BLM to be stronger in Q4 than it was, and that is partially due to likely some orders being taken off the street just before the close, if you can understand that behavior.

In addition to that, it just a matter of actually getting what is a new vendor to Ericsson through all of their processes, and they have very rigorous processes for how they bring things through their company, even if it turns out to be the very products that they had prior. It's actually a delay in the BLM 1500. The rest of the things are actually tracking roughly according to plan.

Michael Ashby - *Calix Inc - EPV & CFO*

Yes, I think, Ehud, we've always said that we need to integrate through the Ericsson operating system in order to be able to be able to successfully sell the E-series into that channel, and that is a two- to three-quarter process.

Ehud Gelblum - *Morgan Stanley - Analyst*

Normally when we've seen companies or pieces of companies change hands, like when Sienna, for instance, bought the Nortel piece, they were allowed to, and actually we've seen this with Frontier and Verizon, and that was affecting as well. They were allowed to continue to use the legacy systems until the time that they could actually do a proper transition. But here it sounds like you were not allowed to continue to use the legacy requisitioning systems to get the 1500 through? That kind of came to like an absolute stop (multiple speakers)?

Carl Russo - *Calix Inc - President and CEO*

Well, yes. In fact, we are interfacing into our systems into theirs. So you are largely correct, but I want to put that into a larger context, because when you compare this acquisition to all the others that I am aware of, as you and I discussed before, we did not take on the entire broadband access business. We did not want to take on the legacy revenues, the legacy platforms, and the legacy headcount. We only wanted to take on those resources that were San Jose-based, by the way, from where are making this call today, and we only wanted to take on the going-forward platform of the BLM 1500. Everything else Ericsson took upon themselves to deal with. In light of that, this is the way the deal was structured, and frankly, given the trade-offs, I'm happy to have them.

Ehud Gelblum - *Morgan Stanley - Analyst*

Okay. Appreciate the candor. I'll take the rest offline.

Operator

Thank you. Our next question comes from the line of Mark McKechnie with Evercore Partners.

Mark McKechnie - *Evercore Partners - Analyst*

Thanks. Just a couple of questions, and Ericsson, I know guys have gone over it a lot, but it's hard for me to guess how much of Ericsson you're going to get in Q1. I'm guessing it's still going to be less -- a lot below that $12 million to $15 million number. I'm kind of estimating maybe $5 million or $6 million. It seems like your gross margin guidance is up sequential. Am I thinking about it right? Like, you're not going to have a lot of Ericsson, or the BLM 1500, in the March quarter, or if you did, obviously your margins would be down?

Carl Russo - *Calix Inc - President and CEO*

I think you're thinking about it right, and I would simply categorize it as less than the original number. Michael, any color you want to add to that, please?

Michael Ashby - *Calix Inc - EPV & CFO*

No. I think you are right on the mark. It's the right way to think about it.

Mark McKechnie - *Evercore Partners - Analyst*

Okay, great. Then, hey, Carl, you said something in an answer to a question about drivers for 2013. The third item you listed was new products. Can you give us any hints? I mean, are the new products just kind of evolutionary-type changes to your existing products, or are you thinking of moving into new product segments at all? Like, what can you tell us on that front?

Carl Russo - *Calix Inc - President and CEO*

Well, two things, Mark. First of all, as you can imagine, we are always producing new products. And secondly, as you're probably aware, we don't announce them on quarterly earnings conference calls.

Mark McKechnie - *Evercore Partners - Analyst*

Yes. I'm just looking for any -- I know you had been talking about small cells a bit, a couple of times. Lighting up the conference circuit and what-have-you. I mean, I'm just trying to sniff out. Are you looking to move into any kind of a different product area, or is this more just standard evolutionary products from Calix?

Carl Russo - *Calix Inc - President and CEO*

No. We are, as you know, focused solely on the access infrastructure. Anything inside of how we perceive the access infrastructure is fair game. Inside of that, I wouldn't announce. Stay tuned.

Mark McKechnie - *Evercore Partners - Analyst*

Okay. Thanks, Carl and Michael.

Operator

Thank you.

(Operator Instructions)

Thank you. There are no further questions at this time. I would like to turn the floor back over to Mr. Allen for closing comments.

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

Once again, we want to thank you for joining us today. We hope you can join us at one of our upcoming investment conferences later this quarter, including the three that we're having in February. Information about these conferences is available on the investor relations section of Calix.com. Thank you again for joining us. We remain focused on executing against the opportunities ahead of us, and we look forward to telling you about of our progress at one of these forums. Goodbye for now.

Operator

Thank you. This concludes today's teleconference. You may disconnect your lines at this time, and thank you for your participation.
