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ADTN.OQ - Q1 2022 ADTRAN Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to ADTRAN's First Quarter 2022 Earnings Release Conference Call. (Operator Instructions)

During the conference call, ADTRAN representatives expect to make forward-looking statements which reflect management's best judgments based on factors currently unknown. However, these statements involve risks and uncertainties, including the continued spread and extent of the impact of the COVID-19 global pandemic, the ability of component supplies to align with customer demand, the successful development and market acceptance of our products, competition in the market for such products, the product and channel mix, component costs, freight and logistic costs, manufacturing efficiencies and other risks detailed in our annual report on Form 10-K for the year ended December 31, 2021, and our quarterly report on Form 10-Q for the quarter ended March 31, 2022. These risks and uncertainties could cause actual results to differ materially from those in the forward-looking statements, which may be made during the call.

It is now my pleasure to turn the call over to Tom Stanton, Chief Executive Officer of ADTRAN. Sir, please go ahead.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Thank you, Hanna. Good morning, everyone. We appreciate you joining us for our First Quarter 2022 Earnings Conference Call. With me today is ADTRAN's CFO, Mike Foliano. Following my opening remarks, Mike will review the quarterly financial performance in detail, and then we will take any questions that you may have.

Q1 continued our trend of record demand for our fiber broadband solutions with a diverse mix of service providers across our key growth markets in the U.S. and Europe. This demand continues to be driven by the massive buildup of fiber broadband networks paired with the deployment of mesh WiFi solutions in the home and the adoption of cloud-based network automation tools.

Some of the key highlights for the quarter included the following. Overall revenue was up 21% year-over-year. Fiber access platforms revenue was up 61% year-over-year, led by a diverse mix of regional service providers in the U.S. and Europe and included the expected ramp in shipments to Tier 1 customers. Our residential WiFi platforms were up 64% year-over-year, led by volume shipments of our latest mesh WiFi 6 systems. Continued rapid growth in our SaaS customer base, up 31% year-over-year with a growing backlog of customers following the launch of our Mosaic One platform.

In the latest market share reports from Dell'Oro and Omdia are for Q4 of 2021, ADTRAN shipped more 10-gig OLT ports in both North America and EMEA than the next 2 closest U.S.-based vendors combined. This highlights our continued success in fiber footprint capture with our 10-gig fiber access platforms. We secured an additional Tier 1 European service provider award with our SDX fiber access platform, bringing the total to 6 Tier 1 fiber customers in the EMEA region.

Lastly, we had 10 -- we had 3 10% customers for the quarter: A U.S. distribution partner that serves hundreds of regional broadband service providers across the U.S.; a Tier 1 European service provider; and a Tier 1 U.S. service provider, highlighting our continued success in geographic and customer diversification.

The success in the quarter was driven by the continual increasing demand for our fiber access solutions across a broad base of regional service providers in the U.S. and Europe, along with a ramping business with our Tier 1 customers.

Service providers are increasingly selecting ADTRAN due to our full range of fiber access platforms and mesh WiFi platforms and SaaS applications. In turn, this is driving sustained revenue growth in these strategic segments as we continued our rapid pace of fiber footprint capture.

From a portfolio perspective, our investments in fiber access, connected home and software solutions continued to pay off. Our fiber access platform revenue has grown over 140% in the past 2 years and now dominates our business. This success has been driven by our investment in 10-gig access technology and our market leadership in open disaggregated fiber access platforms. Our success in fiber access has driven a sharp increase in pull-through revenue for fiber CPE and mesh WiFi platforms, up 31% year-over-year and SaaS applications up 32% year-over-year. We expect to see even higher growth rates in these areas in the quarters ahead as more service providers adopt our 10-gig, fiber CPE, mesh WiFi 6 platforms and our Mosaic One SaaS platform.

We successfully grew our business in these strategic market segments despite the supply chain constraints that continue to limit our revenue growth potential and negatively impacted our profitability during the quarter. We expect these constraints to continue to reduce the impact of the supply chain issues on our profitability in the future quarters. We continue to drive cost optimization, portfolio consolidation and material purchases.

Despite industry-wide supply chain challenges, our outlook remains positive. We continue to have broad-based success in fiber footprint capture with a broad mix of customers across the U.S. and EMEA. Our Tier 1 fiber customer business continues to ramp with existing customers on track for large-scale deployment and another Tier 1 European operator award during the quarter. We also have a strong funnel of additional high-scale opportunities.

