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EDITED TRANSCRIPT

VIAV - Q3 2016 Viavi Solutions Inc Earnings Call

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OVERVIEW:

Co. reported 3Q16 revenues of $220.4m and non-GAAP EPS of $0.09. Expects 4Q16 revenues to be $212-228m and non-GAAP EPS to be $0.08-0.10.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to the Viavi Solutions third-quarter 2016 Viavi Solutions earnings conference call. (Operator Instructions) As a reminder, this conference call may be recorded.

I will now like to introduce your host for today's conference, Bill Ong, Head of Investor Relations. Please go ahead.

Bill Ong - *Viavi Solutions Inc. - Senior Director of IR*

Thank you, Charlotte. Welcome to Viavi Solutions' third-quarter fiscal 2016 earnings call. My name is Bill Ong, Head of Investor Relations.

Joining me on today's call, Oleg Khaykin, President and CEO, and Amar Maletira, CFO.

Please note this call will include forward-looking statements about the Company's financial performance. These statements are subject to risks and uncertainties that could cause actual results to differ materially from current expectations. We encourage you to review our most recent SEC filings, particularly the risk factors described in those filings. The forward-looking statements, including guidance we provide during this call, are valid only as of today. Viavi undertakes no obligation to update these statements.

Please also note that, unless we state otherwise, all results are non-GAAP. We reconcile these non-GAAP financials to our preliminary GAAP financials and discuss the usefulness and limitations in today's earnings release. The release, plus our supplementary slides, which includes historical financial tables, are available on our website.

Finally, we are recording today's call and will make the recording available by 4.30 p.m. Pacific time this evening on our website.

I would now like to turn the call over to Amar.

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Amar Maletira - *Viavi Solutions Inc. - CFO*

Thank you, Bill. Overall, we executed well in our fiscal third quarter. Revenue of $220.4 million was above our guidance midpoint of $218 million, whereas we exceeded the guidance while NSE was at the lower end of the guidance range.

Revenue was up 3.8% year over year, driven by strong performance in our OSP segment that offset the decline in NSE. Our operating income at $26.2 million grew $7.2 million or 37.9% year over year. Operating margin of 11.9% was below our guidance midpoint of 11.7% and up 300 basis points year over year as a result of continued strong performance in OSP and operating expense management. Operating expenses declined 7.2% year over year or $8.5 million, driven primarily by G&A expense reduction and R&D spend optimization. EPS at $0.09 was at the high end of the guidance range of $0.07 and $0.09 and grew 50% year over year.

Now, moving to the results by segment, starting with NSE. NSE revenue at $158.3 million declined 3.5% year over year, driven by the decline of 11.8% in the SE segment. While the enterprise business within SE grew double digits, we remain challenged in the insurance business where the mature products' revenues declined at a faster pace compared with the growth in the new products. NSE gross margins at 63.5% decline to 440 basis points year over year due to margin degradation in SE as a result of a steep run-off of the higher margin mature products and a nonrecurring dilutive impact to margins from initial acceptance of solutions in the growth products.

NSE's operating margins was roughly breakeven and was below the guidance range due to the gross margin decline in SE, which has partially offset by a reduction in operating expenses. The book-to-bill ratio for NSE was slightly above 1 with higher bookings over revenue both in the NE and SE segments.

Turning to OSP. OSP revenue at $62.1 million grew 28.3% from a year ago levels, driven by higher demand in the anti-counterfeiting business. Gross margins at 57.8% improved 350 basis points, and operating margin at 42.4% improved 670 basis points from last year due to higher revenue, favorable product mix, and higher factory utilization.

Turning to the balance sheet. Our total cash and short-term investments ending balance was $1 billion, which includes the remaining 9.2 million shares in Lumentum, valued at $244.3 million. During the quarter, we sold 2.5 million shares of Lumentum stock with an average stock price of $24.47, reserving and net proceeds of $61.2 million. Our book cost basis on these shares is approximately $8.57 per share.

As a result, we realized on GAAP only P&L an accounting gain of approximately $39.7 million. Our operating cash flow for the quarter was $36.3 million.

