

Viavi Solutions Inc. NasdaqGS:VIAV

FQ3 2024 Earnings Call Transcripts

Thursday, May 02, 2024 8:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2024-	-FQ3 2024-	-FY 2024-	-FY 2025-
	CONSENSUS	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.09	0.07	0.39	0.57
Revenue (mm)	253.71	249.08	1017.65	1086.35

Currency: USD
Consensus as of May-02-2024 12:49 PM GMT

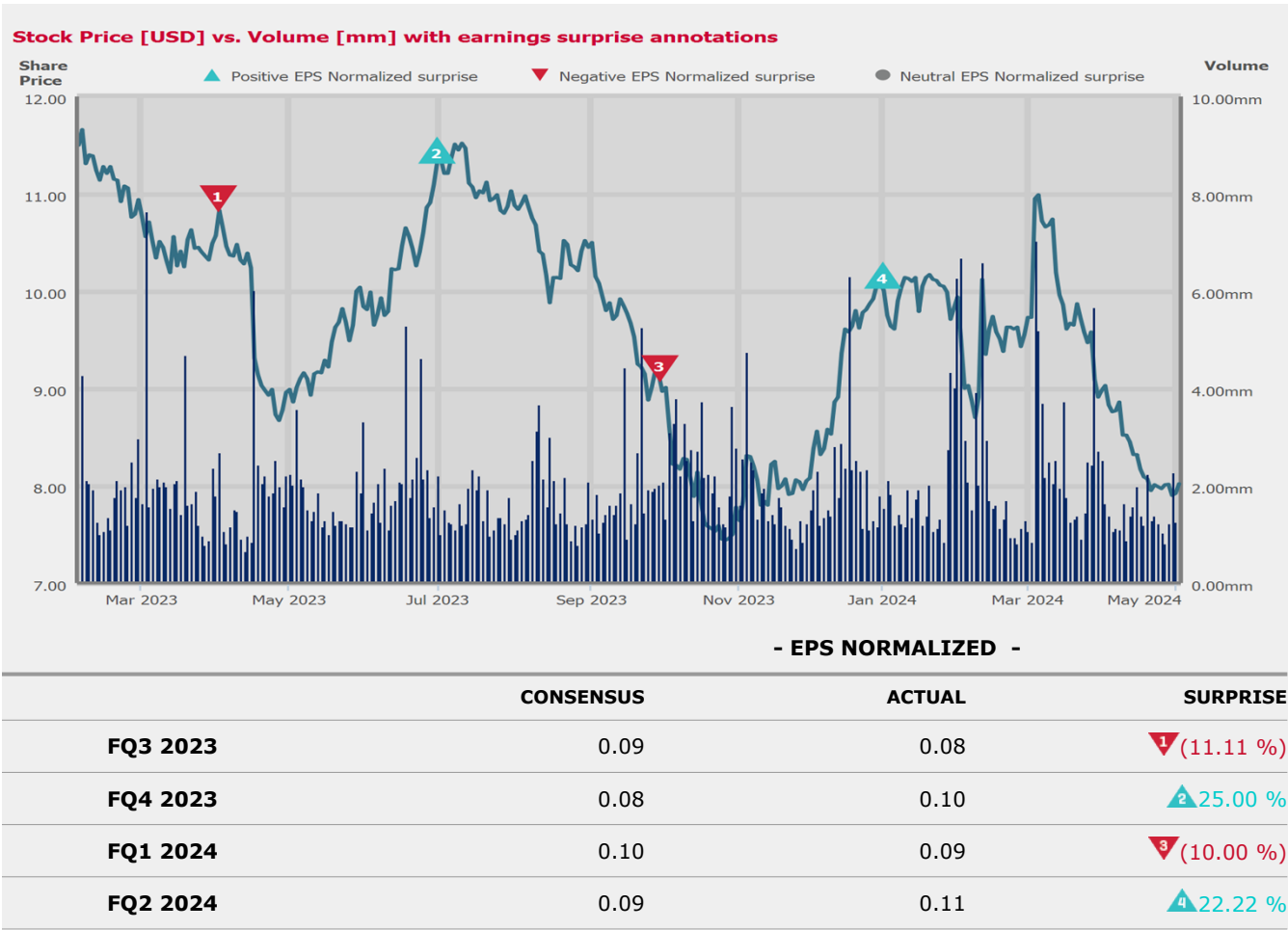


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Call Participants

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Presentation

Operator

Hello, everyone. My name is Jericho. Welcome to Viavi Solutions Third Quarter FY '24 Earnings Call. [Operator Instructions] I will now turn the conference over to Ilan Daskal, Viavi Solutions' CFO. Please, go ahead.

