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EDITED TRANSCRIPT

VIAV - Viavi Solutions Inc Analyst Day

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CORPORATE PARTICIPANTS

Bill Ong *Viavi Solutions Inc. - Head, IR*

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

Amar Maletira *Viavi Solutions Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Alex Henderson *Needham - Analyst*

Jorge Rivas *Craig Hallum - Analyst*

Rod Hall *JPMorgan - Analyst*

Mike Genovese *MKM Partners - Analyst*

Patrick Newton *Stifel - Analyst*

Meta Marshall *Morgan Stanley - Analyst*

Dmitry Netis *William Blair - Analyst*

James Kisner *Jefferies - Analyst*

Paul McNab *Viavi Solutions Inc. - CSO/CMO*

Erik Mahland *Soros - Analyst*

PRESENTATION

Bill Ong *- Viavi Solutions Inc. - Head, IR*

Good morning, everyone, and welcome to Viavi Solutions 2016 Analyst Day event. I'm Bill Ong Head of Investor Relations and this presentation event will be webcast live over the Internet over the company website.

So let's begin with the Safe Harbor disclosure. Forward-looking statements are all statements we make other than those dealing specifically with historical matters which include, among other things, financial guidance.

Please refer to the Company's filings with the Securities and Exchange Commission, including our annual report on Form 10-K filed on August 30, 2016, for additional factors that could cause actual results to materially differ from current expectations.

The forward-looking statements included in this presentation are valid only as of today except where otherwise noted. Viavi Solutions undertakes no obligation to update these statements.

This presentation and the Q&A that follows include non-GAAP financial measures which complement the Company's consolidated GAAP financial statements. These non-GAAP financial measures are not intended to supersede or replace the Company's GAAP financials. We will provide a detailed reconciliation of the GAAP financial to the non-GAAP results at the end of this presentation.

The presentation is located in the Investor Relations section on our website at www.viavisolutions.com.

Let me just go with the agenda where Oleg Khaykin, President and CEO, gives you the Viavi overview and network service enablement and as well as the OSP strategy.

Following that, we will have a brief Q&A and then we'll have a break. And then Amar Maletira, our CFO, is going to present the financial and capital model and then Oleg will have a closing summary and then we'll have another Q&A.

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And then that's when the webcast closes formally at around 11.30 a.m. Pacific Time. And then we'll have NSE and also OSP demo -- product demonstration at the back of the room. And then we'll also provide lunch and then we'll have the formal event close at 1 p.m. Pacific time.

With that, I'll pass over to Oleg.

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

Thank you, Bill. Good morning and welcome here in Southern -- in Northern California.

It's a pleasure to have you all here and we look forward to a good session. We are looking forward to share with you our strategy, our vision, our take on the company state today and where we plan to go in the near term.

I've joined this company a little over seven months ago. So as we go through it, I will share with you my perspective on the industry, on the company and the things that we are looking for as we shape our strategy. And we also had draft a number of strategic initiatives that the company is looking to undertake.

As we think about Viavi, it is a company that's made essentially out of two businesses. The first one is the NSE products and solutions that help service providers to -- and IT organizations to optimize and maintain their network. That includes test and measurement, service activation and assurance, and performance management.

The second part of the company is our optical and security product, the OSP group. They're the experts in manipulating light and provide coatings and pigments for what I would call an AMI segment or the automotive, military/medical and industrial applications.

And it's usually high value, high margin type of applications which value our technology and the service that we provide. Our biggest business within that area is the anti-counterfeiting and optical security followed by optical sensing and the underlying technology of thin film optical coatings.

So first I will do is I will talk about the company today. As you know, Viavi is a relatively young company. We've been around actually for a very long time in various instantiations.

Some of the roots trace back to 1923 in Southern Germany, a company called Wandel & Goltermann. It was an instrumentation company. Over the years, the company grew through acquisition by acquiring and merging with various entities.

And there were three distinct segments of -- in our evolution. One is the network enablement which is the test and measurement instrumentation and you can see all the way up until 2013 mainly that's all we were doing.

And, of course, the optical coating with the acquisitions and through various morphing of that company, it's today called our OSP business unit. And then more significantly in the last I think four years, the company has diversified into what I would call a software part of the business, a service enablement, mainly by acquiring multiple startups as well as the legacy Agilent business.

So as we look at Viavi traditionally through our history, most of our roots have been in instrumentation and optic with their relatively recent parlay into the software or service enablement part of the business.

As we see of the recent revenue and profitability dynamics, the business has been improving over the last several years. A lot of it was driven by the OSP business unit.

We've seen very healthy expansion of both gross margin and operating profits. A lot of it was driven by, I would say, not one time but specific high level of demand related to the new counterfeiting features being introduced to the currencies and a lot of the reprinting.

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So we've seen a very nice growth from fiscal 2015 to 2016 and it resulted in a major operating and gross margin expansion. Unfortunately, this is not something that is going to be recurring this year.

In fact, this year, we are seeing some pullback as the market adjusts to the new demand equilibrium. But it is a solid business that we're going to grow at least at the GDP level rate.

And the NSE business has been struggling in the last three years. While we have a very healthy gross margin, it's been a year of zero operating profit business.

Although same with last year, part of our spinoff, we are taking aggressive measures to restructure OpEx and we're able to increase our profitability to 2% operating margins.

There's more work to be done and what we see here is some erosion in our business on instrumentation side, the NE part of the business and we will also see some shrinkage in the SE part of the business which is primarily driven by legacy business that we bought from Agilent starting to decline and the declines have not been sufficient to offset the growth in the new software service enablement segment.

Although,the company will have very healthy expansions in the operating margins mainly driven by very nice performance of our OSP. So that's where we are today.

So I've been here for seven months and I've had a chance to deep dive and understand the history of the company. I looked at the businesses. I looked at our customer base, understand the dynamics. And I'd like to summarize with what myself and my management team see today of the company.

So as I said, Viavi is composed to two profitable mature businesses and a number of growth initiatives, right? So the test and measurement business that's called NE and the anti-counterfeiting segment generate most of the revenue and profit, but they're also at the same time relatively slow growing mature segments, Okay?

So, if you look at the company, so instrumentation on the NSE side and the anti-counterfeit segment is what drive most of our revenue and profits. To drive growth, the company has embarked on both organic and inorganic initiatives to enter into the higher-growth market segment.

The acquisition of a service assurance products or Agilent kind of launched our parlay to the software side of the networking enablement, service enablement business. And then we acquired also a number of early stage startups to complement this.

And on OSP side, most of our diversification was driven through internal initiative targeting, as I said earlier, AMI, automotive, military and industrial applications, and the emerging 3D sensing application.

So if we look at that, as I've said, most revenue and profit are generated by two mature segments and the emerging applications are the biggest consumer of the operating profitability generated by this segment.

The second part is when we look at these acquisitions, I would not comment on my predecessor's decision, but by aggressively growing and acquiring all these startups as well as the legacy mature business from Agilent, we have positioned ourselves in a very precarious situation.

Because on one hand, while the legacy of revenue loss provides very healthy cover for the startups. But the moment that thing starts to decline, all the loss get exposed.

And on top of it as we all know, when you buy startups, the best day to look is the first day, you see that PowerPoint presentation. From there, it fell down. You quickly find out the technology is not fully baked as it was represented.

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You find out that it needs a lot more development. You need to pump more R&D. There is really no meaningful sales and marketing. You have to build out a whole go-to-market channel. And the readiness for primetime is always layered that everybody anticipate.

So as such, these startups have put significant pressure in NSE business unit. So when we look at NSE and we say effectively zero to 2% operating margin business, it doesn't tell the whole story.

The instrumentation business within that piece of it is actually quite profitable and it very much subsidizes all the software businesses. So that's the situation we have today.

And what's even worse, was I think, to fund that business, some of the investment that should have been reinvested in the instrumentation business has been diverted to fund the service enablement, the software application development and that put our leadership position at risk vis-a-vis the competition in terms of staying ahead in technology, Okay?

The third duration is the OSP business unit. It's outperformed great. It's done very well in the recent history. However, it is facing some near-term headwinds as our customers are adjusting new run rate.

They're having some inventory adjustment and we mentioned in our earlier call that the first half of the year, we'll be experiencing headwinds and the business recovering in the second half. But overall, we feel very positive about this business and some of the growth opportunities within.

So the current growth strategy needs to be very much revisited, revised and reexamined but fundamentally, it's not working. The growth initiatives that we funded for the last four years through NSE have not really amounted too much.

And they're -- while the business is growing and is doing well relatively speaking and the technology reputation and the performance has really top notched, we fundamentally lack scale to take full advantage of it and the time period over which it will take this business to get profitable is not something that this company can tolerate for a very long time.

So when we look at this business, we see several initiatives here in terms of riding the shift in NSE. The first one is we need to really refocus in our test and measurement instrumentation and rebuild that business both through via organic and inorganic means.

Because creating greater scale in this business is profitable today and it will become even more profitable as it scales up. And the reason of the profitability to our company is there is tremendous synergies in OpEx such as sales, marketing and R&D leverage that we get with scaling the business up.

The second thing we got to do, we're going to narrow the scope and focus of our SE business to complement and reinforce NE. Now as I said we're just going wide and all over the place and going big on SE and building a business for itself.

We're going to retrench and make that business very much tighter linked to our NE business. So make it much more focused.

And the third element, we'll continue to drive the expansion of OSP addressable market by leveraging our core technologies into new and adjacent applications.

The fifth point is we have -- as we look at Viavi today, this is a company that will put together for a lot of acquisitions. And as such, our operating footprint and infrastructure is very complex.

We have a lot of site for a company of our scale and the problem we have is when you look at engineering development and communication and getting anything done, the more locations we have, the less sufficient you are in executing with your R&D or effectively you drive a lot of deal that had expansion.

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And that also leads to what I would call a sub-optimal OpEx productivity because when you are all over the place, there's a lot of decision-makers. They're not always well coordinated.

There's lack of integration and standard business process across multiple entities because if they were integrated or acquired, so they were not always integrated. And as such, there is reasonable level of duplication and redundancy across multiple locations and there's a good opportunity for us to consolidate sites and also consolidate number of functions that's further driving operating leverage.

Okay. So that's where we start, this is where I am today having been here for seven months.

So what I'd like to do is now go a little deeper and talk about the network service enablement strategy. Okay. That's the first component.

So if we thing about NSE, effectively, that business is designed and served what I would call the network lifecycle, right. The typical network lifecycle, you plan the network, you build it, you certify it, you activate it then you monitor, troubleshoot it, you manage it and then you optimize it further.

That's kind of the virtuous cycle that service providers go through or IT providers go through when they deploy their network. The NE part of our business, Okay, very much focuses on the early stages of the network deployment.

So with the physical instrument that provides service providers a cost-effective workflow value proposition. What that means is we allow them to bring up the network and the lowest possible cost to the highest quality.

That means that fewer truck rolls, more the data and performance of our instruments to tell them if there's any issues and really just get this thing up and going. And then later, these instruments are also use in telling the troubleshooting at the later stages on the network to maintain it.

And if you think about it, what it means, it means very much lab instruments to facilitate the equipment development or the advanced content testing and the field instruments to monitor measure and manage the network. And if you think about the kind of stack, the OSI stack, it's really covering from the physical to the transport layer, Okay?

When we think about our SE business, it's very much focused on the higher layers of the protocol stack, that's the service enablement. The network self-optimization, user experience, and virtualization of some functions.

And when we look at this segment, the network enablement segment is a fairly mature, slow growing. It's mainly physical instruments with some virtual instruments being introduced.

And the service enablement is the area that's growing fast and thus a lot of people look at the growth, they look at the size and say, wow, this is great. However, when we look at it and it's -- the picture looks very good.

