Ciena Corporation (Q1 2025)
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Corporate Speakers:

- Gregg Lampf; Ciena Corporation; Vice President of Investor Relations
- Gary Smith; Ciena Corporation; President and Chief Executive Officer
- Jim Moylan; Ciena Corporation; Chief Financial Officer
- Scott McFeely; Ciena Corporation; Executive Advisor

Participants:

- Adrienne Colby; Citi; Analyst
- Meta Marshall; Morgan Stanley; Analyst
- Amit Daryanani; Evercore; Analyst
- Joe Cardoso; JPMorgan; Analyst
- Simon Leopold; Raymond James; Analyst
- Tal Liani; Bank of America; Analyst
- Alyssa Shreves; Barclays; Analyst
- Ruben Roy; Stifel; Analyst
- Tim Savageaux; Northland Capital Markets; Analyst
- Ryan Koontz; Needham; Analyst
- Andrew Spinola; UBS; Analyst

PRESENTATION

Operator^ Good day. Welcome to the Ciena Fiscal first quarter 2025 Financial Results Conference Call. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference over to Gregg Lampf, Vice President of Investor Relations. Please go ahead.

Gregg Lampf^ Thank you, [Michael]. Good morning. Welcome to Ciena's 2025 fiscal first quarter conference call. On call today is Gary Smith, President and CEO; and Jim Moylan, CFO. Scott McFeely, Executive Advisor, is also with us for Q&A.

In addition to this call and the press release, we have posted to the Investors section of our website an accompanying investor presentation that reflects this discussion, as well as certain highlighted items from the quarter.

Our comments today speak to our recent performance, our view on current market dynamics and drivers of our business, as well as a discussion of our financial outlook. Today's discussion includes certain adjusted or non-GAAP measures of Ciena's results of operations. A reconciliation of these non-GAAP measures to our GAAP results is included in today's press release.

Before turning the call over to Gary, I'll remind you that during this call we'll be making certain forward-looking statements. Such statements including our quarterly and annual guidance, commentary on market dynamics, and discussion of our opportunities and strategy are based on current expectations, forecasts, and assumptions regarding the company and its markets, which includes risks and uncertainties that could cause actual results to differ materially from the statements discussed today.

Assumptions relating to our outlook, whether mentioned on this call or included in the investor presentation that we'll post shortly after, are an important part of such forward-looking statements. And we encourage you to consider them.

Our forward-looking statements should also be viewed in the context of the risk factors detailed in our most recent 10-K and our 10-Q, which we expect to follow with the SEC by this Thursday. Ciena assumes no obligation to update the information discussed in this conference call whether as a result of new information, future events, or otherwise.

As always, we will allow for as much Q&A as possible today though ask that you limit yourselves to one question and one follow-up. Also in case there's a slightly longer pause than usual during Q&A, please note that our team is in two different locations for this call.

With that, I'll turn the call over to Gary.

Gary Smith^ Thank you. And good morning everybody. Today we delivered strong fiscal first quarter results including revenue of $1.07 billion, adjusted gross margin of 44.7%, and adjusted EPS of $0.64 per share. Positive demand dynamics drove very strong order flow in the quarter. Significantly, direct orders from cloud providers were half of overall orders in Q1 and we've had our strongest back-to-back quarters of orders from service providers in over two years. This outstanding performance reflects balanced growth and strong momentum across all aspects of our business.

As we execute our strategy to take full advantage of the growth of cloud and AI traffic. Since speaking with you last in mid-December, we've seen the continuation of the positive demand dynamics that we've been discussing in recent quarters. This is playing out across our primary customer segments and geographies and in both our foundational business and our market expansion opportunities. The rapid expansion and distribution of AI training and inferencing infrastructure is driving global investment in ultra scalable, high performance networks operated by both service providers and cloud providers. And as the global leader in high-speed connectivity, we are best positioned to partner with them on these critical infrastructure builds to help scale and monetize their networks.

So as we continue to execute our strategy and take full advantage of these opportunities, we remain focused on extending our leadership and growing market share in our core businesses, inclusive of subsea, long-haul, Metro DCI and MOFN opportunities and growing our addressable market into adjacencies, particularly inside and around the data center over time as well as in metro routing, all areas where our foundational optical technologies and leadership provide a significant competitive advantage.

To best understand how our investments are fully aligned with these market dynamics and our customers' priorities, we believe that viewing our business through the lens of our major customer segments provides the most insight.

So let's start with service providers. The supply and demand dynamics that we experienced in previous periods continued to come into balance. We believe service provider inventory digestion impacts are largely now complete. Accordingly, we saw our ongoing improvement in Q1 in revenue and orders, with North America leading the way and international markets continuing to show positive progress. Service provider revenue in Q1 increased 14% year-over-year, comprising approximately 51% of total revenue. Clearly these customers are once again investing to scale their networks. Specifically for the anticipated increasing cloud traffic and new AI workloads including for MOFN opportunities with the cloud providers. We've now seen a couple of quarters with an improving service provider trend-line. We believe these positive service provider spending dynamics will continue moving forward.