Ilan Daskal

Executive VP & CFO

Thank you, Jericho. Good afternoon, everyone, and welcome to Viavi Solutions' Third Quarter Fiscal Year 2024 Earnings Call. My name is Ilan Daskal, Viavi Solutions' CFO, and with me on today's call is Oleg Khaykin, our President and CEO.

Please note this call will include forward-looking statements about the company's financial performance. These statements are subject to risks and uncertainties that could cause actual results to differ materially from our current expectations and estimations. We encourage you to review our most recent annual report and SEC filings, particularly the risk factors described in those filings. The forward-looking statements, including guidance that we provided during this call, are valid only as of today. Viavi takes -- undertakes no obligation to update these statements.

Please also note that unless we state otherwise, all results discussed on this call, except revenue, are non-GAAP. We reconcile these non-GAAP results to our preliminary GAAP financials and discuss their usefulness and limitations in today's earnings release.

The release as well as our supplemental earnings slides, which include historical financial tables, are available on Viavi's website at www.investor.viavisolutions.com.

Finally, we are recording today's call and will make the recording available on our website by 4:30 p.m. Pacific Time this evening.

Now I would like to review the results of the third quarter of fiscal year 2024. Net revenue for the quarter was \$246 million, which was above the low end of our guidance range of \$245 million to \$253 million. Revenue was down sequentially by 3.3%, and on a year-over-year basis was down 0.7%.

Operating margin for the third fiscal quarter was 9.3%, which is slightly above the low end of our guidance range of 8.8% to 12%. Operating margin decreased 390 basis points from the prior quarter and on a year-over-year basis, was down 210 basis points.

EPS at \$0.06 within our guidance range of \$0.05 to \$0.09 and was down \$0.05 sequentially and on a year-over-year basis, was down \$0.02.

Moving on to our Q3 results by business segment. NSE revenue for the third fiscal quarter came in at \$169.8 million, which is below our guidance range of \$173 million to \$179 million. This was mainly driven by more conservative spend environment at enterprise customers. On a year-over-year basis, NSE revenue was down 4.2%.

NE revenue for the quarter was \$151.7 million, which is a 0.1% year-over-year decline. SE revenue was \$18.1 million, and declined 28.7% from the same period last year, driven by a slowdown in enterprise customer spend.

NSE gross margin for the quarter was 61.4%, which is 190 basis points lower on a year-over-year basis. NE gross margin was 61.5%, which is a decrease of 70 basis points from the same period last year as a result of lower volume as well as product mix. SE gross margin was 60.8%, which is a decrease of 930 basis points from the same period last year as a result of lower volume.

NSE's operating margin was negative 1.8%, which is a 540 basis points decline sequentially and a 320 basis points decline on a year-over-year basis. NSE operating margin was below our guidance range of 0% to 3%.

OSP revenue for the third fiscal quarter came in at \$76.2 million, which was above the high end of our guidance range of \$72 million to \$74 million and was up 8.1% on a year-over-year basis. OSP gross margin was 50.1%, which is a decrease of 50 basis points from the same period last year and was primarily due to a reversal of variable incentive compensation that benefited Q3 last year.

OSP's operating margin was 34.3%, which is 210 basis points lower sequentially and decreased 230 basis points on a year-over-year basis as a result of a reversal of variable incentive compensation that benefited Q3 last year. OSP operating margin exceeded the high end of our guidance range of 29.8% to 33.8%.

Moving on to the balance sheet and cash flow. Total cash and short-term investments at the end of Q3 was \$486.1 million compared to \$571.8 million in the second quarter of fiscal 2024. Cash flow from operating activities for the quarter was \$19.5 million versus \$17.8 million in the same period last year. We have not purchased any shares of our stock in the third quarter.

