Operator

Good afternoon and welcome to Casa Systems Third Quarter 2023 Earnings Call. At this time, all participants are in a listen only mode and there will be a question and answer session opportunity at the end of this call. As a reminder this call is being recorded.

At this time, I would like to turn the call over to Dennis Daly, Vice President of Corporate Development and Investor Relations.

Dennis Daly, Director of Investor Relations at Casa Systems

Thank you, operator, and good afternoon, everyone. Casa Systems released results for the third quarter fiscal year 2023 ended September 30, 2023 this afternoon after the market closed. If you did not receive a copy of our earnings press release, you may obtain it from the Investor Relations section of our website at investor.casa-systems.com. With me on today's call are Michael Glickman, President and Chief Executive Officer, and Ed Durkin, Chief Financial Officer. This call is being webcast and will be archived on the Investor Relations section of our website.

Before I turn the call over to Michael, I'd like to note that today's discussion will contain forward-looking statements based on the business environment as we currently see it and as such, it does include certain risks and uncertainties. Please refer to our press release and our SEC filings for more information on the specific risk factors that could cause our actual results to differ materially from the projections described in today's discussion. Any forward-looking statements that we make on this call or in the earnings release are based upon information we believe as of today and we undertake no obligation to update these statements as a result of new information or future events.

In addition to U.S. GAAP reporting, we report certain financial measures that do not conform to generally accepted accounting principles. During the call, we may use non-GAAP measures if we believe it is useful to investors or believe it will be helpful to investors to better understand our performance or business trends.

And with that, I'd like to turn the call over to Michael. Michael?

Michael Glickman, Chief Executive Officer of Casa Systems

Thank you, Dennis, and thank you all for joining us today. Since joining Casa Systems in August, I've had the opportunity to spend time with many of our employees, customers, and partners. These discussions further reinforce my decision to take the role as CEO due to the great global customer base of top-tier communication service providers, our ability to quickly innovate, our strong engineering team, and market-leading cloud-native virtualized network functions, both for wireline and wireless customers. I see a company with industry-leading technology, talented employees, and significant potential to disrupt legacy incumbent solution providers and change how the world communicates.

Service providers around the world are beginning to utilize more flexible, agile, and cost-efficient virtualized solutions across cable, telco, and wireless spaces and the total addressable market is both large and growing across all major geographies. Driving these transformations are strong use cases that incrementally monetize providers' networks as well as continued convergence of DOCSIS, fiber, and wireless for broadband services. Casa is uniquely positioned to take advantage of these transitions of both current and future spending with a combination of our virtual software offerings, including CCAP, Packet Core, BNG, and secure gateway solutions.

Key to the adoption of these solutions will be strong partnerships to assist in the systems integration, operationalization, and support of these virtualized platforms. We are currently forming new partnerships with a combination of systems integrators, value-added resellers, OEMs, and cloud service providers whose capabilities complement

Casa's and who can help us drive adoption of these solutions. We look forward to sharing more details on these new partnerships in the very near future.

While many of these markets that Casa currently operates in or undergoing delayed transition for network updates, Casa continued to build momentum in 2023. During the third quarter, revenue came in at $62.1 million which marks the second quarter in a row of quarter-over-quarter revenue growth. Our financial strategy is to focus on cash and capital efficient operating results with a return to EBITDA profitability as well as consistent positive operating cash flow so that we can remain in control of our own destiny.

As part of our ongoing transformation, we are continuing to evaluate noncore asset sales that will help further delever our business, such as the sale-leaseback agreement for our headquarters building and Andover that was completed in late October. Ed will provide further details on that and additional efforts we are taking to further delever our business shortly.

Turning now to our product portfolio, I'm incredibly excited about the opportunities of our cloud software business which is comprised of our industry-leading cloud-native virtualized Packet Core and Small Cell Core portfolio as well as our virtual BNG and virtual secure gateway. We are currently forecasting that we will end fiscal year 2023 with approximately $25 million of GAAP revenue and $35 million of billings for our cloud software business, growing at approximately 50% in fiscal year '23. We currently have 10 customers, over $100,000 in fiscal year '23 revenue that utilize components of our cloud portfolio, more than half of which are in production.

Our partnership with YTL, a leader of mobility services in Malaysia, which we initially announced last year, has taken another step forward. In our recent announcement, we outlined how our software helped them win the Ookla award for the fastest mobile network in Malaysia as well as assisting their launch of the iPhone 15.

Our strategic partnership with Verizon has also continued to grow with both the adoption of new software components as well as software developments to enable Verizon to monetize their 4G and 5G investments. With our growing pipeline and continued growth from our current customers, we are on track for our cloud business to continue to grow approximately 50% in 2024. Focusing on B2B business outcomes such as mobile private networks, fixed wireless access, and IoT telematics.

