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###### 0:00 Operator

Ladies and gentlemen, welcome to the conference call ADVA Optical Networking for Q2 2018 IFRS Financial Results. This call is being recorded. After the presentation there will be an opportunity to ask questions. I now hand you over to Mr. Stephan Rettenberger, ADVA Optical Networking’s Senior Vice President Marketing and Investor Relations. Please go ahead sir.

00:41 Stephan Rettenberger

Thank you and a warm welcome from my side. This earnings call builds on a presentation which is available for download in PDF format from our homepage under [www.advaoptical.com](http://www.advaoptical.com) in the about us/investors section. Should you not have the presentation in front of you, you might want to access it on the conference call’s page in the financial results section of the investor relations website. Before we will lead you through the presentation, as always, please be informed that this presentation contains forward looking statements with words such as believes, anticipates and expects, to describe expected revenues and earnings and anticipated demand for optical networking solutions, internal estimates and liquidity. These factors are discussed in greater detail in the risk report section of our annual report 2017. Please also be reminded that we provide consolidated performer financial results in this presentation solely as supplemental financial information to help the financial community make meaningful comparisons of our operating results from one financial period to another. This pro forma information is not prepared in accordance with IFRS and should not be considered a substitute for historical information presented in accordance with IFRS. Pro-forma operating income or loss is calculated prior to non-cash charges related to the stock compensation programs and amortization and impairment of goodwill and acquisition related intangible assets. Non-recurring expenses related to restructuring measures are not included. Unless stated otherwise, all numbers are presented in euro. We will target to limit this con call to 60 minutes. As usual, Brian will start and provide a business update and outlook and then Uli will talk us through our Q2 2018 financials. And finally we will have sufficient time for your questions, which we will be happy to answer. Brian, please go ahead with the business update.

2:54 Brian Protiva

Thank you, Stephan, as always we will start with the business update and outlook on page 4 of the presentation. Q2 revenues reached euro 123.8 million, up from 120.5 million in Q1 2018, but down from 144.2 million in Q2 2017, where North America and ICPs still contributed higher revenues. This was within our guidance corridor provided on April 26, 2018 at between euro 120 million and 135 million euro. Our Q2 pro-forma operating income was at euro 6.1 million, or 5% of revenue, it was at the upper end of guidance, between 1 and 6% of revenue. On a positive note, although we lost quite a bit of revenue from one strategic customer from last year, our total gross profit remained at a comparable level from Q2 2017 to Q2 2018. All in all we quickly recovered from the dip in Q3 2017, showing both slight growth in revenues and stronger gross margins, which will have a positive impact on our calendar year 2018 results. We were able to demonstrate good execution when it comes to our strategic investments, which are beginning to deliver returns. Our third consecutive quarter with growth and strong margins and good profitability is building a foundation for driving stronger shareholder returns. The optical market remains competitive, while both the packet edge and the synchronization solutions are delivering according to plan and helping us to secure solid gross margins and profitability.

Prospects for Q3 2018 page 5: We will continue to strengthen our balance sheet and return to normalized growth by tightly managing our costs and driving greater growth in some of our highly differentiated market solutions, such as our packet edge solutions area, and our Edge NFV portfolio. For the first time in many quarters, we forecast both sequential growth and annual growth of between 10 and 20% off Q3 2017. Revenue growth on an annual basis 2018 is still challenging. As already mentioned, we have to replace strong ICP revenue numbers from one of our largest ICP customers, who made large revenue contributions to the first half of 2017. However, strong order entry, and early indications from major customers point to a strong second half of the year. And as presented last quarter, we now service three of the big five ICPs and we are working diligently on the next generation of DCI technology to upsell our existing customer base. Every revenue Euro means more to us into 2018 than 2017, due to our increasing gross margins. The optical market will remain very competitive until further consolidation occurs in the market, as some of the weaker players are selling purely on price to stay relevant. On the next three slides I will outline my views on our position in our three technology segments.