But clearly, the SE segment is about $3.7 million, expected to grow at 9% per year CAGR and the NE, on the other hand, is going about 3% and the overall market is growing from $5.6 million through 2016 to about $7 million in fiscal 2019.

So when we look at it, clearly, SE has a lot of very positive elements, clearly for software with high margins, but let's not forget that the OpEx efficiency -- OpEx intensities to be here, and it's growing faster and it's a bigger market, Okay?

However, when we look at it, it's a very fragmented market. So, yes, the market is big and by the way, when you look at here, these are all the different segments and some very big players in this market and you guys can only what their names are and they make money.

Most of all these little ones as they nowhere aligned are losing money or barely breaking even. And this whole light grey area at the top, it's other. That means the company solution providers were even smaller than the smallest ones players in that region.

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So when you look at it, yes, it's a big market but it's extremely fragmented and more importantly, we are very small player in this business. In fact, our biggest share is in the legacy wireline which is -- two words that don't inspire much, it's legacy that we saw in wireline in a world that everything is going wireless.

So in everyone else, we have very minor players, much smaller than what we have- in the segment. When you look at that, on one hand, we have very good technology. But on the other hand, it's a public company and there's the question, how many years does it take to slowly penetrate the market.

And when I look at it, it's not -- we probably could use these resources better in the other area. So that's we'd like to scale and to be profitable in a broad -- as a broad-based player in SE.

And this is what this company did, we went a mile wide and inch deeper. Instead of having taking some of these in a retrospect, hindsight is always 20/20, have we taken not try to go as far and really build position in one of these segments, the situation might be different. But instead, we have -- we got very wide and each of these segments require is on R&D, it's on sales, it's on marketing, a massive overhead to support.

The situation is very different in the network instrument. There, we're either number one or very strong number two in all the key segments. We're number one in access, number one in cable and number one in metro and we are very strong, very close number two in fiber.

We also launched a number of exciting new products this year. We hope it will help us gain share taking advantage of the 100 gig deployment. Migration of the access network back to 3.1 and G.fast.

And take advantage of the, you know, rapid expansion of fiber everywhere, I mean, all the way now to the antenna, right? So we have a lot of products to take advantage of this fundamental high-growth trends in the industry as I've said earlier, 100 gig deployment, back to 3.1, G.fast, fiber to everywhere and the upgrade of the mobile infrastructure to push fiber all the way to the antenna.

So when I look at this business, we're really very strong and with this, an opportunity to become stronger either through taking share or through consolidation in this industry.

So when I look at it with my team where we would discuss it, we have to look at various options. The first one I would say stay the course or maintain Big NE and maintain Big SE.

So continuous expanding, keep rolling the dice, taking the game forward and gradually build our SE business to the point where it becomes breakeven and then becomes profitable.

The pros for that is we will enjoy a higher top line growth over time. We'll eventually exploit the synergies within NE and SE to capture share of the NFV and SDN evolution.

And it provides us with a good strategic customer stability with whom we're already engaged. I mean, we are already involved and we'll continue to gradually build our position.

The cons here is we will continue to provide significant drag on our operating performance due to the continuous significant investment. And by the way, it's only going to go up because as you engage with more and more customers, everybody needs something different and you need to even go with a relatively standard products.

There's a new tool always, some customization and not necessarily because of our products but because of the customers' network, because everybody's network is different. They have a different level of legacy components and to bring up a solution in every network requires a lot of customization.

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The second option is double down on NE and completely jettison SE, just sell it, exit it whatever. The pros here, very quick pump in our operating results. Very nice, very strong pump. And ends up with much more business complexity.

The cons here is it's a major negative impact in our customer relationships and commitment. And by the way, these are the same customers who buy our instruments. So this is one area that we cannot, right?

And also it's negative impact to the long-term competitiveness to our instrumentation roadmap because you are moving towards greater level of virtualization and things like that. There's a very strong link between the two. And we're going to see significant revenue decline and lower growth.

And, of course, the third one is you double down on NE and deploy a highly focused strategy in SE, I call it Big NE, Focused se. And what it means here is significant improvement for us in operating leverage, not as big as option number two which still retain competitive overlooking NE roadmap.

And we maintain good relationships with our existing customers. We can migrate gradually to reduce our involvement in SE. And we retain critical software structure and software development skills.

And what it means is there's a slower cost reduction profile. We have to complete a number of SE commitments which we have contractually obligated with our customers and it takes time to scale that business in a disciplined, non-value destructive or non-customer impacted manner and you could eventually get better value out of this asset.

So any guess which option we have chosen? Number three. All right. There you go. Absolutely.

So strategy going forward is Big NE, Focused se, that's what we call it. Reality is on one hand, it looks like those were three options, you put two of them taken easily and dismissed it. The reality is not.

There's been a lot of very active dialogue and there's always people making great cases, pros and cons, but in the end, you got to look at the reality, you got to look at your market position, you got to look at the reality of competition and the opportunities -- opportunity cost that you will forego if you take one option over the others.

And we feel that option three is actually the right approach for this company. I would actually say it would have been the right approach three to four years ago as well.

So what does Big NE and Focused se means for us as a company? Well, first of all, kind of looking at the lifecycle, that means really growing from the area of strength.

So it's reinforcing our lab and field instruments position, defending and growing market leadership, both organically and inorganically, and really be the person now or the company that consolidates the mature but still growing physical instrumentation space.

For the Focused se, that means focusing on virtualized instruments and assurance that is tightly integrated and has synergies with our Big NE. Because here by being number one in this area to the extent I overlay a software layer or assurance layer right on my instrument, I immediately capture the share of that business by default and that's not 5%, 10%, that's immediately significantly higher share.

So that's what it means and also as we go to the floor when we look at the lab NE, it's mainly build and buy. And in case of the Focused se, we also added partnering because there are major players with whom we will be extremely complementary if we focus with the strategy who will enable us to get into the markets where we're not playing today.

So by thinking this strategy, it will involve us to do a lot of partnering with a major SE operators in the field and linking very closely our instrumentation business into their ecosystem.

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More specifically if we look at the -- where we're going, it's also aligning with the fundamental industry trend. I mean, if you look at today, it's effectively have instruments like this grid instrument, a multiple domain.

We have lab, wireless access, wireline access, Ethernet, fiber. On an SE side, you have location, self-optimizing network, backhaul, mobile core, data center, all the different things and they're just the instrument for each one of applications.

What things that are going is from our perspective on the physical instrumentation, we've taken this platform and reducing them into a fewer platforms but they are much more flexible. So you may have the low end, midrange and high performance platforms in terms of computing and performance with the software layers on top of it that can give multiple of these functions in one instrument.

And also then in the longer term developing virtualization equivalent of this thing so we can put virtual instrument in the network which work with our physical instrument and actually retaining some of these functions and virtualizing them as well.

So it's really creating a virtualized instrumentation layer for both NE and SE components and having a more consolidated hardware platform architecture as you perform the multiple test and measurement needs and actually interacting with the cloud of the data depository and data play. Okay. We can talk more about it.

So what are the processes of this strategic roadmap is a three-phase process. We are here today. We are number one in lab and field instruments.

Over the next two years, we look to drive hardware/software consolidation. So reducing the number of hardware platforms that will bring to market that cover all the segments we compete in.

Delivering workflow hardware/software optimization as we are driving operating cost of our customers in the field, being able to troubleshoot, diagnose and fix the problems with a small amount of resources. And developing Focused se software which is aligned with our virtual instrument.

And our goal going to 2018 and beyond is to become number one in lab and field instruments through deploying cost-effective workflow and become number one in a virtualized test and measurement and assurance that other fits right about our instruments. So we're driving for number position in the instrumentation either it's physical or virtualized.

So we talked about corporate development, right, how do you grow? In a mature market, we got to consolidate. I mean, we all know trying to be captured in a mature market usually is a result in price destruction and not much more in the market share.

So the best thing you can do in the mature industry is consolidate the players. We've seen it happen in semiconductor industry. We've seen it happen at the OEM space. We've seen it happen at the service provider space.

And I think there's a matter of time before we see a lot of more of that happening in our space as well. And when I think about corporate development, I think of two axis. There's a go deep axis and there's go wide.

Go wide means I can grow my revenue by just buying a lot of dissimilar companies like what we did. We are an instrumentation player. We've got into software, and about a different software. And, yes, on one hand, you could build the revenue but you also build tremendous complexity and you get none of the OpEx synergies here because each of the diversification plays requires its own R&D and a lot of its own OpEx.

The other way to do this is go deep where you acquire substantially the same businesses and you can extract significant amount of rationalization. And kind of that blue area, it's kind of -- I call it the golden triangle of where you want to be. Anyway, it's blue but we should make it golden.

Where we are today is we're about here. This kind of gotten a way too wide. We separated from Lumentum, and we have some [buoyancy]. The first step we're going to do is we're going to smaller.

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We're going to exit a lot of these software opportunity businesses. We're going to retrench closer to the Big NE, Focused se, Okay, and then we're going to go up within the same thing.

What I'll do as of now -- I think some people may have seen this curve before. It's the scale curve. That's a -- for those of you who remember your MBA lessons, that the B2B scale curve.

You got your -- it's a log-log and what it essentially says what happens to a unit cost, the percentage of your revenue as you double, quadruple the revenue as you go down the line. And depending on the functions that's anywhere between 65% to 85% flow.

What it means, let's say you have OpEx -- let's say you have the SG&A as a percentage of your revenue is at 30% and you're saving up here. When you double it, it means your SG&A, to do it right, if you don't do these stupid things like you double your expenses, your SG&A should go down by roughly 30%. So it drops to 21% with your operating profit increases by 9%.

Very simply math but it's magical. The thing is you'll never get that if you go in this direction because this thing has an ugly sister called complexity and it goes the other way.

So by doing a lot of diversification, this way, you actually go up that curve and in the end, you end up well positioned today. So our goal is really through organic and inorganic means to drive share in our core market and let all the OpEx benefits drop right to the bottom line, Okay? So that's our corporate development framework.

Next, I'd like to spend some time on the optical security and performance product business and strategy. So we've inherited a lot of these technologies for acquisition of OCLI lab and it traditionally had two things, it had pigments and it had optical coating.

And if you look at this business, it's about $1.1 million [sic -- see slide 23] SAM today. With anti-counterfeiting, it's about half a million of it, 3% to 5% growth which is very reasonable growth, highly profitable segment.

High-performance interference pigments and the smaller business growing a little bit faster and the thin film coating today is $450 million but expected in much stronger growth rate. A lot of it is driven by the emergence of the 3D sensing and things like that.

So it's a very attractive market we are in and we've got reasonable growth profile. There's two proprietary technologies driving that business. The first one as I said is the proprietary anti-counterfeiting pigment and why is it proprietary?

Well, because everything about this thing is unique. The technology, the machines to build -- there's actually one machine. So you can see this is not something you can buy off the shelf.

So the process, technology and equipment are all proprietary. So it's not something you can just buy a machine and get in a business. But this is what makes this business so attractive to anti-counterfeiting is because the barrier of entry is massive, Okay?

And there's some of these elements like state-of-the-art vacuum roll coating technology, the engineered materials, the color of physics, all proprietary IP, both know-how and patent it and the more importantly, process control and highly secure supply chain.

So that you can imagine people who use your products on their money, you do not want sending things by U.S. post office or FedEx or anything like that, right?

The second technology is the advanced optical coatings, exactly the same thing. Three to four decades of development, combination of product, technology and the machine design, the actual chambers that deposit with coating.

Same kind of thing, not exactly an easy market to get into but very strong IP defense position for us. And it thoroughly comes down to position, how well you place the position.

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So our strategy with OSP, first and foremost, defend our anti-counterfeiting business and grow it with the market. That means reinvesting technology, maintaining high quality performance, maintaining strategic partnerships between customers.

And one of the things that we're trusted, we are trusted partner for over 100 countries and 300 denominations. Heritage is a big deal in this business and your application means a lot.

