Ciena

Takeaways from management meetings

Maintain Rating: BUY | PO: 59.00 USD | Price: 48.60 USD

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Equity

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Positive tone overall

We recently hosted Ciena's CFO James Moylan for management meetings and provide below the key takeaways. We continue to believe Ciena remains an attractive stock for investors who are looking to invest in the future buildout of networks for both Cloud and Service providers. We believe Ciena continues to lead the market with its technology and competition remains muted. However, we note some potential spending challenges for 2024 and flag the potential risk of lower growth guidance under certain scenarios. We maintain our Buy rating and $59 PO, given Ciena's robust leadership in Optical and growth in adjacent markets.

Some risk to 2024 spending levels, but solid backlog

Management's 2024 guidance assumes some level of Telco spending recovery in 2024. While the Street is generally modeling growth at the mid-point of the guidance, management will have better visibility around mid-February, with a better idea on where revenues fall within the guided range (high vs. low end of the range). On backlog, historically, year-end backlog accounted for about 35% of the following year's revenue guidance. In 2021, it climbed to 65%, on the back of early ordering due to supply constraints, and then grew to 95% by YE22. At the end of 2023, lower orders and some absorption drove down backlog to ~60% of next year's estimated revenues, and management believes this could normalize in 2024. This number may never return to the historical 35%, as Cloud customers may continue to order ahead of deployments, yet management still expects the 60% mark to drop significantly in 2024. This suggests that the weak ordering environment will likely sustain, at least at the beginning of the year.

Strength from cloud customers, mainly Cloud Titans

Cloud orders should still grow in 2024, despite the strong growth in 2023. About 95% of the cloud orders are concentrated around the big 4 cloud titans, and revenues increased 57% YoY in 2023 and 100% in 4Q. Cloud revenue accounted for 22% of historical revenues yet climbed to 35% of revenues in F4Q23. Both of the two 10% customers in 4Q were Cloud Titans. This may not be sustainable and management expects the growth rates to decline materially in 2024, as Cloud customers absorb previous orders. However, revenues are still expected to grow YoY in absolute terms on the back continued deployment of Data Center Interconnect optical gear. AI contribution remains an unknown factor and the current growth is mostly driven by sheer bandwidth demand and traffic growth between data centers.

Key takeaways continue on Page 2

Stock Data

Price	48.60 USD
Price Objective	59.00 USD
Date Established	16-Jun-2023
Investment Opinion	B-1-9
52-Week Range	39.94 USD - 54.25 USD
Mrkt Val (mn) / Shares Out (mn)	7,541 USD / 155.2
Free Float	98.6%
Average Daily Value (mn)	96.84 USD
BofA Ticker / Exchange	CIEN / NYS
Bloomberg / Reuters	CIEN US / CIEN.N
ROE (2024E)	15.4%
Net Dbt to Eqty (Oct-2023A)	26.3%
ESGMeter™	High

Key highlights from CFO meeting

- Blue Planet has been disappointing thus far, running at about $70mn annual revenues vs. the historical $150mn target. Management has realized that customers require more installation and related services around the Blue Planet software, similar to the services provided by Amdocs and others. The company intends to address some of these demands in 2024, together with further technical enhancement and believe that this might help lift up the growth rate from the current disappointing levels.

- WaveLogic 6 offers great cost and throughput advantages to customers. Customers are not expected to rip-and-replace existing gear with the new solutions that are based on the WaveLogic 6, yet eventually the cost of operations, the power requirements, cooling and the general economics will drive a refresh cycle to the new WaveLogic 6 based solutions.

- Cable MSOs account for 7-8% of revenues, with segment revenues being generally flat YoY. The biggest swing factor is Comcast, which slowed down purchases substantially. This segment might grow somewhat in 2024, yet this is highly dependent on Comcast's plans for spending renewals.

