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ADVA Optical Networking - Full Year 2020 IFRS Financial Results

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PRESENTATION

00:00:04 Operator

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

00:00:36 Stephan Rettenberger

Yes, thank you and a warm welcome also 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 calls page in the financial results section of the investor section of our website. And 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 estimate, and liquidity. These factors are discussed in greater detail in the risk and opportunity reports section of our annual report 2020 which we've published today. Please also be reminded that we provide consolidated performance 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 performance information is not prepared in accordance with IFRS and should not be considered a substitute for historical information presented in accordance with IFRS. Performer 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. Non recurring expenses related to the restructuring measures are not included and [0:02:21 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, and then Uli will talk us through our q4 and full year 2020 financials. And finally, we will have sufficient time for your questions, which we will be happy to answer. So with that Brian, please go ahead with the business update.

00:02:48 Brian Protiva

Thank you, Stefan. Let us move to page number four please: q4 and full year 2020 highlights. Q4 was the fourth sequential quarter that was significantly influenced by the global COVID-19 pandemic. It was overshadowed by a second wave with infection rates rising in many countries, triggering severe and long-lasting lockdown measures. 2020 was a challenging year for us. In fact, all of us. Yet, due to decisions we made in 2019, and the product focus that we selected over the past three years, we were able to report one of the best quarters - and one of our most successful years in our history. Our pro forma operating income for q4 2020 was euro 14.3 million (or 10.2% of revenues) and increased considerably by 38.8%, compared to euro 10.3 million (or 6.8% of revenues) in q4 2019. For the full year, pro forma operating income in 2020 significantly increased by 36.4% to euro 33.8 million (or 6% of revenues), up from 24.8 million (or 4.5% of revenues) in 2019. What is that? A 33% increase. Net debt stood at euro 25.5 million at the end of

2020 when also accounting for the new IFRS 16 regulation, a significant improvement of 58.2% compared to 2019 where it was euro 61.1 million. Without applying IFRS 16 which includes lease liabilities ADVA is once again net cash positive and has a really solid balance sheet. As for our customer satisfaction, we use the net promoter score to track our progress: with 50.2%, one of the best in our industries. We were able to significantly improve the value from the previous year (of 44%), and we achieved great levels of customer satisfaction. We will continue to focus on our customer experience in order to drive stickiness and long term customer relationships and absolute strengths, where we differentiate ourselves to many other suppliers in our market space.

Page five: ADVA managed the pandemic well. 2020 will go down in the history books as the year of the COVID-19 pandemic. With the rising spread of infection rates at the beginning of the year, uncertainties for the global economy began to grow. At the beginning of the COVID-19 crisis, we were one of the first companies to point out that the city of Wuhan in China is a center for Optoelectronic components, and that supply constraints were to be expected due to lockdowns and plant closings that were being imposed. After the virus spread globally, the greatest risks for ADVA were the maintenance of supply chains and a possible decrease in demand. We reacted swiftly, and transferred around 80% of our workforce to a home office environment. In addition, we developed a strategy to absorb potential production and supply constraints due to a possible site closure through comprehensive planning and even relocating resources. Due to our response, there were only temporary interruptions in our supply chain. The delays and customers' delivery were largely back to normal in the third quarter, before some further delays occurred in the fourth quarter due to renewed tightened lockdown measures. On the OPEX side, we were faced with significantly higher freight costs which we had absorbed to serve our customers. And despite our stringent work from home approach, we had two cases of COVID-19 - one in the UK, one in Germany- which triggered quarantine measures on both sides. Finally, on the demand side, we saw shift between our two biggest technology legs. Demand for additional capacity in the transport networks, as delivered by our Cloud Interconnect portfolio, was double digit higher than originally planned supporting operators in their laudable efforts to respond to the increase in bandwidth demand. Conversely, the demand for Cloud Access Solutions was softer: this portfolio is used by many of our customers to connect small and medium sized enterprises. With large parts of the economy being in distress, there was less demand for such services, and therefore less demand for our products. Once again, our team stood strong. And thanks to the incredible commitments from our employees, we were able to manage all challenges and deliver outstanding results.

Page six: 2021 market growth drivers. The pandemic clearly demonstrated that economies, industries, and companies that have a higher degree of digitization are better able to cope with lockdown measures and more resistant to the crisis. Enterprise transformation to a more digital framework is accelerating, creating opportunities for technologies and service providers that empower such a transition. In this context, security is of highest importance as digital content and applications become the lifeline of every enterprise. ADVA has a broad portfolio of encryption solutions for the fundamental network layers, and is the innovation leader in post-quantum secure networking. The transformation of the enterprise is part of a larger move to the cloud, which has been accelerating for years. Video continues to be the killer application that is consuming ever greater amounts of bandwidth and requires terascale solutions for data center interconnect. But the importance of other aspects beyond raw bandwidth are on the rise. Secure cloud access, faster service creation through virtualization, and edge cloud solutions that optimize where data is collected, stored, processed, and even disseminated drive investments in solutions that we provide to the market. And last but not least: mobility, 5G, and the Internet of Things are quite possibly the biggest infrastructure project ever seen by our globe. This infrastructure requires new fronthaul, backhaul, and timing investments. Edge compute resources inside the network expand rapidly -

and most importantly (unlike in many of the 4G deployments) in 5G mobile networks, operators will aim to share more of the infrastructure and open wholesale models will prevail. Our technologies are perfectly aligned with today's mega trends. These trends drive investment folks to the edge where we are a global leader.