Page 6, open optical networking: Our focus will be to leverage the metro core upgrade cycle at our current customers to drive additional optical revenues by expanding the use cases at our existing customers. We are also aggressively pursuing DCI opportunities with open line systems, and we are introducing a number of new products for this market segment later this year. In addition, we are going to win new footprint for flexible and programmable 5G infrastructure where we can leverage all three core technologies and our software expertise. We believe for the first time there will be opportunity for networking equipment manufacturers, other than the big three mobile network providers to win real share due to the virtualization of certain parts of the network and the differentiated technology needed for 5G. Investments are too big and the lock-in too great for carriers, who solely rely on the big mobile network equipment vendors. In the meantime our business is moderately positive as we continue to win a greater number of CloudConnect customers. With the addition of our TeraFlex features, we will be expanding both our CloudConnect product architecture, while winning further customers. In the meantime, our MicroMux product is shipping with initial volumes. And finally, ADVA Optical Networking continues to invest in a software-defined strategy in order to support our customers looking at flexible capacity in the network in order to support cloud like flexibility in a carrier networks.

Physical and virtual packet edge – moving to page 7: With respect to our second technology segment, we have a number of opportunities to grow our ADVA packet edge market share throughout 2018. The first and primary goal is to protect our MRV customer base and drive cross-selling initiatives with our NFV solution or other ADVA products. Next we plan on extending the customer base for cloud access solutions by offering both physical and virtual packet edge solutions for complete flexibility and a secure access. They can choose to use our all in one hardware solutions which lead with price performance or to use our software solutions over their cloud infrastructure on white boxes to build high bandwidth and software-defined on-ramps to data centers or cloud infrastructure. Furthermore, we plan on accelerating revenue contributions for our Ensemble software solutions as we see a lot of activity from the carrier landscape and our win rate is increasing. This is based on our comprehensive product strategy, ease-of-use, secure platforms and some of our latest technology features such as zero-touch service delivery or provisioning for both carriers and enterprises. Our channel base for the Ensemble products continues to strengthen with one global integrator and one global manufacturer reselling our product platforms. The list of potential customers is growing rapidly and our reach is at a never seen before scale. We have positive revenue and larger growth in this area, and we have made a number of new customer announcements, such as our recent announcement with Colt based on our Ensemble software, universal CPE solution.

Synchronization, final slide, page 8. We are winning multiple footprints and growing rapidly with our synchronization strategy. So far we are leveraging our large footprint in the carrier space, but there are a number of other customer segments which we will successfully expand into over the next two to three years. We are utilizing our technology leadership in synchronization to further improve overall corporate gross margins and win new footprints, where we can cross-sell our other technologies. With the decision for 5G infrastructure builds being made now, we have all the pieces in order to offer a comprehensive portfolio with core, access and even software-based assurance solutions, which far exceed our competitors’ offerings.

Our recently introduced new products, the OSA 5430 and 5440 put us, once again, 18 to 24 months ahead of all competition. Accurate and scalable time and frequency synchronization will continue to give us a strong third leg to stand on and the ability to leverage optical, packet and timing technologies for next-gen networks. With ICPs and carriers now both scaled market verticals we will be adding other customer segments throughout 2018 and 2019. And now for the financial overview with Uli as the next speaker, thank you very much.

12:21 Uli Dopfer

Thank you Brian and hello everybody. Let us move to slide 10, quarterly IFRS revenue and pro forma profitability. As already stated, we ended Q2 2018 with revenues of 123.8 million euros. These results are within our guidance range of 120 and 135 million euros and represent an increase of 2.7% compared to the 120.5 million euros Q1 2018. The change in customer and product mix, combined with a successful cost reduction efforts led to a strong gross margin of 36.7% compared to 32.4% in the year ago quarter. Despite the fact that our revenues decreased by 14.2% year over year, we managed to maintain almost similar levels of gross profit compared to Q2 2017. These effects are also reflected in the strong pro-forma operating income which was in Q2 2018 with 6.1 million euros or 5.0% of revenues at the upper end of our guidance of between 1% and 6% of revenues.