The second element here, leverage this core pigment and optical coatings to expand into the higher value existing and emerging automotive, military and industrial applications and I'll talk about it shortly.

And selectively target emerging high volume consumer 3D sensing? Why did I say emerging? Because anytime you get consumer in mobile handset, that means lousy profit, that's value destruction.

So you got to be highly selective and what we do here is we only engage where we have a clear differentiation and proprietary technology and a protected IP where we can enforce and we have a significant customer commitment to work with us over a long period of time.

And last element, this is the only business where we invest CapEx. So clearly, exercising very tight CapEx discipline and driving continuous operational improvement and maintaining low-cost, high-volume production in Asia. So we can always go after high-volume applications at low cost.

So this is an example of some of the applications. So this is a pigment. You probably don't realize but each one of you has Viavi product in your pocket.

So if you take, I don't know if you have $100 bill but probably a lot of you have $20 bill. So the 20 -- on your $20 bill is Viavi pigment and it's called optically variable pigment. So as you tilt it, you see the color change, right?

If you have a euro note or better yet like some of the euro notes, you see a more brighter brilliant colored pigment. It's called optically variable magnetic pigment. So it's -- as you tilt it, you see clearly color change but you also see like a colored bar and there's some very interesting features you can put in like a picture, almost it's like a hologram.

So these are the kinds of features you can introduce that are very difficult to counterfeit, Okay? We'll talk about the diversification opportunities in automotive for example, there's pigments.

We can also this kind of ugly -- well, they're not ugly, they're nice looking cars. However, you put Viavi pigment and you get some really brilliant colors that are very -- they extend out. But that's -- we actually have some posts over there you got to look at.

And I'll tell you, there's actually similar production cars already coming out with this and it's surely striking the difference you've seen in a car, right? Like you sped out in a traffic, let's put it that way.

It would not be a good idea when there's a highway patrol looking for you but it really looks very nice. And, of course, with this whole, as we move towards autonomous driving vehicles, sensors that getting everywhere in the automotive and sensing technology and display technology and our optical coatings have a very distinct advantage in line of the competition.

The defense and aerospace is another major segment especially with the laser eye protection, night vision, missile guidance system. By the way, the same kind of technologies you've seen here are now migrating into the 3D consumer application and industrial application. Of course, satellite for aerospace.

In fact there's new satellite that get launched recently to go to the asteroids to look around. It has a very nice piece of Viavi technology on it. So in taking a lot of this know-how and really continue to -- it's not a big market but it's a very profitable market and there's a lot more and more applications coming out that require our technology. So it's a good profitable to market.

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And the very selective targeting high-volume consumer applications, if we look at -- and it's not just 3D cameras. More and more today, we can take up semiconductor sense of OEMs or anything else, we want to put a lens on it.

We cannot only put-] it in a module, we can actually coat optical film coating directly onto the semiconductor wafer and that gets shipped directly to this customer, right?

So we're seeing a lot of interest from semiconductor. Companies are coming to us to do processing -- for our processed to do coatings onto their wafers. We're seeing a lot of interest for the 3D cameras are being introduced in the mobile handset as well as the back camera.

And multiple [updates], it's -- you can just count how many cameras and sensors. Each one potentially represents one opportunity for us, Okay?

And where we, as I said, will go here, we're not foolish. I mean, business as business before, both on the contract manufacturing and semi-conductor side. Most people lose money in this; it's a profitless prosperity.

However, if you are selective and you only go in to where you have a unique protected IP, we have strategic partnership with the major consumer electronically, understanding the customers where they sign up with a long-term commitment, that makes a good sense in that business. If don't get those things guaranteed, you're going to lose your [strength]. So I hear a lot of people talking about it and I tell you, they're all going to lose their strength especially if it requires massive CapEx investment.

They'll make a massive CapEx investment that would be good for one year and that really allows you for multiple year. So you got to be smart about getting in that business and how you play in it.

All right. So that concludes my overview of the OSP and the key strategies. I think we'd like to open it now to Q&A.

QUESTIONS AND ANSWERS

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Yes. So taking Q&A so we have a roaming mic around. If you can just state the name and the company for the webcast listeners. Let's go with Alex.

Alex Henderson - *Needham - Analyst*

Good morning. Alex Henderson at Needham. So one of the challenges of the modeling a description that you just described a small amount of focus of se is, A --

[Inaudible -- microphone inaccessible]

Alex Henderson - *Needham - Analyst*

But more importantly in reviewing some of the question, scaling more revenues.

So how do we think about what, let's say end of the 2018 fiscal year, the quarterly revenue run rate would be a little more than --

[Inaudible -- microphone inaccessible]

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Alex Henderson - *Needham - Analyst*

What is that $151 to go to, and three, the model acquisition to offset it or how do we adjust to that or is it in fact a lower revenue base to the overall company --

[Inaudible -- microphone inaccessible].

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

So very good question, Alex. I mean, however, I like to defer it for a little more because there's two Q&A session. This one is more in the first part one. I will let Amar to answer because he's going to go in and lay out financial and capital allocation model.

There -- we're not going to talk about exactly how much we take out on any Viavi product line but we're going to give you a near term and the longer term financial model, both revenue, margins and others. We can defer yourself how much we're taking from there, okay?

Jorge Rivas - *Craig Hallum - Analyst*

Good morning. Jorge Rivas from Craig Hallum. I would like to get your thoughts on the Chinese market. I understand there's a problem awareness in China. But since Viavi is heading towards becoming a communication technology leader in a few years, so I'm wondering if Viavi have a near to long-term strategy to penetrate our market.

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

Very good question. So Viavi traditionally has been very smaller player in Asia. I mean, in some way it's just possibly but reality is it came out through the North America with a big domestic market. Frankly, I think we've been quite lazy about diversifying in Asia.

We're changing it now. We're actually going to be shifting more resources and we are at the area where we are engaged within China today with our highest [represent] product.

So the whole idea that China is cheap and it's crap market, it's not true. In fact, the area where we're getting the most traction is actually for our most advanced products and we'll make money there as well as anyone else.

So in that respect, I think China is a major opportunity. We're highly penetrated in the North American market and I would argue that to the extent the North American players stand last, we're going to lost share as a result because there's more [straining] going outside of the U.S.

So we are actually now pivoting our sales and marketing resources to put greater focus on Asia. And there's two elements -- three areas in Asia where we're looking. We look at the kind of Japan, Korea and we look at China, right? The China itself is a huge segment.

But Japan and Korea are also very attractive markets for both service providers as well as NEM for us. So I actually view China and Asia in general as a major opportunity for us to grow share because that's one area where if I look at where I am in North America, where I am in Europe and where I am in Asia, it's very different.

And I think my product line and they just like going to Europe and North America a lot more than they like to go to Asia. So they're going to learn to love in economy class seat in United Airlines or any of the others.

But it is a major opportunity, I'm betting about it but you got to be there. Every company I ran up before with Amkor and International Rectifier, we had huge, over 60% of our revenue came from Asia and we made very good money there. So that's one reason why we're going to do the same.

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Bill Ong - *Viavi Solutions Inc. - Head, IR*

We'll do Rod and then we'll do Alex.

Rod Hall - *JPMorgan - Analyst*

Okay. Yes. It's Rod Hall with JPMorgan. I guess I've got two questions for you, Oleg.

I wanted to go back to the strategic options and just options two seems like an obvious non-starter because of the customer problem you have and you need to shut down SE.

Option one though, could you just -- I don't think it means I wanted you to go to option one but I think -- could you just outline again why it is you don't believe you've got the right assets there in SE with the acquisition historically you did this for and quality or what the reason you can't expand on SE?

And then I also wanted to see if you could comment on kind of the elephant in the room which is OSP and this and SE business obviously don't belong together. So if you could just comment on that.

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

Yes. Well, so let me answer your first question. So first of all, option one there's nothing wrong with our technology. In fact, it's really good. I mean, our customers love it.

But when you think how long you need to invest to deploy it, how much money you have to lay out, it will take three to four years before we break in. I mean, just like -- I think the most -- it's just because it's not like I have a shrink wrap software, I'll come in and I'll sell it to Alex or I'll sell it to you.

No. It's like, yes, it's a software but then it requires massive installation and deployment of our resources and bringing up and there is a long decision cycle that you've got to compete.

And let's not forget there is always an incumbent in those accounts and they can play heavy-handed. I mean, we've seen cases where our competitors who were by far the most favorite solution to win and competitor just gave away this technology application for free to the service provider so they would not have to worry about the other parts of the network where they were willing to protect just keep you out of the account.

When you have that happening then you still look at these things, you know what, if I take all that energy that I can spend climbing uphill and underperforming and being bitten down by the shareholders, I mean, I could take this money and that effort and go somewhere else and make more money.

And I tell my team I'm here to make money. I'm not here to dream up high and that every technology is good, our last technology as much as the next guy but it doesn't making money and they're we're making money within a reasonable amount of time.

And frankly, if we -- we want to wide. The problem is you have too many masterpiece. And when I say with Focused se I'm not saying we're getting out of it. I'm just saying we going to focus at this area where we actually can gain scale faster and it does not take up as much of our operating profits from other businesses to see this.

So reduce the number of [miles] so to say and really make those opportunities grow faster and get to the profitability sooner. And by doing -- by making sure that it's tightly linked to our position of strength which is our instrumentation, we are actually the incumbent who can pull that technology in by already having a significant deployed asset base.

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Whereas in all these applications, when we look at going far and wide, even though we're maybe a major player in NE, we are nobody in the service enablement section.

All right. The other question with OSP, well, it does not share obviously the sales and R&D. This is a different business. But there's many companies who are investing in different businesses and make a lot of money.

We feel we can operate this business very well and we have a unique assets that most companies don't which is NOL. When this business look -- runs the business where he makes all that profits, we shield it from taxes. So the EBITDA he generates, we get much bigger bang for the bucks in multiple shareholders within our NOL infrastructure. Then the next person, we'll now have to take 40% tax.

So in that respect, it makes a lot of sense and, I mean, from my perspective, I actually like the business because I know it's quite a bit about the end market there and I help other businesses.

But you're right, I mean, it is underrated business but I don't see anybody willing to give us the amount of money for that business that is worth within the venue given our NOL. The bottom line is everybody will always discounts out. But wait a second, the moment I buy it, I have to pay taxes.

And there's another element in here, it says very like driven by a single application. So its risk profile is very high as a public company. It's sort of customer concentration and revenue concentration.

As we diversified and make it much bigger, who knows, the situation may change. But today, as the public company, it will get big for that but also so then all the infrastructure that you have to build up to be a public company especially your own will detract a lot from a lot of their operating profit. Okay.

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Okay. Mike and then we'll get Patrick.

Mike Genovese - *MKM Partners - Analyst*

Okay. Thanks. Mike Genovese, MKM Partners. I have a couple of questions.

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

Yes.

Mike Genovese - *MKM Partners - Analyst*

For those of us where you said historically working at SE as trying the Arieso, Network Instruments and packet portal, can you just give more color on how those different pieces fit into the or don't fit into enhanced SE strategy?

And I hope if you want to divest in one or more of those, would you -- would it makes sense that one buyer with item or would you need to find multiple buyers?

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

So, well, here's why. A, it's not as simple as having like we'll just take one piece and sell it. When we say Focused se, it has elements of all of them, just a different layer.

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Maybe not go as high up in terms of all the bells and whistles but there's a fundamental element that works better with the instrumentation, right? Now in terms of divestment, clearly, there's multiple options we're looking at.

Our number one and the most important kind of guiding principle is its gotta meet and continue to meet all the customer expectations as are there today. So to the extent, we have an installed based.

We have communicated certain roadmap. Whether it's inside Viavi or outside, whoever has it has to meet all its obligations. We're not going to leave our customers stranded, right, because the relationships mean a lot to me, same with customers by other products.