Page seven: new markets, dynamics, and opportunity expansion. As stated on the previous slide, the growth drivers for our markets are fully intact. On top of the underlying technology drivers, there are new market dynamics that are changing our industry. The realization that communications infrastructure is an invaluable asset for all economies and companies has prompted a rethink in politics and business. A few years ago, network technology primarily had to provide cost effective bandwidth. Today, the focus is increasingly on security aspects. In particular, the expansion of 5G and the industrial use cases associated with it have made this more critical, and the use of technology of questionable origin is now viewed very negatively. In many industrialized nations of the Western world, the dependence on large Chinese network equipment suppliers - in particular Huawei - is perceived as a serious threat. Following the US, network operators in Europe with high Huawei exposure are now also working on concepts to free themselves from this dependency. For ADVA, this new dynamic creates additional opportunities. After years of consolidation in the market, our profile as a Western network equipment supplier with a European-American corporate culture, strong innovation, and a solid business model is being perceived extremely positively. In the network operator environment that increasingly favors local value creation and secure technologies. We can open new doors and gain market share in Europe, the US, and other parts of the world.

Page eight: business transformation. Our focus on innovation has involved heavy investment, often at the expense of higher profitability. Over the last few years, we've brought several new technologies to market and have started to see the returns. It is now time to write the next chapter in our corporate history: a chapter focused on stronger growth and cash generation. The following three points are the cornerstones of our strategy. First, new applications and markets with a high degree of differentiation. Our investments in new technologies give us access to new markets in which we can operate in a highly differentiated - and therefore highly profitable - way and grow at an above average rate. Revenue contribution of our network synchronization technology area has outperformed other technologies and will continue to increase disproportionately and show that growth. With our technology investments of recent years, we can address new higher valued applications with carriers and ICPs and open up new markets outside these customer groups. Revenue contribution from non Telco customer segments will grow from approximately 30% last year, to over 40% in the next three years. Second, increased growth in the areas of software and services. In recent years, we've been steadily increasing the share of software and services in our revenue to around 20%. In 2020, the contribution grew further to 23%. This growth is positive for our customer retention, and will further increase our margins. Over the next three years, we will continue to increase the share of software and services, so that the total contribution to revenue will exceed 30%. Third, verticalization. An important aspect in our industry is to maintain control over crucial parts of the value chain. This includes components and subsystems that either ensure additional differentiation on the product side (and thus increase competitiveness) or decisively improve the cost basis of our own solutions. We have an excellent network of partners in the field of electro photonic components, and will continue to use the added value of this industry to the advantage of our systems. However, we've also launched our own activities in the field of photonic integration. With a key focus on optical transceivers, we launch a family of highly integrated multiplexers, and we'll further expand this product line going forward. These pluggable modules are required in large quantities in our own systems and provide increasing value for neighboring technology areas. With our activities around photonic integration, we are sustainably improving our cost base and opening up new markets. The revenue contribution from these modules will grow to 15% of our revenues in the next five years. In summary, we are leveraging our investments of the last years to a sustainably higher margin model.

My final page or slide, page nine: transformation has already started. The transformation of our business has already started, as indicated by the last slide. It can be seen in our 2020 numbers and will further support our financials going forward. Here are a few examples. New applications: revenue contribution from our network synchronization technology has grown at a compound annual rate of over 25% over the last years and will continue to increase disproportionately. Furthermore, we have had interesting wins and government projects and leverage our unique selling points around security. And we started to commercialize the customer gains of the last 24 months with our ensemble virtualization solutions. Dell - as our new sales partner - is opening up new doors into enterprise IT applications in interesting verticals, bringing us new customers. In the software and services area: in 2020, the software and services contribution grew from the low 20s to close to 23%. Going forward, we see good results from our business development activities. Our ensemble software solutions have gained a lot of momentum, and our newly introduced network operating systems - ensemble connector and ensemble activator - have particularly high growth potential. In our services portfolio, we are further expanding our competencies including the use of artificial intelligence and launching new offerings in the areas of network security, planning, and consulting. In verticalization, earlier this month, we announced the expansion of our MicroMux family. The first generation of these pluggable modules has already been delivering several millions of revenue...euros in revenue in 2020. And, the new models allow us to address use cases and switching, routing, and 5G RAN technology. We are at the beginning of a new transformation based on our investments of the past. And with that, - exciting times ahead - and I'd like to now hand over to Uli, for the financial section. Thank you very much.

