an NTT Communications Company

Transcription
ADVA Optical Networking SE
February 22, 2018
EV00068366

Thursday, February 22, 2018

00:00 Operator

Dear Ladies and gentlemen: Welcome to the conference call of ADVA Optical Networking for the full year 2017 IFRS financial result. This call is being recorded. After the presentation there will be an opportunity to ask questions. I now hand over to Mr. Stephan Rettenberger, ADVA Optical Networking Senior Vice President Marketing and Investor Relations, please go ahead sir.

00:45 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 in the About Us/Investor Relations section. Should you not have the presentation in front of you, you may want to access it on the conference call's page in the financial results section of our investor relations website. Before we 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, 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 pro forma 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 losses calculated prior to non-cash charges related to the stock compensation programs and amortization and impairment of goodwill and acquisition related intangible assets. Additionally, as already stated in our last earnings call, from Q3 2017 onwards, 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 and Brian will start and provide a business update and outlook, then Uli will talk us through our Q4 and full year 2017 financials. And finally, we will have sufficient time for your questions which we will be happy to answer. So, Brian, please go ahead with the business update.

02:38 Brian Protiva

Thank you, Stephan. My voice is not as strong as normal because I had a head cold this last weekend, I am on the mend, but I still have a bit of an issue with my voice. We will move to the business update and outlook on page 4. Q4 revenues came in at 117.2 million, up sequentially from 111.2 million in Q3 and down annually from 128 million in Q4, 2016. Our revenues were within guidance, provided on October 26, of between 115 and 130 million, including revenues from MRV. Q3 pro forma operating increased sequentially to EUR 4.5 million or 3.8% of revenues, up from -0.8 million or -0.7% of revenues in Q3 2017. This result is above the mid-point of our guidance we provided on October 26, 2017. After the Q3 revenue drop caused by two customer-specific events in North America, one of which was due to M and A activity beyond our control, we reacted promptly to the new boundary conditions by adjusting our cost structure and returning the profitability in Q4. Our carrier and enterprise business in Europe continues to be strong. The integration of MRV which we acquired in August 2017, is progressing well and is already proven to be highly accretive.

Moving on to page no. 5, prospects for 2018: We are rebuilding our balance sheet. Remember, in 2017 we had a strong start in the new year with significant ICP revenue contributions in Q1 and Q2. This revenue contribution declined in the second half of 2017. In 2018, we will backfill with new business from other areas while still aggressively pursuing new ICP opportunities. We have already won a few small ICP footprints over the last month. According to our plan we will be profitable, generate cash and continue to tightly manage our cost model throughout 2018. The MRV integration and our restructuring initiative yielded more than 20 million annualized cost savings form our peak OPEX cost. With this we expect moderate single-digit revenue growth and a return to a pro-forma EBIT in the mid-single digit range, when measured in a percent of revenues. Longer term we believe that we are ideally positioned for continued success based on the strategic investments that we have made in our business, with the FSP 3000 CloudConnect we successfully introduced a new architecture for programmable and open Optical Networks. We have established a differentiated software architecture for virtualizing network functions with our Ensemble offering which we have won Verizon as a customer. With the acquisition of MRV we have extended our customer base for cloud-access solutions to support our global leader positioning and we have been advancing our technology leadership in network synchronization, increasing our presence among large network operators. On the three next slides I will outline my view on our position with our different customer groups.

Moving to page 6: Private enterprise networks. We have been serving private enterprise customers since our early beginning. This customer segment represents a smaller total available market than our other customer segments, but we are the global market leader in addressing the various application segments within the enterprise. ADVA is the original DCI company, we have served fortune 500 companies around the globe with best in breed data center interconnect solutions to build their business continuity and disaster recovery solutions. Furthermore, security and information technology is becoming increasingly important and more stringent data protection requirements are impacting the cloud. Thus, our leadership in encryption has helped us to sell differentiated solutions to the enterprise. ADVA is the leading European specialist in transmission technology but we are for most international security certifications and we are a reliable partner for thousands of global companies. Our connect guard security portfolio provides customer with comprehensive protection and different network scenarios and brings numerous competitive advantages. ADVA as a global market leader with strong visibility and trust among data center and network operators worldwide is well positioned to further grow in this field.