Now, turning to our guidance. We expect fiscal fourth-quarter revenue to be in the range of $212 million to $228 million, operating margin at 12.7% plus or minus 1%, and EPS to be $0.08 to $0.10. We expect NSE revenue to be slightly up sequentially at $160 million plus or minus $6 million with operating margin at 2.5% plus or minus 1%. We expect OSP revenue to be at $60 million plus or minus $2 million, with operating margin at 40% plus or minus 1%.

Our tax expense is expected to be about $5 million. We expect other income and expenses to be a net expense of $2.5 million and our share count to be approximately 237 million shares.

With that, I will now turn the call to Oleg.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Thank you, Amar. Before I get to my commentary on our business, I would like to share with you my initial impressions and perspective since coming to Viavi three months ago.

In the past 90 days, I visited many of our locations and have met with our major customers. There are four major areas of strength that clearly stand out: the first, the impressive and abundant technical talent within the company; the second, the strength and competitiveness of our product

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portfolio; the third, a strong reputation for innovation, quality, and service with top customers around the world; and, lastly, the many promising innovative growth initiatives within the Company.

At the same time, Viavi faces operating challenges that need to be addressed. Our R&D and SG&A footprint is too broad for a company of our size. Our resources are too thinly stretched to both geographically and financially to execute on all of our products and technology initiatives. Many of our issues stem from a lack of comprehensive integration and rationalization of the many acquisitions that the Company has made over the years.

In addition, we need to further improve our discipline in planning and allocating our investment resources.

My management team and I have already started to address some of these challenges. We are in the process of putting together a comprehensive new strategy that is built around driving share in Viavi's core markets and improving OpEx productivity. In the coming months, I will be providing you with more color around our strategy and share with you our goals, objectives, and milestones.

Now, getting back to commentary on our quarter. We exceeded the overall guidance midpoint for Viavi, despite both delayed customer spending and weaker results in the SE business segment. The March quarter is traditionally a seasonally weak quarter for us. Our service providers and enterprise customers get their CapEx and IT spending budgets for the calendar year. It was further exacerbated by macroeconomic concerns in January that caused NSE customers to either scale back or delay spending.

Our instruments business, or NE, was essentially flat year over year. During the quarter, we saw strength in the demand for fiber lab and field test equipment, driven by fiber to the home and fiber for wireless backhaul deployments in North America and 100-gig deployment globally. Access and storage network tests also grew from levels a year ago.

Cable was down year on year as customers reduced their purchases in anticipation of DOCSIS 3.1 upgrade cycle. The exact timing of the DOCSIS 3.1 upgrade cycle remains unclear, but we are still expecting the deployment to start in calendar 2016, ramp gradually, and spread over the next several years.

Viavi is very well positioned to benefit from this upcoming upgrade cycle.

The macroeconomic uncertainty and slower deal closure challenged the SE segment of our business. During our enterprise -- although our enterprise business was up by double-digit percentage from a year ago, our revenue levels were below our internal expectations as IT budgets were slow to release. Furthermore, our mature products within SE, as expected, continued to decline significantly year over year. The decline in margin-rich mature products was greater than the growth in SE products, leading to a weaker than expected overall performance for the SE segment.

Given the projected reduction in carrier CapEx and weaker enterprise IT spend, we are taking a more cautious near-term outlook for our NSE business. In addition, we are putting together a plan to revamp our NSE strategy along three vectors: the first one, aggressively defend and expand our market share position in instruments; the second, exercise greater investment discipline in customer and application focus on the SE side of the business; and, thirdly, drive OpEx productivity improvement. We will provide greater details around this strategy over the next two quarters.

On the OSP segment, the OSP segment delivered the second-highest revenue quarter at $62.1 million. The business continues to benefit from high-volume banknote printing. While the current level of banknote printing demand is expected to continue into Q4, we expect it to come down to historical levels thereafter. As such, we expect the OSP revenue to be down modestly during the fiscal year 2017.

