CALIX, INC
Form 10-Q
May 01, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 29, 2014

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-34674

Calix, Inc.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	68-0438710
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1035 N. McDowell Blvd., Petaluma, CA 94954
(Address of Principal Executive Offices) (Zip Code)
(707) 766-3000
(Registrant’s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: x No: o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes: x No: o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o	Accelerated Filer x
Non-accelerated filer o (Do not check if a smaller reporting Company)	Smaller Reporting Company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes: o No: x

As of April 21, 2014, there were 50,328,165 shares of the Registrant's common stock, par value $0.025 outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements
CALIX, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	March 29, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$75,169	$82,747
Restricted cash	295	295
Accounts receivable, net	44,134	43,520
Inventory	45,060	51,071
Deferred cost of revenue	17,843	21,076
Prepaid expenses and other current assets	4,869	5,757
Total current assets	187,370	204,466
Property and equipment, net	17,122	17,473
Goodwill	116,175	116,175
Intangible assets, net	39,100	43,740
Other assets	1,618	1,745
Total assets	$361,385	$383,599
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$10,887	$23,163
Accrued liabilities	34,570	32,075
Deferred revenue	29,013	34,862
Total current liabilities	74,470	90,100
Long-term portion of deferred revenue	18,469	18,431
Other long-term liabilities	1,090	1,145
Total liabilities	94,029	109,676
Commitments and contingencies (See Note 5)		
Stockholders' equity:		
Preferred stock, $0.025 par value; 5,000,000 shares authorized; no shares issued and outstanding as of March 29, 2014 and December 31, 2013	—	—
Common stock, $0.025 par value; 100,000,000 shares authorized; 50,321,551 shares and 50,224,952 shares issued and outstanding as of March 29, 2014 and December 31, 2013, respectively	1,258	1,256
Additional paid-in capital	785,700	782,253
Accumulated other comprehensive income	201	190
Accumulated deficit	(519,803)	(509,776)
Total stockholders' equity	267,356	273,923
Total liabilities and stockholders' equity	$361,385	$383,599

See accompanying notes to condensed consolidated financial statements.

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CALIX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended	
	March 29, 2014	March 30, 2013
Revenue	$85,820	$90,548
Cost of revenue:		
Products and services (1)	46,806	47,345
Amortization of intangible assets	2,088	2,088
Total cost of revenue	48,894	49,433
Gross profit	36,926	41,115
Operating expenses:		
Research and development (1)	19,630	20,171
Sales and marketing (1)	17,390	15,801
General and administrative (1)	7,251	8,131
Amortization of intangible assets	2,552	2,552
Total operating expenses	46,823	46,655
Loss from operations	(9,897)	(5,540)
Interest and other income (expense), net:		
Interest income	4	1
Interest expense	(57)	(28)
Other income (expense), net	33	(279)
Loss before provision for income taxes	(9,917)	(5,846)
Provision for income taxes	110	357
Net loss	$(10,027)	$(6,203)
Net loss per common share:		
Basic	$(0.20)	$(0.13)
Diluted	$(0.20)	$(0.13)
Weighted-average shares used to compute net loss per common share:		
Basic	50,271	48,911
Diluted	50,271	48,911
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments, net	11	(18)
Total other comprehensive income (loss), net of tax	11	(18)
Comprehensive loss	$(10,016)	$(6,221)

(1) Includes stock-based compensation as follows:

Cost of revenue	$354	$351
Research and development	1,180	1,186
Sales and marketing	1,368	1,279
General and administrative	1,000	1,903
	$3,902	$4,719

See accompanying notes to condensed consolidated financial statements.

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CALIX, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended March 29, 2014	March 30, 2013
Operating activities:		
Net loss	$(10,027)	$(6,203)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,271	2,854
Loss on retirement of property and equipment	—	542
Amortization of intangible assets	4,640	4,640
Stock-based compensation	3,902	4,719
Changes in operating assets and liabilities:		
Accounts receivable, net	(614)	(11,198)
Inventory	6,011	4,050
Deferred cost of revenue	3,233	(5,340)
Prepaid expenses and other assets	1,016	74
Accounts payable	(12,276)	(3,131)
Accrued liabilities	2,485	482
Deferred revenue	(5,811)	10,449
Other long-term liabilities	(56)	442
Net cash (used in) provided by operating activities	(5,226)	2,380
Investing activities:		
Purchase of property and equipment	(1,908)	(1,326)
Net cash used in investing activities	(1,908)	(1,326)
Financing activities:		
Proceeds from exercise of stock options	21	42
Taxes withheld upon vesting of performance restricted stock units	(473)	—
Net cash (used in) provided by financing activities	(452)	42
Effect of exchange rate changes on cash and cash equivalents	8	(32)
Net (decrease) increase in cash and cash equivalents	(7,578)	1,064
Cash and cash equivalents at beginning of period	82,747	46,995
Cash and cash equivalents at end of period	$75,169	$48,059

See accompanying notes to condensed consolidated financial statements.