Next slide, quarterly IFRS profitability: In Q2 2018 IFRS operating income was at 4.1 million euros or 3.3% of revenues, up from negative 0.4 million or -0.4% in Q1 2018. This result was impacted by 0.3 million euros, restructuring expenses. The integration of MRV has been completed and we expect no further restructuring expenses. A stronger US dollar supported 1.3 million euros of financial gains and combined with an effective tax rate of 7% resulted in a net income of 4.6 million euros, or 3.7% of revenues. As the number of weighted average shares outstanding has not changed significantly, diluted EPS developed in proportion with IFRS net income to 9 cents per share.

Next slide, quarterly revenues per region: As already seen in Q4 2017 and Q1 18, we benefit from the strong MRV presence in Asia Pacific, reliably contributing now more than 10% of total revenues. Revenues in the Americas recovered nicely and increased by 10.6 million compared to Q1 2018. EMEA continues to be our strongest region and contributed 46% of total revenues in Q2 2018.



Slide 13, IFRS balance sheet: Overall networking capital of 121.8 million remained at a similar level as at the end of Q1 2018. Inventory increased slightly to 76.3 from 73.0 million euros at the end of Q1 2018. Due to a very back-end-loaded quarter, both accounts receivables and payables increased significantly compared to the end of Q1 2018. In Q2 we repaid 5.6 million euros of debt and increased our cash level slightly to almost 60 million euros. Consequently, net liquidity improved by 7.6 million to a negative 36.6 million euros. Equity ratio is at 49% with a total stockholders’ equity of 233.2 million euros.

Slide 14, Outlook for Q3 2018: We project Q3 2018 revenues of between of 123 and 133 million euros with a pro-forma operating income range to range between 2% and 6%% of revenues. We remain committed to a flexible cost and operating model that allows us to quickly adapt to changing market conditions. We will continue to perform detailed reviews of the expected business development in respect of all intangible assets, including capitalized development projects. In case of highly adverse business prospects, such a review may result in non-cash impairment charges in Q3 2018 and beyond. The operating pro-forma income guidance we provided today excludes any such potential impairment charges. With that I would like to summarize today’s call, and that is in the final slide 15: We have good execution and focus. Our strategic investments are delivering returns. Our acquisition of MRV, which we completed in August 2017 and have now fully integrated into our business, has delivered the anticipated revenue contribution in synergies. Coupling this with our continued financial discipline and strategic focus, we believe ADVA is on track towards increasing profitability and sustainable growth. Q2 2018 marked the third consecutive quarter of sequential growth with increasing profitability. The global growth drivers cloud and mobility and the preparation of the network infrastructure for 5G creates new opportunities for us with multiple ways to win. Our open, programmable optical transmission technology offers significant value in terms of capacity, flexibility and automation to network operators, large enterprises and internet content providers. Traction with our cloud access solution is growing and we are winning more and more designs. Our technical advantage in network synchronization is growing and we are developing a strategic presence with tier 1 network operators. Both technology pillars, cloud access and synchronization are delivering increasing revenue contributions and opening new doors to new customers. Altogether we expect continued positive business development in the second half of the year. Let me thank you for your participation in today’s call and with that I would like to turn the call over to the operator to begin with the Q and A portion of the call.

Q AND A SESSION

21:00 Mirko Meier (LBBW)

Thank you for taking my questions, a couple I have mainly for Uli. First on outlook – if I add to your outlook, you have mentioned in your report of this high-single digit revenue growth in 2018, together with your outlook for Q3, that means from my point of view that in Q4 you are planning assumptions are for negative revenue growth. Is this right? And secondly, it seems that your visibility is somewhat higher because you came back with a range for guidance in the 10 million range, is this also right and the third question if you could share with us the revenue numbers from Oscilloquartz in Q2 and progress in the last year? And the last question on those special customers in the US, could you give us an update how the discussions are going with this special customer? Have you lost this customer or will he come back with some orders in the next couple of quarters?

