



Casa Systems Q3'21 Earnings Call Transcript November 2, 2021, 5pm ET

Jackie Marcus, Investor Relations

Thank you, operator, and good afternoon, everyone. Casa Systems released results for the third quarter of 2021 ended September 30, 2021, 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 investors.casasystems.com.

With me on today's call are Jerry Guo, Chief Executive Officer, and Scott Bruckner, Chief Financial Officer. This call is being webcasted and will be archived on the Investor Relations section of our website. Before I turn the call over to Jerry, 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, 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 that 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-



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GAAP measures if we believe it is useful to investors or we believe it will help investors better understand our performance or business trends. And with that, I'd like to turn the call over to Jerry. Jerry?

Jerry Guo, Executive Officer of Casa Systems

Good afternoon, everyone. Thank you for joining us today as we discuss our third-quarter results. As you know, we had a very solid start to our fiscal year. During the first half we successfully managed to avoid any material impact from what now very widespread supply chain issues are. And we delivered record growth and profitability. Unfortunately, I cannot say the same about the third quarter. As we are seeing across our industry, our third quarter results were impacted by worsening supply chain issues.

To add some color:

- We estimate that the revenue impact from delayed deliveries across all our product lines in the quarter amounted to approximately \$11 million.
- With the global chip shortage continuing to worsen in Q3, we are now facing order lead times for certain components of over a year.
- Finally, lower revenue from supply chain delays also meant lower year-over-year gross profit. Our gross profit margin in Q3 was lower also because of a higher percentage of hardware product revenue than we normally see each quarter. This resulted from a few customer software order delays that we expect to recognize as revenue in Q4.



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While we anticipate that supply and logistics challenges are only temporary, we do expect them to continue for at least the fourth quarter of this year and likely into 2022.

As you saw in our press release, we are updating our guidance to reflect this current reality.

We did mention on previous earnings calls that we would revise our assumptions if supply chain disruptions got worse. Unfortunately, and as I just laid out, they have. Scott will provide our revised guidance assumptions in his remarks later on this call. But please bear in mind that the supply chain situation is very fluid, which naturally limits our visibility deep into any quarter. So, our revised guidance is based on the best information that we have today.

Having said this, I want to reiterate that short-term or quarterly blips in our results in no way diminish our expected longer-term growth trajectory. In fact, we continue to see growing demand for our products, particularly in wireless. We continue to have a large backlog across all our products. And we fully expect to benefit materially from RDOF, 5G, and the deployment of mobile private networks. We will provide more details about all of this, and about our growth expectations, during our November Investor Day.

While industry-wide supply chain and logistics constraints made this a tough quarter, we did see several significant successes in Q3. To name a few:

- Mediacom chose Casa's innovative fixed wireless access devices and 4G/5G Combo packet core as a packaged solution to bring reliable, high-speed internet to underserved communities in rural areas.



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- We announced an exclusive agreement with Bell Canada to provide new 5G Sub-6 fixed wireless access devices for Bell's Wireless Home Internet service. This will deliver broadband to customers in small towns and rural communities.
- And, Vodafone successfully tested our open architecture disaggregated virtual BNG router in a multi-vendor solution. We believe that our virtual BNG will disrupt the industry by being the first and only product that can work with separate hardware and software provided by multiple vendors. As such, it helps our customers to seamlessly scale and deploy new features and enhance their time-to-market in launching new services.

With that said, let me turn to our results, which again reflect significant supply chain headwinds. Total revenue for the quarter came in at \$99.2 million, a 6% decline year-over-year. Adjusted EBITDA was \$5.5. On a year-to-date basis, however, revenue of \$296 million was up 8.6% over the comparable period in 2020. And year-to-date EBITDA of \$37.4 million was up 24.5% over EBITDA in the first 3 quarters of 2020. Moving on to our product areas; starting with wireless. Despite supply chain headwinds, wireless revenue was \$44.2 million...that's up 26% sequentially...up 51% year-over-year...and represents 45% of our total revenue in the quarter. Wireless revenue growth in Q3 came from continued success in our 4G & 5G packet core and fixed wireless access devices. Our wireless backlog at the end of the quarter remained large and stood at \$101.2 million. In addition to the product successes, I mentioned earlier, we continue to make progress with our cloud-native 5G



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solutions both in terms of industry recognition by cloud leaders like Intel, Red Hat, Amazon and Google, as well as in terms of customer adoption. In fact, we have seen our 5G cloud-native core network functions chosen by a major North American mobile network operator and an MNO in the APAC region, to name just a couple. And, finally, as our cloud software products continue to gain traction, we will have a wider moat to mitigate the impact of hardware supply chain disruptions.