Tier 2 and regional service providers continued their strong performance. These customers have high adoption rates of our complete portfolio of fiber access connected home and cloud software solutions, driving synergistic growth across these product segments. With a very strong outlook for our multi-gig mesh WiFi 6 platforms, a robust funnel of fiber access opportunities and a healthy backlog of SaaS customers, we expect these customer segments to remain high -- to remain in high-growth mode for the quarters ahead.

Our portfolio enhancements and customer diversification success come at a time when we continue to see a strong environment for funding the deployment of fiber broadband networks. In the U.S., the $42.5 billion in broadband infrastructure spending that is part of the Infrastructure Investment and Jobs Act will lead to significant future opportunities.

Meanwhile, tens of buildings and funds have begun to be released for RDOF and ARPA. This funding is helping to drive significant investment cycle that we are seeing in broadband spending here in the U.S.

In Europe, similar increases in spending are occurring as high-growth countries like the U.K. and Germany increased their funding to drive the deployment of more efficient, sustainable and scalable all fiber networks. While these operators shift to next-generation fiber networks, they continue to shift away from high-risk vendors, ADTRAN is very well positioned to benefit from these transitions, given our market-leading fiber access portfolio and a strong and growing presence in Europe.

Speaking of that presence, I want to update you on the business combination with ADVA. We remain on track. We are working diligently with German officials to obtain FDI approval foreign direct investment approval, which is the last milestone we must reach before closing. The process is progressing as expected, with close expected in Q3.

Our optimism continues to grow around the portfolio synergies offered by the strategic combination of 2 leaders in fiber networking. Both companies are seeing record demand for their complementary portfolios, and we expect this to further accelerate through our proposed combination.

In summary, despite continuing supply chain constraints, we are making great progress with increased customer funding, record demand, a diversified customer base and a differentiated product portfolio. We are on track for added growth this year.

With that background, Mike will provide you with some details and a review of our financials. Following Mike's remarks, I will be happy to open up to any questions you may have. Mike?

Michael K. Foliano - *ADTRAN, Inc. - Senior VP of Finance, CFO & Corporate Secretary*

Thank you, Tom, and good morning to all. I'll cover our first quarter of 2022 results and provide our expectations for the second quarter. I'll be referencing both GAAP and non-GAAP results with reconciliations presented in our press release and the supplemental financial schedules on our Investor Relations page at investors.adtran.com. The supplemental financial schedules on our web page also present certain revenue information by segment and category, which I will be discussing today.

ADTRAN's first quarter 2022 revenue came in at $154.5 million, slightly up from the prior quarter, driven by higher sales in both our Access & Aggregation and Subscriber Solutions and Experience portfolio categories. First quarter revenue increased 21% year-over-year with increases in all segments and categories. On a regional basis, domestic revenue grew by 15% and international revenue grew by 35% year-over-year.

For the first quarter of 2022, as reflected in the supplemental schedules, we had a slight quarter-over-quarter decrease in both our GAAP and non-GAAP gross margin, which is the result of customer and product mix as we continue to experience abnormally high supply chain and logistics costs.

The year-over-year gross margin decreases in both GAAP and non-GAAP gross margin were primarily attributable to increased supply chain expenses, partially offset by higher sales volume and increased manufacturing absorption. While we remain focused on gross margin improvement and are actively managing higher component costs, freight expenses and expedite fees related to the supply chain constraints, we do anticipate continued challenges.

To provide context on our first quarter's operating expenses, we decreased spending in our GAAP and non-GAAP quarter-over-quarter and GAAP year-over-year expenses, while the non-GAAP year-over-year increased. The GAAP quarter-over-quarter decrease was the result of lower market-driven deferred compensation expense, acquisition-related expenses and engineering and project expenses, partially offset by higher labor, fringe benefits and legal expenses.

The decrease quarter-over-quarter in non-GAAP operating expenses was primarily due to market-driven lower deferred compensation and lower engineering project expenses, partially offset by increases in labor, fringe benefits, legal and marketing expense. The year-over-year decrease in operating expenses was a result of lower market-driven deferred compensation expenses, partially offset by higher acquisition-related expenses, variable labor compensation, marketing and travel expenses.

The year-over-year increase in non-GAAP operating expenses was driven by higher labor, marketing, travel and insurance expenses.

Shifting to operating profitability. The quarter-over-quarter and year-over-year improvements in GAAP operating profitability were mainly attributable to lower operating expenses, with higher sales volume also contributing to the year-over-year improvement. The non-GAAP quarter-over-quarter improvement in operating profitability was driven by slightly higher sales volume and lower operating expenses. The non-GAAP year-over-year decrease in operating profitability was the result of higher cost of goods sold due to the supply chain constraints.