While we are pleased with the solid execution and record profitability of our OSP business, we continue to look for opportunities to diversify its revenue base through increased leverage of its core capability, intellectual property and fixed assets.

In closing, I am pleased with our performance during what turned out to be a challenging quarter for our customers and peers. I am happy to be part of the Viavi team and look forward to driving the transformation of our Company into a profitable and growing enterprise. We have a lot of work and many challenges ahead of us, but I have strong confidence in the Viavi management team and our dedicated employees to achieve our goals and objectives and delight our customers and shareholders.

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Thank you for joining us today, and I look forward to seeing many of you at the upcoming investor conferences and events. I will now turn the call over to Bill. Bill?

Bill Ong - *Viavi Solutions Inc. - Senior Director of IR*

Thank you, Oleg. I would like to highlight the following upcoming investor relations events. We will be presenting at Stifel's Investor Conference in San Francisco on June 6th. Our Analyst Day event will be held on our Milpitas campus on September 15.

Charlotte, let's begin the question and answer session, and let's take our first caller.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) James Kisner, Jefferies.

James Kisner - *Jefferies - Analyst*

Your guidance at the midpoint here suggests some of the -- a pretty weak sequential performance, just given typical seasonality on (inaudible) spending. One clarification, have you factored any potential weakness for a potential strike at Verizon? And I guess I am trying to understand better why the instruments business wouldn't be up more or any business wouldn't be up more in June just from carrier spending seasonality.

Amar Maletira - *Viavi Solutions Inc. - CFO*

So I think you said it well here. When you look at our guidance for fiscal Q4, the historical seasonality is -- in NSE, the revenue goes up roughly 9% to 10%. But we are modeling a low single digit increase in revenue from Q3 to Q4 because we are factoring in the macroeconomic pressure in terms of IT spending and enterprise, as well as the CapEx spending environment in the service provider. We also are factoring in some of the strikes that you just mentioned with some of our top service providers.

So that is what is factored in. We are taking -- as Oleg mentioned in his prepared remarks, we are taking more cautious near-term outlook on the environment. And if the spending goes up, we will execute aggressively and we will capture that spend.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

This is Oleg. Just adding to it, if you look at a lot of the announcements from major service providers, they all kind of missed, if you can call it, their quarterly CapEx spend. What it tells me is essentially they are holding back on spending the money and kicking the can forward. While, at the same time, they all claim they are still committed to their annual CapEx.

So I think if I were a betting man, I would probably wait to see the money before I do any kind of spending, and from my perspective, I think it is prudent to be cautious and control your costs until we see meaningful movement on the spend and major service providers actually trying to hit their spending targets.

If the second quarter -- they continue to miss their spending targets and they still stay committed, we may see a stronger second half. But somehow, I think everybody is just announcing the numbers, and we will watch carefully how the spending environment is going to develop during the year.

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James Kisner - *Jefferies - Analyst*

Okay. Just a quick follow-up on that on NE. You said you want to aggressively defend your share instruments. What tactics are you planning there? Should we infer that you plan to compete more aggressively on price, or is there some other inference we should draw? Thanks.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Well, I mean, our products are very good. We don't need to resort to price-cutting to win it. I think, when I talk about aggressively take back market share, it is really about putting more sales resources on the segments that we have somewhat pulled out. In the last few years, Viavi has spent a lot of effort developing the SE side of the business and, to some extent, I would say we probably did not pay enough attention to our traditional core business, although we did very well. I believe by increasing the level of focus in our sales force and our channels on our instruments business, we are going to take back our fair share of the market.

Operator

Patrick Newton, Stifel.

Patrick Newton - *Stifel Nicolaus - Analyst*

First, I wanted to drill in on the SE business and hoping you could help us understand how big the legacy service assurance business is currently within that mix. And then, when you look at the assets within SE, do you think M&A is required, or do you have the right pieces in place to compete in that market?