Moving on to fixed telco. Fixed telco revenue was \$21.0 million in Q3 and accounted for 21% of our total revenue. This is down 39% year-over-year...but it's up 22% on a sequential basis. As I previously mentioned, the lumpiness we've seen in our fixed telco revenue has been due to product and customer concentration...which we have been working towards resolving. We believe that the 22% sequential growth in this product area is evidence that fixed telco is beginning to regain traction, both with fiber extension products and our virtual BNG router products. Before moving on to cable, let me point out that revenue from our new product areas of fixed and wireless accounted for 65% of our Q3 revenue.

Finally, let's turn to cable. Cable revenue in the quarter was \$34 million...or 34% of revenue. While this was down 19% year-over-year, I would note that a majority of the negative impact from supply chain was in cable. Normalized for this impact, we believe our cable revenue would have been within the \$40 million to \$50 million range that we have been seeing each quarter. In spite of the supply chain issues, Cable demand continues to be relatively stable with most of our customers opting for extended life in their existing



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integrated CCAP architecture, while also investing in high- and mid-splits as they await deployable remote MAC PHY.

Before turning the call over to Scott to review our detailed financial results for the quarter and our outlook for the remainder of 2021, I want to thank our best-in-class team members who worked extremely hard to try to minimize the impact of the supply chain environment on our customers and our company. Their efforts are responsible for the exceptional products we have developed and for our continued success in expanding our customer and revenue base.

With that said, I'd like to turn the call over to Scott. Scott?

Scott Bruckner, Chief Financial Officer

Thank you, Jerry. Good afternoon, everyone.

As Jerry mentioned, our third quarter results were unfortunately impacted by what are now widespread supply chain disruptions and component shortages. Let's take a look at the numbers –

Revenue for the third quarter came in at \$99.2 million...that's down 6% year-over-year. This decline was driven entirely by supply chain disruptions, which as Jerry mentioned, reduced



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our top line by approximately \$11 million in the quarter. Breaking down our revenue across our product lines:

- Third quarter wireless revenue was \$44.2 million...that's up 51% year-over-year, with wireless accounting for 45% of total revenue. This strong quarterly performance was driven by continued success with our fixed wireless access solutions. But we are also seeing growing industry recognition and starting to see customer traction for our cloud-native 5G products.
- Cable revenue came in at \$34 million, or 34% of total revenue in the quarter. As Jerry mentioned, a majority of the approximately \$11 million supply chain impact to our top line hit our cable revenue.
- And our fixed telco revenue came in at \$21.0 million, or 21% of total revenue. While fixed telco is down year-over-year, fixed telco revenues are up over 22% sequentially. We believe this indicates that we are making progress in addressing revenue lumpiness in this area by reducing customer and product concentration.

Moving down the income statement –

GAAP gross profit for the quarter came in at \$40.6 million...that's down 22.8% year-over-year, but up almost 3% on a year-to-date basis. Our GAAP gross margin in the third quarter came in at 40.9%. This is well below where we normally see gross margin...and it resulted primarily from a few software orders that pushed out of the quarter, as Jerry noted in his remarks. We expect to see this software revenue recognized in Q4...and then



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expect our gross margin to return to within a more normal range in the fourth quarter and for the full year.

Turning to GAAP operating expenses...OpEx for the quarter was \$42.6 million...that's a decline of 2% relative to Q3 2020. For the fourth quarter I expect OpEx to increase a bit and be in a range of \$45 million to \$47 million. This is largely due to additional R&D headcount that will start hitting our income statement in Q4.

We did have a GAAP operating loss of \$2 million in Q3. But, on a non-GAAP basis, we had an operating profit of \$3.1 million.

After interest and other expenses, we had a GAAP net loss of \$876 thousand. This result was due in part to a net tax benefit of \$5.3 million that we accrued during the quarter...and this was related to a CARES Act benefit that we were able to take. On a non-GAAP basis, we had a net loss of \$4.1 million.

Adjusted EBITDA for the quarter was \$5.5 million, or 5.5% of revenue. This is down 67.6% from the third quarter of 2020. But on a year-to-date basis, EBITDA is up 24.5% year-over-year.

