Transcription

ADVA Optical Networking, First Quarter 2020 IFRS

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PRESENTATION

00:00 Operator

Dear ladies and gentlemen, welcome to the conference call of ADVA Optical Networking for the first quarter 2020 IFRS financial results. This call is being recorded. As a reminder, all participants will be in listen only mode. After the presentation there will be an opportunity to ask questions. If any participant has difficulties hearing the conference, please press the star key followed by zero on your telephone for operator assistance. And I'll hand you over to Stephan Rettenberger ADVA Optical Networking's Senior Vice President Marketing and Investor Relations. Please go ahead sir.

00:39 Stephan Rettenberger

Thank you and welcome from my side. This earnings call builds on a presentation which is available for download in PDF format from our homepage under www.adva.com. In the 'About Us / Investors' 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 the 'Investor' section of our 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, anticipated demand for networking solutions, internal estimates and liquidity. These factors are discussed in greater detail in the risk report section of our annual report 2019. Please also be reminded that we provided consolidated pro forma financial results and 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 the restructuring measures are not included. Unless stated otherwise, all numbers are presented in euro. We will target to limit this conference call to 60 minutes. As usual, Brian will start and provide a business update and outlook. Then Uli will talk us through our Q1 2020 financials. And finally, we will have sufficient time for your questions, which we'll be happy to answer. Now, Brian, please go ahead with the business update.

02:50 Brian Protiva

Thank you, Stephan. Let's see we will move to page number four, Q1 2020 in review. After our strong finish in 2019, we started two twenty with good momentum and a healthy order backlog. As communicated in our last earnings call, the COVID-19 crisis, with its origins in Wuhan, was primarily a concern for the supply side of our business. But thanks to our agile and flexible supply chain model, we were able to largely mitigate the effects and serve most of our customers well. We only had a relatively small impact on the delivery side, resulting in a deferred revenue impact of about Euro 10 million. We had expected more earlier on. Our Q1 revenues reached euro 132.7 million, up nicely by 3.5% year over year from 128.2 million in Q1 2019. Our Q1 pro forma operating income was negative at minus 1.3% of revenues. Customer concentration on larger accounts with lower margins, lower revenues, costs to protect our supply chain and the usual Q1 seasonality were the main contributors to this result. We continue to see good demand from the larger communication service providers and internet content providers. And the demand covers all of our the three technology legs. While the demand for our solutions has been holding up, we continue to face pressures on our margins. The revenue delays, the costs for protecting our supply chain, the customer mix and especially the US dollar strength, with related cost, which it puts pressure on our margins. Thus we are further tightening our OPEX control. Our Q1 results and achievements underscore the resilience of our business in times of crisis and economic downturn.

Page five, how does the customer demand evolve in times of COVID-19? Let me start with a quick overview of the three main customer groups that are driving our business. Carriers or communication service providers, are our largest customer group, representing, in average, approximately 65% of our revenues. They are in the business of building and operating large scale networks that they use to offer communication services to end users or other CSPs. Their network is their product, and all of our technologies are relevant to their expansion. Internet content providers, ICPs, are companies whose principal business is the creation and dissemination of digital content. They operate data centers of enormous proportions and are often referred to as hyperscale or cloud scale operators. The main asset of an ICP is its digital content and the associated services. They represent approximately 10% of our revenues. Over the past few weeks providers video conferencing solutions and cloud services have been reporting record usage. Remote working is practiced wherever possible, and school closures are leading to the rapid adoption of e-learning techniques. The consumption of digital content is increasing. And both providers of cloud services and telecommunications service providers confirm significant higher network utilization. Both customer groups are very important to us and in the past quarter orders from several major customers in the CSP and ICP space actually grew. We suspect, however, that this increase only partially reflects the actual growth and current demand, with a significant part serving as a safety buffer to prevent delivery and production bottlenecks that may arise. From our large corporate customers, who use our technology to build private enterprise networks as part of their IT infrastructure, we have observed the first signs of more careful ordering behavior. Many corporations have been directly affected by the drastic economic effects of the crisis, experienced severe slumps in orders, had to temporarily shut down plants, implemented short time work, or even reduced the headcount of their workforce. On average, private enterprise demand contributes about 25% of our sales. We expect this customer group to be more reluctant to make future-oriented investments in the coming weeks and months. In general, our global and diverse customer base provides some resiliency, as communication infrastructure remains vitally important in times of travel restrictions and lockdown. But new projects and new customer wins will take longer to materialize than planned.