So there's got to be -- but they're obviously going to be certain. If there's -- if we do want to divest certain businesses, certain people are a lot more attractive than the others. I think the number one thing is you got to take care of our customers and our customers are going to be happy with you.

So that's one element. The other thing is let's say we don't have anybody. It's not a problem. I'm not in a hurry to sell anything. It's a [technology]. I can always scale it down and really refocus it in the area where I -- it may not be as all bells and whistles but just smaller piece that's in a different value proposition.

So we have multiple strategies to go one way or the other and from our perspective, this technology is really world class and we can continue to -- instead of going on and say, we are in SE and we're going to make NE, we'll say our principal business is building our NE and SE integrated within it so we can pull through it and gradually build scale and profitability build scale in our business.

Mike Genovese - *MKM Partners - Analyst*

I have another more on SE.

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

Yes.

Mike Genovese - *MKM Partners - Analyst*

Just -- because it's high volume consumer application in 3D sensing coatings, what do you think the timeline could look like in terms of where you were actually forecasting numbers in the model?

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

So by the way, I don't think we have any of these numbers mixed in in our model, right? And I'm just being prudent. I've been in this business long enough.

In SE, I know certain models can get detailed and things like that. So I think we hear a lot of people talking. Frankly, we know a lot more what's going on than many of them do and I think it's super mature to talk about it.

However, we will talk more about it in the first half of next year and if things go as we expect, we will be seeing initial revenue towards the end of this fiscal year really ramping up next September quarter.

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But I think we are choosing to be responsible here because we all know models can get delayed, interesting things get dropped and I think it's simply mature. There's still lot of equipment need to be installed, processes to be released and a lot of things have to happen before we can start communicating and guiding into our model.

So you should view it as an upside, Okay?

Bill Ong - *Viavi Solutions Inc. - Head, IR*

We will have Patrick and then Meta.

Patrick Newton - *Stifel - Analyst*

Great. Oleg, thank you for taking my question. Patrick Newton, Stifel, here on your left.

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

There you go.

Patrick Newton - *Stifel - Analyst*

Two questions. I guess just filling up that first one on the consumer electronic opportunity, for you to go after that using your OSP solutions, do you have to have that new relationship with Lumentum as you had in the past on just the recognition or can you do it alone?

And then my second question is just on the third prong of any which is the inorganic opportunities, you talked about share gains, organic and inorganic. On inorganic given that you talked about OpEx leverage being still the key to the story, should we think about your adjacencies being within target or would you think more at a high level about technology -as we improve this record.

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

Okay. So let me take the first one. So we don't need Lumentum. It's a completely different place. So it's a different -- it's intermediated. I mean, and you win, really, we win mainly on the strength of our technology. In fact, I think it's going to be multiple layer centers, multiple companies selling layers. There's actually fewer companies selling filters, right?

And in that opportunity, clearly, the big one is a 3D camera module for the handsets but we're already selling in high volumes our services to semiconductor players who send us their wafers and we just did the coating. I mean, I think it's just the market is still in early stages but I think it could also be a very -- additional very nice segment product. But in that respect, I'd say probably every major handset manufacturer is looking at our technology for potential application in their own.

On the M&A, well, as I said, to me, the best M&A, I'm not going to chase technology. I think we have technology space in this company. To me, the best M&A is buying a company that's already profitable and has significant overlapping OpEx with Viavi. To me, it's very much a financial consolidation and margin expansion play.

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Okay. Meta and then Dmitry.

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Meta Marshall: Just quick question -- Meta Marshall of the Morgan Stanley, when we look at the SE business and just what Focused se means from --

[Inaudible -- microphone inaccessible]

Meta Marshall - *Morgan Stanley - Analyst*

You kind of gave the $4 million or $5 million and where to focus [NSE within that] And then as we look at the segment of the business, if you could just rank like whether you look at time of profitability, the growth of the business or the [way] of NE as far as like evaluating whether that be a [conflict].

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

Sure. Good question. Look, I mean, given how big the whole SE TAM, in fact -- I hope you're talking about TAM, it's irrelevant to talk about this TAM because there's so many different segments and there's so many different things.

I look at it purely from our perspective. We have this big here and we can do this big in that. So it's good enough for me, right, and I'm not spending much money to get there.

So it's -- and we're not going after this [probable TAM]. A lot of what we are going after is what's emerging. So right now actually we're capturing that business from the position of power where we are -- the whole virtualization of instruments, the new way of how the data gets captured and analyzed through the network to enable lower cost to network operations, that's the piece we are going with.

And let's put it this way, I think that market is multiple times with revenue we have today but it's also growing significantly faster than the overall SE segment. I mean, they were -- I think we sold like 20% plus annual CAGR in that particular space but it's growing from a smaller base. But in that particular area, we have a distinct advantage.

Meta Marshall: [Inaudible -- inaccessible microphone].

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

So any of that they're already profitable and --

Meta Marshall: [Inaudible -- inaccessible microphone].

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

So the bulk, I mean, first, you look at the operating loss that the business generate and then you look at the required investments and then you look at the most optimistic trajectory and then you just roll it out and you say, my God, that's how much more that I need to funding it.

And reality is what makes us multiple years to get to profitability, you see how these established players already engaged in all these markets, for them, it's like within six months, it could be multi-hundred million dollar business or within a year.

See, that's a very different thing. It's like the old thing in the old days. Cisco bought a startup and within a year, it was a billion dollar business because they've got Cisco channels and Cisco relationships, Okay?

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I mean, our technology is actually extremely good and to the right partner, it's massive asset. So I told my team, this is -- we're not in the fire sale mode. In fact, we can do with a lot of that technology internally, we're just going to have to slim it down.

But if there's a very good strategic partner who comes in and we can do a partnership that they take care of our customers, our obligations and we partner with them on the market [creating] our instrumentation business with the overall strategy, that would be the best possible outcome.

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Dmitry?

Dmitry Netis - *William Blair - Analyst*

Okay. Dmitry Netis, William Blair. Thanks for taking my question. I have two, actually one on the NSE and the other one is OSP.

On the NSE part, this is related to this three-pronged strategy, Oleg, that you talked about and kind of the scale curve where you actually get smaller before you get bigger.

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

Yes.

Dmitry Netis - *William Blair - Analyst*

How smaller can you get is the question. And as far as the, I guess the number of instruments that you're going to take out, right? You said there's a reduced or you're reducing the number of instrument platforms, how many you have now? How many do you think you can get --

---

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

No. No. That's all. Yes. Let me clarify. We're not getting smaller in instrumentation. Getting smaller means we're getting less se. Instrumentation actually make them bigger.

And let me say by the way, reducing platforms, it's an engineering optimization. It's not the shrinking mark. They're still going to be addressing everyone at the market.

So for example, today, if you're doing a handset that is used to check out cable. You have another handset that checks out a G.fast and another handset that does the antenna, wireless antenna check.

When we say about that, you have a fusion. You have one instrument that can be all three. So it's much -- that's what we mean by this or you have one instrument and I'll just download a different software stack so I can sell it to you to put in cable, well, now I want to when I use it for something else, pay me more and I'll give you the code for measuring something else. That's what we mean by that.

So instead of having an engineering group working on every one of them, different engineering groups, now you have less engineering so you actually get greater efficiency in R&D. That's what I mean by more platform consolidation.

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Dmitry Netis - *William Blair - Analyst*

And then I guess part of that strategy, it's really consolidating hardware and software virtualized into this, right? So where are you on that path of virtualizing your instruments? And [if this -- relatively], how long it will take to virtualize? Is there a potential to do all 100% of those instruments in software? I guess that's one question.

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

Well, I think it's more selective. We already have some virtualized instruments, right, and there's always pros and cons. I mean, when you're deploying that pros, you got to have --

[Inaudible -- microphone inaccessible]

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

Because you got a book certificate, right, and then you can put virtualized instruments somewhere else.

So I think, I mean, I don't call what it seems like. Within two areas where we have seen of [time for either one] the market is going to be ready to adopt it.

Paul McNab - *Viavi Solutions Inc. - CSO/CMO*

[Inaudible -- inaccessible microphone]. -- what Oleg said, you will always have physical instruments. You always going to have physical instruments. Growth opportunity, you will have the biggest change now of virtualized instruments, too.

Dmitry Netis - *William Blair - Analyst*

[Inaudible -- inaccessible microphone] impact from this virtualization impact or you guys not thinking about that?

Paul McNab - *Viavi Solutions Inc. - CSO/CMO*

Well, no, what you'll see is you will still see our instrument business grow at least with market. We have a good market share in this business. It's just that by area of growth, we'll have a good proportion to be virtual instrument in that growth.

Dmitry Netis - *William Blair - Analyst*

Okay. Good. Fair enough.

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

The market is not shrinking. What we're doing is we're going to be replacing a lot of other things today which are like hardware-based probe sitting in the field, they would get replaced with virtualized [growth]. So we're actually going to be gaining share because in many of these areas, we're not --

[Inaudible -- microphone inaccessible]

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Erik Mahland - *Soros - Analyst*

I have a question on the OSP side of the business, I was just curious, the venture into the new application for AMI and consumer cameras, that's quite interesting path you are taking. Any way to estimate sort of its AMI consumer application as far maybe taking a BOM cost per device or ASP per device and maybe multiplying by 7 billion smartphones out there in the world and maybe building the same on the automotive side, so how do we estimate that?

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

I really -- I tell my guys to don't waste time estimating. The reality is the opportunity is bigger than the entire business today so go and win the design.

But it is a very [risk then], I mean, if you just -- I mean, but then you have to make -- start making assumption as well, how many of those going to be performing, how many of them will go into the other like in automotive?

I think it's always assumption. The reality is we know with this first application, we have a very nice ROI, right, and then it just go there. So I tell my team, stop wasting time on market strategy and paying and where do you think it's going to every big player in the market and the numbers will take care of itself. We'll let you guys do the [analysis of accounts].

Erik Mahland - *Soros - Analyst*

[Inaudible -- inaccessible microphone].

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

But it is, I mean, you can actually all this already is -- but there's not enough people trying to sell you their [studies] but it's all assumption. In fact, we're actually no much more what's going to be every platform.

So when we look at it, it makes sense. So there is actually people who now and don't talk about it and there's people who don't know and who talk about it and there's some few folks who talk about it and know about it and then they're going to be nailed by their customers so I'll leave at that.

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Okay. James?

James Kisner - *Jefferies - Analyst*

Yes. James Kisner of Jefferies. So I guess just a follow-up to that. I'm wondering if you could give you a range in dollar content per phone for these applications for you.

And separately just back with the emerging opportunities to grow in any -- I appreciate your comment with regards to the reg cost of users , is it the orientation with [users] being larger or you will likely to focus on [the second]?

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

All right. So dollar content, I'm not going to talk --

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[Inaudible -- microphone inaccessible]

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

For the dollar content, I'm very happy with dollar content and it's only going to get bigger, right?

But it's not less relevant at this point what should dollar content, it's more relevant what penetration of new models we're going to get. Because if you have a billion phones, I'd rather have 60% of the market then a lot of content for 2% of the market, right?

So I think at this point, as the marching orders starting go in every platform out there and we held our walkaway price although which where I go to engage. So for this way, I'm very happy with our content. I'm pretty happy with our current position in this market and I'll leave at that.

James Kisner - *Jefferies - Analyst*

[Inaudible -- inaccessible microphone].

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

I'm not going to go there. You know what, let's put it this way, these guys are not working for pennies of a dollar. They know where the real money is.

In terms of many assets, I don't care about -- I mean just that you do as much work as anything else, for me, it's more interesting and as I said, you got to be a company already with a sizable revenue and market position and significant -- more importantly, significant OpEx overlapped with [that] because it's very much a consolidation play.

I'm not interested in buying or get another technology and keeping everything and making the same mistake over again. Okay.