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CALIX, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Company and Basis of Presentation

Company

Calix, Inc. (together with its subsidiaries, “Calix,” the “Company,” “our,” “we,” or “us”) was incorporated in August 1999, and a Delaware corporation. The Company is a leading provider in North America of broadband communications access systems and software for fiber- and copper-based network architectures that enable communications service providers ("CSPs") to transform their networks and connect to their residential and business subscribers. The Company enables CSPs to provide a wide range of revenue-generating services, from basic voice and data to advanced broadband services, over legacy and next-generation access networks. The Company focuses solely on CSP access networks, the portion of the network that governs available bandwidth and determines the range and quality of services that can be offered to subscribers. The Company develops and sells carrier-class hardware and software products, which the Company refers to as the Unified Access portfolio, that are designed to enhance and transform CSP access networks to meet the changing demands of subscribers rapidly and cost-effectively.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, including the accounts of Calix, Inc. and its wholly-owned subsidiaries, have been prepared in accordance with the requirements of the U.S. Securities and Exchange Commission (“SEC”) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by U.S. generally accepted accounting principles (“GAAP”) can be condensed or omitted. In the opinion of management, the financial statements include all normal and recurring adjustments that are considered necessary for the fair presentation of the Company’s financial position and operating results. All significant intercompany balances and transactions have been eliminated in consolidation. The Condensed Consolidated Balance Sheet at December 31, 2013 has been derived from the audited financial statements at that date. The results of the Company’s operations can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be the same as those for the full year or any future periods. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the audited financial statements for the year ended December 31, 2013, included in the Company’s Form 10-K.

The Company's fiscal year begins on January 1st and ends on December 31st. Quarterly periods are based on a 4-4-5 fiscal calendar with the first, second and third fiscal quarters ending on the 13th Saturday of each fiscal period. As a result, the Company had one fewer day in the first three months of 2014 than of 2013. The preparation of financial statements in conformity with GAAP for interim financial reporting requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

2. Significant Accounting Policies

The Company’s significant accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013. Our significant accounting policies did not materially change during the three months ended March 29, 2014.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force) ("ASU 2013-11"), which provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward or a tax credit carryforward exists. Under the new standard update, the Company’s unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. The accounting standard update became effective for the Company in the first quarter of 2014. As the Company’s disclosures already conform to the required presentation, adoption of this standard did not impact the financial position or results of operations of the Company.

3. Goodwill and Intangible Assets

Goodwill

Goodwill was recorded as a result of the Company's acquisitions of Occam Networks, Inc. (“Occam”) in February 2011 and Optical Solutions, Inc. ("OSI") in February 2006. This goodwill is not deductible for tax purposes, and there have been no adjustments to goodwill since the acquisition dates.

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Goodwill is not amortized but instead is subject to an annual impairment test or more frequently if events or changes in circumstances indicate that it may be impaired. We evaluate goodwill on an annual basis at the end of the second quarter of each year. Management has determined that we operate as a single reporting unit and, therefore, evaluates goodwill impairment at the enterprise level.

At the end of the first quarter of 2014, the Company reviewed events and changes to its business subsequent to the end of fiscal 2013 and concluded that there were no indicators of impairment to the carrying value of its goodwill during the three months ended March 29, 2014. As of March 29, 2014, there was no impairment to the carrying value of the Company's goodwill.

Intangible Assets

Intangible assets are carried at cost, less accumulated amortization. The details of intangible assets as of March 29, 2014 and December 31, 2013 are disclosed in the following table (in thousands):

	March 29, 2014			December 31, 2013		
	Gross Carrying Amount	Accumulated Amortization	Net	Gross Carrying Amount	Accumulated Amortization	Net
Core developed technology	$68,964	$(49,427)	$19,537	$68,964	$(47,339)	$21,625
Customer relationships	54,740	(35,177)	19,563	54,740	(32,625)	22,115
Total intangible assets, excluding goodwill	$123,704	$(84,604)	$39,100	$123,704	$(79,964)	$43,740

Amortization expense was $4.6 million for the three months ended March 29, 2014 and March 30, 2013.

Expected future amortization expense for the fiscal years indicated is as follows (in thousands):

Period	Expected Amortization Expense
Remainder of 2014	$13,921
2015	18,561
2016	5,805
2017	813
Total	$39,100

4. Balance Sheet Details

Cash and cash equivalents consisted of the following (in thousands):

	March 29, 2014	December 31, 2013
Cash	$55,326	$62,905
Money market funds	19,843	19,842
Total cash and cash equivalents	$75,169	$82,747

Accounts receivable, net consisted of the following (in thousands):

	March 29, 2014	December 31, 2013
Accounts receivable	$45,745	$44,642
Allowance for doubtful accounts	(373)	(358)
Product return reserve	(1,238)	(764)
Accounts receivable, net	$44,134	$43,520

Inventory consisted of the following (in thousands):

	March 29, 2014	December 31, 2013
Raw materials	$5,845	$6,591
Finished goods	39,215	44,480

Total inventory	$45,060	$51,071

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Property and equipment, net consisted of the following (in thousands):