00:16:37 Uli Dopfer

Thank you, Brian. Welcome, everybody. And thank you for joining us in our q4 and full year 2020 conference call. I will review our results followed by our outlook for 2021. All numbers are presented in euros. We finished 2020 successfully with revenues of 565 million euros, up 1.5% from 556.8 million euros in 2019. Revenues are at the lower end of the adjusted guidance corridor of between 565 and 580 million euros. Despite the pandemic, demand in 2020 was pleasingly robust. However, the devaluation of the US dollar against the euro had a negative impact on US dollar denominated revenues, especially during the second half of the year. Our pro forma operating income was 6.0% of revenues, or 33.8 million and increased by 1.5 percentage points compared to 4.5% or 24.8 million we have seen in 2019. This result was at the top end of our adjusted guidance corridor of between 5% and 6% of revenues. It was one of the best results in ADVA's history and was driven by multiple effects. Firstly, the cost improvement measures we introduced in 2019 showed the expected effects. Secondly, discretionary spending remained at very low levels throughout the year due to travel restrictions and other lockdown related savings. Thirdly, 2020 was a very successful year for our synchronization business and on top we were able to further increase software and service revenues. Please note, as explained earlier, revenues are negatively impacted by the US dollar devaluation. Of course, we see the opposite effect on our cost. However, since we are close to a natural hedge, the impact on our profitability was minor. And there's one more thing. We always said that over time the income from R&D capitalization will go to zero. We were almost there in 2020. The income from R&D capitalization dropped from 9 million in 2019 to only 2.6 million in 2020. Our cash generation in 2020 was strong. We reduced our net debt from 61.1 million in 2019 to 25.5 million. Excluding IFRS 16 effects, that would translate into a net cash position of approximately 2 million euros. And despite the repayment of

18.5 million of our outstanding debt, we were able to increase our cash position 54.3 million in 2019 to 64.9 million in 2020.

Next slide please: q4 2020 key financials. Revenues in q4 2020 reached 140.6 million and were down by 7% from 151.1 million in q4 2019. Besides the already discussed FX effects, certain orders were deferred to q1, due to longer than usual lead times. Pro forma cross profit was 54.6 million and compared to q4 2019 was stable in absolute terms, but relative to revenues it increased by 2.8 percentage points from 36.1% to 38.9%. Three major effects lead to this margin step up. The year ago quarter was negatively impacted by US tariffs and additional costs resulting from the relocation of production facilities out of China. In q4 2020, we experienced less tariffs due to these measures. Furthermore, as mentioned before, network synchronization with his high margins had a very successful final quarter. And finally, our gross margins benefited from the weaker US dollar. Q4 was a record quarter in terms of pro forma operating income. We achieved 10.2% of revenues up from 6.8% in q4 2019. In addition to the strong gross profit, the substantial margin improvement was also due to the aforementioned OPEX improvements. I mentioned the R&D income from R&D capitalization in my previous slide. Please note that in q4 2020, the income from R&D capitalization was at negative 2.1 million, compared to a positive income of 0.9 million in 2019. Net income reached 13.2 million, significantly up from 2.5 million in the year ago quarter. Please note, q4 2019 was negatively impacted by non-recurring expenses of 3.2 million. Consequently, earnings per share increased from five cents to 26 cents. As discussed, we are pleased with our cash generation and I will explain on free cash flow later.

Let's move to the next slide: regional revenue development. EMEA revenues increased sequentially throughout 2020, and by 6.7% year over year, now representing 61.8% of revenues in q4, and 54.7% for the financial year 2020. The increase in EMEA was mainly driven by enterprise and government wins. The Americas developed below expectation, partially due to the negatives FX effects, but also due to deferred shipments. Compared to q4 2019. revenues in the region were significantly down by 32.7%, now contributing 27.7% of total revenues for q4, and 35.7% for the full year. Asia Pacific had a very successful year and increased sequentially throughout 2020. Revenues in that region grew by 24.3% year over year. With that increase, the reach now represents 10.5% of q4 revenues, or 9.7% of the full year revenues.

Slide 14, please: cash flow and balance sheet. We made great strides in terms of cash flow generation and achieved a free cash flow of 39 million euros compared to 6.6 million in 2019. Our cash balance reached 65 million and increased by 10 million year over year. As a result and based on our positive outlook, we did not draw on our 40 million government backup credit line, and we have since terminated it in early January. With a debt leverage ratio of 0.7 times EBITDA, and an equity ratio of 52.6%, we have a very solid capital structure and investment grade credit metrics. ROCE also developed in the right direction with 10.4% in q3, 14% in q4, and 7.3% for the full year, we are on the right track for a consistent improvement. Value creation will continue to be a key focus area in 2021 and beyond. Our strong balance sheet allows us to deploy our capital within a variety of different strategic options. We have a clear path toward creating shareholder value while maintaining our investment grade capital structure.

Next slide: outlook. In the past, we were often criticized for the level of our profitability. But there was of course, a reasons for that. Our mission to be an innovation leader drove heavy investment in R&D, and also M&A has impacted our margins. This uncompromising focus on innovation has allowed us to keep up in a consolidating market. While many competitors struggled, we have brought new technologies to market and we have started seeing returns. Combined with our strict OPEX control, we will leverage our investments to a higher margin model. Our outlook into q1 2021 is very positive. Our order book is not only filled, but also contains a favorable customer and product mix. From a current perspective, we expect revenues of between 143 and 148 million euros and a pro forma operating income between seven and 9% of revenues. This is quite different from historic patterns. And this is the reason why we decided to provide a guidance for this particular quarter, in addition to our annual guidance. The momentum is great. And at this moment, we reiterate our guidance for the full year 2021 that we provided in early January. We strongly believe, that combined with continued OPEX control, our business transformation strategy will level up our margins further in the midterm. For the current financial year, we expect revenues of between 580 and 610 million euros, and a pro forma operating income between six and 9% of revenues. Next, and final slide. We will host a capital markets day on March 18 2021, and look forward to explaining in more detail our midterm goals and our business transformation strategy. Our investors and analysts will receive an invitation in a timely manner. Thank you. And now I hand over to the operator to open the Q&A session.