Moving now to cloud providers. We continue to broaden and deepen our relationships with cloud customers. In Q1, total direct cloud revenue comprised 32% of the total revenue, with five cloud providers in our top 10 customers for the quarter. AI is the key driver of scaling and provisioning these high-speed networks to support increased bandwidth demand and enable the monetization of AI, today and well into the future. We expect these to be large, long-term investment plans over many years to come, as evidenced by the strong CapEx plans and strategic commentary that most cloud providers have recently announced relating to networks.

Turning to the critical technologies that are required by both our service provider and cloud provider customers, we are seeing broad-based momentum again across our portfolio. WaveLogic six Extreme is off to an incredibly strong start in the marketplace, gaining momentum with customers who seek increased capacity and reduced space and power requirements in their networks.

In Q1, we added 20 new customers for WaveLogic 6E. We continue to ship our WaveLogic five solution. In Q1, we reach more than 1,600 WaveLogic modems shipped worldwide, 160,000. Confirming the WaveLogic portfolio is the foundation for world-class network backbones for the AI and cloud economy, both terrestrial and subsea. Our intelligent line systems including our RLS photonic platform and Waveserver wavelength solution, are designed for the type of traffic and applications that are emerging and are the preferred choice for both service providers and cloud customers alike. In fact, we have nearly 100 total customers now for RLS and more than 400 total for Waveserver.

Importantly, our interconnects portfolio is gaining traction and represents a substantial growth opportunity for us moving forward, particularly in the context of AI within the Metro data center campus and in the future inside the data center itself.

As a reminder, interconnects is a general industry term to describe the infrastructure technologies that provide the connectivity between and within data centers. It includes both pluggables and component technologies. Demand for our high performing best-in-class pluggables is strong and growing. Q1 was our highest orders quarter yet for pluggables, as we continue to take share in this fast-growing market. We are also on track for general availability of our 800 gig WaveLogic six nano pluggable solution in the first half of this calendar year and expect deployments later in the calendar year for Metro DCI use cases.

The WaveLogic six nanotechnology also supports the industry's first 1.6T Coherent-Lite solution for two kilometers to 20 kilometers campus applications, which will also be productized for deployment in the 2026 timeframe. And in fact, we will also be showing the first live 1.6T Coherent-Lite solution demonstration at the upcoming OFC Conference in San Francisco in early April. We will be hosting investor meetings to provide further details about our ongoing R&D efforts in this area.

Before handing over to Jim, I'd summarize by saying that as the global leader in high speed connectivity for both systems and the underlying technology, we are incredibly well-positioned to partner with customers to address rapidly increasing bandwidth demands driven by cloud connectivity and AI. As a result, we have strong momentum across our business, which is driving balanced growth and providing a solid visibility and confidence in our future.

Jim, can you now take us through a more detailed readouts of our financial performance in Q1, as well as our outlook. Jim?

Jim Moylan^ Thanks, Gary. Good morning, everyone. As Gary mentioned, we delivered strong fiscal first quarter financial results. Total revenue in Q1 was $1.07 billion. This included [two 10% plus] customers, one cloud provider and one service provider. Adjusted gross margin was 44.7%, driven by a few non-recurring events including software. Q1 adjusted operating expense was $347 million. With respect to profitability measures in Q1, we delivered adjusted operating margin of 12.3%, adjusted net income of $94 million and adjusted EPS of $0.64. In addition, we generated $104 million in cash from operations. Adjusted EBITDA was $156 million.

Finally, we ended the quarter with approximately $1.3 billion in cash and investments. We repurchased approximately 1 million shares for $79 million during the first quarter. We continue to target the repurchase of approximately $330 million total in fiscal year 2025.

Turning to some additional highlights from the quarter, as Gary mentioned, we had a great quarter in optical. We have 25 total customers for WaveLogic six Extreme including large service providers like Lumen, Etisalat, Korea Telecom, Southern Cross and Vocus, as well as several of the major cloud provider customers that are planning to standardize on this technology. We remain the only vendor in the market with a 1.6

terabit WAN solution and expect to hold that lead in this next generation of optical technology for at least two years. And pluggable momentum was strong in Q1 putting us well on track to at least double our revenue this year from fiscal 2024.

In routing and switching, Q1 revenue was $93 million up 17% sequentially. The total count for our adaptive IP customers is now [390] including nearly 40 added during the first quarter. We are winning new customers for our coherent routing solution including international service providers and enterprise customers. Other portfolio highlights from Q1 include platform software and services including Navigator had another good quarter with revenue up 6% year-over-year. Blue Planet quarterly revenue nearly doubled year-over-year. Turning now to guidance.