22:24 Dopfer

Thank you, I need to clarify one thing, so our 2017 revenues were 514.5 million euros and we in our outlook say we will see moderate single digit growth in 2018. So with our guidance that we provided now – and I did not really get what we were trying to say with the negatives – but we will have to have a strong Q4, yes, if you take mid to a high-point of guidance, we still have to step it up significantly in Q4 to get there. What makes us confident, can we still reach it? We had very strong order entry in Q2, like Brian mentioned in his part of the presentation and we had some good signs from several larger customers, and now it is about execution, of course there are several challenges, we have seen some of the challenges already in Q2 with some shortages on the component market for certain low-value components, but is it doable? Yes, it is going to be tough, yes as well. In regards to the Oszilloquartz revenues we do not disclose these revenues as of now but we are currently considering this going forward, so please allow us not to disclose these numbers.

23:52 Protiva



Two comments from my side, the 10 million range Uli, yes, the answer is better visibility and Oszilloquartz is profitable and growing quickly but we are not going to disclose each piece at this point, so it is a nice business for us. And discussions around the special customers was reference I believe to our large ICP where we lost revenues after the first half, they are still a fine customer, we in fact won another footprint with them, just recently over the last 6 months, which is small volume but it shows that we are an existing supplier and we hope to become very strategic over the next six to 12 months with our latest generation of technology. And I think we are well positioned there.



24:50 Meier

Great. Thanks.

25:05 Tim Savageaux (Northland)

Hello, I just wanted to follow up on that conversation around 2018 growth potential, and try to understand what you are trying to communicate here. So in the prepared comments Brian I thought you indicated that growth in 18 will be challenging, it sounds like in this most recent conversation that is challenging but doable, so I want to get a better sense of whether you are kind of maintaining that low single digit growth guidance for the year by pointing out some risks to it and to the extent that you have got some funnel or order visibility into a potential pretty strong ramp in Q4, I wonder if you could characterize what sort of opportunities are driving that. Whether it is cloud, you mentioned you know at least some uptick in others and you saw a strong increase in America’s revenues in Q2 or whether there are other areas that might be providing this sort of visibility that would lead you to say that is still possible, although tough, if I am hearing you right.

26:40 Protiva

That is why we prepared, and taking on what Uli said, we are all focused on getting back growth and we as an executive team and the entire ADVA is clearly our variable pay is based on getting that mid-single digit growth. So we are very focused on it, it becomes more challenging because our growth rates, it has been slight growth, quarter for quarter. And I think that we can continue that slight growth quarter for quarter, as Uli said we have good bookings in Q2 but it is competitive optical market, where pricing is still having too much influence on the market space. So we feel good about our position, we feel it is risky to commit and that is why we are saying to everybody right now, it is going to be a hard push, because we are going to have a strong Q4 to make that original commitment come true, but based on some of the bookings and opportunities that we saw in Q2 it is still doable. Even if we do not achieve that, I think it is our goal to make sure that the profitability is there, the cash flow is positive, we are evolving nicely as a company, the three segments, and I just want to repeat this, is optical is the most challenging over the last six to nine months, synchronization and timing coming along very nicely and our packet edge, both from the physical network element equipment but also with the Ensemble architecture software, we are doing nicely in growing that business. We do believe that our optical products architecture is getting more competitive by the week and month and quarter, and therefore it will allow us to attack the optical segment aggressively with the right technology. I hope that answers your question, Tim.

28:32 Savageaux

It does and I would like to follow up and see whether it is possible to put any more specific metrics around the extent of the booking strength in Q2, whether that is a kind of a book to bill indication, sounds like it should be solidly above 1 but to the extent, you would like to comment in more detail on the nature of the booking strength, I would be interested in hearing that.