Q&A

00:27:25 Operator

Thank you, ladies and gentlemen, we are now starting the question and answer session. If you would like to ask a question, please press zero and one 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 a selection. One moment please for the first question.

00:28:01 Paul DeFromment (Kepler Cheuvreux)

Yes. Hi, this is Paul DeFromment from Kepler Cheuvreux. Yes, just one quick question on the supply shortage risk. How do you see it in 2021? And what could be the impact on the working capital management? I mean, do you think that the q4 working capital levels in terms of sale could be the non normative rates for 2021? Thank you.

00:28:39 Brian Protiva

Uli, do you want to cover working capital? Do you want me to answer that? Are you...?

00:28:43 Uli Dopfer

You can...you can start and I chime in, if you want me to.

00:28:46 Brian Protiva

So from a supply shortage perspective, I believe that...you know, the biggest challenges right now is we're moving through the COVID crisis into a Silicon, let's say, shortage because of car companies coming back online. I think we're all reading the same articles. We've moved early and quickly to address that. Clearly that's going to bind some cash. But the fact is our cash generation is really, really strong. We feel very, very comfortable with...with making some small, let's say, strategic moves to shore up that. We don't see that as impacting our q1 or q2 numbers. And yes, that will have some impact of slightly increasing working capital, is the way I would see it, but our CFO should answer that one.

00:29:34 Uli Dopfer

No, that's a good point. So of course, I guess for certain components. Our suppliers asked us to place orders early similar to what we have done with our customers in the...when the pandemic started. We [0:29:50 would] certainly do that. This should lead to an increase in... a slight increase in inventory, probably, but also, of course, an increase in payables again. So yeah, working capital will be probably a little bit higher than we...than we want it to be but it should be all manageable.

00:30:05 Paul DeFromment

Okay, thank you.

00:30:16 Michael Junghans (Commerzbank)

Yes. Good afternoon, gentlemen. Thanks for my...taking my question. First is on...I mean, at the moment, the markets are currently concerned with rising inflation expectations. I mean, are you already experiencing higher inflationary pressure on your raw material side? And could you raise prices this year to offset any mounting headwinds coming from this that would otherwise weigh on your gross profit margin development? This would be my first question.

00:30:48 Brian Protiva

So in general, I mean, the...there [0:30:49 unclear] inflation, I mean, there...we're all reading the same articles and stuff, I...we don't see it in a bigger way outside of the Silicon space, in the Silicon area. Anything that's, you know, the chip, basic FPGAs, a lot of the small semiconductor products that we use, there will be...we won't be getting cost reductions this year, most likely. But again, that is not a huge part of our cost base or our material cost base. So in general, no, we don't see that as hitting us, as of yet, point 1. Point 2 is we have increasing margins, so feel very comfortable. And again, we're transforming the business, going back to software and services verticalization, and moving into new markets. You know, we're very focused on driving higher margins into some of the new verticals. And I think that can definitely offset any change in inflation over the next 6/12/18 months. So I think it's more, let's say, company specific. Let's execute on our plan. We've got a lot of good things, not too worried about that picture. Third point is, can we increase pricing? Of course, one can increase pricing, if the industry is facing lots of inflation together, is...there's ability to increase pricing. Does it...is it tough in a in a Telco environment? Yes. Outside of the Telcos? No. So it really depends. But again, I don't see that as a... something that's worrying me at all, or keeping me up at night presently, because I think we've got very good momentum in our strategic moves.

00:32:33 Michael Junghans

Yeah, I mean, it's a good point about your...as you aim for increasing your recurring revenue share from software and services from 22% currently to 30%, over the next few years. I mean, could you elaborate a little bit on the specific measures you will have to execute, and what products are in your offering now that are giving you this better growth trajectory?

00:32:59

So first of all, let's start with services, professional services. We've, you know, we have this build care, you know, kind of maintenance stuff, and then we have professional services. So we're driving more build capability and more professional services, we've been increasing that year over year for a number of years, and there's a lot of potential to increase that further. And that's rock solid margins, point 1. Point 2 is from a software specific issue. Clearly, we've rejiggered our entire architecture into the ensemble, let's say software architecture, into our Controller/Director Product Solutions area. And there, we're using cool new features, even you know, things like ML, flowing [0:33:43 into] offering differentiated capability to...for Service Assurance, another area for growth. And the third one is in our network operating systems, where we have both the Ensemble Connector and the Ensemble Activator. The connector basically is set for the uCPE. You know, it's an operating system that gets put onto an Intel architecture, and then it's basically an OS and you can scale VNFs and/or micro services at the edge of the network. And the second one, activators is virtualized or software architecture for Broadcom environments for what we call the DCSG is a cell site gateway, Next Gen. It's TIP based, so supported by many large carriers and also Facebook. And they are...we are in a leadership position as well. So two interesting OS platforms, one prime edge, one south side gateway, combined with what we've done in our assemble architecture plus our services. And that's why it's been increasing nicely over the last three or four years, and believe that we can continue increasing that as a part of our revenue flow and therefore help our margins going forward.