Our Access Device business continues to see wins as well in areas such as fixed wireless access broadband, including our recent deployment we announced in September with U.S. Cellular. They selected Casa's new Auris Link fixed wireless access outdoor device that provides high-speed broadband Internet solution for homes and business to help expand U.S. Cellular's addressable market across diverse urban, suburban, and rural markets.

As we look towards the future of our access device business, our focus will be on profitable deals which utilize our market-leading provisioning and management software and our outstanding customer support. This decision will have a positive impact on our gross profit with an eye towards achieving our goal of returning the company to EBITDA profitability.

Within our Access Device business is also our 4G, 5G enterprise small cell business that has continued to scale as well. We are proud to be one of a handful of U.S.-based RAN companies in the world. Our focus is industry-leading solutions for scalable indoor enterprise small cell deployments for in-building coverage, either enhancing existing DAS or replacing it. Given our current customer deployments, we expect revenue this year to be north of $10 million, representing year-over-year growth above 50%. We expect this level of growth to continue in fiscal year 2024 as we continue to add new customers in Europe and North America.

Turning now to cable, where the transition to DOCSIS 3.1 and 4.0 for high-speed services, along with the transition to a virtual CCaaS core and DAA will continue to provide Casa significant opportunities moving forward. Our installed base of customers as well as new MSO customers are migrating to Casa's portfolio and away from end-of-life equipment replacing legacy solutions from vendors that have exited the business.

We are also excited about participating in new markets with our MSO customers utilizing virtual BNG to support their fiber-to-the-home and wireless installations. We have several customers in production as well as multiple proof of concepts with Tier 1 MSOs. The convergence of fiber-to-the-home DOCSIS and fixed wireless access broadband is the perfect application for our flexible virtual BNG solution.

However, as with most vendors serving this market, there has been a slowdown in spend during these transitions which have MSOs utilizing current capacity in their networks, as well as reducing inventory built through later stages of the pandemic timeframe. After revenue growth in Q2 2023 as compared to '22, these factors drove meaningful decline of 42% in our cable business in the third quarter compared to the prior year and we expect to see similar dynamics in the fourth quarter of this year. With that said, it is important to note that this shortfall in revenue is not due to competitive market share losses but rather the delays associated with these transitions.

Before I turn the call over to Ed, I would like to note that we still have a lot of work ahead of us to achieve our transformational goals. We are making meaningful progress on achieving these goals by expanding our team with proven industry veterans, modifying our product strategy to leverage our technical differentiation to drive accelerated growth, and fine-tuning our partnership strategy. Our financial strategy continues to focus on a return to EBITDA profitability and generating consistent positive cash flow. As we look towards 2024, we believe we are very well positioned to be a dynamic leader with our market-leading product portfolio, growing sales pipeline, and expanded partner ecosystem.

With that said, I would now like to turn the call over to Ed to review our financial results for the quarter. Ed?

Ed Durkin, Chief Financial Officer of Casa Systems

Thank you, Michael, and good afternoon to everyone on the call. As Michael mentioned, revenue for the quarter came in at $62.1 million, up 7% from the prior quarter.

Breaking down the revenue across our product lines for the third quarter. Cloud revenue was $11.5 million, an increase of $9.5 million from the prior year and up $9.2 million from the prior quarter of 2023. Cable revenue was $17.5 million, which was down 42% from $30.2 million from the prior year and down 37% from $27.5 million in the prior quarter.

As Michael just mentioned, the decrease in Cable revenue was driven by a slowdown in spending from Cable MSOs as these MSOs focused on utilizing existing capacity in the networks and this decline was not market share losses. Competitively, we continue to do very well as evidenced by our recent Claro Colombia win earlier this year, among other factors.

Access revenue which includes our access device products from our 2019 NetComm acquisition, plus our 4G and 4G, 5G radio products totaled $33.1 million which was down 4% from $34.6 million from the prior year but was up 17% from the prior quarter, driven by sales of our RAN product which increased by almost 100% from the prior quarter.

Moving now to gross profit, GAAP gross profit for the third quarter was $25.9 million or 42% of revenue. Gross margin during the quarter was impacted by a noncash charge to increase our inventory obsolescence reserve by $7.9 million. Excluding the impact of this noncash charge, to increase our inventory reserves, gross profit would have been 54%, reflecting the higher mix of very high-margin cloud software revenue we realized in Q3 2023.

GAAP operating expenses for the quarter came in at $44.3 million. This is up $3.3 million or 8% from the prior quarter. This increase is largely driven by a $4.7 million noncash and nonrecurring impairment charge recorded during Q3 for the sale and leaseback of our Andover headquarters.