James Kisner - *Jefferies - Analyst*

[Inaudible - microphone inaccessible] just to ask [Inaudible - microphone inaccessible] of Rod's question. You said with OSP, you couldn't get the value for it in NOLs and [Inaudible - microphone inaccessible] What about the inverse of that? Are there any cyclicality [Inaudible - microphone inaccessible].

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

There's a cyclicality with -- it's really -- I mean, to me, any business that makes money is a good business.

James Kisner - *Jefferies - Analyst*

So if there's interest than what I see from someone else, there is no reason with --

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

If somebody comes one and gives me outrageous amount of money, sure. But put it this way, it's -- whatever makes the most sense for our long-term development that creates the most profit for shareholders really.

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But the thing is I don't want to waste my time thinking how can select one business from another. So far, I haven't seen anybody coming in willing to write me a big check. So there's a lot of work to be done on either case.

And in essence of that, we just prefer to continue doing what we are doing best and go win in every business we compete. And if somebody comes in and wants to pay us for the privilege of selling in the business, I've done this before and done very well so.

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Great. Well, we stop here and get 15-minute break. We'll reconvene at 10.30. Thanks.

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

All right. Thanks.

PRESENTATION

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Okay. Welcome back. We're in part 2, Amar Maletira, our CFO. He will go over the finance and capital allocation side.

Amar Maletira - *Viavi Solutions Inc. - CFO*

Right. Thank you. Welcome, everyone. Thank you for rejoining. I know Oleg went through the strategy for NSE and OSP and it all comes back -- it comes down to what's the financial outlook and the capital allocation model. I'll go ahead and cover that.

Okay. So, let me first start. I know you guys know this very well but I think I need to set a context here before I get into the outlook. So we'll talk with the overview of Viavi's revenue and profit mix. As we said, we have two business, NSE and OSP.

So we delivered about $906 million in revenue and 73% of it is in the NSE segment, about $258 million and the balance, $248 million or 27% is in the OSP segment.

Now, if you look at the NSE mixed here, our NE -- our core instrument business which is both the lab as well as in field is the major portion of our revenue mix in any NSE. When you look at OSP, it is anti-counterfeiting business is the significant portion of our mix in the OSP business.

But if you look forward, looking ahead into the future, the other businesses that you see here is going to more meaningful as a ratio of the mix as we start to see some of those exciting opportunities that I'll talk about in the distant markets within the high value industrial applications as well as selective areas and the high volume consumer application start to materialize.

So when you look at the operation profit, from an operating profit perspective, OSP delivered $103 million of the $116 million of operating profit and NSE contributed about $13 million. Now, if you guys know the historical trend in this business, this is the first time in a few years that NSE had a positive contribution to the operating profit for Viavi on a fully loaded basis.

Because, you know, we started putting this fully-loaded number starting fiscal year 2016. So we finally, we're able to stop the bleeding in NSE, but let me tell you very clearly, although it is moving in the right direction, on a management team perspective, we are really not happy with the profit performance in our NSE business and there's more work to do there and you will see us aggressively go after optimizing our OpEx and I will talk about that shortly.

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Before I go into the regional revenue on the right side, let me just also give you some color on the capital requirements in this business. So both this business of NSE and OSP have slightly different dynamics in terms of capital requirements.

As Oleg mentioned, in our OSP business, OpEx requirement is relatively low but it has relatively high CapEx intensity. And the reason we have a high CapEx intensity is because we all use all the manufacturing to protect our proprietary technologies in that business.

But looking forward, as we go forward and you should expect the CapEx, although the amount will remain the same roughly but it will shift towards building capacity in some of those intensive opportunities that we talked about.

On the other hand, in the NSE business, it's a different dynamics. It is -- the OpEx requirement is relatively higher and because, one, it's the nature of the T&M industry, the scale is important in that business. Number two, we have a very complex go-to-market because of the diverse set of customers we have and a very broad portfolio. And this is the area that will be very aggressive in addressing the OpEx intensity in this business.

On the other hand, the CapEx requirement in the NSE business is relatively low. Because most of our manufacturing of the NSE business is actually outsourced.

Now, when you look at the regional profile here and the reason I wanted to put it here is because I wanted to give that some color on the opportunities here from a regional perspective, for overall Viavi, Americas has about 50% of revenue. The balance, 30%, is in EMEA. That's Europe, Middle East, and Africa. And then APJ which is Asia Pacific Japan is roughly 20%.

But when you dissect this and look at just the NSE revenue, nearly two-thirds of the revenue is in the Americas and the balance is one-third in other regions which means outside of the Americas, we are highly underpenetrated in this business. And this represents an opportunity as it focus on a core instrument business and drive market share, this is the region -- these are the regions outside of the Americas where we have to go grab a fair share of market.

And so we have always started working on this as Oleg mentioned and we will -- and we will basically drive it to both direct as well as our channel strategy.

Now, going to -- again, I'll come to the financial outlook but it was important I tell this both by spending some time discussing about the key performance drivers in FY16 starting revenue.

As you can see here, Viavi delivered $906 million revenue which grew about 3% year-on-year and it was mainly driven by our OSP business. If you look at NSE, NSE revenue went from $681 million to about 658 million so it declined about 3%. And that decline was mainly driven by the SE Mature business running off at a faster pace, about 37% decline.

It was not completely offset but the revenue increased in an SE growth business. And we expect that SE Mature business as we have indicated earlier that this will continue to run off in 2017 as well as 2018. When it comes to 2018, this revenue profile would be roughly less than 5% of our overall NSE revenue profile in 2018.

Now, when you look at the NE business, our core instrument business in both lab and field, it was roughly flat on a year-on-year basis and this follows a steep decline in this business in fiscal year 2015.

So as we started re-fixing on a core instrument business in 2016, we have started seeing some early signs of stabilization in this business and we believe that we have maintained market share in 2016.

In fact, in certain product areas, specifically in labs, across most of the technologies as well as in the fiber fill instruments, those are the areas that are going very fast. We actually outdo the market and we believe that we have gained market share.

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So this is the business that we continue to walk on. On the OSP side, as you can see, in all, it was a phenomenal growth. We went from $193 million to $248 million of about 29% growth. But what's notable on that side of the chart is we all know that this was led by our anti-counterfeiting business that actually grew 29% but it was the other businesses that also have started contributing to the growth in OSP, although of a lower revenue base.

Now, if 2016, anti-counterfeiting business had an unusually high revenue year because we took advantage of multiple demand drivers and currency reprint and redesign and we expect this to actually start correcting in fiscal year 2017.

So now more into the profit performance, so we grew our operating profit from $68 million to $116 million as well as our operating margin expansion in one year with 500 basis points.

So this profit performance was a result of the OSP revenue growth and at the same time, the actions that we have started taking in the NSE business to drive our OpEx down and I will give more color of that area when I come -- I have an OpEx slide and the OpEx action slide. But it's -- this is an area where, I think, there's lot more work to be done. We have just started working on it and what we have done is sort of optimize our G&A function. There's more work to do there but there is lot of opportunities across R&D and sales and marketing where it can drive more OpEx efficiency.

So, just stay tuned. I'll cover that in my latest slides.

So we are, basically, when you look at our EPS, it doubled from $0.19 to $0.38 and this improved performance is a result of a disciplined execution and improved execution which we intend to carry forward. And also, very favorable market conditions in our OSP business.

So, now, this is the money chart. I'm sure you guys are waiting for this one. So this is the outlook for fiscal 2017 and these are non-GAAP measures except for revenue.

So for fiscal year 2017, we are projecting the revenue to be in the range of $830 million to $860 million, so roughly about $845 million at the midpoint.

So roughly a decline of about 6% on year-on-year basis and it's mainly driven by a decline in anti-counterfeiting business as the demand price as well as our SE business declining. So I will give you more color shortly.

So we expect NSE revenues to be in the range of $610 million to $630 million. Currently, we are seeing some softness in the customer spend in NE or instrument market. So early in the year to see the spend but we had been very prudent here and we are being a bit cautious and we are expecting the softness to continue through fiscal 2017.

So what we are projecting in the NE business for 2017 is to be flattish, to slight business given that we are focused on depending this core business and growing market share, we believe that we will, at the minimum, maintain market share in this business.

In fact, if the market is better than what we assume, I think it will there to capture the revenue as well as the profit upside and that's reflected in the high end of the guidance here.

In SE, we are factored in two things. One is continued revenue runoff from a mature assurance business as I talked about earlier as well as we have factored in the negative impact on revenue on the SE growth side as we start rationalizing our SE business and deemphasizing some of the unprofitable product line.

On the OSP side, we have -- the revenue is $220 million to $230 million. As we said, currency reprinting and redesign volumes, you know, anti-counterfeiting business returns to normal demand environment, one of -- one thing to note here is in Q2 fiscal 2017, OSP will see the maximum impact on revenue due to the demand correction.

With revenue expected to be in the mid to high $40 million. I said high 40, but it's mid to high $40 million. That's what we are expecting in Q2.

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However, in second half, we expect the OSP revenue to recover more so during the latter part of the second half and this should also support higher or better performance in EPS in second half versus the first half.

So operating margin, for Viavi will be in the range of 11.5% to 13.5%. OSP will be in the 39% to 41% operating margin range and NSE will be anywhere between 1.5% to 3.5%. As start rationalizing our SE portfolio, there might be some stranded cost, etc. So we have factored in some -- we've been very prudent in terms of -- in terms of operating margin outlook in that business.

Non-GAAP EPS is predicted to be between $0.30 and $0.38. The guidance also assumes other income and expenses which includes interest expenses on our converts to be an expense between $8 million to $9 million and a tax expense rate of 17% to 19%.

So in summary, fiscal 2017 is going to be a transition year as we work on a number of areas to execute our near-term priorities. And we do see some challenges in the market conditions but we are working very quickly and aggressively to address that externally to the extent it's possible as well as internally from across perspective so that we can land on this guidance.

Going to fiscal year 2019 outlook. So as we complete the transition and transformation in fiscal 2017 and 2018, in fiscal 2019, we expect Viavi will have a smaller but more profitable revenue base compared to fiscal 2016.

Assuming that the macro environment does not degrade, we expect Viavi's fiscal 2019 revenue to decline at a three-year CAGR of roughly 2% to 4%, so roughly about at the midpoint would be about $840 million as we rationalize the SE business to the focus SE strategy which will impact the revenue but improve profits overall.

Since we expect NSE business will decline at a three-year CAGR of 3% to 6%, primarily, due to the double digit decline in the SE revenue, we expect NE or our Instruments business to grow very low single digits. That's what we are modeled at this point in time.

OSP revenue is predicted to grow at the three-year CAGR of anywhere between 0% to 4% as the demand in anti-counterfeiting business normalizes in fiscal 2017 and then it bounces back to a normal, sort of, growth rate in that business.

Viavi operating margin is expected to be in the range of 17% to 19%. The operating margin expansion of 400 to 600 basis points compared to fiscal 2016. Operating margins of 12.8% is primarily driven by three things. One, its rationalization of our SE business. Number two, OpEx efficiencies in NSE. And number three is a payable mix as OSP becomes a larger portion of the Viavi mix.

NSE operating margins was in the range of 7% to 9%. We are assuming, for modeling, the gross margins will contract a little bit, maybe between one to one and a half points due to change in mix. This is more than offset by the OpEx reductions that we are going to drive in this business. We are also making some investments that we need to automate and streamline our business processes.

OSP operating margins, the leakage here will be in the range of 39% to 41% as higher volumes will drive more fixed cost adoption. Non-GAAP EPS is between $0.45 to $0.55 cents. We assume the share count to be flat at $238 million so that we can get a good operational comparable performance.

Other income and expenses which includes interest expenses that I mentioned earlier is between $8 million to $9 million and tax expense rate between 17% to 19%.