00:34:59 Michael Junghans

Yeah, okay. Thank you. So a question I have is on the revenue mix per region, I mean, you had a strong year finish in q4, particularly in Germany and in Asia Pacific. What can you say about the current growth momentum in q1 for these two regions? And in terms of Asia Pacific, how much of revenue did you achieve with Chinese only customers in 2020?

00:35:23 Brian Protiva

So let's start with APAC. It's our smallest region. China, we've always...you know, I've never wanted to do business there because of the local competition. So we have some bits and pieces, because we just have some products that no one else has, or other people that might want to take in a product of ours for their...you know, their architecture solution, providing for...for a specific customer. But no, we have no exposure. So that's an excellent. APAC, I think we're getting some momentum there. And it seems to be solid. But Europe is clearly very strong for us, and will remain strong in the beginning of the year as expected. So we've got very good momentum in those areas. In the US and the Americas was a little lighter, for a couple of reasons, we felt that, you know, there was some pullback in the US. Plus, we have the exchange rates issue with business in the states, when we bring that back home into euros. That's, you know, a lot lower today than it was 18 months ago. So from that perspective, we do see Americas as lagging Europe, and APAC. But actually coming back nicely, and we have some big, big things we've been working on, we've won some things that I think we feel well positioned to recover based on some of the strategy we have also in verticalization, and some of the other pieces of our product strategy. So in general, Europe is the lead. No risks from this de-globalization, I think, mostly upside. And we're seeing that already, in some, you know, smaller use cases and customers that can react more quickly. And then it's slowly rolling through the industry as a whole. So actually, we see that as a midterm to long term steady advantage for a company like ADVA.

00:37:07 Michael Junghans

Yeah, thank you, just a quick follow up. Could just strip out the amount of what has driven down revenue in q4 in America, driven by the weaker US dollar and driven by volume?

00:37:24 Brian Protiva

So we don't break... [37:24 unclear] to the US dollar, it was one of them. And I think...we haven't we haven't lost any strategic customer, we just see that it spends [0:37:32 a bit] slower in across the board. And I don't think it was just seen by us because we've looked at a few other companies, some other companies that seen some slower results in optical in the US. You know, it's ebbs and tides, the optical piece. That's why we've been building our strategy over the last three years to become a lot less dependent on that broader various verticals balanced approach, as well as moving into some of these new technologies that we've done [an] exceptional job at moving into, that are also leveraged by some of the application spaces like 5G, etc. So in general to your answer, no specific one thing, no one customer out of the US, but just from the general market, and also the US dollar.

00:38:20 Michael Junghans

Yeah, thank you. So the last question, before I go back to...

00:38:23 Uli Dopfer

Maybe...maybe to add this, Brian, we had a couple of delayed shipments in the US, larger actually, that moved into q1 due to some of the supply issues we had.

00:38:34 Michael Junghans

Okay, that's very helpful. Thank you. The last question I had, before I [0:38:38 unclear] is on your sales marketing expenses? These were down by I mean, 17% to about 61 million now, as you could, I presume, save a lot on less trouble in marketing. But I mean, how sustainable is this level, actually this year, given that you're guiding for a positive revenue growth?

00:39:01 Brian Protiva

So I guess it's not just the COVID stuff. So you know, we've shifted some costs out of sales and marketing and into operations, like our freight costs, and some other...you know, juggling multiple different, let's say, supply chains, where ultimately we need to consolidate back into more efficient. So we've had our downs in our upside. And let's say, the upside has been into the sales and marketing. Now, part of that has been strategic. As you know, back in 2019, we looked at our business and felt that we needed to consolidate accordingly. I think we have a good strong plan of how to manage that. Scott St. John has been...done an excellent job at managing his budgets over the last three years. So I think part of it is strategic. And part of it is yes, lower travel and lower events, lower marking events. So we'll have some return of those cost in this year but not huge. And then we have actually realized how efficient we are in limiting travel and the virtual world. So I... we believe in handshaking and spending the time, but we don't believe that, you know, somebody should be traveling every week, five days of the week, you know, to get away from home, they should spend more time with their family. So bottom line is you'll see some of that return back, even in so normal and growth environments, we don't see us going back to spending the high single digit millions that we were spending in travel. Events will come back some. So you'll see a shift back, but we'll save in other places of the business as the efficiency comes through on the operation side and the supply chain.

00:40:40 Michael Junghans

Okay, thank you.

00:40:54 Tim Savageaux (Northland Capital Markets)

Hi, there. And good morning for me. A couple of questions. Not to beat the geographic thing to death. But I'll do slightly here. You know...and you're right, we have seen some some weakness in Americas in q4 from other suppliers, although, typically that's been pretty customer specific and very tier one focused. And then that's kind of my only, kind of, surprise. Given, you know, at least my impression was you didn't have a ton of exposure there. Would that weakness extend to cloud in the quarter as well? You mentioned some nice growth and cloud data center interconnect in calendar '20? Or is this just the, you know, you really did see it across, you know, what might be a larger base of smaller customers, in the US? You know, and I'll follow up from there.