Before I talk about the guide, I will say that we are certainly aware of the potential for disruption in U.S., and the international economy given the prospect of additional tariffs and retaliatory actions. However we firmly believe that bandwidth demand will continue to grow through this period. Given the fluidity and uncertainty surrounding the situation, our guide does not include the effects, if any, of additional tariffs.

For the fiscal second quarter, we expect to deliver revenue in a range of $1.05 billion to $1.13 billion. We expect Q2 adjusted gross margin to be in the low 40% range and we expect adjusted operating expense to be approximately $355 million. We are very encouraged by the strength in our business and the continuation of positive demand dynamics across all of our segments.

We are very confident in our well-established position, as the global leader in high speed connectivity as both our service provider and cloud provider customers invest at scale and monetize their networks in the AI era. With that momentum, though it's still early in the year, we are increasingly confident that we can deliver revenue growth toward the high-end of our 8% to 11% guidance range for fiscal 2025. Also for the year, we continue as we said last quarter to expect adjusted gross margin to be in the 42% to 44% range for the year and adjusted operating expense to average $350 million to $360 million per quarter.

In closing, I'll say that the strength of orders across all our market segments and verticals indicates that our position in the market continues to improve. Our leading technology, which we believe is sustainable, coupled with the depth and breadth of our customer relationships, set Ciena up nicely for long term growth.

[Michael], we'll now take questions from the sell-side analysts.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) The first question comes from Atif Malik with Citi. Please go ahead.

Adrienne Colby^ Hi. It's Adrienne Colby for Atif. Thank you for taking the question. I was hoping we could talk a little bit about the dynamics you were seeing in the cloud service provider segment. Interested in what the linearity of the order trends were in the quarter, if you saw any kind of a pause or a shift or signs that cloud customers are rethinking some of their strategy for the year? Thank you.

Gary Smith^ Yes, Adrienne, I'd take that. We've seen very solid order growth really around accelerating demand across multiple cloud players. We saw no linearity at all around that. In fact, we are probably seeing an increase in demand, which has actually continued right now into Q2. We've actually started Q2. Another way of addressing your question here is saying, Q2, we've started super strong with cloud providers, and we expect that to continue.

The fundamentals around that dynamics are driven by a multitude of things. One is machine-to-machine learning. We see expansion opportunities there, particularly in North America, where there's a need to -- basically they can't get all the power and compute in one space, therefore, it has to link up to multiple data centers requiring low-latency, high-bandwidth solutions.

Then globally, just the increase in cloud traffic and move to inference to link up all of these data centers requires a very large scale up and build of submarine systems, metro across the global landscape. We have seen absolutely no yielding in that at all. In fact, I'd describe it as an acceleration. When you think about it, they need to connect these data centers if they're going to monetize any of this. In fact, if we get more proliferation of reasoning models, that's just going to drive more traffic frankly.

Jim Moylan^ One thing I'd add to that, Gary, is that in a more general sense, our orders for the quarter were more than double over the last year during the same quarter and well above our revenue. And about half of those orders were cloud. So just accentuates the comments that Gary made.

Adrienne Colby^ Thank you.

Operator^ The next question comes from Meta Marshall with Morgan Stanley. Please go ahead.

Meta Marshall^ Great. Thanks. Maybe to start with, just in terms of kind of following-up on the previous question, but just kind of how do you see seasonality of cloud customers, obviously it's kind of down quarter-over-quarter, but you noted very strong order activity. So just kind of what you're seeing in terms of seasonality? Then maybe as a second question, you noted no further tariffs contemplated, but just what are you assuming for tariffs as announced? And just how are you looking to mitigate, those either through price or moving kind of distribution? Thanks.

Gary Smith^ Meta, why don't I want to take the first part of that and then Jim can take the second. On the cloud side, we're not -- given the scale up and the nature of it, I think we're not really susceptible to seasonality. You can have some ebbs-and-flows based on the end of their calendar year and shipments and things.

But I on the whole, I don't think you're going to see a lot of seasonality here. I think it's largely up into the right with a few variables quarter by quarter. I think there's an increasing demand to make sure that they've got the right kind of scaled infrastructure and connectivity to be able to take advantage of this, because this traffic, matter is this stuff is now beginning to come outside of the data center, both in terms of training and in terms of inference and just the general growth in cloud traffic. I think that's going to be a very consistent over, I think the next few years.