	March 29, 2014	December 31, 2013
Test equipment	$36,627	$36,932
Computer equipment and software	28,141	27,280
Furniture and fixtures	1,633	1,614
Leasehold improvements	7,091	7,077
Total	73,492	72,903
Accumulated depreciation and amortization	(56,370)	(55,430)
Property and equipment, net	$17,122	$17,473

Accrued liabilities consisted of the following (in thousands):

	March 29, 2014	December 31, 2013
Accrued warranty	$10,827	$10,856
Accrued compensation and related benefits	14,002	13,127
Accrued professional and consulting fees	1,830	1,634
Accrued excess and obsolete inventory at contract manufacturers	702	756
Accrued customer rebates	989	712
Accrued business travel expenses	1,037	540
Sales and use tax payable	801	521
Income taxes payable	501	368
Accrued other	3,881	3,561
Total accrued liabilities	$34,570	$32,075

Deferred revenue consisted of the following (in thousands):

	March 29, 2014	December 31, 2013
Product and services - current	$26,044	$32,051
Extended warranty - current	2,969	2,811
Extended warranty - non-current	18,382	18,335
Product and services - non-current	87	96
Total deferred revenue	$47,482	$53,293

Deferred cost of revenue consisted entirely of products and services.

The following table provides the changes in accumulated other comprehensive income by component for the periods indicated (in thousands):

	Three Months Ended			
	March 29, 2014		March 30, 2013	
	Foreign Currency Translation Adjustments	Total	Foreign Currency Translation Adjustments	Total
Balance at beginning of period	$190	$190	$132	$132
Other comprehensive income	11	11	(18)	(18)
Balance at end of period	$201	$201	$114	$114

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5. Commitments and Contingencies

Commitments

The Company’s principal commitments consist of obligations under operating leases for office space and non-cancelable outstanding purchase obligations. These commitments as of December 31, 2013 are disclosed in our Annual Report on Form 10-K, and have not changed materially during the three months ended March 29, 2014 except for the following agreement entered into during 2014.

On March 4, 2014, the Company entered into a new commercial lease for a facility in Santa Barbara, California. The lease is set to commence on July 1, 2014 and expire on June 30, 2019. The total minimum future payment commitment under this lease is $1.0 million. In connection with this lease, the Company received an incentive consisting of $0.4 million that can be used for leasehold improvements.

On March 20, 2014, the Company entered into a new commercial lease for a facility in Richardson, Texas. This lease is set to commence on August 1, 2014 and expire on January 31, 2022. The total minimum future payment commitment under this lease is $1.5 million. In connection with this lease, the Company received an incentive consisting of $0.4 million that can be used for leasehold improvements.

Accrued Warranty

The Company provides a warranty for its hardware products. Hardware generally has a one to five-year warranty from the date of shipment. The Company accrues for potential warranty claims based on the Company’s historical claims experience. The adequacy of the accrual is reviewed on a periodic basis and adjusted, if necessary, based on additional information as it becomes available.

Changes in the Company’s warranty reserve were as follows (in thousands):

	Three Months Ended	
	March 29, 2014	March 30, 2013
Balance at beginning of period	$10,856	$11,762
Warranty charged to cost of revenue	909	1,167
Utilization of warranty	(938)	(944)
Balance at end of period	$10,827	$11,985

Litigation

From time to time, the Company is involved in various legal proceedings arising from the normal course of business activities.

On September 16, 2010, the Company, two direct, wholly-owned subsidiaries of the Company, and Occam entered into an Agreement and Plan of Merger and Reorganization (the “Merger Agreement”). In response to the announcement of the Merger Agreement on October 6, 2010, a purported class action complaint was filed by stockholders of Occam in the Delaware Court of Chancery: Steinhardt v. Howard-Anderson, et al. (Case No. 5878-VCL). On November 24, 2010, these stockholders filed an amended complaint (the “amended Steinhardt complaint”). The amended Steinhardt complaint named Occam (which has since been merged into Calix) and the members of the Occam board of directors as defendants. The amended Steinhardt complaint did not name Calix as a defendant.

The amended Steinhardt complaint sought injunctive relief rescinding the merger transaction and an award of damages in an unspecified amount, as well as plaintiffs' costs, attorney's fees, and other relief.

The merger transaction was completed on February 22, 2011. On January 6, 2012, the Delaware court ruled on a motion for sanctions brought by the defendants against certain of the lead plaintiffs. The Delaware court found that lead plaintiffs Michael Steinhardt, Steinhardt Overseas Management, L.P., and Ilex Partners, L.L.C., collectively the “Steinhardt Plaintiffs,” had engaged in improper trading of Calix shares, and dismissed the Steinhardt Plaintiffs from the case with prejudice. The court further held that the Steinhardt Plaintiffs are: (i) barred from receiving any recovery from the litigation, (ii) required to self-report to the SEC, (iii) directed to disclose their improper trading in any future application to serve as lead plaintiff, and (iv) ordered to disgorge trading profits of $0.5 million, to be distributed to the remaining members of the class of former Occam stockholders. The Delaware court also granted the motion of the remaining lead plaintiffs, Herbert Chen and Derek Sheeler, for class certification, and certified Messrs. Chen and Sheeler as class representatives. The certified class is a non-opt-out class consisting of all owners of Occam common

