Operator

Good afternoon and welcome to Casa System's Second Quarter 2023 Earnings Call. At this time, all participants are in a listen-only mode, and there will be a question-and-answer 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, VP 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 second quarter ending June 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 investors.casa-systems.com.

With me on today's call is Bruce Evans, Casa's Chairman of the Board of Directors; Michael Glickman, our new President and Chief Executive Officer; and Ed Durkin, our 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 Bruce, 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 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'll be helpful to investors to better understand our performance or business trends.

And with that, I'd like to turn the call over to Bruce Evans, Chairman of the Board of Directors. Bruce.

Bruce Evans, Chairman of the Board of Directors at Casa Systems
Thank you, Dennis, and thank you, all, for joining us today. I'm excited to begin today's call by introducing our new President and Chief Executive Officer, Michael Glickman.

As previously announced, we started a comprehensive search process earlier this year with the objective of finding the very best executive to lead Casa forward as our new President and CEO.

Casa has developed a terrific range of cutting-edge communications technologies and solutions. Our search was designed to find a strategic thinker with strong domain expertise and a successful track record of driving revenue growth globally at scale, and I believe we found the perfect leader in Michael.

Michael brings over 35 years of experience in the networking and telecom space and has an impressive record in driving top-line growth and cultivating major new industry partnerships. His experience is strongly aligned with Casa's strategic priorities, as we embark on the next phase of the company's growth.

With his proven track record of leading multi-billion-dollar businesses and spearheading global sales organizations focused on service providers, including telcos and cable MSOs at Cisco and elsewhere, Michael brings a unique set of qualifications and relationships that position him for great success in his new role at Casa.

The full Casa board and I are also enthusiastic about Michael's inspirational leadership style and his plan to leverage Casa's cutting-edge technology solutions to optimize our go-to-market strategy so we can scale the business on a cash and capital-efficient basis and continue to deliver innovative solutions that create sustainable value for our customers and shareholders.

With that brief introduction, I'll now turn the call over to our new president and CEO for his thoughts. Michael.

Michael Glickman, Chief Executive Officer of Casa Systems

Thank you, Bruce, and thank you to everyone for joining us on our call, today. Suffice it to say, I'm very excited to be joining Casa Systems as the new president and chief executive officer.

I first became aware of Casa when I was at Cisco and always viewed Casa then as a very tough competitor, given their great technology core and their ability to move fast and disrupt incumbents.

Fast forwarding to today, as I start my new role, I believe the opportunities that lie ahead for Casa are significant for many reasons.

They are principally rooted in the global demand for cloud-based virtualized network functions, including virtual CMTS, CCAP, 5G Core, and MEX solutions. And I believe Casa is uniquely well-positioned to capitalize on this global market opportunity given their differentiated and proven product portfolio.

I am also excited, honored, and energized to lead this next chapter of growth for Casa. And I would like to thank Bruce and the entire board for their confidence in selecting me. I truly appreciate what this talented Casa team has built over the past 20 years, and I am committed to our collective vision of transforming Casa Systems into a market-leading industry disruptor for the benefit of our customers with a return to capital-efficient top-line growth, over the coming years.

I'm happy to take questions at the end of the call, and with this brief introductory comments, I would now like to turn the call over to our CFO, Ed Durkin, who will cover our operational and financial highlights for the quarter. Ed.

Ed Durkin, Chief Financial Officer of Casa Systems

Okay, thank you, Michael. Welcome to Casa. I know all at Casa are very excited to have you join the family, and good afternoon to everyone on the call.

Thank you for joining us, today. I'd first like to start by touching on some of the headline qualitative highlights accomplished during the quarter, as we made a lot of great progress in positioning ourselves going forward, after which I'll get into the financial quantitative details.

Perhaps the biggest highlight was, indeed, completing the comprehensive search process Bruce mentioned in his opening remarks, which led to the Board selecting Michael to lead Casa for the coming years. As part of that process, I actually spent time with Michael, worked closely with him since he started last Tuesday.

And I do believe, like Bruce, he is uniquely well qualified and, indeed, the best possible person to lead Casa forward. I'm also very confident he will help deliver big dividends to Casa in the quarters and years ahead in the form of accelerating top-line growth and return to EBITDA profitability and cash flow positive operating results.

In addition to closing on Michael during Q2, the team at Casa, JPM, and Sidley was also able to amend and extend substantially all of our term loan B debt, which had an original maturity later this year of December 2023.