Our GAAP operating loss for the quarter was $18.4 million. $12.6 million of this loss was related to noncash inventory reserves and the aforementioned $4.7 million noncash impairment charge on the sale and leaseback of the building and $2.3 million related to nonrecurring workforce charges during the quarter.

Finally, related to our third quarter P&L, our GAAP net loss for the quarter was $25.6 million or $0.26 loss per diluted share versus a net loss of $31.2 million in the third quarter of 2022. Our $25.6 million net loss in the quarter also includes $10.7 million in -- interest expense which includes $4 million of charges reflected in interest expense related to noncash amortization of deferred debt issuance cost. We also had a $3.8 million noncash gain related to the fair value under the warrant liability during Q3.

On a non-GAAP basis, we had a net loss of $20.2 million or $0.20 loss per share and reported a net adjusted EBITDA loss of $6.1 million as reflected in the schedules shown in the back of the press release.

Turning to our balance sheet, we ended the quarter with cash, cash equivalents and restricted cash of approximately $49.7 million. Our cash balance at September 30 was down $16.3 million compared to June 30 due primarily to our net loss for the quarter, timing of payables, and a large quarterly debt service payment made in September 2023. We ended Q3 with $37.4 million of high-quality receivables. These receivables are from the very financially capable MSOs and CSPs and our receivable collection experience remains excellent.

As Michael mentioned earlier in the call, we recently completed a sale and leaseback for our Andover, Massachusetts headquarter October. As a result of the sale leaseback agreement, we received approximately $6 million of net proceeds which will be used to help pay down our term loan B debt and further delever our business. The interest savings from this debt paydown will more than cover the operating expense increase, we will see as part of this transaction and the sale of the building gives us the flexibility to rightsize our office space needs as we embrace a hybrid and more geographically diverse workforce. As part of our financial strategy, we're also evaluating the sale of other noncore assets that we can use to help further delever our business.

As noted in our earnings release today, we're adjusting our full year 2023 revenue guidance to a range of $205 million to $225 million. The decrease in guidance is being primarily driven by the delay in cable MSO spend that Michael mentioned earlier as well as some telco customers pushing out deliveries of backlogged access device orders into 2024 to manage their own inventory levels. Again, it is important to reiterate that the softness is not due to competitive market share losses but rather due to delays in new purchases, delays in deployments of awarded virtual CCAP deals, and delays in timing of delivery of backlog orders from Q4 '23 into the first half of 2024. Our guidance also being impacted to a lesser degree from the timing of shipments from some of our access device customers which we have agreed to push from Q4 to the first half of 2024.

I'm very pleased that Cloud and RAM revenues and business momentum continue to exceed our expectations and that our growth expectations for these strategic market segments for 2024 look strong. Given the shortfall in revenue for the second half of 2023, we no longer expect to be net adjusted EBITDA positive for the year. As part of our current 2024 planning process and consistent with our North Star goal of returning to EBITDA and cash flow positive operating results, we are evaluating our cost structure to make sure it better aligns with our future revenue and gross margin outlook.

Finally, regarding our backlog and deferred revenue metrics, we currently have approximately $136 million in profit and service backlog and deferred revenue. And we have $96 million remaining of future billings under the Verizon contract to be built in 2024 and beyond which brings our total backlog, deferred revenue, and future Verizon billings to approximately $232 million.

As we noted last quarter, we also have approximately $40 million of remaining closed contracted business for our 4G, 5G enterprise small cell radios with a major North American mobile network operator. That began shipping in Q3 where we get POs on an annual as ordered basis. And we also have an award from a major European cable customer for a virtual CCAP core project with approximately $53 million of estimated TCV value that we will begin deployment in 2024 and continue over the next few years.

I would like to note that these last two award agreements are not included in the backlog and the deferred revenue numbers I cited and will be reflected as we receive binding purchase and delivery orders for shipment deployment to these customers.

Before I turn the call over to the operator to open the line for questions, I would finally like to wrap up by discussing our ATM program which we have received many questions on from investors since August. Our ATM program was put in place in Q3 to have it on hand if we ever needed it as we complete the transformation Michael mentioned and return to profitable operating results. But given our current share price, we currently have no plans to use our ATM program to issue any shares.

I'll now turn the call over to the operator to open up the line for any questions. Operator?

Operator

Thank you. We'll now be conducting a question and answer session. If you'd like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you'd like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key. One moment please while we poll for questions.

Thank you. Our first question is from Tim Savageaux with Northland Capital Markets. Please proceed with your question.