During the quarter, we repaid our outstanding balance of our 2024 convertible notes in the amount of \$96.4 million. The fully diluted share count for the quarter was 224.6 million shares, down from 225.3 million shares in the prior year and versus 224.7 million shares in our guidance for the third quarter.

CapEx for the quarter was \$3.2 million, which is \$7.6 million lower versus the same period last year when we were completing the construction of our new facility in Chandler.

Moving on to our guidance. For the fourth fiscal quarter of 2024, we expect revenue in the range of \$246 million and \$258 million. Operating margin is expected to be 10.6% plus or minus 120 basis points, and EPS to be between \$0.06 and \$0.08. We expect NSE revenue to be approximately \$184 million plus or minus \$5 million, with an operating margin of 2.5% plus or minus 110 basis points.

OSP revenue is expected to be approximately \$68 million, plus or minus \$1 million, with an operating margin of 32.5% plus or minus 150 basis points.

Our tax expenses for the fourth quarter are expected to be about \$8 million plus or minus \$500,000, as a result of jurisdictional mix. We expect other income and expenses to reflect a net expense of approximately \$3 million, and the share count is expected to be around 225.5 million shares.

With that, I will turn the call over to Oleg. Oleg?

Oleg Khaykin

President, CEO & Director

Thank you, Ilan. Viavi end market spend environment continues to be challenging, particularly the service providers and enterprise customer segments. In view of these continued headwinds, our revenue came in at the lower end of our guidance, with stronger OSP demand, partially offsetting weaker-than-expected NSE demand. Our EPS was in the lower half of our guidance range, driven by lower NSE volume and less favorable product mix.

Starting with NSE. For the third quarter, NSE revenue came in below the lower end of our guidance. NSE revenue declined on a year-over-year basis, driven by softer North American service provider, NAMs and enterprise customers' demand.

Decline in field instruments has driven -- was driven by reduced demand for field fiber and cable instruments. Revenue decline in SE was primarily due to the push out of several major projects by our enterprise customers.

Fiber lab and production demand was relatively flat with stronger 800-gig demand, offsetting weaker computing and storage. And AvComm remained a bright spot, seeing year-over-year increase in revenue driven by growth of customer orders for our PNT business.

Looking ahead, a seasonally stronger Q4 across all product segments, notwithstanding, we expect the conservative spend environment to persist for the remainder of calendar '24.

Now turning to OSP. In fiscal third quarter, OSP grew on a year-over-year basis, driven by higher demand for anti-counterfeiting and 3D sensing products. Overall, OSP results exceeded the higher end of our guidance range. Looking ahead, we expect OSP to be seasonally down in the June quarter, mostly driven by seasonally weaker demand for 3D sensing products. We expect the demand for 3D sensing to rebound in the first half of '25 -- fiscal '25, together with the continued recovery in demand for the anti-counterfeiting products.

In conclusion, I would like to thank my Viavi team for managing in this challenging environment and express my appreciation to our employees, customers and shareholders for their support. With that, I will now turn it back over to operator for Q&A.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Ruben Roy with Stifel.

Ruben Roy

Stifel, Nicolaus & Company, Incorporated, Research Division

Oleg, I was wondering if you could maybe provide a little more detail on how the quarter progressed? It sounds like enterprise might have worsened relative to how you were thinking about things 90 days ago. And an update on service provider sort of the same, I guess, as we've been seeing. So maybe not a surprise there. But any additional detail on how the quarter progressed, linearity, et cetera, across those 2 end markets would be interesting?

Oleg Khaykin

President, CEO & Director

Yes. I mean, as you know, with the service providers, we usually get quite a bit of in-quarter book ship. And what we saw, especially in the North America, there was just very anemic spend. And I mean, if anything, I would say, gradually decreasing interest and even for some of the projects that -- which were announced, they're just being delayed or ramping slower with the service provider customers.

On the enterprise space, it's really is a -- there's -- on the good positive side, we are getting some very big deals. On the negative side, when any one of these deals slips and we had the deals which were committed for the quarter and literally, at the end of the day, a major deal slipped to the next Monday of the quarter. So it just shows you the customers are also trying to manage their spend. And I mean, it was really ironic because it just made no sense, since the very beginning of the quarter, there were saying we want to take this product. And at the end, they literally just decided to book it on Monday after the end of the quarter. Had we gotten this deal when we were supposed to get it, it would be right at the middle of our guidance.