Slide 7: Internet content providers. The internet content provider drives high-volumes, but at more competitive pricing than other market segments. The internet content providers grow the major share of our growth in 2015 and 2016. Our FSP 3000 CloudConnect, an extension of the FSP 3000 platform specifically designed to interconnect large data centers sets new standards as open optical transmission technology. The market launch came later than planned and revenue contribution 2017 fell short of expectations, but the platform is now evolving quickly. Inside and outside the ICP community we have increased the number of customers for our FSP 3000 CloudConnect offering from 16 in Q3 2017 to 41 in Q4. Within the ICP community we are starting to expand our application space, some of these new applications drive smaller revenue numbers but increase our strategic importance within the community. Three of the top five global ICPs are currently buying our technology.

Moving to slide 8: Communication providers. CSPs play a key role in the digitalization of society, they also represent the largest purchasers of our equipment presently. They are long-term focused, and they need innovation, quality and great support. The internet of things, autonomous driving and the preparation for the fifth generation of mobile technology all require a robust and scalable communications infrastructure with more fiber-based information super highways, new models in automation for providing communication services and more accurate network synchronization. In recent years we have precisely addressed these aspects by making investments that are strategically important for the future of service provider networks. Our optical platform is more open, agile and flexible than ever before. Operators can turn their high-capacity bit-pipes into a software-defined resource pool that serves as the infrastructure for cloud-based networking. The virtualization of the network functions is changing a business model of network operators, enabling them to provide innovative and customer-optimized services globally. In addition to the FSP 150 product family, it is ADVA’s Ensemble software solution that provides additional market differentiation. NFV is driving convergence in the markets for access solutions and expanding ADVA’s addressable market. The strategic importance of synchronization technology continues to increase, the progressive expansion of mobile networks towards LTE advanced 4.5 generation – 4.5 G, as well as the efforts of network operators prepare for the fifth generation of mobile technology 5G, exasperate requirements regarding timing and frequency synchronization and networks. ADVA’s Oscilloquartz product portfolio is industry-leading, winning numerous sync bid tenders in 2017 and promises to out-perform revenue growth and margins in 2018.

I would now like to hand over to Uli to move us through the financials part of the presentation. Thank you very much.

12:55 Uli Dopfer

Thank you, Brian and hello, everybody. Let’s move to slide 10, quarterly IFRS revenue and pro-forma profitability. As already stated, we ended Q4 2017 with revenues of 117.2 million euros. This result is within our revenue guidance range of 115 and 130 million euros and represents an increase of 5.5% to the 111.2 million euros in Q3, 2017. Year over year our revenues decreased by 8.4%. The change in customer and product mix combined with successful cost reduction efforts led to a strong gross margin of 36.2% compared to 33.1% in the year-ago quarter. These effects are also reflected in the strong pro-forma operating income which in Q4 2017 was 4.5 million or 3.8% of revenues. And this was the mid-point of our guidance of between zero and 5% of revenues. This compares to -0.8% in Q3 17 and shows our strong return to profitability.

Let’s move to the next slide, please. Quarterly IFRS profitability. In Q4 2017 IFRS operating income was at 2.3 million or 2% of revenues, up from negative 11.5 million or -12.6% in Q3 2017. This result was impacted by 1 million euro restructuring expenses, total cost of restructuring in 2017 accumulated to 9.4 million euros, leading to annualized cost savings in 2018 and beyond of about 20 million euros annualized. Similar to other companies, the US tax reform triggered a revaluation of our tax assets in North America, driving our Q4 2017 net income down to a negative 0.9 million euros, or 0.8%. Income before tax effects is positive at 0.8 million euros. As the number of weighted average shares outstanding has not changed significantly, diluted EPS developed in proportion with IFRS net income to -2 cents per share.