This transaction, which was announced on June 15, extended maturity date of substantially all of our senior secured debt to weigh out into December 2027.

It should also be understood that the lending syndicate under a very comprehensive due diligence process is part of their underwriting. And this successful refinancing was a great vote of confidence in Casa by the lender group and validates the bright future we have been discussing with you on our past calls.

Further, as part of this transaction, we've leveraged our strong cash position and balance sheet and paid down an additional $40 million of our existing debt principle at the closing date of the term loan B refinancing on June 15, 2023. I'm very, very proud to say in the last several months, we've paid down approximately $90 million of our debt, and we remain committed to further de-levering.

Moving off to refinancing and over to Verizon, our strategic partnership with Verizon continues to remain strong and on track during the quarter, and we have now achieved all required delivery milestones at this point in time.

Verizon's confidence in our offering is an important validation of the unique capabilities of our truly cloud-native 5G Core and Mac software, and to this point during the quarter, we were also able to bill and collect approximately $20 million from Verizon, mostly related to our 5G software deal, last April.

Further, in early July, right after quarter end, we also received an important acceptance from Verizon and the software we have delivered, to date. Based on the timing of this July acceptance, I'm pleased to share that we expect to record approximately $10 million of software revenue in the third quarter of 2023, which was deferred out of Q2, which sets up our cloud business for a strong second half of the year.

In terms of other contextual highlights, I think it's also important to recognize that, notwithstanding the GAAP net loss you see in the press release, which includes our typical high levels of non-cash depreciation, amortization, and stock-based comp, these Q2 results also include approximately $29 million of non-cash charges related to our debt refinancing completed in June, primarily related to the warrants provided to the lender syndicate.

And we're actually operating cash flow positive for the quarter, primarily as a result of strong billings and collections during Q2.

Further, during the quarter, we closed many new deals with major customers, such as Claro Columbia, the virtual CCAP RPD deal announced in early May, and the deal with LGU Plus announced in April.

And many of the deals that got delayed during Q2 for various reasons, including competitor spread fear and certainly in doubt and refinancing concerns, are now in very good shape and expected to close in the coming months, now that this refinancing matter is in our rearview mirror and our new permanent CEO has been named.

And finally, there are many other positive qualitative accomplishments in Q2, such as the hiring of a great new head of global business development, Rod Gilbert, who joined us from VMware, where he helped build their billion-dollar telco and cloud global partner program.

And even the announcement in early April of our new FPGA-based DOCSIS 4.0 ready RPD node. All of these qualitative accomplishments during Q2, individually and collectively, do position us well for future success as we turn the page and start the second half of 2023.

Let me now move to the quantitative details of financial results for the second quarter. Revenue for the quarter came in at $58 million, which was down 18% from a year ago, but up 28% from the prior quarter. As noted, these Q2 results exclude the $10 million of software revenues from Verizon mentioned earlier due to the timing of early July acceptance, and this revenue will be recognized in July 2023.

Breaking down the revenue across product lines, cloud revenue was $2.3 million, which is down from $8.8 million from the prior year. Again, this decline is related to the timing of revenue recognition from our Verizon, which slipped till July.

Cable revenue was $27.5 million, up 9% from the prior year, and up 79% from the prior quarter. This increase in cable revenue was largely due to increased software licensing revenue during the quarter from our global MSO install base.

Access revenue, which includes our access device products from our 2019 Netcom acquisition, plus our 4G, 5G, small cell radio products, totaled $28.2 million, which was down from the prior year but up 10% from the prior quarter.

Moving below revenue to gross profit, GAAP gross profit for the quarter came in at $23.8 million, or 41% of revenue. Gross margins during the quarter were impacted by a $3.8 million non-cash inventory obsolescence charge, and pro forma excluding this charge our gross margin would have been approximately 48% of revenue.

On operating expenses, GAAP operating expenses for the quarter came in at $41 million. This is down $4.3 million, or 10% from the prior quarter. As a quick reminder, the first quarter included $2.2 million of severance expense related to Jerry's retirement. This second quarter also includes $2.2 million of severance related to our second quarter reduction in force that was completed in mid-April.

Our GAAP operating loss for the quarter was $17.2 million. This was driven by the second quarter revenue results which, again, exclude the $10 million of high-margin software revenue from Verizon, which got deferred to July, includes the non-cash $3.8 million inventory obsolescence charge and includes all of the other items I just covered, including the $2.2 million severance charge in April.