Amar Maletira - *Viavi Solutions Inc. - CFO*

So let me start and I am sure Oleg will join in here. So, in terms of the mix, Patrick -- the mix between the mature product and the new growth product is roughly about, I would say, 38% to 62%. So 38% of mature, 62% of growth products. So that has flipped from, say, a year ago, as we see, continue to see the runoff in the mature products, and the growth side not picking up at the same pace. Although it is picking up from a lower pace, but it is growing high double digits, but not as the same pace as the mature product runoff.

So anything else, Oleg?

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Sure. I think -- let me give you a little better way to understand it. I mean we talk about mature growth. Realistically, every business has mature; every business has growth. So I think there is probably no sense putting lipstick on a pig. The issue that Viavi has is we are missing the middle portion of the business, which is products in its prime.

So Viavi had a very strong position in what today is a mature product back, say, 15 years ago. Then, the Company missed effectively the next generation of technology and then put together a strategy through acquisition and new development to develop the next generation. So we have maturing products, which, you can call it, N minus 1. And we have very nice product offering N plus 1, which is now ramping up, and we are spending a lot of money to deploy it and install it at the customer sites. And the mature products, which is generation N minus 1, is obviously requiring very little cost. It is almost all, pure 100% margin, but unfortunately for our technology or fortunately or unfortunately, it is working really well. And customers are realizing this thing has been working and it is like why pay insurance on a car that sits in a garage. I mean, they realized that, hey, there is no more sense paying maintenance fees because the software is mature, it is running very well, and we never have any problems. So they are scaling back that spend.

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What is missing for us is the generation that we missed, which, today, would be just at about peak of both the revenue and margin generation. So, as such, we have that gap in between that as mature business drops off, and while our growth business is picking up very nicely, we are missing that piece that kind of provides a stabilizing force for the segment P&L. And that is really what, the best way to understand our SE business in the situation in which we find ourselves today.

Patrick Newton - *Stifel Nicolaus - Analyst*

Great. That's very helpful. And I guess just looking for the big picture question as investors are increasingly questioning the impact is, either enterprise is moving apps to the cloud or service providers implementing SE and NSE. So if we look at both your SE and NE businesses, what are the implications of your customers moving more of their applications to the cloud and virtualization, and how is Viavi adjusting to the shifting environment?

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Well, I think we are not a very big player, so I mean we clearly see, actually, quite a bit of growth in our enterprise business, and we are getting quite a bit of traction with major data center operators.

So I think in that respect, if we were obviously an 800-pound gorilla, I could probably give you more indication whether things are up or down. But even from where we said, we feel pretty comfortable that we have more growth potential in our enterprise business.

Patrick Newton - *Stifel Nicolaus - Analyst*

And on the core service provider with NE?

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Again? Go ahead.

Patrick Newton - *Stifel Nicolaus - Analyst*

Any implications on the NE side from the same types of trends (multiple speakers)?

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

On the NE side, most of our instruments go to service providers, but we do have the lab equipment like network storage test and some of the fiber test equipment that you need to deploy fiber in a data center. So, in that respect, we do not see any impact.

I think network storage is largely driven by the new protocols and new standards being introduced, such as fiber channel and 100-gig, 400-gig ethernet. And on the fiber test, that is a very healthy market as more and more data centers deploy 100-gig in their data centers, and 400-gig, we see healthy demand there as well.

Operator

Rod Hall, JPMorgan.

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Rod Hall - *JPMorgan - Analyst*

I wanted to ask you, the first one would be with regards to your commentary on the Verizon strike. I think you had said, Oleg, that is factored in, but I am wondering what length of strike you are assuming in your guidance? So if you could give us any color on just how long you are assuming the strike lasts, that would be helpful.

And then the second thing I wanted to ask is on the -- I mean, I thought the N plus 1 and minus 1 generation in commentary was helpful. I just wanted to understand whether for N plus 1, you feel like you are completely -- you feel like you have got all the technology you need. So is that all developed and ready to go, Oleg, and it is just a question of the market catching up with your products, or do you feel like there is more to do there to be positioned? Thanks.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Thanks. Well, I have no crystal ball for Verizon strike, and I think we don't have any, I would say, precise calculation or mathematical model. Really, I think that the primary thing for us is we are estimating that, first and foremost, is just the reduced spend of the service providers. That is a fact, and I think that is by far the biggest driver of lower spend. And, clearly, the Verizon strike probably impacted us a bit more on the incremental -- incrementally, because they are one of our biggest customers. And, clearly, when there is a lot of uncertainty, a lot of decisions get delayed.

