



Ciena – Benefitting from the shift to LTE

We sum up comments on our quarter preview and our thoughts on optical network upgrade opportunities in FY14+, in our Quarter Preview - published alongside this MWC note.

Our MWC conversations with Ciena's CTO gave us insight on management's view on Alcatel Lucent selected recently as the second source supplier at Verizon, on 100G and OTN switching upgrade opportunities this calendar year, etc.

We get the read from our conversations with management that Verizon is likely to follow an 80/20 rule for its optical network sourcing – i.e. appx 80% of long haul and metro optical networking upgrades using Ciena's platforms and the remainder likely allocated to the second-source supplier.

Further, we note that a meaningful runway for Ciena's Carrier Ethernet (Packet Networking) switches for aggregating traffic from 4G macro cells (and ongoing 4G small cell rollouts) at the major US and rest of world telcos – with Ciena noting that appx 50% of cell towers are lit by fiber – suggesting to us that there is appx a +30% runway remaining for "fiberization" of the radio access and metro aggregation network.

AT&T's \$14B over the next 2-3 years Project Velocity IP capex spend for utilizing IP based fiber networks for access traffic aggregation, etc - is a case in point.

Ciena also noted potential for 1G to 10G access network upgrades in telco networks – as an out quarter refresh cycle opportunity for the company's Packet Networking portfolio.

Ciena management also noted that they see around a 10% OTN switching attach rate in their 6500 series 100G packet/optical networking platform this year – suggesting to us that Ciena could manage to gradually improve the gross margin profile of their 100G platform, based on sales of mid 40s margin OTN switching line cards embedded in their 6500 series platform.

Management remains positive on strength in the 100G optical transport upgrade cycle – in both the long haul and metro networks – at the large telcos and in Cloud datacenters, ISPs, etc – noting that appx 20-25% of their quarterly revenues are from non telcos – i.e. from datacenter interconnect use cases, etc.

Ciena does not see 200G being a meaningful optical network upgrade cycle this calendar year – noting that 100G is still in "year two" of a multi-year refresh cycle. As a case in point, we note that AT&T is yet to commence 100G optical network upgrades at any level of scale and Verizon is still in eval stages of upgrading their metro core networks to 100G – according to our mosaic field research view.

In summary, we remain with our positive outlook and our Buy rating on Ciena, noting favorable risk/reward at current levels – and noting Ciena as a market leader in technology and in carrier customer mind-share in 100G coherent, OTN switching, control plane SW tools, etc.

The recent Ciena – Ericsson partnership is likely to be favorable for sales of Ciena's optical networking gear and control plane automation SW in Telco NFV architectural upgrades – given our view that a high degree of network and services level automation is a key requirement from the large carriers – given the telcos' opex efficiency imperative.