So this is the money chart of how we are going to drive EPS expansion in this business from $0.38 to $0.50 which is at the midpoint and going to $0.55 and beyond.

So when you look at the commitment to the midpoint, it is mainly driven by focus SE strategy and OpEx efficiency and some EPS expansion to OSP and any revenue growth.

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I think of the points that we have been able to note here is we'll be making some reinvestments back into the NE business so that we can get ahead of the technology curve. And as we mention, we want to be number one in both physical as well as virtual instruments. So this is some of the investments we'll go into that area.

We are also investing in automation and I will talk a little bit more about it and where you are making those investments. And so that will take us to about $0.50 and then any upside on revenue or in about what we have modeled, from a midpoint perspective, both on OSP and NE and if we are able to execute better than expected in our SE-focused SE strategy as well as our OpEx efficiency, we should get to about $0.55 at the high end.

Now, the share buybacks, as you know, we've just announced an increasing share buyback from $100 million to $150 million. That's going to reduce the share count.

So any share count after you exclude an impact of the equity-based compensation will help to basically drive the EPS up. So we are assuming a couple of buybacks that will help us to -- that gets us to $0.55 plus of EPS.

Now, this model does not include the upside that we talked about in some of the exciting opportunities because as it materializes, we will come and talk about it but that's not part of this model currently.

Unidentified Audience Member

[Inaudible -- microphone inaccessible].

Amar Maletira - *Viavi Solutions Inc. - CFO*

None of this model. None of the under consumer application and the initial application side. We're not building that into the model currently and I think that it's prudent to do that and we'll come and talk about it once it starts materializing.

So, as you saw on the previous chart, you know, the key driver for EPS expansion is OpEx reduction. So Viavi and I've worked in many complex companies In the past but Viavi is very complex for the size it is and the history -- the past history of acquisitions and not integrating the acquisition has left us with multiple R&D platforms, a number of legal entities in physical sites, a highly complex go-to-market and also, you know, very customized IT application environment, nonstandard business process and I can go on and on and on.

These are all challenges but it represents really good opportunities if we are able to simplify, remove the complexity, and basically bring the cost of doing business down and that's what we intend to do.

So I just put here a funnel and some high level initiatives but if I ever to list up all the initiatives that we are trying to drive, I think I probably need a large number of slides.

So let me just give you some color so that you guys get an appreciation of what we are driving here, right? So I've categorized this into three -- from a timeline perspective as well as the complexity of execution, also the investments required into three categories, short term, midterm and long term.

So we start from the bottom here. in FY16, we reduce our OpEx in NSE business by 33 million or we reduce it by 7% as a revenue was down about 3%. Now, the 33 million of OpEx reduction was mainly -- I mean, as we right size the G&A function post Lumentum separation. So most of this was driven in the finance and IT organization.

We also consolidated a couple of real estate sites and we also did some partial off-shoring of few sub-functions within finance and IT. That's what we have done.

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And we are very successful in doing it. But as we look to do it even in the G&A function. For example, as we offshore two of the sub functions, we lifted and shifted it. Now, we are trying to drive standard processes and more automation so that we can drive more efficiencies when in those centers, right? This is an example.

But there are other things that we are working on starting from the bottom here. R&D, spend optimization and instruments, so platform consolidation and selective outsourcing. We talked about that earlier in the presentation.

We have multiple platforms in R&D on the hardware side and I'll just give you a rough number because somebody asked that question. They're roughly about 15 plus platforms, right? We can consolidate it to six or seven platforms. And so that's what we are working on. That doesn't mean that we are going to reduce the number of instruments. We are actually making lesser and lesser platforms so it's leverageable and then you need lesser number of engineering to go dial it, as an example.

In R&D and I come from an outsourcing services business. I've done a lot of outsourcing services deals in the past, in R&D, when you look at it, we -- there are pockets of R&D that can be very effectively outsourced while [refilling] the skill set of R&D.

For example, we look at R&D, you have a maintenance R&D, you have development R&D, and you have a research R&D. You need to keep your best skill set and talent in the development and the research side.

The maintenance side, can be selectively outsourced and we always started working on that front too, in R&D. So you cannot necessarily reduce that capacity but you actually lower the unit cost. And I can tell you that I've done many of these deals. We are really not optimizing R&D at this point in time.

We also started working on the effectiveness and efficiency in our sales organization. We just completed a study and there's a lot more work to be done there. We are also working on channel strategy.

You know, as you bring in channel, you reduce the OpEx, maybe you have to let go a little bit of gross margins but most importantly, you can reduce OpEx significantly if channel is going.

As we rationalize the SE portfolio, there's an opportunity to optimize OpEx across R&D, across corporate functions and across the sales and marketing organization. So that's another level that we talked about earlier.

Now, legal entities and real estate consolidation, we have too many legal entities in this company. It's 50 plus. We intend to cut it down by 30% and invest in savings. For example, if you have a legal entity, you have to do -- I have to do statutory filing, I have to keep books. I have to run payrolls, right?

You do this, and when you clear the legal entity, you create the legal entity to provide a room for some of your employee. So, now we have started to shut down those legal entities and move the employees into different ways so they're consolidating legal entities and trying to drive cost savings. Now, shutting down those legal entities is not just -- it's not an on/off button, it takes time.

And so we are already down the path. You identify the legal entities that we need to shut down and we are in the process of implementing it.

Similarly on the real estate consolidation, as I've said, we already consolidated a couple of sites but we still have to keep more sites. So there is a lot of opportunities there too. But those are things as you, you know, as we go and rationalize SE, we'll then figure out, Okay, which sites do we need, which sites we can consolidate in and we start executing on those. So a lot of stuff is ahead of us.

Simplification and standardization of business process spanning Quote-to-Cash and Procure-to-Pay. It looks very good on the slide here but this is a lot of heavy lifting. We look at our Quote-to-Cash process. We basically analyzed the Quote-to-Cash end-to-end. We've gotten an exclusive consultant. We had a team, a tiger team working on it.

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When you look at our Quote-to-Cash process, we have about 52 sub processes and within those. We benchmarked each of the sub processes against the best in class and we identified there are 83 issues in that 52 sub processes. So we put about 30 initiatives to go and resolve those 83 issues.

So just to give you some color and this is something that we have to -- it's not something that you can do within a year or so, it takes time but we always started working on those 30 initiatives.

Now what that would do is once you standardize the process, you start automating it and that's where the automation play comes in. So we have factored in some investment to do standardization to clear the business management kind of office as well as to automate the standardize processes and those investments are already baked into our guidance.

By the way, I can go on and on. There's a lot of other initiatives here going on. I just don't want to bore you guys. So here you go.

So now switching to capital allocation here. First of all, it is important to understand that we have healthy cash flows from our operations to good management of our working capital.

In fiscal 2016, as you can see on the left here, our cash flow from operations on the reported basis were $53 million and our FCF was $17 million. But once you adjust for the spend related and restructuring-related cash outflows, our cash flow from operations was 105 million and FCF was about $70 million. So healthy cash generation not only strengthen our capital structure but also gives us some flexibility in our capital allocation priorities.

So when you look at that capital allocation priorities, we have this five priorities that we listed here.

First of all, it is important to continue invest in our maintenance and run-rate kind of activities. And secondly, we'll make organic investment in certain initiatives that drive the top line as well as drive productivity and automation is a good case in point there. And we will return capital to shareholders through buybacks. It's right in the center of our capital allocation priorities. And then we will also keep our powder dry for any M&As and whatever money is left, we'll go and fund our unfunded pension plans outside of the U.S. So, that essentially is how we are thinking about deploying our capital.

So one of the things that I talked about that you saw in the previous slide, share buyback is essential to our capital return strategy. Today, we announced an increase in share repurchase from $100 million to $150 million.

So let me give you some color on how we pose this position to increase cash return to our shareholders. So as you're aware, we were holding about 19.9% stakes on 11.7 shares on of Lumentum for spin-off. And with the recent run-up in Lumentum share price, because they did a nice upside for Viavi.

We were opportunistically monetized about 70% or 8.3 million shares for a total proceeds of $224 million and we are remaining about 30% or 3.4 million shares and that's roughly at $36. And today, it's higher than that but at $36, it was estimated at $123 million.

So when you look at this combined estimated value of $347 million and compared to $247 million, it was a fair first day of trading value. We have realized there's an unrealized and realized upside of roughly about $100 million.

50% of that is basically realized and that's what we are returning to our Viavi shareholders. So that's how we think about how we smartly allocate that capital.

So in summary, our capital structure supports investments in our business as well as cash return to our shareholders in the long term. We have a good liquidity position as you can see here. A strong net cash position. However, we have a 2018 put date on our Convert that limits some of the flexibility in the near-term.

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So let me just talk quickly about the converts here. I won't dig in to the details. It's all out there in public. So we have basically issues about $650 million of converts with a very low coupon rate, about 0.625%.

The put date is 15th of August 2018. The conversion price is $11.28 and, you know, we can settle anything about the conversation price either in cash or in equity. So we have the option to do it.

So just to give you some more color, if the share price increases from $11.28 to $12.28, for every dollar increase, it translates into 4.7 million shares or about $57 million of cash also, right?

So this is still out there at $11.28 and the put date is August, mid- August. So we have some alternatives that we are looking at. First is basically maintain the status quo and refinance when the -- in August 2018. The couple rates are low but I don't believe that we will wait till that long.

We'll do some early repurchases and we'll also see if we can do some convertible exchanges. Now, I'm not going to lay out a strategy here, for obvious reasons but there are certain considerations that we will factor in when we do it.

One is the stock price trajectory which is very important because that determines what are the mix conversion prices are going to be in the new convert. Also, the capital market conditions and all the corporate initiatives that we are running.

So those will be the considerations as we go in -- go out, and think about the alternatives for our converts.

NOLs has been a hard topic. This is a good asset to have. We're about U.S. Federal NOLs about $5 billion in the end of fiscal year 2016 and these NOLs have a shelf life meaning it has an expiration date. So the first is about 20-year carry-forward period on a shelf life and the first significant tranche to expire is in fiscal year 21 and that's the amount of about 1.2 billion.

Beyond that, there's the long tail. So we have utilized NOLs, maybe some of you are already aware of it. We have put a super distributor model where we have repatriated about $100 million plus of profits and cash from overseas and shielded it against tax.

We did the Lumentum spin-off. We did utilize about a $1 billion in NOL so that we can step up their assets and give them a tax advantage position. We also, when sell our Lumentum stocks, we can also shield the gains from the Lumentum stock. So we are using our losses too and do that.

So how can we use NOLs going forward? I think the simplest answer is, first, generate more profits. We all love profits. So once you generate more profits, that's the best way of using it.

We can also use it when we do an accretive acquisition. Now, there are sort of limitations when we do some of those things and that limitation is under Section 382. So if there is 50 percentage points change in the ownership, either when somebody acquires us through an M&A or we acquire somebody and they use shares as a currency to acquire and it changes the ownership structure, it will limit the amount of NOL that we can use in any given year.

For example, if you look at the policy today, basically, the simple calculation, it takes the market cap before the ownership changes occur. For example, if it takes today's market cap of $1.8 billion, there is an LTT rate of about 2.06%. If you multiple those two, you'll see -- it limits the NOLs to roughly about $47 million to $48 million every year.

So you've got to be very careful on how you can utilize the NOLs. So there are sort of limitations and they are working around that to make sure that we continue to utilize the NOLs more productively for the business.

So with that said, I think we'll go to the Q&A. I'm sorry. I think Oleg -- I think it's you. Yes.

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

Very good. Well, so I think, in summary, I just want to summarize our vision. Bottom line is wherever we're going to compete, we want to be number one or at least very strong number two in the markets. The NSE strategy, market leadership and any reinforced by highly focused SE and that means scaling NE through share gain, consolidation and expansion of these markets and scale down SE highly focused, very synergistic and reinforces our NE position for benefits from NE position.