Jim Moylan^ And on the tariff situation, Meta, as you can appreciate, it is very fluid and dynamic. There have been lots of changes and decisions lots of changes to decisions made on tariffs over the last few weeks. We've certainly been very busy looking at how we will mitigate the tariffs if and when they come into play. We do have a resilient supply chain that allows for this kind of mitigation depending upon the shape of the ultimate tariffs. We'll work with our customers for reimbursement of tariffs. So we just didn't put it in there. We'll give you a view of that when and if we have certainty.

Meta Marshall^ Okay. Great. Thank you.

Operator^ The next question comes from Amit Daryanani with Evercore. Please go ahead.

Amit Daryanani^ Good morning. Thanks for taking my question. I guess maybe just to start on gross margins. Jim, you sort of mentioned there were some one time benefits in the Jan quarter you folks had. So could you just talk about very strong performance in gross margins in the Jan quarter? Sort of what drove that upside and what were the things that were perhaps non-recurring that will not sustain in the out quarters?

Jim Moylan^ Yes. I think you can appreciate from past quarters that gross margin is difficult for us to call precisely because there are any number of things that can happen during the quarter that can that are unexpected. In this most recent quarter, we had several unexpected one-time events including some software events that drove it up. We also had a good performance on the supply chain in terms of overheads.

So all of those things were good and we did greatly exceed the number we put out for you this quarter. We don't expect those effects to recur in Q2. We are returning to our guide of low-40s for Q2. Remember, we said at the beginning of the year, the first half of the year was going to be in the low-40s, second half of the year was going to be toward the mid-40s and we'd end up the year at 42% to 44%. We still believe that to be true. Over the long-term, we are hopeful that our margins will improve.

Amit Daryanani^ Fair enough. Then if I kind of step back and think about your commentary around auto growth and the cloud demand, it all seems like up into the right. I was wondering if you'd kind of stack that up against your April quarter guide, which I think is calling for revenue growth of low single digits 2% sequentially, versus I think historically it tends to be up more like 6%, 7% mid to high single digits. So maybe just talk about the guide for April seems to be a little bit lower than normal seasonality, despite some very positive commentary on orders and cloud from your side?

Jim Moylan^ I'd respond to that this way Amit. We used to have a reasonably predictable seasonality in our order and revenue flow when our business was service providers. Now our business is roughly half, driven by cloud providers and their order flow and the resulting revenue is more a function of what projects they're working on at any point in time as opposed to annual seasonality. So my own feeling is that you shouldn't compare year-over-year here that much in terms of overall revenue. You should look at the trend. And as you know we're calling 8% to 11% for this year and actually we're going to put 10% toward the higher end of the quarter for the year.

Gary Smith^ The other thing I'd say Amit, is obviously we had we've said -- we've had strong order flows, obviously greater than one, much greater than one, and our backlog continues to increase. So I think we're setting up for a strong second half as well. And just to clarify one point, the guide for the year on the gross margin is 42% to 44% in total.

Thank you, Gary [ph]. I misspoke.

Amit Daryanani^ Perfect. Thank you.

Operator^ The next question comes from Samik Chatterjee with JPMorgan. Please go ahead.

Joe Cardoso^ Hi, thanks for the question. This is Joe Cardoso on for Samik. I guess first one from my end. As you're thinking about the updated full year outlook for revenue, I guess is there any change in terms of how you're thinking about the composition between the customer verticals that you serve? And maybe more specifically in terms of guiding or raising the guide here, is there a specific customer vertical that is tracking ahead of your plans relative to 90 days ago? Or is this more broad based in terms of what you're seeing across the verticals and the trends you're seeing? Then I have a quick follow-up. Thank you.

Gary Smith^ Yes. Let me take that first and then Jim may add. I would say what's driving the increase for the year, I would say that's two things. One, I think increasing confidence around the service provider recovery. We've seen multiple data points around that and it's quite broad. But I think rather in terms of getting to the upside, that's largely all cloud. That's largely cloud. I mean we've got increasing confidence the service providers are going to do what we thought they'd do in terms of the recovery, which is pretty broad based. I think the additional piece that would take it closer to our higher-end of our range is really driven by cloud.

Joe Cardoso^ No, got it. Thank you. Then for my follow-up, just curious if we can get an update on how you're seeing the pluggable opportunity unfold for the year. It's anecdotally, it kind of sounds like you guys are more confident around revenues here at least doubling for the year. So just curious, is that fair in terms of seeing a better demand in terms of 90 days ago? Then as you think about the expectations for the year, any way just kind of size the contribution between how much is coming from Nano five versus Nano six in terms of what you're embedding into the outlook?

Gary Smith^ I think Jim -- I think well I mentioned it in the comments where we had record order flows for pluggables in the quarter. I think we're increasingly seeing as pluggables move towards more higher speeds, that really plays into our portfolio. So I think we've said, we expect it to double for the year and we're absolutely well on track to doing that.

Scott, is there any other anything else you'd add there?