00:41:47 Brian Protiva

First of all, we have good tier one. I mean, we sell into all but one of the tier ones and I'd say it's a good section of our business at this point in our careers. So we do have exposure there. And yes, probably that area is a little bit lighter. ICPs, I think yes, it was...q4 was somewhat of a struggle. But I think most likely that is...more than anything is customer specific. You know, how investments are rolling out based on technology upgrades, essentially. And therefore don't...our position hasn't changed, customer base hasn't changed. We think there are just some ebbs and tides there. So from those two perspectives, I'd say yes, exposure to tier ones is getting better actually, month for month. Maybe in q4, that wasn't great, or...for us, but I think long term that's actually good for us.

00:42:50 Tim Savageaux

Great. And then as you look forward to the growth that you're guiding to for calendar '21, I want to approach that from a couple of perspectives, kind of both geographic and product, given your comments thus far. I mean, should we assume that if you look at that year on year growth, that Europe will be the primary driver of that? Or might you see some recovery in Americas and then from a...or continued growth in APAC, and...then from a product perspective, you know, do you expect the DCI growth that you referenced in '20, to accelerate or, you know, change meaningfully? Are there other type of product growth drivers that you see for '21?

00:43:39 Brian Protiva

So first of all, you know, we've guided 580 to 610. What are we looking at there? That's probably in the five and a half to - I'm just guessing, currently I don't have that in my head- but five and a half to 8% or so for the year? Our q1, if you guys note, for 143 to 148, you were to take the middle of that range, you're looking at about 10% growth. So we're actually forecasting faster growth into the beginning of the year. And I think we're gonna...we need to look and track that closely and understand what that means. But feel there's, you know, strong opportunity. We've said orders are flowing very nicely for us in the beginning of this year and ended very strongly last year. Europe has been the driving factor in that but I do believe if we're able to come to market with a couple of our new products...we've got a couple really, let's say, differentiated - actually already committed to - products...if we get them to market on time that I think US recovers very nicely in the second half, independently of whether the market recovers. But I also in my heart believe that the US will recover as a market, as a whole, and the tier one space will recover and help some of the suppliers in the US in general. That would be my sense. I don't see any long term weakness there for any potential reason. I mean, yes, we could get some massive inflation and you know, change market dynamics, but it is what it is. I think you need packet, you need optical, you need timing, and you need ever more of that as we move forward into this digitization of society. So, in general, then the last one was kind of products, and you kind of set application spaces? I'd say we've got, you know, fastest growth in the sync and timing area, we think that the edge cloud packet stuff's gonna recover very nicely off of last year, because some of that was just...that was kind of the economic challenges of, you know, the biggest recession or even in some countries almost a depression. And, you know, that's coming back nicely for us. So we're gonna have good growth there. Optical is solid, I don't see it as being outstanding. But you know, a lot of people, somewhere in between the 2/3/5/7%, depending on region, and customer base. And so I see actually good breadths. And finally, from a regional perspective, I also do believe that APAC, we can get good growth there. And I guess I already answered the Americas. So I think the last part of your question is the use case or application areas? DCI is good for us, I mean, in general, enterprise, but we've expanded well beyond that DCI piece in the enterprise, we have a number of different application areas in that enterprise. And we've talked about them a little bit today. And that is, you know, the virtualization, the prem, virtualization, you know, flexible infrastructure for the enterprise network. Two is sync and timing. Three is DCI, four is some of our security solutions - in fact, a lot of our security solutions, because there we're a definite...definitive leader. So we've got a lot of different application areas for that enterprise space, that actually helped us offset some of the weakness and other customer base areas of 2020. So in general, we see things pretty broad, good across technology spaces, good across regional. And that's why I think we're pretty upbeat on our model right now.

00:47:29 Tim Savageaux

Great. And last question for me, and kind of about that model. Specifically focusing in on gross margins, where you saw some nice upside in q4 and, you know, it would appear to me, your gross margin increases year over year, the primary driver of your higher operating margin guidance for '21. And you've talked about some of the factors driving that. But if we could just talk specifically about the positive impacts in q4, you know, assume somewhat product mix]related but any more color there. And then, you know, given kind of the narrative around software services, verticalization, some of the new products...should we expect ADVA to be achieving gross margins that begin with a four consistently in the, you know, reasonably near future? Thanks.

00:48:23 Brian Protiva

So first of all, Tim, as a US analyst, we are in the mid-40s, already. We're a 45% gross margin. You know, we can't you know...the whole issue with IFRS is that you see our 39%, you see a lot less R&D investment. But what you're doing is you're activating development efforts and then depreciating R&D assets above the line. So we're in the mid-40s now, and we're in q4 from a US gap perspective. But let's go back to your question and say from a IFRS perception 39 into the 40s. Yeah, step by step, I think, you know, we don't need to get there to have a very nice model. But again, we're transforming our business to higher margin business. And we think we can get there. In other words, we think we can make progress in our gross margin plan. Will it be steady, every quarter increasing? No, I don't want to commit to that, because we have a lot of dependencies, customer mix, regional mix, as well as currency exchange mix, and therefore, I don't want to commit to that. But I do believe in steady increases over the next 6/12/18 months, based on our business transformation, there I see steady as it goes. Even though we're at a good really good model right now. So that's the one piece, the second piece of your question was q4, the drivers. Maybe I'll add and then Uli maybe you can supplement if I missed anything, but clearly it was customer mix Europe, some really nice business, non Telco business, you know, the 30% sent that we drive today that we're driving now to 40% was getting some nice growth last year out of that space. Next in line, probably we do have the dollar. Yes, we're naturally hedged. So it hurts our revenue number, but it helps our profitability and our margin number, because you take down costs relative to the euro sales that you're doing. So there's a number of things that are slowing into that, generally giving us the momentum that we have also moving into 2021.