29:02 Dopfer

Tim, we usually do not disclose booking numbers, I guess as you said, if you talk about book to bill, we had a very good book to bill ratio. But I guess that is all the details that we can provide as of now, but we have definitely some strong bookings that are not only going into Q3, they are also going into Q4 and even into the first quarter of the following year, so yes, we feel pretty good about this.

29:33 Savageaux

Okay, a final question from me on the competitive situation: I think if anything if you look across the space the challenges have been maybe more on the margin side than the top line in terms of what some of your peers have been saying, kind of echoing some of your commentary around price pressure but also seeing some pretty significant uptick in growth rates, at least in Ciena’s case. I wonder if you can talk to your impression of ADVA’s overall market share development across your served markets on the optical side and how you expect that to unfold throughout the year, any major changes there?

30:32 Protiva

So my view is pricing competitive environment, Ciena is growing but it is not high growth, they are solid. Others are still open to see what is happening out there and as indicated, our other two legs to stand on are stronger, so from an optical perspective I believe that bandwidth is growing like crazy, I think first of all our industry is going to consolidate, rampant room is out there, things happening, so it needs to consolidate, that is going to help the optical space, because the bandwidth growth should be driving much greater revenue growth. So even though we might as a whole industry be seeing slight revenue growth, it is nowhere even close to the bandwidth growth and it is due to very aggressive pricing from certain competitors. And so my view is keep our heads down and drive further build-outs and wins of existing customers, and we are doing that in the cross-selling into other segments, etc. winning some key deals and we are doing that as well. And then we have to see exactly how price compression versus bandwidth growth is really doing but I do not really want to commit to that right now, my sense is that the industry is growing in single-digits growth and at best in upper single digit growth, is my sense, just looking out there as a whole. We are not in an optical up-cycle, there is some consolidation; and Ciena’s numbers seems solid, so it is a competitive interesting market space and ADVA’s technology differentiation and positioning is getting stronger by the month. And the reason is we made a massive transition to new architecture and we were late with it, back in that Q17 range and I think we are catching up there quickly, so we feel good about all three segments but optical is the one to watch as far as growth goes.

32:49 Savageaux

Thanks very much. I’ll pass it on

33:10 Robin Brass (Hauck & Aufhäuser)

Hello, and thank you for taking my question. The first one is: Looking at your three segments, so enterprises, cloud and communication, is there any like strong growth that you like to highlight here? Where is the growth coming from in those three segments? And my second question would be, especially towards the communication space: So here at least you always heard a lot that the Chinese competitors in the EU are trying to get market share – is this continuing, especially given that the US is now even more shutting down to any Chinese entrance? Or how do you see this?

33:46 Protiva

So, from a customer segment is what your first question was, enterprise cloud and carrier space – and I think we are making progress in the enterprise space, step by step, from a cloud perspective we are still in the range of upper single digits and double digit number but not any kind of growth vehicle really for us as an organization today, but opportunity to grow that space, with some things that we are working on presently. And in the com space I’d say is probably the strongest for us right now based on the winds and the sync & timing space / with our packet edge story. So the communication providers is the one that is having the most new footprint opportunities for us and I will let Ulli do the details if he’d like to on any of the numbers in that segment but that is more like what is going on out there in the business. And the second one is, the Chinese have been in Europe for a better part – more than 10 years and they are in many of the accounts already being Huawei. ZTE has struggled except for some southern European countries and now they are pushed back out completely, I think due to their challenges with the US government, which means that they cannot access certain technologies. And really it is not a discussion around the Chinese, as it is a discussion around Huawei, and while we have most of the big carriers at this point, I think that they are in a situation where they need to harvest some of the things they have done in the past. And therefore I think it is very stable, I don’t see them as changing market dynamics in any way or form because they are the leader already in Europe. And the leader does not usually do things that change their market position, so I think they are rock solid good company delivering what is needed but they present us also opportunities because we are small and agile, focus on different opportunities to win new footprints and we are often the challenger in a number of the accounts, so we share a lot of the tier 1 accounts, and tier 2 accounts with them already, so we feel very comfortable that that is stable. Uli – do you want to add any color to the first one?