Scott McFeely^ Yes. A couple of things. First of all, I think we're seeing growing momentum and we expect that momentum to accelerate, as the demand for higher speed pluggables becomes a reality with the introduction of our WaveLogic 6N, 800 gig per plug and beyond that 1.6 terabits. So we're pretty bullish about that and our ability to gain share in that space. And a reminder that -- that is incremental opportunity for us as a company.

Then following on from that, we do see a continued march of coherent technologies being the preferred option in different parts of the network. We've seen it in the WAN for many years. We've seen it now in Metro DCI for the last couple of seasons. We firmly believe we're going to see that in the campus, the two to 20 kilometer space over the next couple of years. And being the leaders in Coherent, that sets us up well for that.

Your question on WaveLogic five versus WaveLogic 6, look, we've done this many generations over in terms of coherent technologies. It always takes a couple of years for the latest and greatest technology coming out of the machine to become the dominant volume contributor. So we would expect WaveLogic five to be the volume dominant contributor through 2025. We do, however those new technologies are the vehicle that we use to compete for new business. So it's incredibly important in terms of winning new footprint. It just takes a while for it to become the volume contributor.

Joe Cardoso^ No. Understood. Then I appreciate all the color guys. Thank you.

Gary Smith^ Thanks, Joe.

Operator^ The next question comes from Simon Leopold with Raymond James. Please go ahead.

Simon Leopold^ Thanks for taking the question. Look, I understand the tariffs are very fluid and change by the minute some days. But I guess what I'm trying to get a better understanding of is I feel like your supply chain and contract manufacturer relationships have been reengineered somewhat and changing apart from tariffs. So if you could help us in understanding maybe what exposure to Mexico and how you envision this changing because I believe you're moving more into Southeast Asia. So any way to sort of quantify the risk if the tariffs stick as they are today and what else is going on in your supply chain reengineering? Thank you.

Gary Smith^ We've designed our supply chain for resilience. So we have the capability to manufacture in a lot of different places, just about all of our products. Our supply chain comes from Mexico, Thailand, Canada, India. I think that lists them all for now. We do have a concentration today in Mexico and Thailand, but we do have the capability to move that around depending upon what the shape of the ultimate tariffs are (inaudible).

Scott McFeely^ And a couple of things to note, Simon, on the just a follow on from Jim, a couple of things to note in terms of the architecture of the supply chain. We've taken steps over the last couple of years to take direct control over our component infeed in the vet supply chain so that we have the flexibility to direct it to different locations and contract manufacturers around the world to take advantage of the resilience that Jim talked about. And just a reminder, I think many of you know because we had the conversation in the past, but our architecture, we own all the test assets.

So we have the ability to invoke that flexibility over time and move the production around the world. Obviously it's shorter time intervals where we have existing capacity for a given product, and that time intervals will lengthen if we have to go to a new location, but we do have that capability.

Simon Leopold^ Yes. Thank you.

Gary Smith^ And Simon, it would not be -- I was going to say Simon, it wouldn't be useful for us to quantify these exposures because it's very dynamic and we have the ability to move things around. So as I said, when we have certainty about the effects of these tariffs, we will update you as appropriate.

Simon Leopold^ Thank you very much.

Gary Smith^ Thanks, Simon.

Operator^ The next question comes from Tal Liani with Bank of America. Please go ahead.

Tal Liani^ Hi. I have a few small questions kind of -- what are the applications for WaveLogic? Why is it growing? And where do you see it in the network? And the second question is about pluggables. Can you same question kind of -- is it because is the growth because of the launch of 800 gig or is it in 400 gig and are you taking share from Cisco? The market share data shows that Cisco was very, very strong in 400 gig. So can you give us a little bit more on pluggables? And I have one little question at the end.

Scott McFeely^ Yes. So Tal, it's Scott. So first of all, starting with our traditional core strength in our business in long haul, submarine, metro regional [networks], we're seeing tremendous demand for increased traffic on those networks driven by all the cloud and AI dynamics that we've talked about on the call. We see it coming at us in terms of demand for wavelengths in various different forms, whether it be pluggables or embedded in our systems.

We see it in tremendous demand for lighting new fibers with our line systems, in particular, our next generation one RLS. So that's the first place where we're seeing it from an application set perspective.

Second place for us is around the metro DCI space. And remember, that wasn't if you go back 4 or 5 years, that wasn't really the domain of coherent technologies. It's become the de facto way to deliver it. That's where the pluggable opportunity has really pluggable coherent opportunity has really been over the last couple of seasons. We serve that with our WaveLogic five and we weren't first to market with that technology, but we have had a growing share.

If you look at the Q4 reports, you see our share substantially growing. We think that's going to grow substantially over in 2025 and will continue to grow as the data rates go from 400 gig to, as you mentioned, 800 gig or 1.6 eventually there as well. So that's here now. That is really mostly net new business for us because we never really had exposure in the past to that metro DCI use case.

