ADVA Optical Networking SE

Preliminary IFRS Full Year 2022 financial results

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Transcript

Speakers:

Steven Williams

Christoph Glingener

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Steven Williams: Thank you, Francy, and welcome to ADVA's Full Year 2022 Preliminary Financial Results Conference Call. In addition to this call and the press release, we have posted a presentation, which is available for download from our homepage, adva.com, on the Conference Call page in the Financial Results section of the About Us/Investor section.

Before turning the call over to Christoph, please be reminded 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.

Please, also be reminded that we provide consolidated pro forma financial results in this presentation, solely as supplemental financial information to help the financial community make meaningful comparisons of our operating results from one financial period to another.

This pro forma information is not prepared in accordance with IFRS and should not be considered a substitute for historical information presented in accordance with IFRS. Pro forma operating EBIT is calculated prior to non-cash charges related to the stock compensation programmes, and amortisation and impairment of goodwill- and acquisition-related intangible assets.

Additionally, expenses related to M&A and 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. Christoph will start this call, providing a business update, and Uli will guide us through our Q4 financials. And, finally, we will have sufficient time for your questions, which we'll be happy to answer. And with that, I turn the call over to Christoph.

Christoph Glingener: Thank you, Steven. Starting with our standard format and our business update and outlook, page 4, Q4 and full year 2022 financial highlights. We're proud to report on a highly successful fourth quarter and fiscal year 2022, where we achieved our highest revenues in the history of our company. Revenues in Q4 2022 reached €195.7 million, up by 24.1% compared to €157.7 million in Q4 2021. For the full year 2022, revenues increased by 18% from €603.3 million in 2021 and reached a record level of €712.1 million in 2022.

Our pro forma EBIT for Q4 2022 was €24.4 million, or 12.5% of revenues, an increase by 108% compared to €11.7 million, or 6.5% of revenues reported in Q3 2022. Compared to Q4 2021, pro forma EBIT improved by 69.9% from €14.4 million or 9.1% of revenues. And we report the Q4 cash balance of €58.4 million. Despite ongoing challenges caused by the semiconductor crisis, bottlenecks in the supply chains, inflation and fears of recession, we were able to stay on course, comprehensively serving and supporting our customers with innovative communication technology, software and services.

Moving to the next slide, page 5, Recent highlights and press releases. I will summarise a few highlights we announced over the recent weeks and try to provide a bit of context. As more and more networking applications need higher precision and assured timing, we brought two new products to market that further solidify our technology leadership in this space.

First, we introduced time-sensitive networking, or TSN, capabilities to our FSP 150-XG418 high-speed packet edge device. The upgraded solution actively uses technologies that minimise latency and reduce jitter. With its new capabilities, the product will simplify the rollout of 5G services at scale and enable use cases, including mobile backhaul, industrial automation and Audio Video Bridging.

Second, we launched our latest optical caesium atomic clock solution, providing unprecedented protection for critical network infrastructure systems that rely on synchronisation from global navigation satellite systems. The new OSA 3350 SePRC delivers extensive timing holdover with high-performance stability and lifetime that significantly outperforms any other solution on the market. The use cases for this product go way beyond the traditional telco space and empower us to further diversify our customer base.

Furthermore, we brought new software capabilities to the market. The new Ensemble Cloudlet software is a direct response to the growing demand from enterprises for on-premise cloud solutions. With Ensemble Cloudlet, enterprises can harness edge computing to meet low-latency requirements for applications such as private 5G, augmented reality and smart manufacturing. The software also enables service providers to offer customers an easily scalable edge cloud with localised control.

On the security front, we were proud to announce that our flagship 10Gbps edge solution with connect guard Ethernet encryption has been approved for transmission of classified data by the German Federal Office for Information Security, BSI. So, BSI approval will be a major boost for customers with high security standards.

Speaking of customers with high security standards, Shibuya, a leading Swedish IT service provider and long-term select partner, is deploying our open optical technology to deliver secure managed services to leading banks across the Nordics and Baltics. The network features robust optical encryption cards from our ADVA Network Security Team for critical data protection.