Other income decreased on a GAAP and non-GAAP basis, both quarter-over-quarter and year-over-year. The quarter-over-quarter decreases were a result of lower dividend income, market-driven losses in our investments, and realized foreign currency exchange fluctuations. The decreases in GAAP and non-GAAP other expenses on a year-over-year basis were mainly related to market-driven losses in our investment portfolio as compared to gains in the prior year and realized foreign currency exchange fluctuations.

The company's tax provision for the first quarter of 2022 was a benefit of $2.4 million, primarily driven by the change in our annual estimated rate due to the requirement to capitalize R&D expense in the U.S. beginning in 2022 and its effect on our valuation allowance.

Closing out our income statement results. The first quarter of 2022's GAAP net loss was $1.1 million with a loss of $0.02 per share, assuming dilution. Non-GAAP net income was $9.9 million or $0.20 non-GAAP earnings per share, assuming dilution.

On the balance sheet, unrestricted cash and marketable securities totaled $96 million at quarter end after paying $4.4 million in dividends during the quarter. For the quarter, we generated $4.9 million in cash from operations.

Net trade accounts receivable was $150.1 million at quarter end, resulting in DSOs of 87 days compared to 95 days in the prior quarter and 73 days at the end of the first quarter of 2021. Net inventories were $171.1 million at the end of the first quarter compared to $139.9 million in the fourth quarter of 2021 and $122.9 million at the end of Q1 2021.

We continue to carry a higher level of inventory in raw materials as we work to minimize supply disruptions given the extremely challenging electronic component market and the associated extended lead times.

Looking ahead to the next quarter, the continuing effects of the COVID-19 pandemic, the ability of component supplies to align with customer demand, the book-and-ship nature of our business, the timing of revenue associated with large projects, the variability of ordering patterns from our customer base, as well as the fluctuation in currency exchange rates in international markets, may cause material differences between our expectations and the actual results.

Keeping that in mind, we expect that our second quarter 2022 revenue will be between $165 million and $175 million. After considering the projected sales mix and component availability, we expect that our second quarter gross margin on a non-GAAP basis will be in the range of 35% to 37%, still lower than normal, due to higher expediting and freight costs.

We also expect non-GAAP operating expenses for the second quarter of 2022 will be between $55 million and $56 million. And finally, we anticipate the consolidated tax rate for 2022 on a non-GAAP basis will be in the high teens to low 20s percentage rate.

We believe the significant factors impacting revenue and earnings realized in 2022 will be component availability and costs, the macro spending environment for carriers and enterprises, ongoing effects of the COVID-19 pandemic, the variability of mix and revenue associated with project rollouts, the proportion of international revenue relative to our total revenue, the adoption rate of our broadband access platforms, potential changes in corporate tax laws, currency exchange rate movements and inventory fluctuations in our distribution channels.

Once again, the additional financial information is available on ADTRAN's Investor Relations web page at investors.adtran.com.

Now I'll turn it back over to Tom, and we'll take your questions.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

All right. Thanks, Mike. Pam at this point, we're ready to open up for any questions people may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from the line of Rob Hall with Goldman Sachs.

Bala Raghav Reddy - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

This is Bala Reddy on for Rob. Congrats on a good quarter and guidance here, especially in this environment.

Tom, maybe you could talk about guidance for the June quarter. And it's better than what you were expecting. And then what really gives you confidence that you would see this quarter-on-quarter sequential increase in revenues in this environment? Is this really inventory build? Or any other thing that you want to maybe provide more color on?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes, sure. Well, as you know, inventories are up, and we've been trying to increase our inventories, both in raw material and finished goods. Our finished goods are turning fairly quickly, so it's really more of a raw material piece to be able to get us in a better position going forward. We feel we are in a better position. We'll definitely -- we don't have any -- we're definitely going to ship more next quarter than this quarter.

And as you know, we really haven't been demand-constrained. It's been all supply-constrained. And I think some of the purchase orders that we placed at the beginning of last year are starting to firm up. We're seeing less of an impact of decommits, really in general. The more complicated silicon that we had problems with earlier in this cycle have somewhat gotten ameliorated, and we brought on second supplies.

We have big teams working on redesigns on a constant basis. They've been doing a fantastic job, and I want to say thank you to them on giving us alternatives. So I just think we're kind of settling into this environment and being able to execute in the environment that we're dealt with.