Page six, supply chain update in times of COVID-19. While demand developed surprisingly well in the first quarter, our main focus is currently on maintaining our ability to deliver. In our last earnings call, we provided additional insights to our supply chain, detailing the work we do with our global EMS partners, and the setup of our main distribution centers, which can be seen on the right hand side of the slide. We were one of the first companies to point out that Wuhan is a center of optoelectronic components and that supply bottlenecks were to be expected due to curfews and plant closures. Since then, Wuhan and the rest of China are on the way back to normal, and we're quickly restoring production and supply chains. However, we have not yet passed the pandemic peak in other regions of the world, and uncertainty has shifted to Europe and Southeast Asia. Every curfew, lockdown or closure of borders in the countries exposed to our supply chain bears the risk of bottlenecks in component procurement, production, goods logistics, as well as any ability to install and maintain our products at customer site. Given the work restrictions and even if demand remains healthy, uncertainties will increase as to whether technicians will be able to implement new installations and system expansions in a timely manner. ADVA has developed a very agile and flexible supply chain and we are fortunate that our development and distribution centers have so far largely avoided the crisis. Our production and supply chains are very much intact. However, as already mentioned above, this can change suddenly. This is why we have developed a strategy that allows us to compensate for production and delivery bottlenecks due to possible location closures. We are working closely with our customers and have asked them to place orders early to help us mitigate supply chain challenges. We will continue to do everything we can to take advantage of our distributed and agile structures and reliably supply them, while we continue to act responsibly and protect the health of our employees and partners.

Then on to my final slide, page number seven, innovation in times of COVID-19. As a telecommunications supplier, our technologies and services are supporting some of the world's most critical network infrastructures, from emergency communication to e-learning, from remote work to mobile communications, from media streaming to online gaming, our technology plays an important role. Securing the digital connection in times of social distancing and working from home is currently a high priority. ADVA took very early preventive measures to ensure the company remains fully operational in these extremely challenging times. And we did this, while at the same time making the safety and health of our employees, partners and customers a top priority. We continue to innovate in line with what our customers need most. With our cloud access solution upper left, we enable CSPs to deliver software defined, differentiated and performance assure wholesale, mobile backhaul and business services. We continue to see good demand for physical access and aggregation solutions. And the acceptance of our new generation hundred Gig aggregation devices has been positive. As expected, with labs being shut down, the testing and onboarding of innovative virtual solutions has slowed down. With our network synchronization solutions, we provide accurate and scalable time and frequency synchronization for mobile network infrastructure, utilities, media distribution networks, financial services, distributed databases and meteorology. Demand from the CSP community for precise timing to achieve better spectrum utilization in mobile networks continues. Due to the shutdown of trade shows and conferences our plans to expand into new market verticals have to wait a bit longer, we need to be a little patient. Last but not least a few words about our biggest revenue generator our Cloud Interconnect solutions to the right. This optical networking portfolio delivers a scalable bandwidth for access, metro and long-haul networks. We provide high levels of open interworking, programmability and ease of use. Per my earlier comments we've seen increasing demand from some of our larger CSP and ICP customers scaling their network and cloud capacity. The number of TeraFlex customers keeps growing. In March, we introduced our innovative spectrum-as-a-service capabilities, creating a new level of openness in our FSP 3000 line system. We also launched a new G.metro product, providing cost-competitive bandwidth out of the edge of the network, supporting growth application applications, such as fronthaul and network slicing for 5G. Every crisis accelerates change and creates new opportunities. Perhaps the current emergency will soon result in noticeable improvements, such as more environmentally friendly lifestyle, more solidarity, appreciation for social professions and the healthcare system, and the better use of digital tools. But first of all, many people have great concerns about the health of their family, their income, their professional existence, or their company. Saving lives and securing basic needs for peaceful coexistence must remain a top priority. Our industry is an essential pillar for maintaining communication and economic processes. Both in the crisis and in the aftermath, we will make our contribution to overcoming this crisis and continue to invest all our energy and creativity in innovative solutions for the benefit of our customers, shareholders and employees. And with that, I'd like to hand it off to Uli, thank you.

15:23 Uli Dopfer

Thank you, Brian. And welcome, everyone. Let's move to slide nine. As Brian stated in the beginning of this call, revenues in Q1 2020, amounted to 132.7 million euros, and we're up by 3.5% from 128.2 million in Q1 2019. Given the presence of COVID-19 and the resulting supply chain constraints in Q1, this is a remarkable result. COVID-19 adjusted revenues would have been at 142.8 million euros. Pro forma gross profit contribution decreased to 42.3 million down from 45.1 million in the year-ago quarter. We had a strong revenue concentration of a few major customers with comparatively low margins and incurred additional efforts for securing our global supply chain. As already anticipated and communicated back in February, our pro forma operating income margin was at negative 1.3% of revenues, down from positive 2.1 in Q1, 2019. Without COVID-19 we estimate we would have been at positive 1.2%. I will expand on that later in the presentation. Net loss for the quarter was 7.2 million euros. The loss included restructuring expenses, adverse exchange rate effects, as well as a higher than usual tax rate. Consequently, earnings per share decreased from positive two cents to negative 14 cents. Net debt decreased from 73.7 million in Q1 2019 to 67.7 million euros.