Looking more into the future, we do see that continued march of coherent being relevant to their high speed data interconnect. The next place it's going to hit, we've been saying this for a while, but now others in the industry have joined us in saying it, is in the two to 20 kilometer campus data center interconnect, which has not been coherent in the past. We would expect to start seeing revenue in our business in 2026 on that use case.

Those all of that is included in our 3-year guide. We have a further belief system beyond that, that March of coherent is not going to stop at the walls of the data center. That is going to bleed into the data center as bandwidth rates increase and the technical challenges servicing those bandwidth rates gets larger. That's a little bit farther out in the future.

We do believe that, that is going to happen and we being a leader is incoherent, that will benefit us. But from a timing perspective, it's a little bit beyond what our three year guide was. Hopefully, that helps you in terms of --.

Tal Liani^ Perfect. Thanks for the elaborated answer. Services, last year was a big year, like a big quarter. Same quarter last year was big quarter for service growth. This quarter, it grew 2.5%. I see that the growth kind of decelerated throughout the year, 12%, then 5%, then 3.5%, 2.5% now. What are the trends in services?

Jim Moylan^ Generally speaking, our services business has grown and it's grown roughly correlative to the optical growth. I would say that we've had a lot of opportunities to help our cloud providers most recently in building up their networks because they don't necessarily have all the resources to do all the building and implementation that they need in order to get their networks right. So we're very happy with our services business and we think it's going to grow for the future. All of the sequential movements are basically just noise.

Gary Smith^ Tal, one thing I would sorry, Tal, one thing I'd just add to that is we are seeing an uptick and it hasn't flowed through the revenues yet probably, but in installation services, both as Jim said for the cloud players and also the service providers. So it is a bit of a sort of a proxy for the consumption and increase of the -- and build out of the networks is the ramp in our installation services.

Tal Liani^ So Jim, the last four quarters was very, very big, from 2% to 12%. What's a good assumption for us for kind of steady state growth ignoring all the mountains and valleys? What's a good assumption for services growth, annual growth?

Jim Moylan^ I wouldn't use any particular quarter. What I would use is, generally speaking, our services revenue is going to grow approximately as our optical business grows over time. It might in any given quarter grow faster or slower given what's going on with particular projects, but I don't think it's a bad proxy. Whatever your assumption is about optical growth to use the same for services growth.

Tal Liani^ Got it. Okay. Thank you.

Operator^ The next question comes from Tim Long with Barclays. Please go ahead.

Alyssa Shreves^ Hi. Good morning. This is Alyssa Shreves on for Tim Long. I just had a quick question on the service provider business. Now with the kind of gradual recovery you've seen in service provider, can you talk about the MOFN opportunities there? Should we still expect this to be, kind of around 10% to 15% of telco? Just trying to get any color there. Then just a quick question on India. How are you guys viewing, India recovery this year upside there? Thank you.

Gary Smith^ Melissa, why don't I take the MOFN, we've generally said certainly in the last sort of 12, 18 months, it's probably about 10% plus of our service provider business. I think that's going to increase over the next years or 18 months. We're seeing a real expansion in opportunity around the globe for these build-outs, which is very consistent with the cloud players wanting to build out their global network capabilities and that's encompassing submarine. It's encompassing a lot of geographies around the world, Europe, Middle East, Asia, India.

So I would expect that to increase over time. You said 10% to 15%, I would even potentially say over the next 18 months or so could be as high as 10% to 20%, given the activity that we're seeing. They want to participate in the ecosystem build out of this.

There are large parts of the world where, for various reasons, the cloud players don't want to have the regulatory challenges of a license, et cetera.

They need to provide the right kind of capacity to enable their business and their connectivity to data center and or consumers. So I think this is a multiyear expansion on MOFN. And on India, as you say it's been a couple of years of kind of digestion, they move to 5G. I think we’re now seeing an improving pipeline there of build out. Some of that, again to your earlier question, is driven by MOFN, a lot of cloud activity in India, fastest growing Internet market in the world. So we feel pretty bullish around India and would expect it to be up for the year by the time we come out of Q4.

Alyssa Shreves^ Thank you, so much.

Scott McFeely^ I'll just add that we have great positions with all of the three or four major operators in India. I think that'll be a real source of growth for us for the next few years.

Alyssa Shreves^ Thank you.

Operator^ The next question comes from Ruben Roy with Stifel. Please go ahead.

Ruben Roy^ Thank you. Gary, maybe to stick with the international service provider theme, wondering if you have some updated thoughts for us on, the Huawei potential for Huawei replacement across various geographies now that inventories have normalized and supply chains have normalized. Any updates there? It sounds like there might be some movement. So just wondering if that's at all, if there are any assumptions with that replacement cycle over your next three year outlook?