And maybe one thing to add is the strong...we had the strongest synchronization quarter in...ever, with double digit million in revenues. So that was really good, too, and contributed quite a bit to the strongest margin.

00:50:49 Tim Savageaux

Okay, thanks very much, and congrats on the outlook in particular.

00:50:58 Operator

And then currently, no further questions. So as a reminder, if you would like to ask a question, please press zero and one on your telephone keypad now.

00:51:14 Michael Junghans

Yes, thank you. A few follow up questions. Your point [0:51:17 unclear] on this, I would phrase it as a paradigm shift from made inexpensive to made in Europe. So what has changed in terms of your most recent discussion you had with clients, compared to the situation we had before COVID, let's say back in 2019?

00:51:39 Brian Protiva

So surprising enough, they... [0:51:42 they/you know] it's broad, and many different clients are coming into us and saying, "listen, we do not only know...want to know where you're building this product, but we want exact content, how much Chinese content is in this stuff?" And some going so far and saying, "we want...no, we don't want Chinese content, period." So I really...we really liked when we read your piece. We liked it, you know, it is...there is a fundamental shift. Now, we're a global company, though. So we are going to be really intelligent about this and use the best of all worlds. We can be seen as an American company in America, European company in Europe, we can produce where most effective cost efficiency, you know. And China was slowly moving away from a wonderful model to just a good model, because costs of employees were going up there faster than anywhere else. And so there's, you know, it's time...it doesn't hurt us radically, we can shift into Europe and shift into the Mexico and shift into other places in the world to get better global leverage and pick our battles where we need them. So when clients are asking that we have a very good story, we can say, "listen, we do...we work in Mexico, we work in Romania, we work in China, we work in Thailand, and we're very flexible to scale our model, we've got our own distribution centers in each of the regions and therefore control our operational model very nicely." Two things challenged us over the last year and a half. And that was one, the Trump/China [0:53:14 warfare] that erupted on trade. And then the second was COVID-19. I think we managed those really, really well, because of the flexible platforms that we have. So it's a long answer. But I do believe that, yeah, like the thinking, you know, things are moving not only in the US, but also in Europe, where clients are asking us about where we're back [0:53:38 ended]. That comes in back [0:53:39 unclear] to, can we increase pricing? Well, if the customer is asking us to do something that increased costs, yes, we can ask for different pricing. And so we're working with those clients closely and saying, "listen, if this is going to make that your decision, we'll do it. But that is...does have implications." And then we can work with that client to have the best solution provided for them to meet their requirements, essentially.

00:54:06 Michael Junghans

That's very interesting. Yeah. So...and I have two last housekeeping questions. So the first one is on your tax rate. So you have utilized about 4 million of tax loss carry forward, which brought down your tax rate for this year to just about 18%. Can you give us more color on what was behind that and which tax rate assumption should we factor in for 2021?

00:54:36 Uli Dopfer

I take this. So the interesting piece is we have a lot of NOLs in the SE and whenever we have some higher profits in the SE, this will help us to utilize some of these NOLs, dropping our tax rate down to below the 20s. So as you know, we had a strong business in Europe, which results in strong profits in the SE and that's why we've seen this low tax rate. So I would assume for 2021, a similar tax rate that you have seen in in 2020 for your model.

00:55:11 Michael Junghans

Okay, this is very helpful. Thank you. And the last question is on the CAPEX assumption. So, is it a fair assumption that as you need to ramp up investments in new technology, new product next year, your CAPEX budget should also be notably higher compared to 2020? Could probably even exceed the level we had in 2019, which was about 63 million...so what is your forecast on [0:55:39 this], on CAPEX?

00:55:42 Uli Dopfer

I would not be overly aggressive on that one. You might see a slight increase. But you know, we learned a lot. We shift, you know, from expenses, CAPEX and R&D into a lower cost area. So I would not go through...I mean, it should be rather flat, maybe a slight increase.

00:56:01 Michael Junghans

Okay, thank you.

00:56:13 Mirko Maier (LBBW)

Thanks for letting me. Short question on your q1 top line guidance, it's very strong. The question is, what proportion of the postponed yields from q4 will have? Is...will there be a single digit number or higher single digit? And the follow on, and the quarterly development in 2021, [0:56:36 unclear]. After the relatively strong q1, and then I look back to those quarters in 2020, I assume that q2 and q3 in 2021 could be less than [0:56:50 unclear] when it comes to top line growth in margin development. And to achieve your full year targets, you expect a strong q4. Is that the right way of looking at it, the quarterly development and 2021? And the last one, was for Uli, when it comes to Asia, the last couple of years, you always mentioned the dose lumpiness in Asia. I hadn't heard this until now, in today's call. Is this not any more the case, the lumpiness, is this more now sustainable in Asia? That's it.