Next slide please, Q1 revenues per region. Looking at our revenues geographically, EMEA revenues decreased by 4.4% year over year, now representing 49.2% of total revenues. The slight decline was primarily due to delays in production and supply chain. Sales volume in the Americas increased by 14.9% primarily driven by a few major customers. The Americas are now contributing 41.8% to global revenues. Asia Pacific revenues increased by 3.1%. The region is still dominated by project-based business, and there were no material country-specific or customer-specific special effects.

Slide number 11 please, quarterly revenue and pro forma profitability. Demand developed well in the first quarter and revenues reached 132.7 million euros, up 3.5% compared to the year-ago quarter, but down from 151.1 million euros compared to Q4 2019. Revenues in Q1 2020 shifted towards the carrier segment, especially in North America. Due to the aforementioned supply constraints, we also decided to prioritize shipments in favor of critical infrastructure projects. However, this coupled with increased supply chain costs lead to lower gross margins of 31.9% in Q1 2020 compared to the 35.2% in the year ago quarter or 36.1%, as seen in Q4 2019. With negative 1.7 million or minus 1.3% of revenues, our pro forma operating income was down from 2.7 million or 2.1% of revenues in Q1 2019 and also down when compared to the 10.3 million or 6.8% in Q4 2019.

Now let's discuss the impact of COVID-19 on our numbers, slide 12 please. During the early phase of the COVID-19 outbreak, we were one of the first companies to point out that Wuhan lockdown will lead to bottlenecks in the supply chain and will likely impact or performance for Q1. Supply constraints ultimately led to a shift of revenues of around 10 million euros. Due to our agile and flexible supply chain, the shift is at the lower end of the initially expected range of 10 to 20 million euros. Without COVID-19 our revenues would have been at 142.8 million euros. This reduction in revenues consequently resulted in lower gross profits. The COVID-19 adjusted pro forma EBIT would have been at a positive 1.7 million or 1.2% of revenues, respectively.

Turning to the balance sheet, slide 13. Q1 2020 credit metrics remained strong with an equity ratio of 48.4%. Gross leverage was at 1.4 indicating a solid investment grade profile. Liabilities to banks were 87.9 million and IFRS16 lease liabilities were 32.5 million and make up our total financial debt of 120.4 million euros. Year to date ROCE came in negative at 4.3% and which was mainly due to the operating loss of 4 million euros. Nevertheless, our cash and cash equivalents were only slightly below the level of Q4 2019 and even 3.4 million above the year-ago quarter. Of course, we are reviewing governmental assistance programs globally. And we will use every sensible measure to protect the company against all existing risks and to maintain a healthy balance sheet.

Next slide, please: cash flow. As mentioned in the past, our operating cash flow is subject to a certain seasonality due to recurring events, in particular employee related costs in Q1 and Q3. Despite the loss of 7 million euros and the difficult situation in Q1, we were able to almost double our operating cash flow year over year.

Next and final slide, please: guidance for the fiscal year 2020. By demand in Q1, 2020 developed positively and our order backlog is encouraging. Business risks significantly increased since our last guidance and issued back in February. As discussed, there are risks in maintaining our ability to supply, and the recession-related declining demand can also have a negative impact on the business performance of ADVA. Due to the current uncertainties about the further course of the crisis and its effects on ADVA's business, it is not possible to reliably predict further implications for the company. Therefore, we decided to withdraw the guidance for 2020 financial year until further notice. Originally, we had anticipated increasing revenues of more than 580 million euros with pro forma operating income to exceed 5%. of revenues. And finally, our strong order backlog makes us confident that we will be able to show sequential growth in Q2. With that, I'd like to hand over to the operator to open the Q&A session.

Q&A

23:26 Operator

Thank you very much, ladies and gentlemen, we will now be starting our question and answer session. If you'd like to ask a question, please press 01 on your telephone keypad. Your questions will be answered in the order they are received. If you're using speaker equipment today, please lift the handset before making your selection. On moment please for the first question

24:08 Simon Scholes (First Berlin Equity Research)

Yes, good afternoon. So you've very helpfully provided numbers which show what Q1 pro forma EBIT margin would have been like, without COVID-19 impact. And you're saying 1.2% margin. And then this is last year, the pro forma EBIT margin was 2.1%. So am I correct in thinking that the main difference between the two numbers is the impact of the dollar, i.e. the strength of the dollar over the last 12 months?

24:49 Uli Dopfer

Thanks Simon. Brian, I take this question. So there's a few things. A, yes, the dollar is definitely some sort of an impact. But if you look into Q1 of 2019 we had a much higher income from capitalized R&D expenses, as well as a higher other income. So if you take this out and actually our pro forma EBIT in Q1 '20 is way above the comparable 2019 number.

25:19 Simon Scholes (First Berlin Equity Research)

Okay, that's helpful. Thanks very much.

25:34 Stephan Klepp (Commerzbank)

Yeah, hi, guys. Thanks for taking my question. First of one is the delta between operating profit and pro forma operating profit, so the delta is 2.4 million, in none of the documents that you provided today you explain that delta. So can you tell me what it is, is it restructuring costs, I would presume? Or...what is it?