Gary Smith^ Okay. No. And I think we've always said this. The greatest opportunity really is in Europe and that remains the case. It is a multiyear opportunity. This is sort of they have a lot of infrastructure here. It's integrated into their back office and there's not the obvious sort of free cash flows immediate to be able to rip all that stuff out. So you've got operational issues, you've got capital issues, etcetera, and that's what's taken a long time and I think just by its very nature.

So I think you've still got a multi-year opportunity in front of us around the Huawei replacement. You are seeing it happen. We are winning those deals more than our fair share of that, particularly in Europe. I think that's going to be a tailwind for us, as the service providers recover over the next 1 years to 3 years.

Ruben Roy^ Thank you, Gary. I had a follow-up for Scott, I think. Scott, kind of considering some of your commentary on kind of longer-term potential opportunities inside the data center, there's been a lot of chatter in recent weeks and months around CPO. I assume we're going to hear more about that over the next several weeks. What are your thoughts there? Again thinking through sort of longer-term prospects for Ciena either with transceivers or ingredients that make up transceivers inside the data centers, CPO an opportunity, a threat or neutral? Thank you.

Scott McFeely^ Hi, Ruben. Thanks for the question. Yes. So if you take a step back, think of whether it is CPO or various other different packaged optics, LPOs, et cetera, That all speaks to the industry trying to innovate around solving the challenge of continued increase in demand for scale. That's scale and compute, but also scale in terms of the high speed data interconnects. And clearly, -- at Ciena, we are more interested in the high speed data interconnect piece of that. All the applications that I talked about coherent sort of having an expanded market perspective, I don't think the CPO conversation has any impact at all on those.

The CPO, we've never said, by the way given that even given the march of coherent becoming more and more relevant up to the walls of the data center and inside of the data center, we never said IMDD or direct to tech was going to go away. CPO and the other different flavors of it is at a really high level as a repackaging of that IMDD technology to solve for the scale issue.

We think there are going to be other challenges there as well and we think some of the component technology that we've had to solve for inside of coherent may have a play as people try to figure that out as well. So we see an opportunity to play both sides of the street, Coherent as it comes inside the data center. Then as they try to solve some of these scale problems in the IMDD world, we have some value there as well. Those are conversations that are ongoing. None of that inside the data center stuff though is in our numbers right now.

Ruben Roy^ Right. Thanks a lot for the detail, Scott.

Operator^ The next question comes from Tim Savageaux with Northland Capital Markets. Please go ahead.

Tim Savageaux^ Hi. Good morning. Couple of questions. I guess the first one on the competitive front, I'd just love to get an update on given the closing of the Nokia-Infinera deal. Are you seeing anything changing competitively either on the cloud side or the service provider side of the market? Then I'll follow-up.

Gary Smith^ Tim, I would say that we've obviously competed with them separately and we've done extremely well with that. I think we're incredibly well-positioned with competitive advantage and a multi-year technology advantage on both modems, line systems and microservices domain manager. So I don't think anything changes from that point of view. Obviously they've got the challenge of rationalizing the portfolio. So I think that's an opportunity for us, as they try and figure out their portfolio. So I think in the short term that's a good opportunity for us.

Tim Savageaux^ Great. Thanks. I think Gary you mentioned that in terms of upside drivers for the year you felt that the cloud was really driving it. But if you look at the dynamic in Q1 where you've got service provider up double digits and cloud down a little bit, as you look at fiscal 2025 and look at that kind of low double digit growth that you seem to be targeting, Is it possible that most of that comes from service provider this year given the dynamics or do we expect you to see a big ramp in cloud later in the year? Looks like your orders might be [cloud] a little bit.

Gary Smith^ I would expect to see a big ramp in cloud. I mean I think so what were the assumptions going in kind of midpoint of that original guide was the service providers sustained recovery and I think we're very confident about that now. So tech, that's one of the big assumptions, I think touched. I think the upside to the range was always really around cloud. I think given the order flows and pipeline and activity that we're seeing both on MOFN and on Direct, I mean the order flows in Q1, half our orders directly were from cloud.

So we're getting good visibility into that as they plan these global build outs. So I would expect that to come on strong in the next few quarters from a revenue point of view. It absolutely will. I think it will form the main elements around driving us to the high-end of the range.

Tim Savageaux^ Great. Thanks very much.

Gary Smith^ Thank you. Operator^ The next question comes from Ryan Koontz with Needham. Please go ahead.

Ryan Koontz^ Great. Thanks for the question. We could double click for a minute on the strength out of North America [SP], which really sounds like it got off to a strong kind of unseasonally robust start here. Is that driven by just purely an improved spending environment. Or maybe are there specific programs or share gains that are driving that uptick?