00:57:32 Brian Protiva

So I'll start, Uli, maybe and then you follow up. So first of all, Uli can answer the detailed question on the number increase. So we're getting, you know, push up...we had some push off from q4 into q1, but it's not huge, but we also have very nice backlog. And so the combination of those things is giving us very positive, you know, view to 2021. And therefore, you know, I at this point in time, I think that you're going to have nice incremental business going...moving through the year, there is no back end loadedness in our model at this point. We have very nice, you know, management of customer demand backlog, order flows, all good. And therefore, I wouldn't make any assumptions like that. Clearly, when you look at our q1, we are...last year, we were slightly negative in EBIT, you guys, and we're giving you a seven to nine, let's say, take the middle of that, 8%. It's a massive increase, which - you split that up over four quarter...on an annual layer - just that alone would put us based on our 6% pro forma EBIT of 2020 above 8% for this year. So we have...you know, we're starting in a much different position than we've ever started, moving into the year. And we've said that we ended the year strongly, we've started the year strongly in orders. And therefore we feel really good about our model. And consistency - probably better than I've ever felt. And therefore the quarterly revenue development should just be you know, step by step. We're moving through the year. And hopefully we'll just continue to build momentum based on...America's also returning some new products. The new transformational focus that we have on some of these new verticals, etc. The APAC side of it is...the lumpiness was due to mostly one customer actually, big customer, that we had some lumpiness but that seems just kind of solid. We're back through new product introductions, so they made new product selections. We got our new products in there. We've expanded in new application spaces in that customer, and therefore that seems to be very steady at this point. And there's no news that it's going to get lumpy. And therefore we see, actually, APAC not being too lumpy because of, let's say, customer specific issues. At the same time, we're starting to win more and more deals in APAC, based on some of our highly differentiated products. Remember, we've been spending...and I've been telling you guys for the last two to three years, we're thinking differently, you know, we're not out to go head to head with the big guys. We're out, really understanding application spaces, use cases, doing things differently and better than anybody else. And it, you know, it's all over the map from the security piece to some of the verticalization stuff, you know, our home MicroMux family in there, the sync and timing piece that no one else has, like we have today. And then some of the other, you know, packet, software solutions, operating systems, we have four or five things that are highly differentiated. With those we are technology...global technology leaders and are able to win small deals here, there, all over the place. And I guess that's where I would say we...I think I can complement what we already have in APAC and win some deals and make it less lumpy. But again, I want to be transparent there, is...we do...we have exposure to one customer, a decent size of our APAC business, and at any point in time that can influence us. So back to Uli on the quarterly, you know, the how much moved from q4 to q1, I think is the only piece that's open?

01:01:36 Uli Dopfer

Yeah, I would say, you know, first of all, our order book, and our pipeline would technically support a higher number for q1 than we are currently showing. But once again, we are assuming what's being shifted from q4 into q1, we will see a similar amount being shifted from q1 into q2, and it's a high single digit million number, Mirko.

01:01:59 Mirko Maier

Okay, thanks.

01:02:11 Simon Scholes (First Berlin Equity Research)

Great. Yes, hello, thanks for taking my question. Brian, you just mentioned the MicroMux products. I was just wondering if you could give us some additional color on the role you expect these products to play in your plans over the next few years, and how important they are?

01:02:31 Brian Protiva

So essentially what these products do, you know, it's like a full little network element in a plug. And those plugs can allow you...and remember, we just introduced a whole family, right? We had the 10 by 10 to 100. Now we introduced the 10 by 1 to 10, and the 4 by 100 to 400. And essentially what these things can do is you can build an architecture that is more efficient at let's say, a node like a 10 gig node, or 100 gig node or a 400 gig node. And then you don't have to have the, you know, the fan out...these line cards to [1:03:06 unclear] out, because you've got these little plugs, you just can pop it into 100 gig plug or a 10 gig plug, and you fan it out to a, you know, an end user or [1:03:16 unclear] for that matter, depending on the application or distributed DCI applications, or enterprise network. So we really like the technology, we do it really well, we still have some challenges ahead of us, we're owning more and more of the verticalized strategies, as we buy the technology and develop next gen technology segments. So you know, we feel it's gonna not only help us differentiate our own products, but if we select to sell it to our competitors, you know, it drives revenue gains across the board and up to now we're selecting who we sell it to. So we...everybody's interested. We're selling it to...strategically, let's say enhancing partners, versus just the growth...the whole market. So it's both a efficiency gain verticalization, cost management, our own product platforms. And it's a revenue opportunity to drive growth over the next few years. And as we said, I mean 15% over five years is a huge change from the couple of percent that we have today. So we see big gains, ...and there's a number of other products coming in that area. So you we've gone into silicon photonics, we've got really good, strong, capability. And you'll see us bringing a whole slew of products in what we call our ADVA optical engines. So that MicroMux will be one family, but you're going to have a whole number of solutions, in 100/400 gigs, as examples, and you'll have customer specific requirements as well...or even one project where we're getting paid, essentially, to develop a product for a carrier. Where a carrier said, "you know what, I'd like to have this product done for us." So there's a number of different opportunities with our ADVA optical engines platform.

01:05:12 Simon Scholes

Okay, thanks very much. That's very helpful.

01:05:20 Operator

And currently it no further questions.

01:05:25 Brian Protiva

Thank you very much. It was a long session, good questions. And we will be in touch. I guess latest we talk to you all is third week of April, is correct, and hope to be in touch with you to explain more details over the next weeks. Thank you very much.

01:05:46 Operator

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