- India remains a key growth driver. All three carriers are committed to big network buildouts roughly 18 months ago. Huawei is mostly out of the market and Ciena is leading the market in the Optical domain. The company aims to also penetrate the switching/routing domain, which other vendors currently dominate.

- Management sees share gain opportunity in the switching/routing space. Currently, this segment represents about 11% of revenues and management would like to see it grow to 25% over the very long-run. The solutions offer optical/routing integration and address opportunities in the Access and Metro segments.

- The BEAD program represents a good growth opportunity, with Ciena addressing the PON opportunity through its Tibit acquisition. Federal government allocated $47bn for the program, which still needs to then be allocated to vendors and projects at the state level. Ciena believes we could see some deployments starting later in 2024.

- Lastly on margins, management targets mid-40s for 2024 gross margins. Supply lead times remain 12-14 weeks and put about 100bps pressure on GM, which should be removed by YE24. Further margin upside depends on product mix, which is difficult to predict at this point.

Price objective basis & risk

Ciena (CIEN)

Our $59 PO is based on roughly 14.9x our FY25E P/E, in-line with the company's historical range and peers. We believe the multiple expansion is warranted as Ciena is a market leader and should continue to benefit from the 400G+ upgrade cycle, fiber buildouts ahead of 5G, share gain opportunities in EMEA, and Huawei displacement in India. While the optical market is undergoing a digestion period currently, we believe there will be a resumption in spending throughout 2024 given optical's growing importance as a means to meet rising bandwidth demands. The potential spending return and Ciena's ongoing revenue diversification warrant the multiple expansion to the high end of its typical range, in our view.

Downside risks to our price objective are: sustained weakness in carrier spending on optical infrastructure, lower-than-expected traction with new and 800G products or increased competition from Infinera, and more muted gross and operating margin expansion than currently embedded into our and consensus views.

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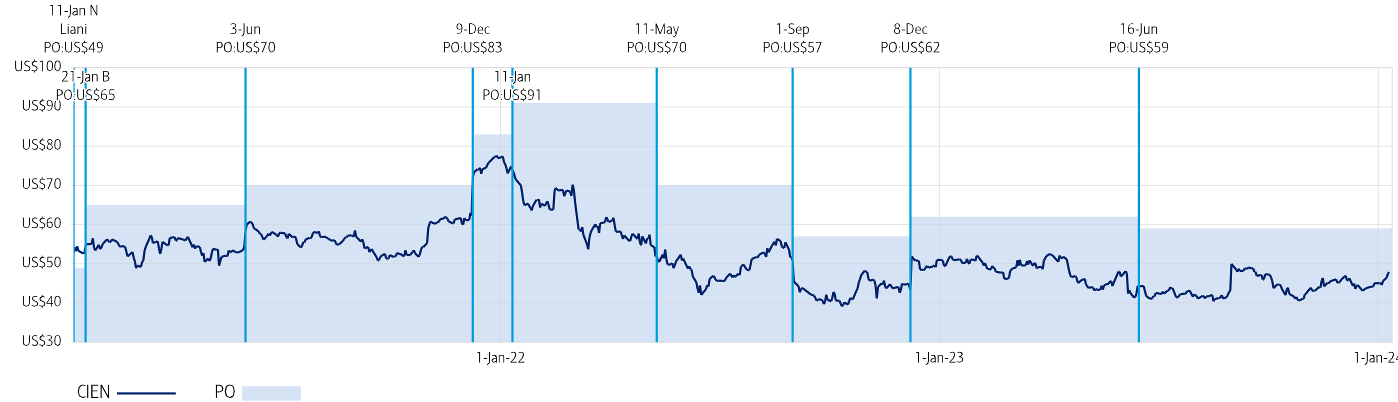
Ciena (CIEN) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

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Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	57	51.82%	Buy	43	75.44%
Hold	27	24.55%	Hold	17	62.96%
Sell	26	23.64%	Sell	12	46.15%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
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Sell	807	22.84%	Sell	383	47.46%

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