Finally, related to our second quarter P&L, our GAAP net loss for the quarter was $51.1 million versus a net loss of $16.7 million in the second quarter of 2022. Again, this Q2 net loss includes $29 million of non-cash charges related to the term loan B debt refinancing and extinguishment, principally related to the warrants provided to the lender syndicate.

And on a non-GAAP basis, we had a net loss of $24.5 million and reported net adjusted EBITDA loss of $9.8 million, all as reflected in the schedules shown in the press release.

Turning from the P&L to the balance sheet, we ended the quarter with cash in good shape, with cash, cash equivalence, and restricted cash of $65.9 million. We only have approximately $1.6 million in restricted cash, a very small amount.

Our cash balance at June 30, 2023, was down approximately $50 million ,compared to March 31, 2023. This is due primarily to the $40 million pay down of our term loan B debt at closing on June 15, plus another $2 million of principal payments prior to the June 15 closing and approximately $13 million in term loan B transaction expenses paid during the quarter.

Finally, on the balance sheet, I'm very pleased to say we ended the quarter also with high quality receivables of approximately $47.4 million, with most of the balance sheet accounts largely consistent with prior quarters and as you can clearly see, we now have substantially improved our working capital position with the long-term debt classification on our balance sheet, as a result of the successful term loan B refinancing in mid-June.

Moving to brief commentary on our cash flow during the quarter. If you look back to our Q1 10-Q, you would have seen we had used or consumed $8.35 million in cash from operations for the three months ending 3/31/23.

If you look at the cash flow statement today in the press release for Q2, you will see cash used in operations for the six months ended June 30 is now down to approximately $4 million, meaning we generated positive cash flow from operations in Q2 of approximately $4.4 million, which is very good and reflective of good billings and great collections and a lower cost structure during Q2.

And as to other major activity in the cash flow statement, this essentially depicts the debt refinancing matters and major delevering covered in my earlier comments.

As noted in our earnings release, we're adjusting our full-year revenue guidance to a range of $265 million to $290 million, and we expect our net adjusted EBITDA to still be positive for the year.

Some of the items considered in this modest outlook adjustment include the potential for some access device customers to defer some of their product deliveries from Q4 to Q1, as they work through issues in their business.

The actual good demand for our cable products, which is supported by our existing backlog, as well as expansion opportunities where our existing customer base, similar to the past few years, expect cable revenue to be back and weighted in the fourth quarter due to positive seasonality, our 4G, 5G small-cell radios, which are expected to see growth in the second half of 2023, compared to the first half of the year.

This is driven by the shipments of our small-cell radios to a Tier 1 customer in the U.S. and, potentially, others.

And as I previously noted, there will be a more meaningful contribution for our cloud product line in the second half of the year, including the $10 million of Verizon software revenue that was deferred out of Q2, which will be recognized in the third quarter, along with other revenue opportunities from Verizon and other cloud customers during the second half of the year.

Regarding our backlog and deferred revenue, we currently have approximately $170 million in backlog and total deferred revenue, and we have another $96 million remaining of future billings under the Verizon 5G contract, which are billable in 2024 and beyond, which brings our total backlog, deferred revenue, and future Verizon 5G billings to approximately $266 million.

In addition, we also have approximately $55 million of close contracted business for our small-cell radios with a major North American mobile network operator where we get POs on an annual as-order basis. So, backlog and close contract visibility remains good.

As we noted on previous calls, we are continuing to see positive improvements in the supply chain, and we are really very excited as we enter the second half of 2023 with a dynamic new leader and CEO, complete product portfolio, growing sales pipeline and expanding partner ecosystem.

And then finally, I would be very remiss if I did not take a moment to profoundly thank the entire Casa Global team for their amazing dedication to the company and our customers during the second half and first half of--second quarter and first half of 2023 as we encountered some headwinds.

I believe with this talented team, our business momentum, our growing sales pipeline, and our new leader, we will indeed see brighter days ahead as we continue to focus on our North Stars of exceeding the expectations of our global customers and substantially improving enterprise value for the benefit of all Casa stakeholders.

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

Operator

At this time, if you would like to ask a question, please press the "*" and "1" on your telephone keypad. You may withdraw yourself from the queue, at any time, by pressing "*", "2". And once again, for your questions, that is "*" and "1".

We'll pause a moment to allow any questions to queue.