Bala Raghav Reddy - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Got it. So lower decommits. Now that's interesting because we have had many companies reporting that they've seen a sharp increase in decommits in the month of March, but it looks like you're not really seeing that. That's good.

As a follow-up. Maybe could you talk about your Tier 1 customer wins, clearly that is strong momentum, especially in Europe, for the past year to 18 months, if you had like a bunch of wins.

As you think about the next step from here onwards for you, is it more you're focusing on really ramping those projects and then capturing the revenue scale that you are expecting to? Or are you also thinking maybe there are more RFPs are more about structure you are waiting for? Any color on there, that would be helpful.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes, sure. So yes, the ones that we have previously announced, all which is not typically the case, but I think that this environment is different are all pretty much in line with where we were hoping they were going to end up, and we're starting to drive shipments for multiple of those ones now.

All of them have -- I shouldn't say all of them, but a large number of them had started placing purchase orders last year just to make sure that they were in line for the supply constraint issues that we had. And they're pretty much coming online. So no real hiccups at this point on the existing ones that are kind of in the launch phase.

There are definitely several large opportunities that are still out there. A couple of them have been stalled for this or that reason. But I would expect that those would still be -- they're going to come to -- they need to make decisions. There's not any major carrier in Europe that isn't having to make a decision, either because of technology or because of vendor positioning or just trying to make sure that they have the right vendor lineup in their portfolio. So nothing is slowing down there.

On the -- the other thing that I don't want to make sure that you missed, is that's not really just our only focus. We continue to drive into the Tier 2 and Tier 3 space. That space has been growing in the roughly 30%-plus range forever. And there's no slowdown in that space. So we're feeling good about that. And then we still have the funding yet to come, right? All the stimulus funding.

Bala Raghav Reddy - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Right. Makes sense. Last question for me. Gross margins for nearly flat, flattish quarter-over-quarter or maybe slightly down from a product and customer mix. But it doesn't sound like you are seeing worsening situation at least in supply chain terms. In that context, how should we think about gross margins in second half of the year? Obviously, revenue scale is improving. Any color there would be helpful.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes, there's probably some factory efficiencies that will come in at some point in the second half, but really trying to nail those down is kind of difficult in this environment. So the best way to think about it is we're managing in the environment we have by paying what we're paying, in expedite fees and whatever, and able to keep customers happy and continue to grow. And I don't see a deviation from that. I mean, you may see a tick up as revenue continues to grow through this year, which we fully expect. But that's something that we're not going to be too ahead of our headlights on trying to forecast.

Operator

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

Michael Edward Genovese - *Rosenblatt Securities Inc., Research Division - Senior Comm and Cloud Infrastructure Analyst*

Great. Just a couple of questions. I guess, first, we've been talking a lot about the gross margins, and I know it's dangerous to make guesses like this. But I mean, I think in the past, you've talked about when you might get back to the 40% range? Or what your current thoughts on that are. So could I ask for an update there?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Let me get Mike to just step in on this.

Michael K. Foliano - *ADTRAN, Inc. - Senior VP of Finance, CFO & Corporate Secretary*

Yes. I think in the past, we said as we get through these supply issues, we should be able to return to that more normalized rate. The hard part is really just figuring out when that is going to happen. I know that a lot of folks have been modeling it as a minor improvement quarter-over-quarter as we go through the year. And then I'm hearing some say that these issues last through the end of the year, through the middle of next year. It is just really hard to tell.

So I'm in agreement that we should see minor improvement each quarter as we just get better in navigating this environment, assuming there are no other big changes that happen. But when we actually get back to that low 40s is really a little bit hard to tell at this point.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

I agree. I think if the environment -- the problem is the volatility in the environment. It's not something -- I think we're managing well now. I think that our management of the situation is actually going to get better. But COVID in Shenzhen can throw a wrench in the works. So those are the things that are probably more worrisome.

Michael Edward Genovese - *Rosenblatt Securities Inc., Research Division - Senior Comm and Cloud Infrastructure Analyst*

Okay. And then so from a customer perspective, it looks like your long-time copper customer has transitioned to a fiber customer in the U.S. and is it -- was it 10%-er, is what I'm seeing, I think. And then a new European fairly new customer in Europe as a 10%-er. So is that a correct understanding?

And then with any of these new wins or your recent wins in fiber, -- is there an opportunity -- should we think of this as being the 10% customer lists? Or who else could possibly be a 10% customer this year or next?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

I think there are several European customers that could be on the 10% list. I also think we have distribution partners, the growth rate here in the U.S. and the Tier 2 and Tier 3 has been phenomenal. And I think that there's always a couple that are right there near that 10% water mark. So I think you'll see some variability.