And in terms of our corporate development framework, it's all go deep, right? I'm not looking to go wide unrelated areas. It's really discovering down in what they're already doing.

The OSP strategy first and foremost defend and expand core anti-counterfeiting business, expand into high value existing and emerging AMI applications using our Pigments and into Optical Coating technologies and selectively target high value consumer 3D sensing applications.

So that's some of the strategy. In terms of the investment thesis, if I think about what makes Viavi an attractive investment, in the near-term, it's really all about operating margin expansion story. It's in NSE. It's deemphasizing unprofitable assurance product lines accompanied with significant OpEx reduction, scaling profitable instrument segments to drive margin expansion and continuing SG&A OpEx productivity improvements that has outlined. And the recovery in the second half in the OSP revenue is providing further boost.

In the medium term, market leadership in physical and virtualized Test and Measurement instruments with opportunity to significantly market share through acquisition, market leadership in anti-counterfeiting, acceleration in OSP growth through diversification in high value applications; increased leverage of our NOLs to drive more profit, to get more benefit from the NOLs; and with that greater flexibility in our capital structure to enable us increase return to the shareholders.

Okay? So that's the summary I'd like to finish on.

QUESTIONS AND ANSWERS

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Okay. We'll open to Q&A. So we'll start with James.

James Kisner - *Jefferies - Analyst*

Thank you. This is James Kisner, Jefferies. So I was just curious on OSP outlook of 0.4% [Inaudible - microphone inaccessible] the optical coating for [filings you are] assuming in there. And then separately, just regarding the investment [automate] in Q1 business processes and kind of thought on, cash thoughts, cash investments with OpEx?

Amar Maletira - *Viavi Solutions Inc. - CFO*

The first question, I'm sorry, I didn't get that.

James Kisner - *Jefferies - Analyst*

So, the OSP revenue guidance for FY 2016 [Inaudible - microphone inaccessible] opportunities, I'm just wondering, why assume for that net adjacency in that growth rate?

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Amar Maletira - *Viavi Solutions Inc. - CFO*

So as I've said, there's -- we have noticed many of those adjacent opportunities.

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

[Inaudible -- microphone inaccessible].

Amar Maletira - *Viavi Solutions Inc. - CFO*

Yes. But there are other opportunities that are -- the [side] of anti-counterfeiting is also promising, some of those opportunities are incorporated but not the big ones that we talked about. I want to take a --

---

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

Well, it's that our philosophy is this company going forward and now, it is first save to invest. So you'll save to invest. There's no bucket of money anywhere else to invest. So from a cash perspective, I think we will -- we'll basically run it our model.

Bill Ong - *Viavi Solutions Inc. - Head, IR*

We'll do Alex and Jorge.

Alex Henderson - *Needham - Analyst*

So, I guess, it's the right time to ask the question?

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

Now you can ask the question. Go ahead.

Alex Henderson - *Needham - Analyst*

So I just kind of ran --

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

Yes. I'm sure you have.

Alex Henderson - *Needham - Analyst*

the model and it looks like you're coming at that's roughly $600 million [inaudible -- microphone inaccessible] NE growth rate and it would suggest a significant reduction in NSE or SE? I'm now around $40 million, $45 million, to $50 million in revenue in that, is that right ballpark that you're thinking about for SE and the smallest in focused business?

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Amar Maletira - *Viavi Solutions Inc. - CFO*

Yes. So I think if you look at the midpoint for 2019, it $575 million for NSE business, 575. I think you're roughly in the ballpark. You know, I think -- I don't want to get ahead of myself here but there will be -- let me see how I can add color for you to model this.

So NSE, if you look at 2016, with about 24% NSE, the balance was NE if you do the math. This will be in very, very low double digit in the NSE and then you can model whatever you want for NE. We believe it's still a low single digit growth.

Alex Henderson - *Needham - Analyst*

So just for clarity purposes, there's no assumption that you've had successful acquisition in the NE division within that --

[Multiple Speakers].

Amar Maletira - *Viavi Solutions Inc. - CFO*

No. It's all organic.

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

We are just trying to give you standard phase of this once we do. Anything that we're doing acquisition, we'll revise the model and update it to the extent, some of our facilities become greater source of (inaudible). We will update that. Also, we expect to keep updating this model as soon as it becomes, you know, more pronounced.

Alex Henderson - *Needham - Analyst*

Just to go back to the [following] question because it seems there's been a lot of attention, without letting this get out over our [Inaudible - microphone inaccessible] 12 months, 24 months, 36 months, what's the timeline on this type of program because people can get pretty worked up [Inaudible - microphone inaccessible]?

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

Well, if all goes right, we're looking at, this time next year [Inaudible - microphone inaccessible]

[Multiple Speakers].

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

I mean, my view is I don't want to get ahead of ourselves. I'd like to good little tidbits for you guys throughout dinner as we get closer and the visibility is much better.

Unidentified Audience Member

[Inaudible -- microphone inaccessible].

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

Because there is really no forecast are -- so that's forecast. Yes?

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Jorge and Patrick.

Jorge Rivas - *Craig Hallum - Analyst*

I have a couple of questions. First, over the [Inaudible - microphone inaccessible] business for FY 2017, you mentioned some softness in customer spend, I wonder if you can give us some detail on which areas -- in which areas [Inaudible - microphone inaccessible]?

And then what would take -- what would have to take for your guidance to go [Inaudible - microphone inaccessible] and the deployment of [Inaudible - microphone inaccessible] it seems like the [Inaudible - microphone inaccessible] continues? So I wonder if you can touch on that?

And again, how do you envision the transition from 100 gig to 400 gig in your business whether it's [Inaudible - microphone inaccessible] on your revenue [Inaudible - microphone inaccessible] FY 2018. I wonder if you can provide some color on how [Inaudible - microphone inaccessible].

Amar Maletira - *Viavi Solutions Inc. - CFO*

Okay. So I'll start with the first one. [Inaudible - microphone inaccessible]

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

So you've got so many questions. What are the first ones? So there we are seeing the weakness in customer [spending]?

Jorge Rivas - *Craig Hallum - Analyst*

[Inaudible -- microphone inaccessible].

Oleg Khaykin Yes. So, let's -- so what we are seeing is -- it's very early, right? We are just three months into the year right now.

We are seeing some things in customer spending and it is mainly on the field side, field instrument side, that's where we are seeing. Now, whether will it bounce back, we don't want to plan for any bouncing back and build the cost structure so that it bounces back. So what we are expecting is if it bounces back, it will be all offsite and that's already impacting the offset of our guidance range. So it's the field set of the instruments is where we are seeing some softness.

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

That's right. You mentioned about 100 gig and 400 gig? So, clearly, right now, we're shipping a lot of 100 gigs because that's all the deployment both from the field as well as the lab side.

Next week, there's a major trade show in Dusseldorf in Germany. Stay tuned. We'll be talking more about the 400 gig roadmap and we'll be making some announcements and I think, today it's mainly 100 gig is what we are shipping into the field and I imagine the 400 gig will start shipping as early as next quarter to the development partners.

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Bill Ong - *Viavi Solutions Inc. - Head, IR*

Patrick and then Rod

Patrick Newton - *Stifel - Analyst*

[Inaudible -- microphone inaccessible] focused on the -- mainly on the operating margin in the 2019 outlook. We have a 7% to 9%. Can you help us understand the rough split between SE and NE you see it today?

And then maybe longer term, Oleg, if you can comment on the five years down the road, how we should view NE? I think if you look at your peers across the industry margin range, anywhere from low 20 and through a cycle, I would say, it's pretty reasonable. So, given the changes that you're making, it seems like FY19 outlook seems relatively conservative.

Amar Maletira - *Viavi Solutions Inc. - CFO*

So starting with the -- I would give you the split between NE and SE operating margins but don't disclose that. Let me see if you can give you the color here.

So in 2016, we did see losses in our SE business and there are a lot of numbers out there. Sometimes I feel like we just give a number so that people are not assuming how much of loss we have. But we did have -- maybe I should just give it so people can model a little better --

[Multiple Speakers]

Amar Maletira - *Viavi Solutions Inc. - CFO*

-- because otherwise you guys will run with different numbers.

So we had roughly about $40 million of loss on a loaded basis, Okay, in our SE business. Now, you have to keep in mind that some of those are also allocated costs, right? So when you go and rationalize our SE business, you can't just go and shutdown a site. It will take time to shut down the site.

So that's the upside to the model, right? So this -- some of the stuff that I talked about, automation, site consolidation, our sort of beyond 2019. So the 7% to 9% range basically factors in that we will rationalize SE or take out cost. At the same time, we'll reinvest some of it back into the business on the inside so that we have focused SE strategy as well as reinvest some in automation. So that's all factored into the -- into the 7% to 9% range that are provided.

And I'll let Oleg talk about the long-term vision in the operating margin. But if you just look at the organic side. I think you should be, in this business, in there between mid teens or so should be the operating model in this.

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

And to the extent you scale it through acquisition, you could push it to 20% or even above it. It depends how much [you save]. In the end, once you have your field force deployed, your sales engineers, all they deploy, any dollars that you will grow beyond it falls right to the bottom line. That's where you get the massive OpEx numbers.

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Amar Maletira - *Viavi Solutions Inc. - CFO*

For example, if we were like a several billion company, I don't see a reason why we wouldn't be [Inaudible - microphone inaccessible] on the NE business.

Rod Hall - *JPMorgan - Analyst*

Okay. I got three quick questions. Two in the weeds and one high level. So, you gave -- this is not really in the weeds -- we get this governance update, could you guys just give us any color on what's changing there, why you put that slide into the appendix of the pack because I don't think -- you didn't comment too much on that? So, could you just comment about that?

And then the super distribution setup and the NOLs, is that a going forward consideration for us and the treasury rule changes that at all, your ability to repatriate that cash or utilize that cash against the NOLs? Just double checking that and other [changes affecting how many] --

[Multiple Speakers]

Amar Maletira - *Viavi Solutions Inc. - CFO*

In fact, actually, we want to increase the coverage on the super distributor model.

Rod Hall - *JPMorgan - Analyst*

Okay.

Amar Maletira - *Viavi Solutions Inc. - CFO*

And I think we are already working on it. So, you know, we have several NOLs of $5 billion. In certain tax jurisdiction, we still pay taxes and we generate profit. In certain tax jurisdiction, we do have [imported tax] we do have some NOLs but in some, we don't.

And those other areas where we are trying to repatriate back and we want to -- 17% to 19% is not ideal. We have so much of NOL, and it's better than 35% to 40% but it's not ideal. So we want to reduce the tax rate. In fact, we want to go increase some of the model --

[Multiple Speakers]

Rod Hall - *JPMorgan - Analyst*

But this treasury changes don't have any --

Amar Maletira - *Viavi Solutions Inc. - CFO*

No. Not that I'm aware of.

Rod Hall - *JPMorgan - Analyst*

Okay. Maybe you want to comment on that, my last question?

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

Sure. I think, you know, there's a lot of things we discussed and it's kind of [new] so we just felt to the extent people will bring in the governance, the activist positions, we just put it all in one slide. We are a very shareholder-friendly company. We have a classified board. All directors are reelected on annual basis. No (inaudible) so we just said just put it all there. Here's the points, write them down so we don't need go into any one of them or selectively mention something here and not mention anything there.

Rod Hall - *JPMorgan - Analyst*

Just double checking. Nothing is changing.

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

Nothing change. So, basically -- yes.

Rod Hall - *JPMorgan - Analyst*

And then the last question, I guess, is what is on the coating opportunity that you've laid out but not [giving the] numbers on, what is the -- what [does excess] look like? Is it you get into one flagship model by the end of next year or what --

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

See, now, you're fishing. I told you --

[Multiple Speakers]

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

Look, I mean, I wouldn't be talking about it if it was not a good one, right? So I think -- let's leave it at that. I think it's premature to discuss because as we've said, a lot of products [Inaudible - microphone inaccessible]. But my view is I think we are positioned as well as anybody else [in the United States]. It's not that [Inaudible - microphone inaccessible].