And we'll take our first question from Tim Savageaux with Northland Capital Markets. Your line is open.

Tim Savageaux, Northland Capital Markets

Hi, good afternoon, and congratulations, Michael. I had a question about kind of your second half outlook, and you mentioned that guidance has reduced a bit. I think you kind of focused on access devices and maybe inventories there as a primary driver. But I want to check on that. But as we look to the second half over first, and you're still looking for a pretty significant increase, I think we have a little visibility of that with your Verizon commentary.

But if you were to look at that half over half growth, I don't know about 65 million bucks at the middle of your range, any way you could take a chance on kind of segmenting that by growth you expect in cable.

Clearly, I think you're looking for a stronger second half there. Cloud, we've got 10 million from Verizon; there may be more, 5G small cells. If there's any way to kind of get an order of magnitude around those various growth drivers into the second half, that would be great, and I'll follow up from there.

Ed Durkin, Chief Financial Officer of Casa Systems

Yeah, sure thing, Tim, good question. Actually, we see all of the four product lines growing in the second half. I think on cable, there's good market dynamics around the move to virtual CCAP and RPD nodes, which we're well positioned to exploit. I think we also had some deals that got moved out of Q2 for some of the refinancing and competitor FUD that are well positioned close in the second half of the year.

Obviously, with Cisco exiting the cable market, that's beneficial for Casa. Moving over to the 4G, 5G small cell radios, we do have closed contracts with a major tier one operator that we've talked about, and those will be shipping in the second half of the year.

On our access device products from the Netcom acquisition, we did kind of pare back the re-forecast for that. Obviously, we're not immune to the telecom contagion, if you will. You've seen Ericsson and Nokia and others see a little bit of slowdown.

Again, it's not a matter of losing business, but there's a potential for some of the order scheduled for delivery in Q4 to slip to Q1, so that was part of the reason for the modest reduction in the outlook.

Then on the cloud side, obviously, we had 10 million slip out of Q2 that goes into Q3. We have more opportunities at Verizon and other cloud customers that we've been working hard to close, and we're hopeful to close some of those in the second half of the year. So, that's kind of the context around the top line outlook.

Tim Savageaux, Northland Capital Markets

Okay. Well, if you had to pick one, I guess is the primary growth driver for the second half, what might you--it looks like the growth is coming in higher margin areas, given your reiterating guidance for EBITDA positive for the year, so that would guide me toward 5G cloud and cable being primary growth drivers, just given the margins. With Verizon and Q3, should we be looking for an EBITDA positive Q3? Looks like we should.

Ed Durkin, Chief Financial Officer of Casa Systems

Yeah, I mean, we don't comment on quarterly projections, but I think you captured it, well. I think we are looking for cable to improve substantially in the second half, cloud as well, and even our 4G, 5G, small-cell radios will contribute, meaningfully, in the second half. And those are--have higher gross margin attributes than some of the access device products from our NetCom acquisition from 2019. So, I think you captured it well, Tim.

Tim Savageaux, Northland Capital Markets

Okay, great. And the last question for me, if you look at the cable networking performance in the quarter, I wonder if there are any notable growth drivers there. I assume most of that growth is international, it's a pretty broad base, or a couple of big customers. How would you characterize that rebound in cable in Q2?

Ed Durkin, Chief Financial Officer of Casa Systems

I guess I would say at a high level without getting into too many details that, Q2 was a good quarter for cable after a somewhat soft Q1, which was related to a large deal that got pulled into, Q4 2022, and we see the cable business as a strong growth business for us, going forward.

For some of the reasons I mentioned earlier, both the move to virtual CCAP and RPD nodes, and Cisco's exit from the market, and even some of the deals that we have been working that got temporarily delayed, we're hopeful we get them closed in the second half of the year.

So, we've always been a leader in the cable space, have a great cable product portfolio. We think that’ll serve us well, as the year goes along here.

Tim Savageaux, Northland Capital Markets

Okay, thanks very much.

Operator

And it does appear that there are no further questions at this time.

Ed Durkin, Chief Financial Officer of Casa Systems

Okay, well, thank you again for joining us, today. We've made a lot of progress over the past many months. We do believe we have great momentum going into the second half of the year, and Michael and I look forward to keeping all of you updated on our progress, as warranted over the balance of the year. Thank you.

Operator

Thank you. That does conclude today's teleconference and webcast. You may disconnect your line at this time and have a wonderful day. We thank you for your participation today.