36:21 Dopfer

I mean I can, for sure, so if you look at the three segments, carrier enterprise and ICP you can definitely see carrier business is up compared to the previous quarters and it contributed almost 70% to the revenues and then followed by enterprise with almost mid-22 or 23% and the rest is ICP, ICP was actually surprisingly strong in Q2 but was also up from previous quarters but we do not expect this to be growing strongly going forward for the short-term at least, but should be around that range.

37:13 Brass

Brian, you also mentioned the new products you are probably rolling out, I think you also have one that is specifically linked to the ICP space? Is this correct and what is your view here, especially maybe to win market share the ICP space at the beginning of next year with this new product?

37:35 Protiva

So yes, the TeraFlex is a really high-capacity low-cost 100 gig engine, essentially, and that product is in fact in Q2 ahead of plan, so wonderful news. Remember though that is just an extension to our CloudConnect. The CloudConnect was a full new hardware architecture, full new software architecture, we don’t have those challenges any more. That product is solid, many customers already, and now we are bringing out new features. The TeraFlex can be considered a new feature, but it is a chassis very scalable, very focused on that market opportunity, so that is coming to market and we feel good about our competitive position there. Combine that with what we call open optical systems, and that is allowing our customers to build optical networks very open, meaning that they can use multiple different suppliers for the transponders, or for the optical modules – you could put the optical modules in a switch router you can have a standalone product, you can add it to other network equipment elements in the network, or - it is an architecture where we are a leader in. And so we have a couple of initiatives and the third piece is all the software, open interface, the standards, that are coming to market, so we are not offering just one, we are offering very flexible, very focused on that customer segment saying we will do whatever you need, essentially very quickly in supporting that customer base with all those optical open interfaces.

39:15 Brass

And is it fair to assume that you use this new product first with some smaller clients before you offer it to the larger ones at this moment?

39:22 Protiva

I think we will go to market at about similar times. Clearly the larger ones had their cycles, depending on if their cycle is early or mid will be determined whether they will see that first or after some of the smaller players, they go through cycles of product evaluation, what we are trying to do is align all of our customers with our product introduction, so that at that point then if that is all aligned clearly we would be positioning with the largest customers first, just because of the scale. But again there, that is an issue of alignment that is not our decision alone.

40:05 Brass

OK. Thank you.

40:20 Johannes Ries (Artus Capital)

Hello, maybe a follow-up question, coming back to CloudConnect where you said you were late in the market and now with TeraFlex you have an add-on within the ICP market, maybe you see good chances – maybe what was the reason that CloudConnect was not at the first steps so successful, you expected that you had to be delayed or add-ons like TeraFlex were not available. How do you see your competitive position against the closest players in the space? That is the first question.

41:00 Protiva

On that we indicated middle last year that it was a software architecture and a supplier challenge, so one of the engine installations was not done in a timely fashion, and the software frame was completely new and it is usually a 10-year software frame, we did try to make big innovation steps, and that was more challenging than we anticipated, but we are through those things, we have integrated and we are in the normal process of customer evolution. And the issue is long gone with the engine piece and we are now moving to the end of that 2nd generation piece for the CloudConnect and that is working very well, so stable nice position, let’s make sure that we continue ahead of plan with go to market strategies on our TeraFlex, so I think that is all good. What was the 2nd question?

42:11 Ries

How you now feel having solved the problems and making add-ons and the software is running, which is a new solution, and how you see your competitive position against the closest competitors?