Slide 12. Quarterly revenues per region: EMEA continued to deliver stable revenues of 58 million euros, representing 49% of our total revenues. As you remember, the Q3 revenue decrease in North America was caused by two customer-specific evens. For Q4 we are pleased to see improved order volumes from one of these customers, supporting a sequential growth of 11% in this region. The strong MRV presence in Asia Pacific resulted in a growth of 45% quarter over quarter and 15% year over year. We expect this region to become a strong contributor to ADVA's results in 2018.

Slide 13: Annual IFRS revenue and pro-forma profitability. After several years of strong revenue growth 2017 shows a decrease of 9% compared to the year-ago year, 2016. Clearly, we did not deliver on our revenue expectations, however, an improved product and customer mix combined with a quick and aggressive restructuring program secured a stable profitability of 3.8% of pro-forma EBIT in 2017.

Next slide (14). Annual revenues per region: EMEA contributed with 258 million of revenues in 2017, showing a slight increase of 2% compared to 2016. EMEA remains a stable contributor to our overall performance. Due to the afore-mentioned reasons, revenues in the Americas decreased by 20%, representing now 44% of total revenues in 2017. In Q4 we already experienced a slight return to growth, again in this region and we expect this momentum to continue throughout 2018. Despite the strong Q4 2017, Asia remains small at 6% of total revenues in 2017, as mentioned before driven by the MRV acquisition we expect this region to become more relevant in 2018.

Slide 15, IFRS balance sheet: Overall, networking capital of 124 million decreased compared to the 136 million reported at the end of Q3. While accounts-receivables and accounts payables remained on a stable level, the increase of revenues in combination with lower purchasing volumes resulted in significantly lower inventory levels. This also reflects our improved Q4 liquidity of negative 38.2 million compared to negative 44.1 million end of Q3, 2017. Growth cash also increased to 58.4 million euros, compared to the 57.2 million euros at the end of Q3. Although at a lower level due to regular debt repayments of 4.7 million euros. Year over year, net liquidity decreased mainly due to the cash-based acquisition of MRV Communications. Out of the 96.6 million euros financial liabilities end of December 17, 79 million euros relates to short-term financial obligations. This is mainly driven by a bridge-loan used for the MRV acquisition in Q3 2017, which we will refinance by a long-term alternative within the next weeks. Equity ratio is up at 49% with a total stockholders' equity of 227 million.

Slide 16, guidance Q1 2018: For 2018 we expect a moderate single-digit percentage revenue growth and mid-single digit pro-forma EBIT. Due to uncertainties and timing and recognition effects in Q1 2018, we remain conservative in our guidance and consequently project Q1 2018 revenues of between 115 and 130 million euros with pro-forma operating income to range between -1 and +4% of revenues. We remain committed to a flexible cost and operating model that allows us to quickly adapt to changing market conditions. We continue to drive operational efficiencies within all facets of our organization. We will continue to perform detail reviews of the expected business developments 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 Q1 2018 and beyond. The pro-forma operating income guidance we have provided today excludes any such potential impairment charges.

Let's go to the next and final slide, in summary: In our 20-year history we have had a few set-backs that were mostly short-lived. We reacted promptly to the Q3 events by adjusting our cost structuring and returning to profitability in Q4. Today, and thanks to the acquisition from MRV, we have more customers, better revenue diversification, a broader solutions portfolio than ever before. The synergy effects with MRV are significant, with the acquisition being immediately accretive in 2018. With our realigned model we have a solid foundation for growth and increased profitability in 2018. Thank you for participating in today's call, with that I would like to turn the call over to the operator to begin the Q and A portion of the call.

Q AND A SESSION

23:28 Tim Savageaux

Yes hello and I'm going to assume you are talking to me, okay, great, sorry. Well, I have a couple of questions, one sort of a housekeeping one, which is if you could specify the contribution from MRV in the quarter? And it is sort of related, I may have had a partial quarter last time and a full quarter this time and I assume that is sort of contributing to some of the uptick in Asia-Pac but I wonder if that is the same with regard to the strength you saw in Americas, given that you sort of drilled down further on your comments about expectations for continued momentum in the Americas region in 18 and what might be behind that?