So in that respect, to me, I still view it as a decreasing customer spend or more conservative customer spend. I mean the thing is that customers are not canceling orders, but what they are doing is they are pushing and trying to manage their individual quarter CapEx as well. And that's the general pattern we are seeing what used to take, let's say, on the enterprise side, 3 months to convert the deal; on the carrier side, 6 months, it's now taking a few months longer.

Deals are not going away. The customers are still interesting in the product, but they are spreading it out over more quarters or pushing it down the line. So that's really, I would say -- truly, I would say in the last 2 weeks, some of the major projects, which should have come through in the SE, got pushed to the next quarter and beyond.

Ruben Roy

Stifel, Nicolaus & Company, Incorporated, Research Division

Okay. That's really helpful. I guess a follow-up would be, obviously, there's not a lot of visibility here, but in terms of how you think second half to first half or typical seasonality across the quarters, would you expect sort of seasonal trends to persist as you think about September, typically, that's a lower quarter. So just wondering how you're thinking about that.

Oleg Khaykin

President, CEO & Director

Yes. I mean the September is generally a lower quarter, driven by service providers, right? Because they just basically -- for some of them, it's the beginning of their fiscal year. For some of them, it's the first half -- I mean second -- beginning of the second half. So then they see how much money they left and then they decide either in December quarter or June quarter to place the orders.

Now one of the major changes I would see for the second half, I don't see a service provider getting any better. I think for the remainder of calendar '24, it's going to be more of the same kind of very tactical approach. One thing we were expecting in the second half is a significant uptick in cable. What became more apparent is that number of cable players are pulling back on their more aggressive plans that they had early in the year to do the upgrades. And they're still proceeding with the upgrades. But what they're going to do is they're going to spread over 2, 3 quarters rather than doing it all at once in over the 3 to 6 months.

And as a result, some of the uptick to negate the seasonality in the September quarter that we were expecting probably will not show up there. So I would expect the field instruments, service providers to be fairly similar to the first half, fairly anemic spend and just continue to, what they call it, sweat the assets.

On the positive side, we do see the lab business, particularly in fiber computing and storage should be getting better in the second half, as more projects are going to move forward with the next technology nodes being introduced. We expect beginning of the migration and development in 1.6 terabit speed. So in that respect, it will be, I would say, a somewhat better outlook.

I also expect on our SE side to have a better second half. I mean with the anemic spend that we saw in this quarter or last quarter, things being pushed out. The positive thing is our design win and booking funnel continues to perform really well. And as those things start going into -- being adopted to the customers, we expect that business to continue to recover gradually.

And last but not the least is I think the AvComm avionics, communication, PNT business will continue to do well. And we expect that part of the business continue to see good momentum.

One thing I forgot to mention is wireless. Clearly, I don't need to remind everybody the current state of the 5G deployment. A number of our major customers have seen significant drop in their sales. That doesn't mean they don't continue to do the development. They continue to buy and purchase products, but at a lower rate and lower intensity than in the prior years, as the end market demand for 5G infrastructure has weakened significantly. So that's where we are.

On OSP side, I think generally second half is a stronger half. I mean, I think we're all waiting for major mobile phone announcement. I mean, clearly, the volumes are lower, but it's still the second half of the calendar year is generally a stronger seasonal quarter, and we do expect other parts of the -- our OSP business to continue to recover.

Operator

Our next question comes from the line of Ryan Koontz with Needham.

Ryan Boyer Koontz

Needham & Company, LLC, Research Division

With regards to the NSE business, a couple of questions there. You've done a good job unpacking I think most of the clarification here. But the miss on -- the SE miss, can you give us any color there? And then with regard to the broader -- your review of the broader kind of wireline telco business for fiber builds, et cetera, wonder if you have any idea what you're thinking of rebound for field might look like in terms of time frame there?