42:30 Protiva

Existing competitor position we are in the ballpark with our CloudConnect, we have some very nice differentiating features but our competition has differentiating features. I think the TeraFlex really changes the ball game and makes us very efficient on the scalability/costing. So in a full picture the CloudConnect continues to evolve, we continue to add features as we go forward and that is what I indicated earlier, I think that we are more competitive today than we have been over the last 12 months and we are getting better and better each quarter, so I think that is really important for us as we build holistic platforms in that CloudConnect. The 2nd piece is the issue around the scalability of 100 gig pricing and really hard-core infrastructure piece and there with the TeraFlex I think we will be market leading, and I think we will have a very nice competitive position to go and attack the market, and we will.

43:31 Ries

So taking this and maybe that also maybe Oscilloquartz will pick up more in revenues next year because some orders you win now maybe is picking up next year, and you mentioned also some markets are not booming but there are signs that maybe there is an up-cycle ahead in the coming two years or so, so LTE, 5G, maybe switch to 400 gig, therefore could there be a chance that the revenue could accelerate going forward with all the uncertainties you have today but maybe the basic success of the fundamentals are made and so the market is moving in the right direction?

44:23 Protiva

My view would be that we can grow enterprise, we can grow carrier but we all know that the carrier market space is competitive and there is consolidation there, and that can evolve, and I think the ICP space is the one where we can get strong growth if we perform well, but we are not promising that and therefore my statements have been that we are evolving the business, we are managing the business well, gross margin expanding, profitability expanding, but right now I cannot make a call on the industry as a whole, specifically the optical space to see do we go back into double-digit growth next year. That will be our intent, I will be pushing the company aggressively to make that happen, but I cannot sit here today and say that is definitive. What I feel comfortable with is an evolving story, growth, strong margins, good profitability – continuing to invest and having three legs to stand on to win business, cross-sell and build the business. And then we will have to get back on our next calls to really see how the optical space is expanding into next year, probably early next.

45:47 Ries

Maybe ICP is moving back to a strong growth, will this time be not a negative impact on profitability like we are seeing in the last phone call of the ICP business, because you have another product which has better margins or should we expect because it is a very competitive space that growth is moving up but margin maybe we will see some negative impact?

46:15 Protiva

You are right, if we go into a rapid growth phase, coming from ICP that will dilute our gross margins but will still drive profitability, but I think what we have stronger this time around is that we have three legs to stand on, we have a nice growth business and synchronization in time and good margins, an edge story, that is why we mentioned in the presentation today a nice story evolving and the margins are getting stronger there as we will have more and more software deals, we truly have the leading product on the globe, for a number of different use cases and so if you can grab that and drive sales growth there, that is a good margin development and that is that packet edge story, so we have very good products, good margins future and right now things look good there, and so in and around that optical space if we get that ICP engine going yes we will go faster, margins will be diluted but our profitability will grow nicely and strong. We understand the ramp and the opportunity is a bit better than last time, we will do a good job of managing things and continuing to stabilize on three legs to grow or to stand on.

48:00 Dmitry Netis (William Blair &e Company)

Thank you, 3 questions, I’d appreciate a candid answer. On the TeraFlex, you announced the product in March 17, and you launched it in the fall, so it has been out there in the open and people are trialing it. I am curious to see how many design wins you have on this product, and this was going to be your grand product for ICP market. And you were going to win back that large ICP that you had on the prior generation products and maybe add more to it, so this is a key product to your success in preserving margins and driving future growth in this segment. So can you give us a bit more color how many design wins you have so far, is it close to prime time, is it not yet there? What are some of the steps that you are doing to get Terraflex qualified?

48:55 Protiva

What we had said is that our lab samples Q3, customer demos Q4, ramping sales 2019. We are dependent on the DSP partners that we have selected and the technology is coming to market, it was slower than anticipated in the first half 2017 but they are coming to market and all indications are very good at this point. So we are not in a position to say now we have specific design wins, we are not in a position to recognize any revenue but all indications are that it is rock solid architecture, all the pieces are there, we can show the product, etc, so things are moving around nicely. This is based on the 600 gig per wave length, our last generation was 200 gig per wavelength and the state of the art right now are people either at 200 gig or at a 400 gig platform and are going to market with that solution, is kind of as we speak now. So we feel that we have a competitive edge against other players but we need to get our roadmap. And then to realize revenues, revenue rec (= recognition) is in beginning of next year, that is the plan at this point.