On the other hand, to the extent it ends and things get back to normal, we may see some of the pent-up demand.

Your second question you had on -- could you repeat it again?

Rod Hall - *JPMorgan - Analyst*

Yes. I was just wondering if you feel like you have got all the technology needed for SE for this N plus 1 that you described or if you think that there is still more development needed, more investment needed there?

And also, on your comment on the Verizon strike, can you quantify how much you have taken out of revenue in association with the strike or give us any kind of numerical quantification on that? Thanks.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Well, I am not going to comment on our individual customer revenues or impacts because we don't do that stuff. So I am going to politely decline.

Rod Hall - *JPMorgan - Analyst*

Okay.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Regarding the SE products, we have a very competitive, very nice product offering. Now, it is by no means completely filled out. We have -- I wouldn't say we have a full breadth of all the services, but we have good enough offering to be able to offer end-to-end solutions from the edge to the core of the network.

At the same time, we are -- every time you win business, it is good news-bad news. On one hand, you make great bookings, but now you have to go and deploy and install and spend a lot of money to get that system in place. And, obviously, that drives up near-term OpEx before you see any of that high-margin revenue, and it drives significant demand for a lot of resources.

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So what we are looking to do in that business is really to be more focused trying to target customers and applications where we have effectively -- think of it as a shrink wrapped solution with minimum additional engineering involved in installing at a customer site and targeting the customers whose network more ideally overlapped a solution that we have available today.

So that makes us much more efficient from the OpEx point of view in deploying these solutions, and also it derisks us from basically swallowing bigger chunks of meat that we can chew. And, in general terms in technology, we are qualified especially well-positioned in the 4G against the incumbents and in 5G as it develops a starts getting deployed. So really, this is where we are targeting the market intercept or the sweet spot to position our product offering.

Operator

Meta Marshall, Morgan Stanley.

Meta Marshall - *Morgan Stanley - Analyst*

Just a couple of quick questions. One, to the point that was just made and point from the commentary, are you forecasting no recovery in service provider spend in fiscal Q4 or any sort of -- or is there uptick built in?

And then the second question is just, on some of the sales force focus changes in the NE business, I know you made changes a couple of quarters ago. So I wanted to know, are these changes you feel like are already in motion, or are these changes that will need to take place before we see some increased momentum in the NE business? Thanks.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Thank you. I don't know what is in the service providers' minds in terms of how they are going to spend money. I mean, clearly, we know where the opportunities are, whether they get released or not, still remains to be seen. We are kind of early in the quarter. I just take what any prudent CEO we do. I don't want to put out -- things out there that I have no visibility. And, obviously, to the extent, they try to catch up to at least where they should be in their spend, their announcement for the first half of the year, I think we will see an upside. If that doesn't happen and they still insist on catching up on the spend, then we see stronger second half of the calendar year.

So at this point, I am not going to speculate because I think at this point I don't think there is any data for or against a repeat of the first quarter.

Regarding the sales, I think we started reallocating to sales. We started investing in sales about a quarter or two ago. Obviously, some of that is still percolating. You cannot just hire or redeploy resources quickly. So that is a work in process, but I think we are going further than that.

What I said is, actually, proactively redeploying resources, sales assets and sales resources to give greater focus to the network instruments and focus what I would call a specialized highly trained sales force on marketing and selling our SE products.

Amar Maletira - *Viavi Solutions Inc. - CFO*

And just to add to that -- to Oleg's point, the stuff that we already started out was a channel site. As you recall, we said we had launched a velocity program -- a channel program. So that implementation is already underway, and it will take some time for it to really pick up and ramp up. But that program is already underway.