24:25 Uli Dopfer

Brian I can take it, so theoretically going forward we will not disclose any MRV numbers we cannot, because it is going to be merged into our existing products and product lines. For Q4 I guess it is fair to say it was a typical MRV quarter, very strong in Asia Pac, solid in the US and yes, it also contributed of course to the uptick in North America. But as mentioned during my part, we also had the increased order volume from this one specific customer who drove down the orders in Q3 while going through a merger.

25:09 Savageaux

Okay, I guess I'll follow up on the commentary about expectations for continued growth in 18 and what is driving that? Continued recovery and M and A impacted customers last year? You mentioned a little additional traction on the cloud side – are there any material growth expectations there or as you look at the Americas region heading forward, what is informing your expectations for continued momentum?

25:52 Brian Protiva

Let me grab that one, and that is we are forecasting growth but not a rapid growth, just back to growth model with nice profitability. The growth drivers, we see Europe is being healthy, we see lots of opportunities with our newest products with North America, yes specifically North America, and that is everything from sync-and-timing to Ensemble to some of our latest products like Cloud Connect, etc. So we see growth opportunities there and in A-Pac with a better foundation we'll clearly with the MRV team on board, customer breadth, etc. So it is not a break-out growth year it is just recovery to growth with increasing growth margins and better profitability is our message.

26:48 Savageaux

Right, and I guess mid-single digit wise organically, that is kind of a flattish expectation given a full-year contribution of MRV, relative to the partial year of last year's, is that generally in the ballpark?

27:03 Protiva

So, I think it is a slight uptick to the Q3/Q4, if you were to take MRV out it is, yes, maybe a slight uptick, MRV in any acquisition period we have to go through we forecasted slightly down revenues, after MRV, and then growing again in the second year, so there is some synergy issues and some dis-synergies issues always with every acquisition. I think we are doing a great job at managing that and we see a lot of opportunity for growth, but it is still forecasts, as discussed.

27:43 Savageaux

Got it, and last one from me: You made what I thought was an interesting break-out of your business around cloud carrier and enterprise and I guess my question is trying to distinguish how that carrier and enterprise breakdown matches up with the Ethernet access business, seeing that it is mostly sort of delivered by carriers and when you talk about enterprise it is really within the optical business primarily per se in terms of transport platforms for DCI and financial institutions. But if you could provide any more color with regard to trends in the Ethernet access business as maybe distinct from what is happening in the enterprise and the optical transport market?

28:39 Protiva

I guess there are a few things happening there, clearly our carrier Ethernet business has been more carrier-focused. As we add now layer 3 capabilities, so we are moving to dynamic routing capabilities and support, and as we bring the NFV architecture to market, they are enabling us to attack the new market segment, that is kind of cloud access, added and layered on top of that is security and so high-bit, big-bit pipes access to the cloud, secure access to the cloud, is an area that we will get leverage from into enterprises and even potentially ICPs. So that market segment we are looking at expanding that carrier Ethernet piece out beyond our carrier layer 2 focus to layer-to-layer 3 NFV and as you indicated to our other market segments, our customer segments, both the enterprise and quite likely also the ICP area.

30:00 Robin Brass (Hauck & Aufhäuser)

Yes, hello, thank you for taking my questions. One question concerning the US dollar – do you see any headwinds here also relating to your revenues or how does it maybe affect the profitability at current rates? And secondly, you mentioned that of course you look at the development of your business and possibly further cost-cuts in case something like that would happen but are there any cost-cuts right now also still planned for Q1 or is this fully finished with Q4? And lastly, the gross margin – could we also assume that the contribution by MRV is also helping the gross margin 2018 as well? Thank you.

30:45 Uli Dopfer
To your first question, the US dollar impact with the acquisition of MRV we are almost naturally hedged, so the impact of a weaker US dollar – you see it in the topline but in terms of profitability it is not significant anymore.

31:05 Protiva
Can I make a comment there? It does take our revenue topline down slightly, if it benefits profitability not much but slightly up. So, revenues down, profitability slightly up. Is that correct, Uli?