Tim Savageaux, Northland Capital Markets

Hi. Good afternoon. A couple of questions here. You mentioned the goal for EBITDA profitability a couple of times and it sounds like you're maybe in the middle of developing those plans. You've talked specifically about '24 for a couple of segments but not a couple of others. But understanding that may still be underway in terms of the cost cutting as well, do you have a sense of what you might hope for in terms of targeting a return to EBITDA profitability or EBITDA profitability in general? And how much cash do you need to get there? And I have a follow-up.

Ed Durkin, Chief Financial Officer of Casa Systems

Yeah, Tim, I'll take that and Michael can weigh in also. We are going through the 2024 planning process now. As Michael mentioned, it is our North Star to return to operating cash flow positive and EBITDA profitability in 2024 and beyond and we're working through that now. I think we don't have guidance for 2024's levels of EBITDA profitability. We would plan on providing that in our February-March call when we provide guidance for the year. In terms of cash to get there, I think we should be fine on that front. We did burn some cash in Q3 and expect to use some cash in Q4, but expect to be cash flow positive in Q1 and thereafter. And we are looking at the cost structure too and we'll do what is needed to rightsize that once we finish our 2022 revenue and gross margin planning.

Michael Glickman, Chief Executive Officer of Casa Systems

Yeah. And Tim, it's Michael. I'll just follow on on that. I think it's just really important and I wanted to make it very clear that if there was any expectation that the sole focus of the company was going to be continued focus just on top line growth. I think it's pretty clear coming off of this that we pivoted towards obviously continuing to try to grow the company and we've got great growth in some of the business lines, as I mentioned, but we have to get consistently back to profitability and cash flow positivity, right?

So the way that I think we're approaching it is look above the line first and look at the mix of the products that you're selling as well as the types of deals that you're taking down and as Ed talked about, on a pro forma basis, our gross margin actually expanded to the positive in the quarter and we're going to continue to focus on that. And then you've also obviously got to look below the line as well and we'll be making the right calls as any solid business would on how we rightsize our cost basis as well.

Tim Savageaux, Northland Capital Markets

Right. So it looks like ex the inventory charge in the quarter, you were probably somewhere close to breakeven. Is that fair enough or positive EBITDA? So does that give a sense of what the business could look like in the future in terms of maybe a lower top line but higher margins?

Ed Durkin, Chief Financial Officer of Casa Systems

Yeah, I think that's right, Tim. There are a lot of activity flowing through the P&L and it is an operating loss of $18.4 million. But when you back out the noncash charge for the inventory reserve of $7.9 million which is in cost of goods sold, you back out the impairment charge for the building of $4.7 million in OpEx, back out the nonrecurring workforce charge of $2.3 million in COGS and OpEx, and you back out the stock-based comp amortization depreciation of 5.3 in COGS and OpEx, the operating loss picture gets considerably better.

So very active quarter with lots of kind of onetime charges. But you're right. If you look through and piece it together, the picture looks better on an operating loss basis and we'll continue to improve that and again, make the necessary adjustments we need to make to ensure we're positive in 2024.

Tim Savageaux, Northland Capital Markets

Okay, great. And as you look at Q4, I mean any -- you made some comments, but I don't know if we have a recast last year on cable. But generally, where do you expect the segments to kind of move in Q4? Is it really just Verizon revenue coming out? Or are there any other big moves quarter-to-quarter from a segment basis you can call out?

Michael Glickman, Chief Executive Officer of Casa Systems

I would just say upfront, I'll let Ed comment as well. traditionally, as I look back on the trend of the business, we usually have a very strong Q4 and especially in the cable space, where we were able to traditionally bring in some additional business, both the hardware and software licenses with year-end spend, etc. But as you've heard from pretty much everybody selling into this industry, right, there's just been a fairly significant pullback in spend. And certainly, the MSOs wanting to take advantage of utilizing any inventory that they had purchased and prepurchased during the pandemic. So that's obviously having an effect on us as well as the rest of our peers. And as we said, we expect that to go into Q4 as well.

Tim Savageaux, Northland Capital Markets

Thanks.

Operator

Thank you. There are no further questions at this time. I'd like to hand the floor back over to Michael Glickman for any closing comments.

Michael Glickman, Chief Executive Officer of Casa Systems

Okay. Well, thank you again for joining us today. And we are continuing to make tremendous progress towards bringing our industry-leading products to market during this period of transition and transformation with our growing pipeline, continued expansion growth from current customers, and our focus to further delevering our business. I'm confident that Casa is on the right path towards returning to EBITDA profitability.

I would like to thank all the talented team members for their tireless work and dedication to the business and also thank our customers and our stakeholders for their continued steadfast support. We look forward to keeping you all updated on our progress during the fourth quarter call and our plans for 2024. Thank you.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.