We're hoping not to get to where we have like a 40% customer because that hurts, and we've had that in the past. And the key to that is not to turn down orders is just to make sure the rest of your business has got the right focus. So the answer to your question is, yes, I think that you'll see that continue to kind of change from quarter-to-quarter.

Michael Edward Genovese - *Rosenblatt Securities Inc., Research Division - Senior Comm and Cloud Infrastructure Analyst*

Great. And then last one for me. I guess, one of your competitors recently made, I guess, I think of it as a WiFi in-home SaaS software acquisition. And I guess my question is, is that a direction you would go into? Or do you think that you do it organically? Or could you go through M&A there? Are there other companies out there like that, that are could be...

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

We have right now -- I mean, it would be nice to be able to show you the product. We have right now the best in-home WiFi solution that's out there. So we've already crossed that bridge. We continue to do developments and continue to work on that. But yes, that's not a current hole in our portfolio.

Michael Edward Genovese - *Rosenblatt Securities Inc., Research Division - Senior Comm and Cloud Infrastructure Analyst*

If I could ask a follow-up there then. Is that an ADTRAN solution? Or is that an ADTRAN plus Plume solution, when you say you have the best?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

We have multiple solutions. But -- so I'll just say -- let's just say our portfolio is the strongest that's out there.

Operator

The next question is from the line of Bill Dezellem with Tieton Capital.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO & Chief Compliance Officer*

A couple of questions. First of all, relative to the supply chain, you did reference a couple of factors. And I'm wondering, which from your perspective is the bigger one, relative to the second quarter revenues ramping up from the first quarter? Is it the supply, like the decommits, are improving? Or is it more a result of the ordering that you did months ago? So the planning has now finally had enough months to have an impact.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

They both have an impact. So the ordering has definitely seems to have shored up kind of the major silicon pieces. And then, as you know, there are these ancillary pieces of silicon that are smaller that have been very difficult to get. We have a lot -- like I mentioned in an earlier question, we're doing a lot of redesigns. So we're finding if we don't -- if we can't get the chip that we've been using for 5 years, then we're just going to get a new chip. And we're putting the effort into doing that.

When I say we have a serious -- I mean, we have a very large effort on redesign right now. And that's just an ongoing thing that we're doing to make sure that we get ourselves in the right position. That doesn't mean that a decommit can't happen. And they still happened -- they still definitely start to happen last quarter.

It feels -- but there's 2 things to this. One is there's been an ongoing problem of getting a commitment in general. So you just never got the commitment, so you're just hoping. And that has gotten better. So we -- more of our pipeline now has committed dates to it, significantly more than, let's say, 2 or 3 quarters ago. We've got commitment dates from our vendors.

And then we still run into problems, and we're basically just throwing people at redesigning as quickly as possible. The customer base is very attuned to this. They're allowing these redesigns through an expedited process to get into their network.

So like I said, I think we've gotten better at it, but that's probably being a little myopic. I think us and our customers have gotten better with the situation. And so it's kind of both of those.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO & Chief Compliance Officer*

That's helpful, Tom. And then secondarily, would you either highlight the large projects that are going to be ramping meaningfully over the remainder of this year? And/or kind of in aggregate, the projects that are going to be ramping that are meaningful, what the differential in revenue or incremental revenue on a quarterly basis is that you would expect from them?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

That's such a difficult question because -- and I know you know that. But -- so there's kind of -- let's think about maybe 3 different ramps. There's the ramp that's been going on, there's really 4 different ramps. Okay?

So let me do the first ramp. The first ramp, which is incredibly material, but not much movement, is supply chain ease. I've got tons of backlog, right? Any movement in supply chain ease in these current constraints will substantially affect our results.

Then the second one is, I've got Tier 2 and Tier 3 booking growth that continues to pile on. So it takes some supply chain ease, but it continues to grow at a phenomenal rate. So that's one ramp that's -- I mean, on a year-over-year basis, right, so it's not like it's flat. It's on a year-over-year basis, it's still growing in the 30s, right? It's just a very strong business.

Then I've got Tier 1 that have recently come online. Those are just now launched. So they will continue to ramp. And then I have the new Tier 1 that come online. Those new Tier 1s kind of get dotted throughout the year, and there's actually probably some that are -- I'm sure there'll be some -- I know there's some that are early into next year. Those are the most difficult to forecast because you have to get through lab cycles and stuff.

So those are the least deterministic. But to be honest with you, the other ones dwarf that anyways because it takes time for them to get to a material ramp, a material revenue level.