And, last but not least, I want to highlight a topic that is very near to my heart. The Layer123 Network Transformation Awards shine a spotlight on the industry's most innovative people and companies by recognizing their most notable achievements in accelerating network transformation over the last 12 months.

We won this award in the category, Sustainability, with our coherent 100ZR transceiver. The product is a real game changer in our industry. It enables network operators to introduce coherent optical technologies at the network edge, thus increasing network capacity, while dramatically simplifying the network architecture and reducing the power consumption per bit. We will showcase the product at the end of this month at the Optical Fiber Communications Conference, OFC, in San Diego.

On to my next slide, slide 6, Market environment. We are in a unique investment cycle for communication networks. The digitization of ecosystems has taken centre-stage in both politics and business, and the need for secure high-performance communication infrastructure has never been greater. The market environment provides us with several tailwinds, which include the following topics.

First and foremost, the investment in fibre and bandwidth continues at unprecedented level. Fibre is the basis for all advanced communication infrastructure, including 5G, and viewed as long-term value investment. Capacity demands keep growing rapidly, and the world needs more fibre to satisfy the demand.

Secondly, this upgrade and expansion cycle is supported by a strong funding environment. The US, the world's leading economy, added to the existing programs the so-called BEAD project, valued at USD 42.5 billion and set to launch in late 2024. Also in Europe, there are tens of millions of public funding for fibre broadband paired with robust private investment.

And, finally, we see increasingly strong commitment from network operators in the Western hemisphere to replace high-risk vendors in the networks and limit exposure to the technology in future builds. According to a report published by industry analysts from Omdia in December 2022, ADVA gained 4% market share in the optical networking market in Europe, based on rolling four quarters in Q3 2024, versus Q4 2020. More than any other supplier, while Huawei lost the same amount of share in the same period. A clear indication that this transition is happening, and the US has been expanding their entity list restrictions on Chinese vendors.

The proposed Networks Act in the US had significant implications for operators continuing to deploy high-risk vendors. While we enjoy these tailwinds, we are also mindful of the headwinds facing us. First and foremost, the macroeconomic uncertainty. Inflation remains high, borrowing rates going up, and recession risks remain high. So, we carefully watch the buying behaviour of our customers and manage our inventories carefully.

These macroeconomic uncertainties come at a time when our supply chain risks have started to improve, but are still very demanding. On the one side, transportation-related costs such as expedite fees and freight decrease in a few cases, but sourcing certain components remains challenging. In summary, we are seeing early signs of normalisation in the semiconductor availability and expect to reduce our backlog and inventory level somewhat in future quarters.

Freight costs remain high, and inflationary pressures from energy prices continue to be a concern, but we foresee a gradual return to normal operating modes. Next slide, please.

Page 7, Business combination With Adtran completed. With the registration of the domination and profit and loss transfer agreement, in short, DPLTA, with the Jena local court on January 16th 2023, we can now closely align with Adtran. As a result, ADVA's success story, which we have been writing since 1994, will continue in a financially strong group with more than USD 1 billion in annual revenues under the leadership of Adtran.

Closely aligned with Adtran, we can take even better advantage of the current market dynamics and participate even more in this unique investment cycle. As fibre rollout continues to gain momentum, we can offer network operators a much broader range of products and solutions and a highly differentiated portfolio. Our technology complements Adtran's, and jointly, we can offer optical networking solutions, from the network core to the customer premise.

We can deliver end-to-end automation and insights, as well as enhanced security and assurance. Together, our customer base is nicely diversified. We have a well-balanced mix of national service providers, regional service providers, enterprises and internet content providers as we see continued growth opportunities in each segment.

Also, geographically, we are well balanced and diversified. A balanced mix of US and non-US customers with focus on Europe gives us great exposure to strong growth opportunities in our focus regions. And finally, we are stronger together in our focus markets. By combining our teams and portfolios, we can offer our customers a truly differentiated and compelling set of products and services.