stock whose shares were converted to shares of Calix on the date of the merger transaction, with the exception of the defendants in the Delaware action and their affiliates. Chen and Sheeler, on behalf of the class of similarly situated former Occam stockholders, continue to seek an award of damages in an unspecified amount.
Fact discovery in the case closed on April 30, 2013. On June 11, 2013, the plaintiffs filed their Second Amended Class Action Complaint for Breach of Fiduciary Duty ("Second Amended Complaint"). The Second Amended Complaint adds Occam's former CFO as a defendant, and alleges that each of the defendants breached their fiduciary duties by failing to attempt to obtain the best purchase price for Occam and failing to disclose certain allegedly material facts about the merger transaction in the preliminary proxy statement and prospectus included in the Registration Statement on Form S-4 filed with the SEC on November 2, 2010.
On July 17, 2013, attorneys representing all of the defendants named in the Second Amended Complaint filed Defendants' Opening Brief in Support of Their Motion for Summary Judgment, arguing that all defendants are entitled to summary judgment on all counts of the Second Amended Complaint. Plaintiffs' answering brief to the motion for summary judgment was filed on September 3, 2013, and defendants' reply brief was filed on October 4, 2013. A hearing on the motion for summary judgment was held on December 6, 2013.

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On April 8, 2014, the Court of Chancery of the State of Delaware issued an Opinion granting in part and denying in part the Defendants’ Motion for Summary Judgment. The court granted summary judgment in favor of those defendants who served solely as directors of Occam with respect to all claims alleging improper actions in connection with the Occam sale process. The ruling also granted summary judgment on all claims as to Occam, the corporate entity. The court left in place process-based claims against Occam’s former CEO and CFO, and also declined to grant summary judgment on separate claims that the director and officer defendants breached their fiduciary duties by issuing a proxy statement for Occam’s stockholder vote that allegedly contained misleading disclosures and had material omissions.

The Company continues to believe that the allegations in the Second Amended Complaint are without merit and intends to continue to vigorously contest the action as it moves forward toward an eventual trial. However, there can be no assurance that the defendants will be successful in defending this ongoing action. In addition, the Company has obligations, under certain circumstances, to hold harmless and indemnify each of the former Occam directors and officers against judgments, fines, settlements and expenses related to claims against such directors and otherwise to the fullest extent permitted under Delaware law and Occam's bylaws and certificate of incorporation. Such obligations may apply to this lawsuit.

The Company is not currently a party to any other legal proceedings that, if determined adversely to the Company, would individually or in the aggregate have a material adverse effect on the Company's business, operating results or financial condition.

6. Fair Value Measurements

In accordance with Accounting Standard Codification ("ASC") Topic 820, Fair Value Measurements and Disclosures, (“ASC Topic 820”), the Company measures its cash equivalents at fair value on a recurring basis. ASC Topic 820 clarifies that fair value is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, ASC Topic 820 establishes a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 – Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Observable inputs other than quoted prices included in Level 1 for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-driven valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 – Unobservable inputs to the valuation derived from fair valuation techniques in which one or more significant inputs or significant value drivers are unobservable. The fair value hierarchy also requires the Company to maximize the use of observable inputs, when available, and to minimize the use of unobservable inputs when determining inputs and determining fair value.

The following table sets forth the Company's financial assets measured at fair value on a recurring basis as of March 29, 2014 and December 31, 2013, based on the three-tier fair value hierarchy (in thousands):

As of March 29, 2014	Level 1	Total
Money market funds	$19,843	$19,843
Total	$19,843	$19,843

As of December 31, 2013	Level 1	Total
Money market funds	$19,842	$19,842
Total	$19,842	$19,842

The Company's money market funds consisted of highly liquid investments with original maturities of three months or less and are classified as cash equivalents. The carrying amounts of our money market funds approximate their fair values due to their nature, duration and short maturities. The fair values of money market funds were derived from quoted market prices as active markets for these instruments exist. The Company has no level 2 or level 3 financial assets.

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7. Net Loss per Share

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated (in thousands, except per share data):

	Three Months Ended	
	March 29, 2014	March 30, 2013
Numerator:		
Net loss	$(10,027)	$(6,203)
Denominator:		
Weighted-average common shares outstanding	50,271	48,911
Basic and diluted net loss per common share	$(0.20)	$(0.13)
Potentially dilutive shares, weighted average	4,452	4,971

For all periods presented, unvested restricted stock awards are included in the calculation of weighted-average common shares outstanding because such shares are participating securities; however, the impact was immaterial.

8. Stockholders’ Equity

Equity Incentive Plans

The Company maintains three equity incentive plans, the 2000 Stock Plan, the 2002 Stock Plan and the 2010 Equity Incentive Award Plan (together, the “Plans”). These plans were approved by the stockholders and are described in the Company’s Form 10-K filed with the SEC on February 20, 2014. The Company also maintains a Long Term Incentive Program, under the 2010 Equity Incentive Award Plan. Under the Long Term Incentive Program, certain key employees of the Company are eligible for equity awards based on the Company’s stock price performance. To date, awards granted under the Plans consist of stock options, restricted stock units ("RSUs"), restricted stock awards ("RSAs"), and performance restricted stock units ("PRSUs").