So we have a lot of potential. The potential is really what you're seeing us forecast, and what you're going to see us forecast throughout this year, is not about the ramps. It's all about the supply chain availability.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO & Chief Compliance Officer*

So taking that last comment. So essentially, my question is misplaced, trying to identify the -- let's just say, the Tier 1 ramps that you would anticipate over the remainder of the year and whether that's adding $5 million or $50 million of incremental revenue in, say, the coming quarters. You're saying that's really a wrong question. The question is, what's going to happen with the supply chain because that's the limiting factor.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes, absolutely. And it will be for some time. And so if you're -- that's a great question to ask if you're asking me, tell me what the middle of next year or end of next year is going to be? Right? Which I can't tell you. But if you're talking about this year, it's all about supply chain availability.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO & Chief Compliance Officer*

Okay. I appreciate that. And you negated then my follow-on question since you told me you wouldn't answer it. So thank you very much for the time.

Operator

The next question is from the line of [Paul Eze with William K. Woodruff].

Paul Eze

I wanted to follow up on the pay as you go, the residential SaaS, 6 months ago, you told us you had about 1 million end users. Not service providers, but end users. And based on your growth rates of these platforms, it would seem to me you'd be about 1.3 million end users at this point. Is that a fair number?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

That's probably a fair number. But I'll be really honest with you, I don't have that number right in front of me. But that sounds in the ballpark, though. Yes.

Paul Eze

Okay. And then given the supply chain situation, where do you think you could have been at this point in time? Are we maybe pushing 2 million? Can you give us some sense of that, how much that slowed you down?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

The 1.3 million isn't as directly hampered, right? So people that are signing up for SaaS services -- it is and it isn't. It isn't as directly correlated because they're signing up for SaaS services, there are supply chain constraints everywhere, constraints everywhere. And they're really signing up for the kind of capabilities that you have, knowing that getting material is going to be low.

So when you just talk about subscribers, you're not necessarily talking about volume of what you're actually shipping, right, at any point in time. So -- but the net answer is that I don't know. I really don't know. I've never done that analysis. I know that the backlog on [BPG] that's associated with our SaaS service is huge.

Paul Eze

Okay. And you would expect to -- what type of penetration rate on that backlog going forward for the SaaS?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

That's all about (inaudible) product penetration rate of the SaaS piece. I know you're -- let's just say both of them are very large. I mean, so that's -- I mean, we have there are some customers -- let me just give you a little bit of color on that.

For instance, our newest European customer, a very large customer buys a significant amount of CPE and has on order a significant amount of CPE, which dilutes that number because they won't do that. So when you're really talking about SaaS services, you really got to bring it down to the Tier 2, Tier 3 space, and most predominantly, the Tier 3 space. And that has got a very high attachment rate. But I just don't have that number in front of me.

Paul Eze

Okay. That's fair. And did I hear you say you're expecting that to accelerate? Is that due to the Tier 1s? Or is that due to the Tier 3s? Or both?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Predominantly Tier 3s. There's some Tier 1 in that as well, but predominantly Tier 3s.

Paul Eze

Okay. So we could see this 30% or 60% growth rate accelerate going forward?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes. I think I said 30%, right? But yes. The answer is yes.

Paul Eze

Okay. And last question on this subject. When do you guys feel you'll be comfortable enough to disclose more information on this [page] as you go SaaS?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

It will be when we have some -- 2 things. It's got to be material and it's going to be predictable. And supply chain is hurting us a little bit on that predictability to your point before on what you could sell versus what you can -- what you are selling. So I don't have a direct time frame on that, but I would hope it'd be fairly soon.

Paul Eze

Okay. Last question. Have you run into Tarana? Their line-of-sight wireless solution. Especially in the Tier 3 area.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

I don't know if we really run into them much. I mean, I know they've been around for a long time. And they're doing some -- but I don't think we really run into them, no.

Operator

The next question is from the line of Tim Savageaux with Northland Capital.

Timothy Paul Savageaux - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

I've got some background noise here, forgive me. The question about the new European Tier 1 win that you talked about, and I think you said that brings it to 6 in the aggregate. I guess kind of leveraging off your recent answer there. Of those 6, I guess, how many would you put in ramp bucket #3 versus number #4, if you will, in terms of the pacing of those rollouts?

And can you give us any color on this recent win relative to the others that you've already brought in? Or any maybe aggregate metrics about homes passed, spend, either from this deal or the half dozen in the aggregate?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Okay. So First of all, the answer to your first question without literally not trying to be [accurate] here, but they're all in bucket 4, right, or bucket 1, however you define it. I guess I'm defining it backwards, because they all are supply-limited.