Bill Ong - *Viavi Solutions Inc. - Head, IR*

We'll do Mike and then Alex.

Mike Genovese - *MKM Partners - Analyst*

Thanks. Mike Genovese, MKM. Can you talk, Oleg, about the thinking and strategy of nonorganic growth in NE or NSE? What kind of company do you want to buy?

And then to make it a financial question, if we saw you do one or more large NE deals where there as a big opportunity, high SG&A, would that put upward pressure on the 17% and 19% [interest] or would that give you marginal change?

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

So, I mean, it's kind of like when you're planning to get married, right? First, you have to have significant other willing to do that, right? But let me just tell you what I think about what defines the right acquisition opportunity.

You got to be a business that's ongoing, company with a good product portfolio in the market position and emphasize significant overlap in OpEx, right? That, to me, is the ideal candidate about going deep because that's what's really drops to the bottom line. So, yes, absolutely.

If we do something meaningful like that, you're going to see a very nice upside to the operating margin within that timeframe. But, you know, it's got to be, I think that we just laid out our framework. And, of course, to the extent we get it for free, that's the [other side], right? You know, that's got to be the right price as well.

So in the end, the only way acquisitions make sense for us is we got to push and make our shareholders [wealthier].

Mike Genovese - *MKM Partners - Analyst*

When I think about what you just said, I mean, it's a pretty small group of candidates, right? There's not a lot of them.

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

There is [Inaudible - microphone inaccessible] I'm not interested in buying something like a couple of million dollars. It's got to be meaningful, meaningful to move the needle on our market share and it's got to have enough OpEx. But between the two companies we come out, the more and linear efficient structure. And on top of it, benefiting from our NOL, not only you're going to get synergies on that tax adjusted basis, you get significantly greater opportunities, right?

Bill Ong - *Viavi Solutions Inc. - Head, IR*

It'll be Alex then Meta and then Patrick.

Alex Henderson - *Needham - Analyst*

So, just to clarify what I thought I just heard you say, you're suggesting that any margin would be in the 15% range, mid-teens. Correct? Well, same [stuff] with the numbers that we just talked about in terms of revenue, that would imply $80 million in profits on 2019 numbers and, yet, to get to just 9% much less 7%, could imply that SE is still another-] $30 million?

Amar Maletira - *Viavi Solutions Inc. - CFO*

No. So, I think I said not in 2019. It is in the long term, that's where we want to be. Mid teens, right?

Alex Henderson - *Needham - Analyst*

So assuming that the numbers that you gave are not in that parameter.

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

Look at it this way --

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Alex Henderson - *Needham - Analyst*

...essentially eliminating that $40 million dollars in losses by the time we get to the end of fiscal.

Amar Maletira - *Viavi Solutions Inc. - CFO*

Absolutely. By the time we get there and eliminate the losses --

Alex Henderson - *Needham - Analyst*

...combined losses.

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

You're thinking of exit velocity?

Amar Maletira - *Viavi Solutions Inc. - CFO*

Yes.

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

Or at least the total year?

Amar Maletira - *Viavi Solutions Inc. - CFO*

Yes. So, let's keep in mind. When we talk about 7% to 9%, we are, as I told Patrick, they're making investments. That investment is baked into the model. Point number one. Point number two, a lot of opportunities is saving and driving automations, standardizing the process and those stuff. They are still ahead, right? We only see some of it materialize by 2019, there are still a lot ahead.

So I think it will be an OpEx [rate], it would be driven by OpEx. The market is going about 3% to 5%. We would all grow the market but that's not what we are using to get to in the mid-teens. I think there is -- OpEx is more what's driving there.

Alex Henderson - *Needham - Analyst*

[and then the margins essentially on the revenue].

Amar Maletira - *Viavi Solutions Inc. - CFO*

That's right.

Alex Henderson - *Needham - Analyst*

[..and then eventually it's not in FY '19].

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Amar Maletira - *Viavi Solutions Inc. - CFO*

19. No.

Alex Henderson - *Needham - Analyst*

[Inaudible -- microphone inaccessible].

Amar Maletira - *Viavi Solutions Inc. - CFO*

That's right.

Alex Henderson - *Needham - Analyst*

[...you essentially get].

Amar Maletira - *Viavi Solutions Inc. - CFO*

That's right. Long-term model.

Alex Henderson - *Needham - Analyst*

[..they're a lot lower than 10 %].

Amar Maletira - *Viavi Solutions Inc. - CFO*

10%. You mean --

Alex Henderson - *Needham - Analyst*

[...7 to 9 %].

Amar Maletira - *Viavi Solutions Inc. - CFO*

That's right. It's about 10% to 11%.

Alex Henderson - *Needham - Analyst*

[...Thank you].

Amar Maletira - *Viavi Solutions Inc. - CFO*

Yes.

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

Okay. Meta?

Meta Marshall - *Morgan Stanley - Analyst*

Just to rehash a little bit. Can you just go over the scenario in which NOL would be [Inaudible - microphone inaccessible]? Like would be the scenario that [Inaudible - microphone inaccessible] whether the size of acquisition you would do or --

Amar Maletira - *Viavi Solutions Inc. - CFO*

So, it will always be useful. The amount of NOL that you will use to shield the tax, that will actually reduce, right? As I've said, people in the acquisition, somebody acquires Viavi, the amount that will be used is just $37 million to $40 million based on the pre-acquisition market value of Viavi at that time, right?

So the only time the NOLs will totally [assume this is] when it -- when upwards of 20-year lifespan, right? So we see the first tranche of $1.2 billion in 2021. And by the way, we continue to generate some NOLs even now, right, so we are adding some [Inaudible - microphone inaccessible].

So I don't see in the foreseeable future that our -- I mean, we have to be very careful when we do acquisition -- get acquired, et cetera. That's the time the limitation comes into play. But you can always use NOL but the amount is dramatically lower.

Bill Ong Okay. Patrick?

Patrick Newton - *Stifel - Analyst*

So, Oleg, you've addressed what you'd look for on an M&A side [but] I would just love to get some parameters around leverage ratios that you're willing to do, just to give us way markers on the [status of the] acquisition?

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

Yes. So I think the -- currently, we have a very high leverage ratio at $650 million debt and we are servicing it. You know, I'm not -- I'm not spending sleepless nights thinking about interest expense in this business.

Amar Maletira - *Viavi Solutions Inc. - CFO*

First of all, we have a low fund rate too. So I think we will very mindful on how we develop the business. But our business, essentially, has a very good cash flow generation. That gives me confidence that we will -- we can develop at the [stated] time, service and interest expense and eventually pay down the debt.

And remember, in the extent to doing go deep acquisitions, we get --

[Multiple Speakers].

Amar Maletira - *Viavi Solutions Inc. - CFO*

More profit. More cash flow.

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

And to the extent we don't pay taxes, we actually have more cash [to leverage].

Patrick Newton - *Stifel - Analyst*

Is there any max net-debt EBITDA or any type of ratio you can think off that you would be -- you start to get uncomfortable moving forward?

Amar Maletira - *Viavi Solutions Inc. - CFO*

I think currently, we are operating at 7x. If you look at our peer group, they are operating in the 2x to 3x, so long-term debt to EBITDA. I think we are -- again, I'm not going to put a number out there but [in terms of seven X we're there].

Patrick Newton - *Stifel - Analyst*

Yes. I'm sorry. I'm not concerned about the debt servicing at all. I'm talking about net debt, the net cash position, right?

Amar Maletira - *Viavi Solutions Inc. - CFO*

Sorry.

[Multiple Speakers].

Amar Maletira - *Viavi Solutions Inc. - CFO*

Well, if you're going to a net debt --

Patrick Newton - *Stifel - Analyst*

Right. Right. Right. So I'm asking how much are you willing to lever if -- could you go -- do you have the borrowing capacity to go do a billion deal, billion and a half? Stuff like that?

[Multiple Speakers].

Amar Maletira - *Viavi Solutions Inc. - CFO*

Let me answer. Yes. We do have the borrowing capacity to do that.

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

And it also depends on the deal, right? You got to look at how much OpEx synergies we can drive, right? That's the big deal.

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Amar Maletira - *Viavi Solutions Inc. - CFO*

So I think the market will be receptive when we go out. We have a strong balance sheet. We have good cash flow generation. And I think we can lever.

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

Yes. I don't think we'll have trouble finding one. Okay?

Amar Maletira - *Viavi Solutions Inc. - CFO*

And hopefully at attractive rates.

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

Yes. That's right.

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Okay. Dmitry?

Dmitry Netis - *William Blair - Analyst*

Okay. Thank you. Dmitry Netis from William Blair. I couldn't help but notice, just looking at this page 14, it's an excellent slide you provided where you have a lot of grays and very little [purple] on the --

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

Yes. You mean a mile wide and in deep?

Dmitry Netis - *William Blair - Analyst*

Exactly.

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

Yes.

Dmitry Netis - *William Blair - Analyst*

Exactly. Exactly. So natural question, looking at this chart is what happens to your customer base if they decide to view the different vendor for all these different verticals? Almost kind of them that I can count on this stage and neither one of them [knew the shares] stuff like you said, legacy wire line where, as you've said, is more being over to wireless anytime so [Inaudible - microphone inaccessible]. So then, there could be a little bit of a concern on your customer relationships --

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

Well, remember --

[Multiple Speakers]

Dmitry Netis - *William Blair - Analyst*

-- to migrate those customers over.

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

So let's say I'm here, right, if the customer that's in here, we are a 100% sourced. They don't care, really about everything else. As far as they're concerned they just made a bet on this particular vendor, right? So within that group of customers, we are at 100% of the market, as far as they're concerned.

So our big elements here is making sure that we don't let them down and don't [back down]. But you're right. I mean, this is [a rumor]. In terms of if you look at the pipeline of potential deals that's a lot more but it takes a long time to get there.

And none of these other people are willing to step aside and left you have it, right? I actually think there's going to be price erosion, significant price erosion in that business because there is no cost of goods involved?

Dmitry Netis - *William Blair - Analyst*

In that vein, you could potentially enable --

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

In fact, I won't even argue -- exactly. I won't even argue that this, you know, TAM may collapse because of people commit stupid deals like giving away software for free. You know, the problem with a lot of these things because it's such a big fixed cost to develop the software, you can't afford to lose any one deal and we have seen some really aggressive pricing that we did with AT&T and [such] and all that. So reality is, I mean, there -- I expect it to probably be a lot more [in terms of OSP]. Okay?

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Anymore questions? Okay. With that I'll conclude the formal analyst day event. So thank you for those listening on our webcast. The presentation material will be posted on our company website shortly so we're going to sign off.

And then those here, we have our NSE and OSP demo in the back. I encourage you to take a look at it. We're going to have a fiber inspection demo hosted by Matt Brown --

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

So, let me tell you some of the demos that we have here. One is the where does fiber inspection occur? The answer is everywhere. So we have some industry products to share with you.

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Also, very interesting little product we have. In fact, I would venture to say it's kind of a new replacement for the automobile or horse that defines you as the master of your faith for the 21st century, being able to optimize your Wi-Fi at home.

Amazing tools. I mean, probably a lot of you especially those who live in New York probably have issues with your Wi-Fi because of your neighbors and all of the channels, this is one tool that helps the service providers usually optimize Wi-Fi reception and speed rates inside the house and we have a number of our SE products as well.

Okay. Thank you.

Bill Ong - *Viavi Solutions Inc. - Head, IR*

Okay. Great. And we also have lunch provided and then event formally ends at 1 p.m. So, please, work your way to the demo room. There's a lot of fun stuff over there. Thanks.

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