Stock Options

During the three months ended March 29, 2014, the Company granted 551,000 stock options at a weighted-average grant date fair value of $4.43 per share. During the three months ended March 29, 2014, 4,895 stock options were exercised at a weighted-average exercise price of $4.30 per share. As of March 29, 2014, unrecognized stock-based compensation expense of $7.9 million related to stock options, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 2.6 years.

Restricted Stock Units

During the three months ended March 29, 2014, 15,700 RSUs were granted with a weighted-average grant date fair value of $8.47 per share. During the three months ended March 29, 2014, 2,136 RSUs vested and were converted to an equivalent number of shares of common stock. As of March 29, 2014, unrecognized stock-based compensation expense of $9.3 million related to RSUs, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 2.6 years.

Performance Restricted Stock Units

In 2012, the Company commenced granting PRSUs to its executives with two-year and three-year performance periods. The performance criterion is based on the relative total shareholder return (“TSR”) of Calix common stock as compared to the TSR of the Company’s peer group. The TSR is calculated by dividing (a) the average closing trading price for the 90-day period ending on the last day of the applicable performance period by (b) the average closing trading price for the 90-day period immediately preceding the first day of the applicable performance period. This TSR is then used to derive the achievement ratio, which is then multiplied by the number of units in the grant to derive the common stock to be issued for each performance period, which may equal from zero percent (0%) to two hundred percent (200%) of the target award.

During the three months ended March 29, 2014, 144,000 PRSUs were granted with a weighted-average grant date fair value of $8.00 per unit. During the three months ended March 29, 2014, 89,568 PRSUs, net of shares withheld at the then-current value equivalent to the employees' minimum statutory obligation for applicable income and other employment taxes, were converted to an equivalent number of shares of common stock. As of March 29, 2014, unrecognized stock-based compensation expense of $2.4 million related to PRSUs, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 1.6 years.

Restricted Stock Awards

During the three months ended March 29, 2014, no RSAs were granted. As of March 29, 2014, unrecognized stock-based compensation expense of $2.0 million related to RSAs, net of estimated forfeitures, was expected to be recognized over a weighted-average period of 1.4 years.

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Employee Stock Purchase Plan

The Company’s Amended and Restated Employee Stock Purchase Plan (“ESPP”) allows employees to purchase shares of the Company’s common stock through payroll deductions of up to 15 percent of their annual compensation subject to certain Internal Revenue Code limitations. In addition, no participant may purchase more than 2,000 shares of common stock in each offering period.

The offering periods under the ESPP are six-month periods commencing on June 1 and December 1 of each year. The price of common stock purchased under the plan is 85 percent of the lower of the fair market value of the common stock on the commencement date and exercise date of each six-month offering period. As of March 29, 2014, there were 2,845,428 shares available for issuance under the ESPP.

There were no shares purchased under the ESPP during the three months ended March 29, 2014. As of March 29, 2014, unrecognized stock-based compensation expense of $0.3 million related to the ESPP was expected to be recognized over a remaining service period of 2 months.

Stock-Based Compensation Expense

In accordance with ASC Topic 718, Compensation - Stock Compensation, ("ASC Topic 718"), stock-based compensation expense associated with stock options, RSUs, PRSUs, RSAs, and purchase rights under the ESPP is measured at the grant date based on the fair value of the award, and is recognized, net of forfeitures, as expense over the remaining requisite service period on a straight-line basis.

The Company values RSUs and RSAs at the closing market price of the Company’s common stock on the date of grant.

The fair value of PRSUs with a market condition is estimated on the date of award, using a Monte Carlo simulation model to estimate the TSR of the Company's stock in relation to the peer group over each performance period. Compensation cost on PRSUs with a market condition is not adjusted for subsequent changes in the Company's stock performance or the level of ultimate vesting.

The Company estimates the fair value of stock options at the grant date using the Black-Scholes option-pricing model. This model requires the use of the following assumptions:

(i) Expected volatility of the Company's common stock - Starting in the fourth quarter of 2012, the Company computes its expected volatility assumption based on a blended volatility (50% historical volatility and 50% implied volatility from traded options on the Company's common stock). The selection of a blended volatility assumption was based upon the Company's assessment that a blended volatility is more representative of the Company's future stock price trend as it weighs the historical volatility with the future implied volatility. Prior to the fourth quarter of 2012, due to the lack of a sufficient history of the Company's stock prices, the Company’s computation of expected volatility was based on the Company’s peer group in the industry in which the Company does business.

(ii) Expected life of the option award - Represents the weighted-average period that the stock options are expected to remain outstanding. The Company’s computation of expected life utilizes the simplified method in accordance with Staff Accounting Bulletin No. 110 ("SAB 110") due to the lack of sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term. The mid-point between the vesting date and the expiration date is used as the expected term under this method.

(iii) Expected dividend yield - Assumption is based on the Company's history of not paying dividends and no future expectations of dividend payouts.

(iv) Risk-free interest rate - Based on the U.S. Treasury yield curve in effect at the time of grant with maturities approximating the grant’s expected life.