I would say, of the 6, 2 are kind of in that we're off and running and ramping and just trying to get as much material as we can get. And then the others will be coming on, some this year, and then some next year.

And the color on the newest one. I mean, I can say it's Eastern Europe Tier 1 carrier that's a national carrier. I can't really say names until we get approvals. And I can't remember your third question.

Timothy Paul Savageaux - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Well, neither can I, so it's all good. Well, I'll see if I can -- no, I think we got that.

Looking at the Q2 guide, which is pretty strong. As you consider that, what's -- what are the factors driving that sequential growth in particular? You've talked about rural Tier 3, Tier 2, 3, you talked about Tier 1s. Is there any bias as to what's driving that sequential growth outlook between those 2 categories or any others?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

No. We've got effectively unlimited orders in all of those segments. It's all about material availability. So we will end up at the end of the quarter, saying, this is what we ship to Tier 1s, Tier 2s and Tier 3s and whatever in European versus U.S. But that won't be because of the orders. It will be because of, this is where we allocated our supply, based off of where we thought the strongest demand requirements were within the customer base.

Timothy Paul Savageaux - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Great. And congrats on the outlook.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Okay, thank you.

Operator

The next question is from the line of Fahad Najam with Loop Capital.

Fahad Najam - *Loop Capital Markets LLC, Research Division - MD*

Tom, if I look at your over the last 10 years, your peak revenue -- quarterly revenue has probably been around $185 million. Do you think that, going forward, even if -- assuming supply chain improves, do you think you can possibly top that?

And the reason I ask is because we all know how the story goes, right? Component shortages today, labor shortages tomorrow, right? So we will never see that kind of an inflection point. But I'm just trying to figure out, what's the peak revenue you could see or what you were thinking about. Anything you can share with us?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes, sure. The answer to your question is yes. I think we will surpass that $183 million.

Fahad Najam - *Loop Capital Markets LLC, Research Division - MD*

And is that a function because of higher pricing? Or is that because you think that there is fundamentally more capacity to ship more volumes through the system?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes. Yes. I mean we have been continuing to eke out growth. Eke out may be even a little bit of a soft term. But we've been continuing to grow through there, and I think we're continuing to get better at it. And our current thought process is that we will be able to surpass that number.

Fahad Najam - *Loop Capital Markets LLC, Research Division - MD*

I appreciate it. And then I have a follow-up on. In terms of the guide, it's definitely very impressive in the relative, at least to your peers. Anything you can share with us in terms of the component shortages that has materially improved over the last 90 days? Anything you can share with us in terms of the dynamics? What's improving and what's not improving? Or what's gotten worse?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes. I kind of covered a little bit of that, right? So the more complicated silicon that was the headline last year has just continued to get more stable with fewer pull-outs. We had some of that in Q1 and some of that in Q4, but it just feels more predictable.

Then -- so the problem -- the real problem has been more around -- I use the term [clue logic], but it's the relatively inexpensive parts that do things, like power supplies and things. Those continue to be problematic. But really, what's changed is significant -- and I've stated this a couple of times on this call, but just significant effort in redesigns where there are same times where you don't have to have a chip there you can use a resistor and a capacitor and get rid of chips. And where we can do that, that's what we're doing.

So it's just trying to really design out products that are just not available. And that, coupled with that first thing of kind of hitting that 52-week lead time on -- that the semiconductor industry had effectively put in place, I think, has just made it a little better.

Fahad Najam - *Loop Capital Markets LLC, Research Division - MD*

Got it. And then I have one follow-up. So to the extent that the component shortages that you're seeing a more basic passive components that are probably universal across all your product portfolio. Are you maybe allocating more of your supply towards your higher-margin, higher-revenue products? Are you shifting more of your supply towards that? Anything you can share with us in terms of optimization?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

No. We're really not, I think, in a position or in a mode to optimize margins because we're really -- we don't want to lose customers through this process. So it's really, we're shipping a mix that's reflective of where we think the strongest requirements are. So it's not -- we're really not about how do you get the gross margin up -- it's really trying to meet customer demand.

Operator

The next question is from the line of Orin Hirschman with AIGH.

Orin Hirschman - *AIGH*

In terms of getting gross margins back into the 40s, a couple of questions. Let's assume component availability eases, let's say, it eases dramatically. Why is that going to help push your margins higher? I understand how it's going to push your revenues higher, but why will it help on the gross margins?