Our combined solution offerings will be among the strongest in the world for connecting every home, business and 5G site with fibre. Furthermore, by augmenting R&D sales and support resources in regions where we see the greatest growth potential, we'll be well positioned to serve an increasingly significant customer base. We are creating a scaled technology leader with a broad and diverse customer base.

This is an exciting time for the communication industry, and we are confident in our ability to compete and gain market share in several relevant segments. With that, I pass it on to Uli.

Uli Dopfer

Thank you, Christoph, and welcome, everybody. Let's move to slide number 9 and Q4 2022 key financials. As Christoph mentioned, revenues in Q4 reached €195.7 million, up by 24.1% from €157.7 million in the year-ago quarter. Q4 2022 marks a new record for revenues in one single quarter, which was, in particular, due to very high demand from telecommunications service providers.

Gross profit reached 71.4 million and increased by 27.4%, compared to 56.1 million year over year. Our gross margin increased year over year by 0.9 percentage points, supporting the signs of an improved supply environment. Pro forma EBIT margin was 12.5%, compared to 9.1% we have seen in Q4 2021. The strong 2022 finish is due to significantly higher revenues at more favourable margins and reduced opex, relative to revenues.

Net income was €3.8 million, down from 17.5 million in the year-ago quarter. While Q4 2021 net income benefitted from a €5.2 million tax credit, Q4 2022 was negatively impacted by a FX impact of 4.8 million, mainly resulting from the weaker US dollar. Our net cash position of 36.2 million in Q4 2021 turned into a net debt position of 19.2 million in Q4 2022 since we took out additional debt to finance higher inventory levels, allowing us to fulfil customer orders with reasonable timeframes, despite the long lead times on the supply side.

Next slide, please. Regional revenue development. EMEA was, once again, the strongest region. Q4 revenues increased by 15.7% year over year, now representing 59.5% of revenues. Revenue was driven by a strong demand from our communication service provider customer group.

In the Americas, Q4 revenues performed strongly and increased by 43.6% year over year, representing 28.9% of revenues in this quarter. Growth was primarily driven by communication service and internet content providers, in addition to the positive impact from the US dollar appreciation, compared to the year-ago quarter. Asia Pacific revenues grew by 28.1% and now represent 11.6% of Q4 revenues. Growth in Q4 was predominantly driven by a strong demand from customers in Australia.

Moving to the next slide, Cashflow and balance sheet. Operating cashflow was once again impacted by the increase in working capital and was €20.4 million, down from 35.7 million in Q4 2021. We invested 20.8 million in capex and R&D versus 19.7 million in the year-ago quarter. This results to a slightly negative free cashflow of €0.4 million, compared to positive 16 million in Q4 2021.

Our debt leverage ratio of 0.7 times EBITDA and an equity ratio of 57.0% supports our very solid capital structure and investment-grade credit metrics. Q4 ROCE, on a last-12-month basis, was 4.4%, which is below our expectations. However, last-12-month operating income, without pro forma adjustments, was significantly impacted by extraordinary costs related to the business combination with Adtran.

And in summary, despite a very challenging macro environment in 2022, we are very pleased with our operating results. Revenues were the highest we have ever seen in our history, and we were able to deliver solid profitability. And with that, we're happy to answer any questions you may have.

Operator: Ladies and Gentlemen, at this time, we will begin the question-and-answer session. Anyone who wishes to ask a question may press star followed by one. If you wish to remove yourself from the question queue, you may press star followed by two. Anyone who has a question may press star followed by one at this time. One moment for the first question, please.

We have the first question from Robert-Jan van der Horst from Warburg Research. Your question, please?

Robert-Jan van der Horst: Hi, thanks for taking my question. So, I have, basically, only one question, and it's on inventory. So, the last few inventories have increased, of course, as a response to the shortages. How do you predict that the working capital will develop going forward, since you mentioned that the supply situation is still challenging, but as I understand it, the bottlenecks are being limited to a smaller number of components, compared to not last year?