25:56 Uli Dopfer

So this is the usually compensation expenses as well as the amortization of intangible assets from acquisitions, which is usually in the 1.6 million range, and then there's an additional 750k of restructuring expenses.

26:12 Stephan Klepp (Commerzbank)

Okay, thank you for that. And then talking about the "what would have been without COVID," the 10 million higher sales that you talk about. So where's the 10 million coming from? Is it just orders that you couldn't deliver, because you didn't have the product in place that you could ship, or...? Can you tell me where this 10.1 million comes from?

26:36 Brian Protiva

So [0:26:36 unclear] chain...it's a supply chain challenge as we had indicated, we thought it would be greater we just could not ship them. Remember we had said that our book to build in Q4 was very high. We, you know, we named that to you last quarter, and therefore it was coming off of backlog and good bookings in Q1, so that was the 10 million we just couldn't deliver. And therefore we've stated in our notes that that 10 million we believe we can deliver into Q2. Why? Because Wuhan is pretty much at 100% already, and Shenzhen has been working at 100% for some time already. So things are being caught up. And therefore, we believe we can catch back up some in Q2. Having said that, there's still a whole lot of work to be done in Q2. We need, you know, running orders to stay healthy throughout the whole quarter to always get our numbers but we've got a good buffer to start.

27:38 Stephan Klepp (Commerzbank)

Okay, perfect. Thank you...

27:39 Uli Dopfer

...maybe to complete … maybe to complete Brian's comment. We did not experience any cancellations from any customers at this point.

27:49 Stephan Klepp (Commerzbank)

Well, that was my question. Haha. Good. And then secondly, if you don't have any cancellations, can you tell me what's happening with your private enterprises as you pointed out, they're very hesitant. So when you say hesitant, that could mean anything from "Oh, they're basically placing new orders," to "They're placing a reduced number of orders," what are you seeing in that area at the moment.

28:12 Brian Protiva

So let's talk about the market as a whole here, I think, you know, the people that are going out of business and really disappearing as customers are small to medium size. When we talk about our 25% enterprise business, mostly large enterprises, much more resilient than the small to medium sized enterprise area. And we get hit by the small medium sized enterprise a little bit more through our carrier service provider customers. But still from a large enterprise business, it's tailing down, certain of them are very exposed to, let's say, consumer-based business that's tailing off quickly, and they then push out potential projects or budgets. So we are starting to feel that. But everything we see, read, and what we understand from some of our customers...clearly certain of our verticals will be impacted. Now, we're trying to push back against that. How are we doing that? We have direct sales in place out there, teams, and going after large enterprise and healthy verticals. We have some very interesting business in government. And so there's some areas that are still strong and we're pursuing those but in general, that 25% of our business will tail off in q2, and most likely q3 and then we hope to recover very quickly when things stabilize.

29:40 Stephan Klepp (Commerzbank)

Okay, very helpful. Thank you. And then, the last one, if you look at the order book that you have, I mean, you said yourself, "healthy bookings." Can you talk about the margin quality of those orders that are coming in there? Are the like the same level that we have pre crisis of the ICPs and CSPs? Or are these guys more aggressive, these days?

30:02 Brian Protiva

So I think the issue clearly, there's a lot of movement in the market. But the biggest issue is the exchange rate. Weakness, you know, the pound hurts us as an example when we it weakens through this type of a situation. And therefore, I think, you know, at the beginning of the year, point one and two, usually our results aren't as good. Point two, we're getting more of the business coming out of the telecommunications service providers where there is lower gross margins and large customers. And then clearly the currency stock adds to that margin, but as Uli has said internally, and as we look at our forecasting, it looks to be, you know, the low point of our gross margin, Q1 and that we will be able to increase that into Q2, Q3. So I don't like to compare it to pre COVID-19 because there's too many moving factors. But in general, again, it's more exposure to telco, currency change, etc, and we should make gains moving into the further quarters.

31:07 Stephan Klepp (Commerzbank)

Okay, then let me phrase it differently, is there pressure on pricing?

31:12 Brian Protiva

We live in a world of pressurized pricing, we don't see it greater right now the COVID crisis, than we did pre COVID crisis. But you know, it's an ongoing battle. And clearly, environment is such that if there are wounded animals out there, and they're trying to win business because they're wounded, it could get more aggressive, but it's almost more relevant around the competitive landscape, than it is, customers really coming out and trying to abuse suppliers at this point. I think they understand that as well, that that's not an intelligent long-term strategy. So I don't think there's a united front on the customer side of things to put pressure on equipment suppliers. I think it's more just competitive environments and if people are hurting, they're out there, maybe getting more aggressive than they normally would. And in general, it's not a huge factor. And again, the lower gross margin in Q1 isn't necessarily driven from that.