Gary Smith^ Yes. Ryan, I think we've had a number of design wins over the last couple of years that are now beginning to come to fruition with the major service providers in North America. So that is particular to us. I think secondly, you've seen this dynamic around getting inventory in balance. I think over the last few quarters that's cleaned itself up. So now we are able to recognize revenues and new orders, and I think that's sort of all in balance.

I think the third dynamic is they just haven't invested as much in infrastructure over the last few years. I think part of that is, they've been focused on 5G, and that both in The U.S. And globally is now petering down. So they're now returning to look at their overall infrastructure, automation of the networks and how do they sort of scale that to meet the demands of things like MOFN and cloud expansion. So it's a multitude of dynamics that we're seeing, some of which are just industry based, some of which are particular to Ciena of some of the design wins that we've got. We pretty much now are the preferred partner in all of the major Tier one carriers in North America, and that's also playing into the strength.

Ryan Koontz^ That makes a lot of sense. Thanks for that. With respect to your broad exposure in cloud, which sounds like it's poised to see some strong sequential growth through this year, would you attribute that coming primarily from kind of top four classic players? Or historically, more recently, you've talked about strength out of the next tier, Tier 2s that are growing rapidly. How would you characterize your growth there and exposure?

Gary Smith^ Yes. I mean it's tough to think about these as Tier 2s as well the sizes of their business. I think it's sort of their now sort of pivot towards the network part of it, which they've not been focused on before. So I think a telling statistic, which folks might have missed, is we've now got five cloud providers in our top 10 customers for Q1. I think that kind of illustrates the sort of point that you're making around it's broadening out the amount of players that are investing and realizing that for them to optimize their position around AI and cloud that they've got to actually focus on the network from a delivery point of view and a monetization.

You're seeing we've had a number of wins in these newer they're certainly well-established large companies, but these newer wins that are focused on the network. So you've got an expanding group of players. And we've also got deepening relationships with the major existing players as well. You think about the relationships we have, it's submarine, it's metro, it's long-haul, it's pluggables, it's into the campus now with some of the pluggables, it's the services aspect of it, we're increasing our engagement around all of that. So it's both broader and deeper in the cloud market.

Ryan Koontz^ Makes a lot of sense, Gary. Thanks for that.

Gary Smith^ Thank you, Ryan.

Operator^ The next question comes from David Vogt with UBS. Please go ahead.

Andrew Spinola^ Thank you. It's Andrew for David. I wanted to ask a higher level gross margin question. I think you've said you expect it to move higher over time. I think I expect it to move maybe 100 bps, 200 bps higher to get to your three year plan for your margins. What I'm thinking about is I'm wondering, can I model and think about your gross margins moving higher over time as revenue scales and you get typical scale benefits? Or should I think about it more as something that kind of goes sideways for a while and then inflects as your revenue shifts away from line systems, and so maybe the gross margin ramp in the three year model is more back half loaded. I'm trying to think through that.

Gary Smith^ Yes. I'll answer that. Notwithstanding the fact that we had some unexpected one time effects in this most recent quarter, our gross margin is most heavily influenced by mix. Typically we have a somewhat razor-razor blade structure of pricing and gross margins. As we put out the original line systems and photonics, that's at a lower gross margin. As we add capacity to the lines, it's at a higher gross margin and that's where our businesses work for a long, long time. It happens to be the fact that our RLS line system, which is the next gen-line system, it's becoming an industry standard, is really doing extremely well in the marketplace. Essentially all of the cloud providers are buying that.

Most of the service providers are or will buy it. So we have a very heavy percentage of RLS in our mix. We also are beginning to sell plugs and these are 400 ZR plugs. They're at a higher cost point than they will be going forward as we get production to scale and as we cost reduce those products. So we are experiencing a period of lower than trend gross margins, which will trend up over time. I do expect that it will trend up from what we are calling for Q2. I think as we move through time we're going to get back to a more traditional balance between line systems and capacity, which will naturally move our margins up.

So as you said, I think it is reasonable to expect something in the mid-40s over the next couple of years. It is not going to happen this year, probably not going to happen next year. But I think by the time you get out to '27, we should be in that range. Where it goes from there, who knows. We'd like to get back to the mid-40s and then we'll work on it to improve it. Thank you.

Operator^ Thank you, everyone. (inaudible) question and answer session. I'd like to turn the conference back over to Gregg Lampf for any closing remarks.

Gregg Lampf ^ Thanks, [Michael]. Thank you, everyone, for joining us today. We do look forward to seeing everyone at OFC. We will be hosting, as Gary mentioned, a number of investor meetings through that conference, and we look forward to seeing you also at an event we are planning that Tuesday at 04:45 Pacific. Thanks. And we will speak to you all soon.

Operator^ The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.