Oleg Khaykin

President, CEO & Director

Yes. So I mean, on SE, I mean we have 2 parts in our SE. There's a carrier software business and then there's the enterprise business. So the enterprise, we mainly play in health care, financial services and large-scale manufacturing businesses. And there, we had effectively something between \$3 million and \$4 million order that booked on Monday. We were expecting it early in the quarter. It got delayed, delayed, and it got booked on Monday of the June quarter. So as you can imagine, that business is a very high margin business. And as a result, not only do we had about \$3 million to \$4 million shortfall, it also was a

significant hit to the gross margin and thereby all the way down to the operating income, where you had roughly \$3 million impact to the bottom line, \$0.015.

So clearly, this is -- on the positive side, as I said, it's great that we're winning these big deals today rather than a lot of \$0.25 million, \$0.5 million deals. But when some of them really don't materialize when they are supposed to, that tells me that the environment is getting a lot tighter and more conservative among our major customers.

Now the -- on the rest of NSE, I would say the -- generally, service providers are pretty anemic in their spend. But I would say it's not universally true everywhere else. I mean in areas of Europe, amazingly in Latin America, our business is doing pretty well. It's -- I would say that North America is the weakest link in the whole equation. And I would say the popular word we're hearing from our customers, we're just going to sweat the assets until we see market turning around or until one of their competitors starts getting aggressive. And right now, I see it, the environment is basically wink-wink, non-nod, I'm not spending any money. I'm not doing anything aggressive. Let's just generate cash and pay down the debt. And we're seeing the same thing going across the board with all the major service providers.

Ryan Boyer Koontz

Needham & Company, LLC, Research Division

Super helpful, Oleg. And on the gross margin line, any changes there in terms of pricing or structure that we should think of that might be an ongoing step back to gross margins? Or is it purely just volume based from your perspective?

Oleg Khaykin

President, CEO & Director

Well, that's actually the good news. I mean we are not seeing much ASP pressure. I mean, there's clearly once in a while, you do some big deal, you give some discount. But overall, the ASPs are holding very well. The margins are holding -- standard margins are holding well. But when your volume drops, even when you have a significant chunk of your manufacturing is contract manufacturers, you do have the operations team and that piece becomes less and less absorbed and it puts a lot of pressure on the margin. And of course, the big impact in this past quarter is the -- a significant software order that slipped into the next quarter. And as a result, that is a pure margin hit on the mix for the March quarter.

Operator

The next question comes from the line of Michael Genovese with Rosenblatt.

Michael Edward Genovese

Rosenblatt Securities Inc., Research Division

Great. Oleg, how do you think that service provider telco spending will be different in '25? Like what's going to happen as we get into calendar '25 that's different from '24?

Oleg Khaykin

President, CEO & Director

Well, I mean, on '25, when we get to '25, that basically would mean a lot of the instrument, field instrument installed base will be -- that was sold in '22, which was a very strong year. It will all be turning 3 years old. And there's also quite a bit of instruments were sold in '21 and '20, and they'll be turning 4 and 5. And reality is, I mean, once you get to that level, I mean, really at around 4 years of age, I mean you have to start replacing because what the increasing you start doing is as things start getting obsoleted or get damaged. They just keep leveraging maybe using 1 instrument for 2 people. It gets to the point where you need to start doing wholesaler replacement.

I mean we saw a similar picture in '17, '18. There was nobody who was buying anything. And then it resulted in a very significant span for 2, 2.5 years in '21, '22. So I think it will become more and more difficult. I mean we see the big weather events, damaging networks. Networks wear and tear. Things do break and things do go bad. And at a certain point, if you get to the point where you have to start doing a

significant upgrade to your field workforce. And I mean that's how I see. I mean, the longer you delay it, the more you're going to spend and more intensively you're going to have to spend.

Michael Edward Genovese

Rosenblatt Securities Inc., Research Division

Yes, that all makes sense. I guess in some of the work that we've done, we've heard about Tier 1 U.S. service providers that have basically said like '24 is just not a year of network expansion or growth capital, but were sort of planning for 2025. I was wondering if you hear any of that type of commentary from your customers?

Oleg Khaykin

President, CEO & Director

I believe it when I see it. Money talks and bullshit walks to use a very technical term here. I mean they all can say whatever it is. I mean, look, we've seen the cable players. We're going to do a major upgrade expansion. And they just kind of looked around and they just see the interest rates are not getting longer. And they're all taking a very prudent view to just kind of kick the can down the road.