32:12 Stephan Klepp (Commerzbank)

Cool, thank you so much.

32:25 Alex Henderson

Thank you very much. Hey, guys. I was hoping we could talk a little bit about how the conditions have changed on the demand side. As we progress through the quarter and into April, it seems pretty clear that there's been a very rapid shift in traffic patterns as a result from the work from home phenomenon. And service providers have seen - according to [0:32:48 unclear] or CloudFlare, or some of the service providers directly - as much as 30 to 50% month to month increase in traffic, and certainly the cloud companies have seen similar spikes in traffic. So has there been a, you know, any push for incremental capacity, particularly around the DCI space, but by service providers in general for more capacity to respond to that?

33:17 Brian Protiva

So I think, you know, we look at this, yes, we've had good, good book to bill in Q4, we had, you know, good book to bill in Q1. Part of it, we had said it in the notes, were basically that, you know, we feel some of it is pre-ordering, because of securing the supply chains and stuff. Bandwidth is moving, and especially for certain, you know, ICPs, I think more than others, and therefore, it's a combination of a number of different pieces. I don't think there's a radical shift over the last four weeks or five weeks or six weeks in that perspective. I do believe that there's some carriers that are, you know, making sure that they're securing their supply chains. I think there's some customers out there that truly have to invest more short-term, clearly, but that's not a huge number out there. And, you know, then there's the issue of, you know, new projects are being slowed down. So there's a number of factors, and they're all complex. It's not easy to answer that question where you're trying to get boiled down to, hey, there's this big uptick in demand, and therefore they're investing like crazy in infrastructure. I'm, I think we, you know, we're not believers, that that's a massive change. There are...there is more bandwidth, there is more bandwidth to certain areas, maybe some core network nodes need to be built out, in general, but there's not a fundamental shift in demand.

34:55 Alex Henderson

Great, and if I could add a second question. To what extent are you seeing a real acceleration in transition from the 400 Gig [0:35:06 unclear] type products that were out in the DCI space, you know, over the last couple of years, to the 600 Gig oriented DCI modules that are now able to be shipped? Are we seeing a big change in share between you know, the, the 400 Gig and the 600 Gig market? Or is it more reluctant to transition, for whatever reason? [0:35:41 Unclear] waiting for 800 Gig coherent products to come down the pike.

35:43 Brian Protiva

I think it's evolutionary, not revolutionary. And I think, you know, bottom line it's still 100 Gig clients, right? And 400 Gig is still kind of...it's out there but just, you know, slow to take off waiting on some of the inherent changes that are...instructions that are going to come into the network. So with 100...the 400 Gigs VR. So I say it's evolutionary. Our product is very good, very competitive, price-competitive, has, you know better bandwidth. And clearly, maybe a couple of the big boys are still trying to figure out, do they move to the 600 Gig, you know, solution sets, do they wait for the 800 Gig technology that's been promised, which is also shifting as we...you know, shifting out there. So I'm...my [0:36:30 unclear] will be evolutionary, good, good positioning, we win more and more TeraFlex customers, day by day, week by week, month by month, and I think you know, that will continue over the next quarters.

36:45 Alex Henderson

If I could just close the loop on that last question. It … has there been any evidence of delays in the availability of the 800 Gig products, which your competitor said was going to be available here in the first quarter? It doesn't seem like the product is delivering as expected. Have you seen anything change in that? Thanks, [0:37:09 unclear]

37:11 Brian Protiva

You just hear rumors out there...different places...different...you know, that nothing's really shipping at high volume in that space or, you know, 800 Gig, you know, doesn't work like it should work. It's always the case when you develop and introduce a new product, and maybe not everything's working for some applicant use cases, it works really well. For other use cases. It doesn't work yet as well as advertised. I think it's a very complex question. But we don't see a mass movement to, you know, new technologies in any way or form. Point 1. Point 2. We believe our TeraFlex is very competitive today, with anything that's been promised from a price performance and from a capability, it has some really nice capability that we've talked about a number of times and therefore we, you know, it's it's a moot topic. It's really, again, it's optimizing 100 Gig, it's optimizing 400 Gig as a next-gen. And what is going to be the architecture that does that? You know, how much of it is going to be, you know [0:38:14 unclear], that kind of Gig solution set or at 800 Gig from one of the others or 400 Gigs ZR? There's a bunch of stuff coming. But I'd like to, you know, reiterate, I think we've got a great next gen solution set, we've got a whole bunch of stuff that we're coming to market on with new stuff now. So we're moving to the next generation as we speak. And it's, you know, it's an arms race and will stay that way. What's clear is there will not be the, the difference between the 200 Gig and the [0:38:46 unclear] 400 Gig generation where they really beat a global markets and had fundamentally different cost structures. That's not happening anymore. So there's not a huge technology differentiation out there, not for us moving with the TeraFlex and not for the next gen 800 [0:39:08 unclear] is more incremental upgrades, and there's a hell of a lot of other things that are important, like ease of use, like, you know how your software-defined networking...if you're able to use it in certain environments. How far can you transport 400 Gig over certain fiber infrastructures and a hundred other things that are more important than this arms race, 600, 800, etc. And from a cost perspective, they're all very similar going forward.