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Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

It is a very good point, Amar, and as you can imagine, the channels you have to first sign up channel partners. You have got to train them. You have got to give them collateral. So all these things, I mean, you can have the proverbial pig moving through the python. That initiative is already well underway, and we should start seeing results coming up in the next quarter or two.

Operator

Dmitry Netis, William Blair.

Dmitry Netis - *William Blair - Analyst*

I had a quick question on the comments, Oleg, you made with regard to R&D and SG&A being broad for a company of this size, and then you have an international footprint and many locations. How are you addressing this challenge or maybe understanding this is something maybe you are not ready to do yet? But is it -- do you have that sort of on the way? Are you putting a plan together of what that may entail? Just give us maybe a preview of what that may look like when you have your plan and when you are ready to move on that.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Yes. Sure. As you know, the (inaudible) before it was a very acquisitive company. So we have designed centers all over the world, and while some of them are very much at a critical mass or even above a critical mass, we have also a lot of sites that are sub critical mass.

So I think part of it is, there is always inefficiencies when you don't have everybody under one roof. I mean, my dream scenario would be to have everybody in one location, but that is not what we have.

So we have to develop a structure that can efficiently leverage distributed design environment, but also we are going to work to consolidate into fewer locations. And, as you can imagine, that needs to be done carefully because we want to preserve the talent base, and we have got to be careful to see what functions we can move and what functions we cannot move.

So that is, obviously, as you can imagine, quite a bit of work.

And the second one is, if I look at our instrumentation business, it is at scale. It has a strong market position. We have product and technology leadership, and I have no problem to actually increasing the investment in that business because, for many years, it was somewhat of the underinvested area.

As the same time, when I look at our SE, we have spent a lot of money in the past few years. We have gone very broadly, and we have largely filled out a lot of our portfolio. And now what we need to do is really start prioritizing.

So, as products release, we have some of the engineering intensity and load is going to start to decrease, and that will give us an opportunity to reallocate resources to the areas where we want to increase greater focus. But by no means does that mean we are going to increase our R&D budget. But what I am talking a lot is about redeploying and driving efficiencies, which will enable us to do, as our theory goes, the same amount of work with potentially fewer resources and more efficient environment.

Dmitry Netis - *William Blair - Analyst*

Okay. That's great. And if I can have a follow-up, on the NSE side of things, where you noted some strength, specifically in fiber to the home areas, fiber to the wireless station -- base station and maybe 100-gig core, as well as maybe the access side that you think was sort of in line with expectations.

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So can you give us a break down of that business, let's say, the fiber optical business versus access versus cable how those -- how the mix sort of works and maybe wireless, too, like 4G, 3G, 4G tests? What is roughly the mix of those categories within that (multiple speakers)?

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

So I won't give you the mix, but I will tell you in terms of the strongest momentum kind of to the weakest. So clearly, fiber is by far the strongest in both the core and metro area and also when it comes to the access like wireless deployment. The area where there is some weakness in the recent quarter was more cable, and that is largely driven by customers starting to -- cutting back on their spend in buying new instruments as they prepare for DOCSIS 3.1 deployment.

So I expect the cable to kind of follow. First, you're going to deploy the fiber. You do a lot of fiber to also get the products equipment manufacturer products ready for market, and then you bring out the Edge products.

And, obviously, also, the G.FAST is a standard that is developing, and it is also going to be driving some access. So I would say we are seeing a lot more strength today in the core and metro for fiber deployment, and we are expect the access demand to follow thereafter.

Dmitry Netis - *William Blair - Analyst*

Okay. So fiber is the biggest chunk and then comes access and then comes cable. That is kind of the way to think about the rough numbers (multiple speakers).

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Yes. That is more or less kind of the way -- I think about it in terms of moving parts that will drive our business. (multiple speakers).

Dmitry Netis - *William Blair - Analyst*

Got you. And then, lastly, on the mature side of the business in SE, can you give us a view into that? A little bit more specificity as far as what products or product lines or names of those product lines that fit in that category? Are there softer products, hardware products? I mean how do we think about the mature products? Is it the old (multiple speakers) business?