And Part B and C of that question is, when do the price increases that you put in begin to start to really show through your book to increase your gross margins just from the price increases themselves?

And then last, part 3 of that question, Part C, is when does software begin to really become meaningful enough to start also making an impact on the gross margin, 1% to 2%?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Let me just touch on your first one a little bit and then I'll turn it over to Mike. So the reason we feel that it would be in the 40s is because we can actually look at the expedite fees that we pay on a quarterly basis and the freight overages that we're paying on a quarterly basis. And if we subtract those 2 elements from our, let's say, yes, subtract those 2 impacts to our cost, our gross margins today are above 40%.

So -- and this is not saying -- we know that there's been silicon price increases, but we're talking about extra fees that we have to pay to buy on the black -- or on the gray market or extra fees that some people are charging just to meet Their current commitments, the commitments they had before. If we subtract those costs and the freight overages, we're already above 40, right? So yes, we think we can get there. And it's all about supply chain.

Mike, you any color on that?

Michael K. Foliano - *ADTRAN, Inc. - Senior VP of Finance, CFO & Corporate Secretary*

Yes. I think it's roughly the same as what we presented last quarter when we said around 7 percentage points is what it's costing us to be able to expedite materials to be able to keep our customers all -- and then to be able to pay all of these extra fees that are -- charge to be able to actually get these components.

So we are expecting, at some point, that normalizes. The trouble is when is that point? But we're monitoring that very closely. And I think we're also getting a little bit better at managing that as we go. So just finding better ways to manage it. And then the redesign portion that Tom talked about really helps us get out of a lot of those extra costs as well.

Then as far as your price increase question, we have put some price increases out there. They will start to kick in as we go through this year. So some of that, you'll see more on the back end of the year, but that should also help us to try to catch up with the more structural piece of this because a lot of the things I was talking about previously are more transitory issues to be able to get components now. But there are some structural price increases that have come through from some of the larger silicon suppliers.

But I think passing on that piece, we'll bring that back around too. So we do believe in the longer term that we're going to be back to the low to mid-40s, I think as we said our gross margin target...

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

And if you get rid of these expedite fees, we're not materially off of that. And if you way through the price increases that are because of kind of core changes, not just near-term events, then we're in the low to mid-40s now.

Orin Hirschman - *AIGH*

Okay. That's really helpful. And last question on the software in terms of gross margin.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes. I don't know the answer to that. I'm happy with where we are today, but it's not enough to really materially offset that. And that's just something I'm -- we'll just have to -- we have a relatively new launch with Mosaic One. The uptake has been good. Honestly, we'll be going through the onboarding phase right now with a boatload of customers, and we'll just have to see if that works itself out.

Operator

The next question is a follow-up question from the line of Bill Dezellem with Tieton Capital.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO & Chief Compliance Officer*

That's all right. So still Bill Dezellem from Tieton Capital. ADVA, are they experiencing the same level of demand strength that you all are since the announcement? And presumably, they're having the same supply chain challenges.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Yes, I really don't want to speak for them, but I believe from what they've made public that they have -- they're going through a really nice phase of booking as well, and shipments are strong for them. And as far as supply chain, the answer is yes. So I think we're -- I think everybody in this industry is seeing it.

They have a different -- they don't use all the same components that we use. So their profile of their vendor base and which ones are problematic is different than ours. In some cases, a lot of it is the same, too, like a lot of the power supply things and things that we're talking about. But I think the general answer is yes. But they just had a conference call here recently that I'm sure you can get public information on that.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO & Chief Compliance Officer*

And have you had any of your wins or their wins that are really benefited from the fact that the 2 companies are expected to be 1 in the future? And if not, are you hearing is that there will be wins of that sort in the future?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Well, we're kind of limited in the way that we can sell together until we close. So there's not -- we're not out joint selling. I've mentioned before on previous calls that the customer response has been very, very positive. Overwhelmingly positive. I mean, without a single negative feeling from our customer base. And that's jointly. That continues to be the case.

That's -- I think there are customers that can't wait for us to get together so that we can start doing joint presentations on what our road maps will be and how we can better tie the technologies of the 2 companies. But that's limited. Other than just kind of anecdotal, everybody seems to be very happy about the combination coming together as quickly as possible.

Operator

There are no additional questions lighting at this time, so I will turn the call over to the management team for any further remarks.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman & CEO*

Okay. Thank you. Thank you very much for joining us. We look forward to a positive call next quarter. Thank you, everyone.

Operator

That concludes today's call. Thank you for your participation. You may now disconnect your lines.