39:34 Alex Henderson

Very helpful. Thank you very much. I really appreciate it.

39:49 Tim Savageaux (Northland)

Hi, thanks, kind of following up on a few of Alex's questions. I mean, it sounds like at the very least you're describing a pull forward in demand from carriers in response to this increased traffic, if not an overall organic increase in demand to some extent. And I would like to try and get to the magnitude of that to some degree. And maybe the best way to start is, you know, as you came into Q1, I mean, were you anticipating … to the extent you're talking about positive book to bill overall? I imagine the carrier portion must have been quite positive. Were you anticipating that coming in or, you know, to the extent you're looking at positive booking trends in the march quarter, was that unexpected? And you know, should we basically be looking at the degree of positive book to bill, whether it's 1.1 or more...obviously, it was higher in Q4, as that...as representative of that unexpected upside and have those trends continued into April? Then I will follow up.

41:05 Brian Protiva

So we don't guide book-to-bill, you know, it's just one more data thing that once we start that we do it after every quarter, and so we don't go through that process. I mean I think what Uli and I said is we just...you know we had good...better than one, we a good book to bill. Yes, it was probably stronger than we expected. Clearly hard for us to judge exactly how much is being brought forward but we you know, some of our customer...carrier customers especially in North America, were you know, more aggressive and I think it was to make sure that they in our pipeline and secure supply chain through any kind of a difficult period of time. And clearly as also demand was out there for shifting flows - you know, gaming and video conferencing, shifting flows in the network and having to upgrade certain nodes and upgrade their networks in certain area. So I don't...it's not such a clear cut. You know, you're asking kind of like a little formula. I don't think it's out there. And I think that's why we were...we talked about this and said, we want to be very clear, everybody's...because some people out there, oh, [0:42:14 unclear], you know, it's an arms race now it's, you know, this is really good, it's bringing back, there's so much more bandwidth and whatever else. And I think our thinking is, you know, you guys, let's not get carried away. Let's be...yes, I think the industry as a whole did get some nice orders out there. Clearly when we interviewed our customers, many of them said this, you know, this is bringing stuff forward. They're not increasing their budgets their CAPEX for the year and therefore, I think we all have to be a little bit wary of you know, the...when what happens when people over order, you know, in the components side of things, you guys because there seems to be a competitive environment for capacitors. What happens to take that business up like crazy and then everybody pays the price three quarters later, right? So I think we don't...let's not get ahead of ourselves. But we do...you know, we were not in a short work week, we're running our business. We are...we think you know...we're...we're okay. We're okay compared to 75% of the companies out there. And we hope that the orders keep running in May, June and July. But it could turn very quickly as demand changes. Look at at&t, you guys. Comments were CAPEX down and it could go down again. So I think we're all...it's not...your job is not easy. And I can't help you with that job, because I can't give you a formula out there, except for the fact our information is: some of those orders are coming in advance.

43:47 Tim Savageaux (Northland)

Right, well, continuing the theme of not helping us, then they let me follow up. I know you're...and, truly, I appreciate the reason or the value of conservatism in this environment in general. Having said that, you know, as you look into your second quarter, you know, appears you have a tailwind, you know, to the tune of as much as 10 million euro in terms of catch-up shipments and then maybe a similar sized tailwind in terms of positive order trends on the carrier side throughout the quarter offset, most likely, by weakness on the enterprise side. Looking at that, it seems like a fair assumption to assume you might see some growth in Q2, and then maybe to open a new kind of line of questioning. It would certainly stand to reason that, to the extent you're focused on incremental capacity adds system fill line cards, that actually could be a positive margin dynamic. Of course, you have a higher margin enterprise business being weak, offsetting that. I wonder if you could talk about that interplay and whether my very high-level setup of your outlook heading into Q2 is something that makes sense to you.

45:17 Brian Protiva

So I'm going to repeat what Uli said: confident we can grow into Q2. We don't know where we're going to be, you guys.

Let's not get ahead of ourselves. I think we're in unprecedented territory. And I want to repeat that, you guys, going out there because the stock market works in three, six and nine months in advance, right? So going out there and saying that, hey, this is all bandwidth, and people are going to...ultimately because what the question is, really, is are people going to spend more CAPEX in 2020 than planned? That's the real question, from a market perspective. So I'm going to say, we're confident we can grow into Q2. I just don't know more than that. We've got an area that in our enterprise that is going to get hit. We know that. Are certain people going to spend - and given, you know, if you're that exposed, you know, are they going to outspend that weakness? Questionable. The next point is in-fills you guys, I mean, if people are doing infills and if they are higher gross margin, I mean, I think that's more for the companies that are losing customers, they might have short term positive in, you know, infills. Do we then have...you know, from...we're not losing any customers, we're if anything, winning and couple new platforms and footprints, but I don't see a major shift to infill build out I think that's more of a question of companies that are either challenged, that are going about larger portion of their business coming from infill that actually helps them to increase gross margins for a short period of time before they really go down. So I'm going to…I'm going to summarize: confident we can grow into Q2, I'm confident when we come out of this Covid - whatever it is, with some kind of vaccine or some kind of a longer term solution, that our market area will recover very nicely and bandwidth is growing and things will be good. But for the next one, two and three quarters, interesting times, and I don't think we should get ahead of ourselves in any way, or form. As an industry or as an individual company.