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Yes. So let me talk about mature. It is really all software products. So it is the legacy assurance business that would mainly target wireline. It is your 2G. It is your SONET. It is the DS3, these type of products. That was the way that was kind of launched maybe in the early 2000s, something like that, and maybe even late 1990s. That is what we are talking about. So SONET DS3 kind of 1990s legacy wireline and 2G and wireless.

So that is the what I would describe legacy.

The thing that we missed is really this whole 3G and ethernet conversion and things like that, and what we are now investing into intercept is the 4G various service deployments, 5G, and a lot of the virtualization that we are seeing in the network.

So fundamentally for us, it is the part of the cycle that we missed in the 2000s is what is giving us a lot of the drag on the results of that business today.

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Dmitry Netis - *William Blair - Analyst*

Okay. Very good. Thank you for that color. Really appreciate it.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

And, you know, we call it mature products. I mean, unfortunately, those happen to be our most profitable products because there is virtually no investment, and it is pure profit and drops to the bottom line because it is all maintenance fees.

Dmitry Netis - *William Blair - Analyst*

Right. Makes sense.

Operator

Jorge Rivas, Craig-Hallum Capital.

Jorge Rivas - *Craig-Hallum Capital - Analyst*

First, I wanted to -- I wonder if you can provide some color on what is your exposure to data center and webscale data type customers? On the last two calls, it seems like you have been working to increase your offerings on the enterprise side and also the data centers. So if you could give us some color on what you can offer to those type of customers in terms of services and products, and also, if you can quantify the size of the revenues, come back to the overall size of the business?

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Okay. So I'm not going to quantify the revenue, but I will tell you, it is still relatively small in the scope of things, but it is not too small. It is a nice and fast-growing product line. What we sell mainly in data centers is the lab equipment, so it is your storage network test equipment. You have got your fab fiber test equipment. So it is kind of the Level 1 to Level 3 test and measurement equipment that goes into the data center. And we also have, obviously, some of the enterprise assurance software that we target into hyperscale data centers.

Jorge Rivas - *Craig-Hallum Capital - Analyst*

Okay. Great. And then first customer diversification, I believe, last quarter you mentioned you added two new customers for your xSIGHT solutions. First, I wonder if you have been able to penetrate either Tier 1 or Tier 2 (inaudible) or smaller size customers in North America and other parts of the world? And also, what is the status of these two new added customers -- the Tier 1 customers on your xSIGHT solutions?

Amar Maletira - *Viavi Solutions Inc. - CFO*

Let me keep give you some additional color here. So, in my prepared remarks, I mentioned that we drove xSIGHT solutions, and those solutions were accepted by two of our large customers.

So, on one hand, it did create some margin pressure because it came with hardware revenue, which typically comes at a lower margin. So think about we sell a solution, so we sell software that sits on a hardware, and then we sell support and services around this whole solution package.

So, in the first phase of the implementation, the solutions were accepted. The hardware revenue got recognized, which is mainly a pass-through hardware revenue, and that created some pressure on the gross margin.

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But the good news is there was acceptance of the solution, and we were able to drive actually two acceptances and two of our large customers.

Oleg Khaykin - *Viavi Solutions Inc. - President and CEO*

Right. And, obviously, we are working with a number of other customers trying to win more business. But we have a fairly decent backlog that is in various stages of acceptance and deployment, which is what is driving a lot of the costs. Because that is really -- you spend a lot of money in the first phase of the deployment, and clearly, in the last phase of the life, that is where you make the most profit.

So, as we go and since we sell all new products, we still have to develop the SE on those products. As Oleg mentioned, this is generation N plus 1. And once we develop the [NSE], we we are able to recognize software revenue in period as we sell licenses. Until then, we will have to amortize the software revenue over the life of the deal, and that is what you see happening as we ramp up some of these new products.

Operator

At this time, I am not showing any further questions and would like to turn the call back over to Bill Ong.

Bill Ong - *Viavi Solutions Inc. - Senior Director of IR*

Thank you, Charlotte. This concludes our earnings call for today. Thank you, everyone.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.

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