The following table summarizes the weighted-average assumptions used in estimating the grant-date fair value of stock options in the periods indicated:

	Three Months Ended	
	March 29, 2014	March 30, 2013
Expected volatility	54%	62%
Expected life (years)	6.15	6.05

Expected dividend yield	—	—
Risk-free interest rate	1.91%	1.12%

Modification of Stock Awards

In February 2013, the Company entered into a Transition and Separation Agreement ("Agreement") with Roger Weingarth, the Company's former Executive Vice President and Chief Operating Officer. Under the Agreement, Mr. Weingarth transitioned to the role of advisor to the Chief Executive Officer of the Company effective as of April 1, 2013, and would terminate his employment with the Company on March 31, 2014 ("Termination Date"). Upon his termination, the Agreement provides for, among other things, the acceleration of the vesting of his unvested stock options, RSAs and RSUs held by him as of the Termination Date.

In accordance with ASC Topic 718, total fair value of the accelerated stock awards after the modification is $0.6 million, which is being recognized on a straight-line basis over the remaining service period through the Termination Date. During the three months ended March 29, 2014, $0.1 million of the total fair value has been recognized in general and administrative expenses.

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9. Credit Facility

The Company had a revolving credit facility ("Prior Credit Facility") of $30.0 million with Silicon Valley Bank based upon a percentage of eligible accounts receivable, which matured on June 30, 2013. After the Prior Credit Facility matured on June 30, 2013, the Company cash collateralized the outstanding letters of credit with Silicon Valley Bank. As of March 29, 2014, the Company had $0.3 million cash restricted for collateralizing the outstanding letters of credit with Silicon Valley Bank.

On July 29, 2013, the Company entered into a credit agreement with Bank of America, N.A. The credit agreement is structured such that other financial institutions can at a later time become party to the credit agreement through an amendment via a syndication process (collectively, together with Bank of America, N.A., the "Lenders"). The credit agreement provides for a revolving facility in the aggregate principal amount of up to $50.0 million, which includes a $20.0 million sublimit for the issuance of letters of credit and a $10.0 million sublimit for a swingline facility. Subject to customary conditions, up to $25.0 million of the revolving facility may be converted to a term loan facility at any time prior to the maturity of the revolving facility. The revolving facility matures on July 29, 2016, but may be extended up to two times (each extension for an additional one-year period) upon mutual agreement of the Company and the Lenders. The credit facility is secured by substantially all of our assets, including our intellectual property. Proceeds of the credit facility may be used for general corporate purposes and permitted acquisitions.

Loans under the credit facility bear interest at an annual rate equal to the base rate plus 0.75% to 1.25% or LIBOR plus 2.00% to 2.50% based on a leverage ratio of consolidated funded indebtedness to consolidated Adjusted EBITDA (customarily defined). Interest on the revolving facility is due quarterly, and any outstanding interest and principal is due on the maturity date of the revolving facility. The Company is required to repay principal on a term loan in twenty equal quarterly payments from the date the Company enters into a term loan, and all outstanding principal and accrued interest is due on the revolving facility maturity date. Swingline loans must be repaid on the earlier of (i) ten business days after a loan is made and (ii) the revolving facility maturity date. The Company is also required to pay commitment fees of 0.25% per year on any unused portions of this facility.

The credit facility includes affirmative and negative covenants applicable to the Company that are typical for credit facilities of this type. Furthermore, the credit agreement requires us to maintain certain financial covenants, including a maximum consolidated leverage ratio, and a minimum consolidated liquidity ratio of cash, cash equivalents and accounts receivable to consolidated funded indebtedness. As of March 29, 2014, the Company was in compliance with these requirements.

The credit facility also includes customary events of default, the occurrence and continuation of which would provide the Lenders with the right to demand immediate repayment of any principal and unpaid interest under the credit facility, and to exercise remedies against us and the collateral securing the loans under the credit facility.

As of March 29, 2014, the Company had no outstanding letters of credit or borrowings under the credit facility.

The Company incurred $0.3 million of debt issuance costs that were directly attributable to the issuance of this credit facility. These costs will be amortized over three years starting from the effective date of the credit facility. As of March 29, 2014, the unamortized debt issuance costs of $0.2 million were included within ‘Other assets’ in our Condensed Consolidated Balance Sheets.

10. Income Taxes

The following table presents the provision for income taxes from continuing operations and the effective tax rates for the periods indicated (in thousands, except percentages):

	Three Months Ended	
	March 29, 2014	March 30, 2013
Provision for income taxes	$110	$357
Effective tax rate	(1.1)%	(6.1)%

The Company has incurred operating losses since inception and, as such, has not received a tax benefit for these losses. The income tax provision for the first three months of 2014 primarily consisted of state and foreign income taxes. The income tax provision for the first three months of 2013 primarily consisted of federal and state alternative

minimum tax and state and foreign income taxes. The effective tax rates differ from the U.S. federal statutory rate of 34.0% due primarily to the tax affected change in the valuation allowance against the Company’s deferred tax assets. ASC Topic 740, Income Taxes, ("ASC Topic 740"), provides for the recognition of deferred tax assets if realization of such assets is more likely than not. The Company has established and continues to maintain a full valuation allowance against its net deferred tax assets, with the exception of certain foreign deferred tax assets, as the Company does not believe that realization of those assets is more likely than not.
As of March 29, 2014 and December 31, 2013, the Company had unrecognized tax benefits of $14.4 million, none of which would affect the Company's effective tax rate if recognized.