47:34 Tim Savageaux (Northland)

Crystal clear, thanks Brian.

47:39 Operator

Before we take the next question, just a reminder, if you would like to ask a question, please press 01 on the telephone keypad.

47:54 Robert Sanders (Deutsche Bank)

Yeah, hi, good afternoon. So what I'm hearing is 25% of your revenue as an enterprise, which is at considerable risk, and that's your highest margin business, you've drawn down on your committed facilities completely. So I guess from here, when you think about your scenario 1-2-3 that you've laid out, and the scenario three is the crisis continuing until after summer and triggers a global economic recession that lasts for several quarters. What can you do? You've talked about short time work to reduce costs, but are there covenants on the debt that we should be aware of? Are there easy things you can do to reduce expenses, and what's your minimum cash balance that you would actually like to keep in a case of scenario three? Because, you know, you're already quite levered as it is, and you don't generate any cash flow prior to COVID-19. So presumably, it's going to get worse from here. So what are you actually thinking in that scenario three, in terms of how to kind of stay alive?

49:11 Uli Dopfer

So, let me let me take this, or at least a part of this...of your questions. So, essentially, if things get really worse...well, let's put it this way. What are we doing already? So we are already looking globally. What you know, most countries offer governmental support. In China, you get...they wave benefit payments. In other countries...in the UK, there is VAT payments can be delayed into next year, in the US corporate income tax payments can be delayed. So we are looking at all of these things. We of course, also explore short work week, however, we don't have a reason to go into a short work week because I almost think it's almost unethical to do that right now, since we have full order book, right? So this is one thing. Then the next one is we of course look into government loans to have an extra cushion, you know, of liquidity if things get worse and we already have it essentially approved by some of our banks and we already applied for it. If we withdraw it, depends on how things develop. As of now, we have no reason. And then again, you know, we have currently no reason to go into a short work week, that's the that's the thing. And yes, we...our cash flows weren't that great in the previous quarters or years. However, our goal is to be cash flow positive, free cash flow positive in Q2, also positive net income. And I guess this is our strategy going forward. We want to be...we want to generate cash, we want to be no matter what the revenues are, we will do everything to generate cash and to have a positive net income.

50:50 Brian Protiva

Maybe to expand on that you guys, is we've committed to flat OPEX 2019 to 2020. You can see our OPEX in Q1, we have said though it takes time to restructure. So we're at kind of the end of that, you guys. So what you're going to see is actually our OPEX go down, it's going to get better. And now in addition to that, a bunch of discretionary spending is going away. Travel, big number for us, you know, gets ramped way down as an example. Things like, you know, whatever just...you know, summer parties within our organization, offsites. There's all sorts of things...open positions, you know, gets pushed off. So there's a bunch of stuff, that from a cost perspective, we've got it under control, we're looking at very closely, we just came out of a restructuring where we've lowered our whole cost base. And now we're going to go under 219. And in fact, starting for the first time, in years at ADVA, we're going to go down year on year OPEX, down quarter on quarter. You know what I'm saying, quarter to quarter of last year, quarter to quarter of last year, we...so that gives us also some room, depending on, you know, demand cycle, that might just be fine to do exactly what Uli just said is just, we're focused on free cash, we're focused on, you know, good rock solid balance sheet. And so we're already starting in a lot better shape than we at any point in time in 2019...add on top of that discretionary spending that's being lowered, add on top of that these things that Uli rolled out. Short work week, government loans, whatever else, I think that, you know, we are in a really good situation from a balance sheet metrics and to manage this business, because we're not in an industry that's going to collapse by 70%, or 50%, or even 30%. You know, we're talking that it could move down - but who knows, you know, maybe, you know, things churn pretty quickly and people start investing because bandwidth is growing and it is going to continue to grow over the next years.

52:55 Uli Dopfer

I guess there is one question open, Rob, is the minimum cash balance, I guess. I can give you a range: 25 to 35 million is probably the minimum cash balance that we have in our internal calculations.

53:14 Robert Sanders (Deutsche Bank)

Got it. Yeah, and no covenants, presumably, because that was the other part of that question.

53:18 Uli Dopfer

No, no, this is all already aligned with the banks. It's all good.