Let me now turn to our balance sheet. We ended the third quarter in a strong liquidity position with a 14.8% year-over-year increase in our working capital. At quarter end, we



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had \$157.5 million in cash...net receivables of \$80.9 million... inventory of \$91.9 million... and payables of \$22.8 million. The 7% sequential decrease in our cash balance was driven by a 13% decline in payables and a 23% increase in receivables.

At the end of the quarter, gross debt was \$285.5 million, down from \$286.2 million at the end Q2 of this year. But, at the end of October, we paid off the full outstanding balance of \$6.5 million on our revolver. This left us with gross debt of \$279 million.

Before opening the call up to Q&A, I'd like to comment on our guidance for the remainder of the fiscal year. As Jerry and I have noted in our remarks, supply chain issues did have an impact on our third quarter results. And, in fact, throughout the quarter, these issues increasingly diminished our visibility on where our financial results would end up at quarter end. And while we do see supply chain constraints as only temporary, we don't expect our visibility or the supply chain situation to improve materially as we march through the fourth quarter and into the first quarter or two of 2022. We've taken all of this into consideration in revising our guidance and have attempted to err more on the more conservative side in building updated our year-end forecast. So, for 2021, we now expect the following:

- Revenue: \$394 million to \$404 million
- Adjusted EBITDA: \$45 million to 52 million
- GAAP operating income: \$15 million to \$21 million
- Non-GAAP operating income: \$36 million to \$42 million



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- GAAP EPS: \$(0.03) to \$0.05
- Non-GAAP EPS: \$0.06 to \$14

To echo some of what Jerry said, in spite of the disruptions that we are seeing across our industry, we are still benefitting from strong demand for our products. You see that in our strong growth in wireless, and the revenue that we are now booking from rural infrastructure deployments. 5G and RDOF are significant tailwinds for us and they are starting to bear fruit. While on a quarterly basis these results may not always be linear, we continue to believe that there is significant medium-term annual growth in our business...and we will outline this in more detail during our Investor Day on November 19th.

Ok, with that, I'll turn it back over to the operator for Q&A. Operator?

Operator

Our first question today is coming from Meta Marshall from Morgan Stanley.

Karan Juvekar - Morgan Stanley

This is Karan on for Meta. So understanding that gross margins were sort of impacted by the software order that may have been pushed to Q4, I guess I just wanted to get more color on what the COGS impact was from supply chain versus that software order. And if you can give any more detail on which one was maybe -- or guess which one impacted more or any numbers behind that, that would be helpful.



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Scott Bruckner, Chief Financial Officer

Yes. Karan, so we fortunately did not see big COGS impact from supply chain. And in fact, one of the things that we've been working on pretty aggressively is to make sure that if there are increased freight costs or increased component costs, we're able to pass those along to our customers. And to date, I would say we've been extremely successful at that. So the gross margin impact had less to do with what was going on in COGS, and it had almost 100% to do with the fact that these 2 sizable software orders got pushed into the fourth quarter. And in fact, if I add that back to the quarter, we are in a gross margin range that's fairly consistent with what we've been delivering over the past 7 or 8 quarters.

Karan Juvekar - Morgan Stanley

Got it. That's helpful. And you answered my follow-up on ability to pass on pricing. So thank you for that. I appreciate the time.

Operator

Our next question today is coming from Simon Leopold from Raymond James.



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Simon Leopold - Raymond James

A couple of things. I want to clarify a metric that Scott gave us on OpEx. I believe you said \$45 million to \$47 million in the fourth quarter. I wanted to verify. Is that a GAAP or a pro forma number?

Scott Bruckner, Chief Financial Officer

Yes, that is a GAAP number.

Simon Leopold - Raymond James

Okay. Great. That's what I thought. And in terms of your comment right around that on gross margin, you basically have indicated gross margin should be similar to what we saw in the second quarter. It's what you're expecting in the fourth quarter. I think you said that. I just wanted to confirm.

Scott Bruckner, Chief Financial Officer

Yes. I didn't say second quarter. What I said was that with the software orders that we do expect to see in the fourth quarter and based on the estimate that we have for Q4 right now, we expect gross margin to get near to, closer or at -- similar to what we've seen previously.

Simon Leopold, Raymond James



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Okay. Great. So now past the checks there, I want to talk a little bit about what's going on in fixed wireless opportunities for you. One of the things I've been trying to figure out is whether your business cares about the spectrum being used, whether the operators are using mid-band or millimeter, and if you have any observations in terms of the trends and opportunities and what it may or may not mean to your particular role in that opportunity.