50:50 Netis

2nd question on the price competition that you mentioned in the optical market, any specifics, Huawei it has always been a price disruptor, so maybe take them out for a sec but focus on more disciplined players out there, the Nokias etc. of the world, are you seeing more price aggression coming out of these players or is it something else like Coriant, can you give us color what is driving all this price disruption or aggressiveness out there?

51:00 Protiva

I think the most aggressive out there is more the wounded animals that are doing crazy pricing and then some of the more established players, including us, are doing strategic pricing at certain accounts but that can get very aggressive. And I think that is the situation right now, it can come from anywhere, and not particularly the Chinese because again they are well established and not able to attack the American market, where I think they would go crazy if they had that opportunity but they do not, they are established in the other markets and therefore they are not really the leading price-aggressive player but they can be at any given time, naturally. But it is the wounded animals in the first layer and then selective accounts in the more established players, based on strategic direction.

52:00 Netis

That is a helpful color, more established being the Cienas, Nokias is I would imagine is what you are referring, and the last one, more of an architectural shift that is going on, in an open line system there is a lot of buzz around that, today it seems to be coming out of the DCI world – are you seeing any of the tier 1 Telcos talking about it and moving in that direction as well, and if so, how would the margins sort of fare in that architecture? It isn’t any more kind of a razor - razorblade approach I’d imagine, because you are either selling a transponder, or you are selling an open line system or both and so you would have to take the margin up front as opposed to piece meal, razor- razorblade? Correct me if I am wrong I am curios if Telcos are considering that and if so when that really becomes reality?

53:00 Protiva

Correct, with the old version of selling the infrastructure really cheap, all the line systems really, really cheap and then later making the money over the transponders, if it is an open system that might not work the same way and therefore people need to make sure on the line system, so even if you have individual network elements that are managed independently, having said that carriers want to go through this process, and yes we are engaged with carriers as we speak, they want to certify the platforms but in the end they want one throat to choke. They do not want to be dealing with 6 players, so it goes through a process of optical and most likely the two internals may be three players will compete for that optical transponder business, essentially, so carriers will go to the path line, it will be a very managed process, there will be more competition so that in third and fourth year it is not just captive, we have continued to innovate and drive innovation but I don’t think it is going to have fundamental gross margin change within the optical space at all but it will make us drive innovation and continue to innovate rapidly on the transponder side. So in general ADVA here is a leader, we think we can go and win new foot print because of our position and our willingness to go open and we are seeing carriers to starting the process.



54:48 Netis

Do you have a number of design wins you are involved in in the open line system networking deals?

54:59 Protiva

Yes, we have design wins but we have not started to process that or to make that information public but yes we have design wins.

55:00 Netis

Thank you Brian – I appreciate that.

55:11 Tim Savageaux (Northland)

Hi, I have one for Uli on the operating expense front and what your expectations are looking forward, it looked like you saw a solid down-tick in OPEX in Q2 part of the high end of the range, operating margin despite a lower end of the range, revenue is in line with gross margin which with regard to my expectations it looks like you kind of expect that to bounce back up towards Q1 levels, trying to get a sense of what the opex baseline might end up being on a quarterly basis, you are kind of through the MRV, restructuring any color around that would be appreciated.

56:09 Dopfer

Yes, I would assume that our opex basis will bounce back to similar levels we have seen in Q1, we had some special effects in Q2 that helped us to get way below Q1, so Q1 is a good basis for you to do your math going forward.

56:30 Savageaux

Great. Thanks very much.

57:01 Rettenberger

Thank you everybody for joining today’s call and for the interactive Q and A. We will publish the recording of the call and the transcript within the next few days and we hope to have you back on October 25 for our Q3 earnings call. Thank you and bye-bye.