53:22 Robert Sanders (Deutsche Bank)

Okay. And just a follow up question would just be on the telcos, as your biggest...I think it's your biggest customer class group. There's a kind of consensus that, you know, fixed data usage is going up and mobile might be going up a little bit. But, you know, most people are cutting their estimates for CAPEX, and it seems like they're focusing on just priorities. But as you say, new projects are being deferred. "If it ain't broke, don't fix it," kind of attitude. And there are obviously worries about the macro, and what it means. So...and in parallel with that, it does seem like...things like, in California, you can't...there are just no at&t trucks driving around at all, for example. So presumably, there are a lot of logistical problems getting around. I know that you don't...you tend to install equipment indoors rather than outdoors. But I mean, is...just...can you just talk through the practical challenges from lockdowns in terms of your business with telcos. Is it really unaffected or you think there could be impacts down the line?

54:26 Brian Protiva

I think we mentioned again, in our...that it's one of the things that we track very closely, it hasn't impacted as much of it yet, so we are seen as critical infrastructure. You know, we went through it also in our presentation, is that we are the backbone for government, emergency services, national communication, military, all sorts of different applications out there. And therefore, we more than most industries are in a position to get the ability...you know, we have...of our 1800 - 1900 people we have probably 1300 working at home, but we still have a few hundred working in different sites, in different places, and around the globe - because of that critical infrastructure support necessary to continue to deliver products, continue service of products and even to continue to, to supply and install products. So I think we're in better shape than most from that perspective. I think we...you're absolutely right, though. It's a high risk area. I mean, if things...double whammy, second wave comes and things really get shut down. Could that impact us? For sure. Right now, that's not high in our list of issues and challenges. Again, ours is our supply chain itself and, you know, also getting some of our suppliers in that critical...we have to help our suppliers actually position themselves as critical infrastructure suppliers. So supply chain issue is higher on our list, and the demand piece are higher on our list right now, than, let's say the services equation of installation and bringing equipment online. Next point - and I like to you know, push - is that ADVA is a fairly small company to be so well-exposed to the large carriers. So we supply pretty much every tier one in Europe in some way or form and have some nice tier one business in North America, etc. And those tend to have better balance sheets, and clearly critical infrastructure and therefore, things keep running. We're not waiting on a big project right now to tier one, where we were betting 20% of our revenues on that, you know? That wasn't the case. We were not betting on a big ICP win. Remember, I've always said our planning was...has nothing to do with us, you know, being able to win one of the big ICPs in some way or fashion, in the - let's say - in the optical side of things. And so I think we have a little bit less risk than maybe some of the others that space, you know. I think Ciena is very well exposed to the tier ones. And we're always very well exposed to the tier ones and after that it goes down from there. And I think, you know, ADVA is in that second tier of exposure of the strong balance sheets, relative to the number of customers, or I should say, relative to the revenues we have. So I think those are critical aspects of that. So good question. But I think for right now, we're not thinking that collapses on us. But we did have it in our notes. We said, "Absolutely a risk area." We're trying to be very open you guys: there's plenty of risk out here. And clearly, you know, we understand what that means.

57:42 Robert Sanders (Deutsche Bank)

Great, thanks for the color.

57:43 Uli Dopfer

Hey, Rob. Let me let me clarify this – the statement I made to the covenants. Of course we have covenants in place for our existing loans. It's the covenant [0:57:53 unclear] EBITDA gross leverage. As you know, our current gross leverage is 1.4. Our internal policy's gross leverage is 2.5. You can assume that this is below the official banking covenant. However, in case you would, for example, draw a government loan or so, we would get a covenant holiday for a certain period of time. So there's no issue regarding, you know, breaking a covenant here.

58:20 Robert Sanders (Deutsche Bank)

Okay, great. Thanks a lot.

58:27 Operator

There are no further questions at the moment. As a reminder, please press 01 on the telephone keypad if you would like to ask a question.

58:38 Brian Protiva

So I guess I'd like to thank everybody for joining. Lots of good, interesting, you know, questions. I'd say, you know, summarizing that is that we're in at least one of the better areas - not a great area, but one of the better areas. There's fundamental growth and bandwidth in our industry. Good news. I think a number of the…you know, systems, equipment vendors, exposed to the right carriers and to the right ICPs and the right customer base are doing well compared to other companies. I still think there's a lot of risk out there that we all have to manage together. And I – there's no free lunch. So even if there's ordering in advance, etc., I think it will opto come clean, if that's the case, in further quarters out. So I think we need balance, understanding the industry, you know, understanding, and, now if CAPEX truly is being increased, as was mentioned, this call...there's more of a tendency to decreasing CAPEX spending, even in the telco space than increasing. So I don't think we should get caught up in our own, you know, short term views, and we should stay very balanced and move through it. And I think, whatever it is, six months, nine months, 12 months or 18 months from now, this industry will be solid. Thank you.

59:57 Operator

Ladies and gentlemen, thank you for your attendance. This call is being concluded. You may disconnect.