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ITEM 2.Management’s Discussion and Analysis of Financial Condition and Results of Operations

This report includes “forward-looking statements” within the meaning of Section 27A of the Securities Act and Section 21E of the Securities and Exchange Act of 1934, as amended. All statements other than statements of historical facts are “forward-looking statements” for purposes of these provisions, including any projections of earnings, revenues or other financial items, any statement of the plans and objectives of management for future operations, any statements concerning proposed new products or licensing, any statements regarding product development, any statements regarding future economic conditions or performance, and any statement of assumptions underlying any of the foregoing. In some cases, forward-looking statements can be identified by the use of terminology such as “may,” “will,” “expects,” “plans,” “anticipates,” “estimates,” “potential,” or “continue” or the negative thereof or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that such expectations or any of the forward-looking statements will prove to be correct, and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including but not limited to the Risk Factors set forth under Part II, Item 1A below, and for the reasons described elsewhere in this report. All forward-looking statements and reasons why results may differ included in this report are made as of the date hereof, and we assume no obligation to update these forward-looking statements or reasons why actual results might differ.

Overview

We are a leading provider in North America of broadband communications access systems and software for fiber- and copper-based network architectures that enable communications service providers to connect to their residential and business subscribers. We enable CSPs to provide a wide range of revenue-generating services, from basic voice and data to advanced broadband services, over legacy and next-generation access networks. We focus solely on CSP access networks, the portion of the network that governs available bandwidth and determines the range and quality of services that can be offered to subscribers. We develop and sell carrier-class hardware and software products, which we refer to as the Unified Access portfolio, that are designed to enhance and transform CSP access networks to meet the changing demands of subscribers rapidly and cost-effectively.

We market our access systems and software to CSPs globally through our direct sales force as well as a limited number of resellers. At the end of the first quarter of 2014, over eighteen million ports of our Unified Access portfolio have been deployed at a growing number of CSPs worldwide, whose networks serve over 100 million subscriber lines in total. Our customers include many of the world's largest communications providers. In addition, we have enabled over 1,000 customers who have deployed gigabit passive optical network, Active Ethernet and point-to-point Ethernet fiber access networks.

Our revenue decreased to $85.8 million for the three months ended March 29, 2014, from $90.5 million for the three months ended March 30, 2013. During the first quarter of 2014, we experienced softness in our business, as expected, due to lower demand across multiple customer markets, which we believe was due to a slowdown in capital expenditures caused by budgeting delays by our service-provider customers. Continued revenue growth will depend on our ability to continue to sell our access systems and software to existing customers and to attract new customers, including in particular, large CSPs and customers in international markets. For the three months ended March 29, 2014, we had a net loss of $10.0 million. Our net loss was $6.2 million for the three months ended March 30, 2013. Since our inception we have incurred significant losses and, as of March 29, 2014, we had an accumulated deficit of $519.8 million.

Revenue fluctuations result from many factors, including but not limited to: increases or decreases in customer orders for our products and services, large customer purchase agreements with delayed revenue recognition, varying budget cycles and seasonal buying patterns of our customers. More specifically, our customers tend to spend less in the first fiscal quarter as they are finalizing their annual budgets. Customers typically purchase more products during our second and third fiscal quarters. Finally, in our fourth fiscal quarter, customer purchases typically increase as they are attempting to spend the rest of their budget for the year. As of March 29, 2014, our deferred revenue of $47.5 million primarily included certain contracts with customers who receive government supported loans and grants from the U.S. Department of Agriculture’s Rural Utility Service (“RUS”) that require installation services, as well as extended warranty services contracts that are recognized ratably over the period during which the services are to be performed. The timing of deferred recognition may cause significant fluctuations in our revenue and operating results from period to period.

Cost of revenue is strongly correlated to revenue and will tend to fluctuate from all of the aforementioned factors that could impact revenue. Other factors that impact cost of revenue include changes in the mix of products and services delivered to our customers and changes in the cost of our inventory. Cost of revenue includes fixed expenses related to our internal operations, which could impact our cost of revenue as a percentage of revenue, if there are large sequential fluctuations to revenue.

Our gross profit and gross margin have been, and will likely be, impacted by several factors, including new product introduction or upgrades to existing products, changes in customer mix, changes in the mix of products and services demanded and sold, shipment volumes, changes in our product costs, changes in pricing and the extent of customer rebates and incentive programs. We believe our gross margin could increase due to favorable changes in these factors, for example, increases in sales of our advanced E-Series Ethernet service access platforms, upgrades to our C7 platform, new introductions of our P-Series optical network terminals and reductions in the impact of rebate or similar programs. We believe our gross margin could decrease due to unfavorable changes in factors such as increased product costs, pricing decreases due to competitive pressure and an unfavorable customer or product mix. Changes in these factors could have a material impact on our future average selling prices and unit costs. Also, the timing of deferred revenue recognition and related deferred costs can have a material impact on our gross profit and gross margin results. The timing of recognition and the relative size of these arrangements could cause large fluctuations in our gross profit from period to period.