So, do you expect the inventories to come down? How fast will they come down? And are the components in the inventories right now, or were they, maybe, bought at a significant mark-up to, now, current market prices? And do you expect that to weigh on your gross profit in, let's say, the first half of this year? Thanks.

Uli Dopfer: First of all, you were very hard to understand acoustically. I think you have a very bad connection, but I think we got your question.

	So, overall, yes, the supply situation improved. There were less critical components. As you could see, we had really good output in Q4. However, I would assume that the inventory levels will remain fairly high, at least for the first half of the year, maybe going into the second half of the year, simply because, A, we continue to drive material. The lead times are still long, even though the components, or the availability, improved.
	We still need to drive a lot of material because we still have lots of backlog and high demand for many of our products. And so, again, I would assume inventory levels remain high, and with a slight improvement during the second half of the year. As per the pricing of those components, we do not see any lower prices yet, and we don't really expect this to improve drastically this year. However, this has to be seen. It's a little bit too early to comment on that one. I hope that answers.
Robert-Jan van der Horst	Okay, perfect. Yes, thanks so much. Bad connection, but you've understood my questions perfectly. Thanks.
Operator	The next question comes from Nicolas Thorez from ODDO BHF. Please, go ahead.
Nicolas Thorez	Hello, good afternoon, Gentlemen. Can you hear me correctly?
Steven Williams	Yes, we can.
Nicolas Thorez	Okay, thank you for taking the question. First, congrats for the strong finish. Three small ones, if I may. The first question, just getting back to the moving parts impacting the net income in Q4, is there anything else to consider, other than the exceptional expenses, let's say, one-off expenses, related to the business combination? Because those expenses amount to only 3 million in Q4, but the gap between that income and the bottom line looks much bigger, so if we could have a bit more colour on the elements in that in the net profit, it would be great. That was my first one.
Uli Dopfer	So, for whatever reason, the quality, it was really good, and then it got worse, but again, I try to answer this. I think your question was related to the one-time expenses related to the business combination with Adtran, and I would assume, so we are, obviously, the deal is now closed. The DPLTA is registered, as Christoph mentioned, so I would not expect any major costs related to the business combination going forward. So, I think you can scratch this off your financial outlook for the next year.
Nicolas Thorez	Okay, but except for the one-off expenses, it was more like if there's any other element that could explain the gaps between the operating income and the net profit, the bottom line? Because the gap looks much bigger than the one-off expenses.
Uli Dopfer	Oh, it was related to the FX impact that I mentioned during my

	part of the presentation. We had a multi-million FX impact due to the stronger US dollar. As you know, we are hedging on our cashflows, and depending on how the dollar moves, we either see a benefit, a credit or a debit on the net income.
Nicolas Thorez	Okay, crystal clear. And my second question on the outlook for 2023, could we have an idea of your backlog at the end of 2022, and maybe more specifically, your degree of visibility, going into 2023? And, basically, how you see the state of demand this year going forward?
Uli Dopfer	So, first of all, we do not disclose our backlog overall, but I can confirm, we continue to see extremely strong order intake throughout the entire fourth quarter. So, our backlog remains on record levels. So far, it's a little early to say how demand will develop, but as Christoph said, there are so many opportunities, and we're still in this extremely interesting cycle in our industry, that we have to believe that we will continue to see strong orders and strong demand from our customers.
Nicolas Thorez	Okay, thank you. And maybe a last one, that you mentioned in the press release that the first synergies with Adtran should materialise at around 2023. It will be interesting to have a, let's say, first and rough quantitative estimate and also what can be expected regarding cost synergies as well.
Uli Dopfer	So, I believe we will see revenue synergies going forward. We spoke about this in the past. Revenue, as well as cost synergies, we're working on this. We prepared for this. So, as you know, and maybe you need to join the Adtran earnings call, I think they will talk, potentially, about this a little bit more, but we're working on finding the synergies that were disclosed when we announced the deal. We spoke about $52 million within a 24-month timeframe after closing. So, I think we are on it, and realising those synergies, identifying where we can find those, and again, this will be revenue synergies. You will see those in opex, but you will also see those in COGS and so, yes, I hope that…
Nicolas Thorez	Okay, I will attend. Thank you very much. Have a good day.
Operator	Ladies and Gentlemen, as a reminder, if you would like to ask a question, please, press star followed by one. We have a question from Tim Savageaux from Northland Capital Markets. Please, go ahead.
Tim Savageaux	Good morning. I think that's me. Have a couple of questions about the quarter. You mentioned service provide strength driving the strong results in Europe. I wonder if you had any more colour there with regard to particular regions or products, or whether that was pretty broad-based? And same question, I think you touched on it, but I may have missed it, in terms of the