31:16 Dopfer
That is correct. More cost cuts, this question – there will be some further smaller optimizations as move along but nothing significant, not as significant as we saw in Q3, maybe max like in Q4 the 1 million we saw but probably a little bit less.

31:42 Protiva
And maybe one comment from my side on that is that you will see less of, let's say, restructuring costs or something of that nature. But we are very conservative in our budget and we are continuing to optimize all spends throughout 2018, as we committed to better profitability along the course, so we are being very conservative but we have made the major moves that you see from a P and L restructuring side of things in 2018, although some of those things still impact 2018, but they are not a bunch of new decisions coming down the pipeline, they have been made end of last year for our budgeting purposes in 2018.

32:30 Brass
Thank you, the last one, gross margin. Exactly.

32:38 Dopfer
Yes, I can take that of course MRV is supporting gross margins, MRV had a good gross margin, so the customer structure is very good, product mix is very good, so yes, it is helping our gross margins.

32:48 Brass
It should continue at least throughout 2018 given the contracts with the customers, I would say, right?

32:53 Dopfer
Absolutely, as long as we maintain or even increase our revenue levels it will contribute nicely.

33:00 Protiva
My two cents, there are other things that have helped our gross margins, and they include, clearly having lost a very large customer, or one of the applications of one of our large customers, that helped our average gross margins go up. Two is, yes the US dollar change does help our gross margin, we buy a lot in dollars, we sell in other currencies as well, so that helps the gross margin. But in addition to that – so all those three points are important – we are selling some of our newer products have much higher gross margins, including Oscilloquartz and Ensemble, the product, software solutions. So those product areas, as they start to impact our top line more in 2018 are also helping us to support gross margin involvements. So there are a number of positive, influential pieces to our gross margin story.

34:15 Rob Sanders (Deutsche Bank)
Yes, hi. My first question was just on the MRV synergies – how far along are you in terms of taking cost out of that business and how much more cost-savings can you deliver from the current Q1 level? I have a few follow-ups.

34:45 Dopfer
So we are pretty far along, the majority is done, there is another major step happening beginning of Q2 when we roll out our ADVA application landscape into the MRV organization. There will be some further optimizations and synergies realized, but as I

said the majority is done but over the course the majority is done but over the course of the years while merge product lines and integrate features you will see on-going optimizations but the majority will definitely be done after Q2 this year.

35:30 Sanders

The 2nd question, maybe you said it, what do you think your ICP mix will be in the 4th quarter and what do you think it will be in Q?

35:40 Dopfer

So it was in the high single digits in Q4 and should be pretty much the same in Q1, however there are few opportunities that Brian mentioned and so this could bump it up a little bit but we need to see.

36:05 Sanders

Okay, and then the last one would just be – given that ICP is much smaller today than it was, how should I think about seasonality for 2018 for this business as a whole with MRV? Because in the past you had a seasonally soft Q3 but then in the last few years you had stronger Q3s – how should I think about this year's seasonality, assuming you do a flattish year in revenue, how should it break up between Q and 2, 3 and 4? Thanks.

36:35 Dopfer

I would say we probably return a little bit to the pre-ICP seasonality, so you will not most likely see the strong increase in Q2 and 3, it should flatten out a little bit but Q1 will definitely probably be the weakest quarter and then we should see a nice increase in Q2, 3 and also hopefully in Q4, but the large peaks will not be there unless some of these opportunities Brian was talking about will materialize and will contribute significantly.

37:16 Sanders

Got it, so Q1 the weakest, Q2 up and then down for Q3 and hopefully Q4 will be the highest in the year?

37:18 Dopfer

Well, you know, if we knew Q3 yes but also Q3 will be up but as said, we will probably not see the major peaks that we saw in the ICP years 2016 and 15.

38:00 Operator

We have no further questions for the moment.

38:10 Rettenberger

Brian, closing remarks? We thank everyone for joining today's call, we will make the recording and the transcript available and thank you very much for your interest and attention. Bye bye.

38:22 Protiva

Thank you for your participation, bye bye.