Jerry Guo, Executive Officer of Casa Systems

Simon, let me answer that question. We do actually go after all the different type of bands. I usually classify them into 3 categories. One is the CBRS, the free or lightly licensed. And that's relevant in the U.S. and especially in the rural area and RDOF mainly, things like that. And we are deploying with that spectrum, and we think that's going to be significant opportunities in the next couple of years. And we also are deploying in -- the license to Sub-6. So that's -- the operators pay normal prices for the Sub-6. And we have deployment in that and -- in that area. And we have also won some deals in the millimeter wave domain. And those are relatively new, of course. And we do see that to be growing as well going forward.

Simon Leopold, Raymond James

And is it your impression that the favored spectrum is more likely to be CBRS and mid-band as opposed to millimeter? That's my impression. I just want to see if you see it that way.

Jerry Guo, Executive Officer of Casa Systems



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Well, millimeter wave is fairly constrained to certain geographic regions and certain operators. They're not widespread for Sub-6, like n77, n78. You pretty much see it across the globe anywhere. So, in terms of where it's applicable, I do see Sub-6 to be the most popular.

Simon Leopold, Raymond James

And on the cable side of the business, I'm assuming that the components that are tightly constrained were semiconductors. And I guess what I'm trying to get a better understanding of is what sort of led to the issue in terms of -- were you surprised by your supplier? Did you have limited inventory? Or did your supplier breach an order commitment with you in order to satisfy somebody willing to pay more? What was sort of the back story to how this played out during the quarter?

Jerry Guo, Executive Officer of Casa Systems

Simon, it's the surprise part. It was the last thing you mentioned. We thought we had a normal schedule, it was committed, but it was a surprise.

Simon Leopold, Raymond James

So, it's a decommit. I...

Jerry Guo, Executive Officer of Casa Systems

Exactly.

Simon Leopold - Raymond James

I keep hearing about that and...

Jerry Guo, Executive Officer of Casa Systems

Yes. That's a new word we have been hearing lately.

Operator

Our next question is coming from Tim Savageaux from Northland Capital.

Timothy Savageaux, Northland Capital Markets

Sorry about that. A question on -- you mentioned a couple of wins. I don't know if those are orders into backlog yet, kind of on the wireless side. But I guess the overall question is that you've talked about kind of the direction of your wireless backlog and some specificity in the past. I wonder if you had any further comments on that in terms of -- you've talked about strong revenue growth. And also, given the supply issues, maybe any broader commentary about orders or backlog across the rest of the business.

Scott Bruckner, Chief Financial Officer

Tim, let me take the question on backlog. I think Jerry did mention what the wireless backlog is. It's over \$100 million. So it came in a little bit from the second quarter. That's because you saw the wireless growth in the third quarter, pretty significant growth, both



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sequentially and year-over-year. Those orders always come in on a lumpy basis. And it's our perspective that even at over \$100, that backlog is still sizable. We do expect it to grow going forward.

Timothy Savageaux, Northland Capital Markets

Okay. And then to follow up, it looks like based on where you're guiding, you expect revenue up slightly in the quarter. Assuming a fair bit of that -- and I don't know how much is kind of catch-up on the software side and cable, I wonder if you can give us a little more color across your business segments as to how you expect Q4 to look mix-wise relative to Q3.

Scott Bruckner, Chief Financial Officer

Yes. So, look, when we looked in our fourth quarter, we did it based on the best information that we have today, and that's information that comes from our backlog and then from the daily updates that we receive on inventory and also supply delivery schedules. Across each of our products, we -- as we've said consistently, wireless remains our key growth driver, and we do expect wireless to grow in the fourth quarter. Cable is flat. It remains relatively flat. Although having said that, with the supply chain delays hitting cable in particular -- and this is all -- just so that you guys understand what's going on, a lot of this information comes to us at the end of the quarter. We talked about decommit, but this is for next-generation products. So, we are receiving orders, building our backlog to go and deploy next-gen equipment, and we're just being held up by the pacing of chipsets that



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-- so that we can build our products and send them out to our customers. And fixed wireless could be slightly down in the fourth quarter.

Operator

Thank you. We reached the end of our question-and-answer session. I'd like to turn the floor back over to management for any further or closing comments.

Jerry Guo, Executive Officer of Casa Systems

Thank you everyone for joining us today. Before ending the call, I want to remind everyone that Casa Systems will be hosting a virtual investor day on November 19. We appreciate you joining us today and look forward to updating you on our business and long-term vision on November 19th. Thank you.

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