And look, from what I see here is, I mean, unless somebody starts getting hungry and tries to grab market share and get ahead of their competition. Right now, it's a -- I wouldn't call it a collusion, but it's kind of everybody -- I would call like probably more of a Mexican standoff. Everybody standing with their guns loaded, looking at each other. And so long as nobody pulls the trigger, things are going accordingly. But you bring up a good point. I mean if they do decide to start expanding the network, upgrading network, then now you're actually going to create a double whammy of demand because not only now you need to replace the installed base for maintenance of your network, every time you start doing a build-out and expansion, you need to buy new tools for that as well. So to the extent you do believe '25 will be expansion of the beginning -- expansion of the network as well as the upgrade of the network, it actually would put even greater pressure to upgrade and replace the installed base of equipment in the field.

Michael Edward Genovese

Rosenblatt Securities Inc., Research Division

Right. So we need a shootout. That makes sense. So...

Oleg Khaykin

President, CEO & Director

We need a shootout. Somebody needs to go for higher market share. I mean, look -- I mean, think about it, right? If your competitors are not trying to muscle in on your market, and it's a fairly steady-state equilibrium market, every quarter that everybody stays disciplined, you're generating a massive amount of cash. You're not spending CapEx, you're really economizing on OpEx, and you continue to collect your subscriptions. I mean that is like the best possible scenario you can have, right, to generate cash and you take the cash and take down your debt. The moment somebody -- the moment first person tries to grab share and try to get ahead, that's when all the bets are off, and then it's off to the races.

Operator

Our next question comes from the line of Meta Marshall with Morgan Stanley.

Karan Juvekar

Morgan Stanley, Research Division

This is Karan Juvekar on for Meta Marshall. Just a quick question on the NSE operating margin side. I understand that you're sort of seeing headwinds, just given volumes and the guide for next quarter. I guess just is there anything outside of just some volumes coming back that could help maybe get you back to the mid-single-digit operating margins? Or I guess, just how should we think about recovery on that side?

Oleg Khaykin

President, CEO & Director

Well, I think maybe I'll start and Ilan can continue. Clearly, volume is the biggest thing, right? Because you can squeeze your OpEx all you want, you can reduce your OpEx. But it's -- when you're running a business that an incremental variable margin is north of 70% on the lab or the software products north of 60% on the field instruments, I mean it all drops to the bottom line because your fixed cost is largely covered. So A, I think clearly, a recovery in volume is a single biggest driver but also a recovery in the SE business because it's a very high contribution margin to the bottom line. So every dollar of revenue in the software business obviously puts significant chunk of it to the bottom line.

Ilan Daskal

Executive VP & CFO

Yes. I mean exactly that. I mean, obviously, the fall-through from the top line, it all depends on the top line growth and pricing environment, as Oleg mentioned earlier, continues to be stable. So it's just about the volume.

Karan Juvekar

Morgan Stanley, Research Division

Okay. I appreciate that. And then a quick follow-up. I know you mentioned that the PNT business is doing better than some of the other businesses. I guess any detail on sort of where you're seeing the strength on the position and navigation and timing side and where you sort of expect maybe an inflection or continued strength going forward on the PNT side? Any detail there would be helpful.

Oleg Khaykin

President, CEO & Director

It's mostly in the aerospace and defense sector. I mean we've all seen significant issues with the GPS signal in Europe and Middle East. And as you can imagine, it is becoming a very hot topic with the aircraft manufacturers, with the defense contractors, pretty much everything relating to communications or positioning is now becoming vulnerable, and that's generating a lot of interest for our products.

Also the avionics is with the recovery in the commercial aviation market. We're seeing very strong demand for our next-generation avionics products. And just even traditional public safety and military and defense communication testing, we are seeing a healthy demand environment for the base business. But for a lot of our kind of more advanced products that we introduced in the past several years and the acquisition that we've made of Jackson Labs about 1.5 years ago, we are seeing very robust interest in our products and growth in that area.

Operator

There are no further questions at this time. So I'll now turn the call back over to Ilan Daskal.

Ilan Daskal

Executive VP & CFO

Thank you, Jericho. This concludes our earnings call for today. Thank you, everyone, for joining us.

Operator

This concludes today's conference call. You may now disconnect.

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