Our operating expenses have fluctuated based on the following factors: timing of variable compensation expenses due to fluctuations in order volumes, timing of salary increases which have historically occurred in the second quarter, timing of bonus expenses due to changes

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in the Company’s performance, timing of research and development expenses including prototype builds and intermittent outsourced development projects.

As a result of the fluctuations described above and a number of other factors, many of which are outside our control, our quarterly operating results fluctuate from period to period. Comparing our operating results on a period-to-period basis may not be meaningful, and you should not rely on our past results as an indication of our future performance.

Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with U.S. GAAP. These accounting principles require us to make certain estimates and judgments that can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenue and expenses during the periods presented. Management bases its estimates, assumptions and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. To the extent there are material differences between these estimates and actual results, our financial statements will be affected. Our management evaluates its estimates, assumptions and judgments on an ongoing basis.

Our critical accounting policies and estimates are described under “Critical Accounting Policies and Estimates” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our Annual Report on Form 10-K for the year ended December 31, 2013. During the three months ended March 29, 2014, there have been no significant changes in our critical accounting policies and estimates.

Recent Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force) ("ASU 2013-11"), which provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward or a tax credit carryforward exists, with the purpose of reducing diversity in practice. Under the new standard update, with certain exceptions, the Company’s unrecognized tax benefit should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward or a tax credit carryforward. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. The accounting standard update became effective for the Company in the first quarter of 2014. As the Company’s disclosures already conform to the required presentation, adoption of this standard does not impact the financial position or results of operations of the Company.

Results of Operations

Comparison of the Three Months Ended March 29, 2014 and March 30, 2013

Revenue

The following table sets forth our revenue (in thousands, except percentages):

	Three Months Ended			
	March 29, 2014	March 30, 2013	Variance in Dollars	Variance in Percent
Revenue	$85,820	$90,548	$(4,728)	(5)%

Our revenue decreased to $85.8 million for the three months ended March 29, 2014, from $90.5 million for the three months ended March 30, 2013. During the first quarter of 2014, we experienced softness in our business, as expected, due to lower demand across multiple customer markets, which was due to a slowdown in capital expenditures caused by budgeting delays by service providers, especially some of our largest customers in some territories.

Our revenue is principally derived in the United States. During the three months ended March 29, 2014, revenue generated in the United States represented approximately 88% of our total revenue. During the three months ended March 30, 2013, revenue generated in the United States represented approximately 86% of our total revenue. Notwithstanding that our revenue decreased domestically and internationally compared to last year, we expect international and overall revenue to grow as we expand our international markets.

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Cost of Revenue and Gross Profit

The following table sets forth our cost of revenue (in thousands, except percentages):

	Three Months Ended			
	March 29, 2014	March 30, 2013	Variance in Dollars	Variance in Percent
Cost of revenue:				
Products and services	$46,806	$47,345	$(539)	(1)%
Amortization of intangible assets	2,088	2,088	—	—%
Total cost of revenue	$48,894	$49,433	$(539)	(1)%
Gross profit	$36,926	$41,115	$(4,189)	(10)%
Gross margin	43%	45%		

The decrease in cost of revenue during the three months ended March 29, 2014 compared with the corresponding period of fiscal 2013 was due to a $0.5 million decrease in products and services cost, which was primarily related to decreased revenue and lower margins from the recognition of several RUS-funded projects. The amortization of intangible assets remained at the same level.

Excluding amortization of intangible assets, gross margin decreased to 45% during the three months ended March 29, 2014 from 48% during the corresponding period of fiscal 2013, primarily due to a combination of product and customer mix, deferred and recognized or shipped revenues and movements in inventory reserves.

Operating Expenses

Research and Development Expenses

The following table sets forth our research and development expenses (in thousands, except percentages):

	Three Months Ended			
	March 29, 2014	March 30, 2013	Variance in Dollars	Variance in Percent
Research and development	$19,630	$20,171	$(541)	(3)%
Percent of total revenue	23%	22%		

The decrease in research and development expenses of $0.5 million during the three months ended March 29, 2014 compared with the corresponding period of fiscal 2013 was primarily due to a decrease in compensation and employee benefits expenses of $0.4 million resulting from the reduction in number of U.S. employees year over year and severance expenses incurred in the first quarter of 2013; as well as a reduction in previously acquired facility related expenses by $0.1 million.

We are continuing our strategic investments in our Unified Access portfolio. We intend to continue to dedicate significant resources to research and development and to develop new product capabilities to support the performance, scalability and management of our Unified Access portfolio.

Sales and Marketing Expenses

The following table sets forth our sales and marketing expenses (in thousands, except percentages):

	Three Months Ended			
	March 29, 2014	March 30, 2013	Variance in Dollars	Variance in Percent
Sales and marketing	$17,390	$15,801	$1,589	10%
Percent of total revenue	20%	17%		