	sequential declines you saw in the Americas, if there were any particular drivers there.
	And then you mentioned strong order flow throughout the quarter and record backlog. Did that broadly conform to what you saw in revenues, strength in Europe primarily, or was there anything different about the order book versus what you report in revenues? Thanks.
Christoph Glingener	Okay, Tim, let me start with you first question. So, as we said, it was mostly driven by service providers in Europe. To be a little bit more detailed, classical network buildout and metro edge backhaul infrastructures mostly were big service providers' assets in Europe.
	The second one, I think you were referring to slight decline in the Americas, which was really a slight decline, mostly due to semiconductor shortages driven. And the third one I have to ask, I'm sorry Tim, can you repeat the third one?
Tim Savageaux	The third one is about the order commentary and whether we should assume that the strength in orders that you noted, including record backlog, had a similar profile, in terms of strength in Europe. Or, given your commentary about the supply issues impacting America, perhaps Americas could have grown in a normalised supply, and you saw strong orders there. So, I was looking for a little colour on orders versus revenue.
Uli Dopfer	Yes, this is a good question, Tim. So, actually, almost 50% of our order backlog is North America backlog. So, again, our output in Q4 was simply impacted by the semiconductor shortage, so if you look at the backlog, almost 50% is based on US customers, so very strong US share in there.
Christoph Glingener	And no significant change in order patterns between the regions, Tim.
Tim Savageaux	Okay, thanks very much.
Operator	The next question comes from Fahad Najam from Loop Capital. Please, go ahead.
Fahad Najam	Hello. Thank you for taking my question. I guess, a little bit confused on the commentary around component shortages. You are expecting them to improve or normalise. I guess, what does normalise mean, and over what time? If you can help us, maybe, decipher that? Does normalise really go back to pre-COVID-19 supply chain? Is that what you're implying?
Christoph Glingener	Yes, that is what we're referring to, but as we said, we still do see less critical components being short, so the amount of critical components we are chasing is reducing. We also think that throughout 2023, this will ease. Hopefully, by the second half of end of 2023, to be back to normalised, ie, pre-COVID-19

	levels.
Fahad Najam	Sorry, is that referring to availability as well as pricing coming down, or is it just availability of components?
Uli Dopfer	I think there are two components. It's the availability and it's the pricing. And the availability, I think, we will continue to see that this will improve. However, now comes my favourite word, we still see the golden screw issue, that we have a bunch of components, but we cannot complete our systems because there's one important piece missing. And then a second one is the pricing, and the pricing is where we are really careful right now because we don't see any indication that the pricing will decline anytime soon. So, to be honest with you, and Christoph, you chime in if I say something wrong here, but I don't think we will ever see the pre-COVID-19 levels, when it comes to pricing.
Fahad Najam	Got it. Appreciate the colour, thank you.
Operator	That was our last question for today, and I hand back to Steven Williams for closing comments.
Steven Williams	All right, thank you for all your questions. We appreciate it, and in case of any follow-ups, please, feel free to contact us at any time. Enjoy your day. Thank you, bye-bye.