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ADTN.OQ - Q2 2021 ADTRAN Inc Earnings Call

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CORPORATE PARTICIPANTS

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

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

CONFERENCE CALL PARTICIPANTS

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

George Charles Notter *Jefferies LLC, Research Division - MD & Equity Research Analyst*

Michael Edward Genovese *WestPark Capital, Inc., Research Division - MD & Senior Research Analyst of Communications Equipment*

Paul Jonas Silverstein *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

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

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

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to ADTRAN's second quarter earnings release conference call. (Operator Instructions)

During the course of the conference call, ADTRAN representatives expect to make forward-looking statements, which reflect management's best judgment based on factors currently known. However, these statements include risks and uncertainties, including the continued spread and extent of the impact of COVID-19 global pandemic, the successful development and market acceptance of our products, competition in the market for such products, the product and channel mix, component costs, manufacturing efficiencies or other risks detailed in our annual report on Form 10-K for the year ending December 31, 2020. 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, Demetrius. Good morning, everyone. We appreciate you joining us for our second quarter 2021 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.

We continued the momentum that we've seen over the past year with another strong quarter in Q2. Although total revenue in the quarter was materially constrained by supply chain constraints, we grew revenue 11% year-over-year and increased non-GAAP EPS by $0.12 year-over-year to $0.16 per share. Our success continues to be led by strong demand for our fiber-based broadband solutions across regional service providers in the U.S. and Europe, driving 66% year-over-year growth in our fiber access platforms. Reinforcing the growth phase we are in, we increased our product bookings by 43% year-over-year.

The success that we have had in the quarter was against a backdrop of growing investments in fiber access connectivity. In the U.S. market, there is a bipartisan support for a proposed infrastructure bill that includes $65 billion in funding for high-speed broadband connectivity. In addition to this federal funding, there are increasing commitments from state level funding to improve broadband connectivity to underserved households. Similar initiatives are moving forward in the U.K. and the EU to provide universal coverage for high speed broadband. A recent article cited pledges of over $30 billion to be spent in building out fiber access infrastructure in the U.K. alone over the next 5 years.

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As for the market activity, we continue to see increased vendor selection initiatives in our key growth areas of 10-gig fiber access and cloud-managed WiFi 6 as operators look to modernize their networks, diversify their supply base and transition away from high-risk vendors. Given our strong presence in key growth markets, particularly in the U.S. and Europe, we remain well positioned to take advantage of this major investment cycle that is still in the early growth phases.

Taking a closer look at our key investments in fiber access and software, you will see several highlights that reinforce our optimistic view of our positioning in these markets. We added 33 service provider customers in Q2. And as of the end of Q2, we have over 100 of our fiber to the prem customers deploying our latest 10-gig fiber solutions just in the last past year. This has been one of the most successful product launches in our company history.

On the software side, our customer base for SaaS applications increased 57% year-over-year, while revenue increased 46% year-over-year. We also secured our first Tier 1 service provider deploying our managed WiFi SaaS offering. The SaaS segment of our business is poised for substantial growth as we scale the number of subscribers under multiyear SaaS agreements.

As we look at the Q2 financials, revenue for the quarter was $143.2 million and with 43.8% gross margin. Network Solutions accounted for 88% of total revenue at $125.4 million, while global services contributed $17.8 million. We had 10 3% customers during the quarter, 2 distribution partners and one European Tier 1 service provider. As noted in previous quarters, these distribution partners serve hundreds of regional service providers in the U.S. market with a mix of broadband access, connected home and enterprise solutions. This continues to reinforce the success we are having in both customer and portfolio diversification.

Much like the past few quarters, the growth that we saw in Q2 was led by our success with regional broadband operators in both the U.S. and Europe. In the U.S. market, revenue from Tier 3 operators was up a combined 51% year-over-year, while European regional operators were up a combined 91% year-over-year. For the previously announced Tier 1 fiber access projects, we remain on track and have a lab exit from one of these and expect exit for the other 2 in the near future. 2 of these have already begun to place orders with us for deliveries later on this year and next year. In addition to these previously announced awards, we've achieved lab certification from our latest fiber access platform with a Tier 1 MSO on our contract negotiation with multiple Tier 1 fiber operators.

Inventory levels remain higher than normal due to the increased lead times resulting from the global chip shortage and COVID related logistics issues. We continue to see component lead times being extended and becoming more unpredictable. We expect that this will continue into next year, and we are taking the necessary steps to mitigate these challenges to the best of our ability. But supply chain issue constraints do present risk to revenue and gross margins over the near term.

From an organizational perspective, we continue to maintain a disciplined approach to operational expenses as we secure additional Tier 1 customer wins, we expect to see targeted increases in those operating expenses. Looking ahead, we expect to continue to see growth in our core areas of fiber access platforms, and home service delivery platforms and software. Our fiber access platforms -- for fiber access platforms, we are gearing up for a ramp in Tier 1 business in the upcoming quarters in addition to the continued growth we are seeing in fiber deployment from regional service providers.

For in-home service delivery platforms, bookings for our cloud-managed gateways are at an all-time high, and we are working through supply chain constraints to fulfill the demand. On the software side, we -- our enhanced SaaS platform, Mosaic One, with a set of tools, we have increased -- enhanced our SaaS platform with a set of tools to automate and improve marketing operations and customer care for broadband service providers.

Continuing our investment in these high-growth segments of our portfolio, coupled with the success we are having in new customer adoption has us well positioned for additional success throughout the year and will enable us to continue to meet our customer and portfolio diversification objectives.

Finally, I want to thank all of our employees for their continued flexibility and resilience as we navigate the challenges of COVID-19. Their ability to continue to execute while being faced with these ongoing challenges have allowed us to continually meet the needs of our customers.

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With that background, Mike will now provide a review of our financials. And following his remarks, we will open the call up for questions. Mike?

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

Thanks, Tom, and good morning to all. I'll review our second quarter results and provide our expectations for the third quarter of 2021. I'll be referencing both GAAP and non-GAAP results with reconciliations presented in our press release and supplemental financial schedules on our Investor Relations web 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 second quarter 2021 revenue came in at $143.2 million compared to $127.5 million in the prior quarter and $128.7 million for the second quarter of 2020. Subdividing this across our operating segments, our network solutions revenue for the second quarter was $125.4 million versus $113.8 million reported for Q1 of 2021 and $111.3 million in Q2 of 2020. Our services and support revenue in Q2 was $17.8 million compared to $13.7 million reported for the first quarter of 2021 and $17.4 million in the second quarter of 2020. Across our revenue categories, access and aggregation revenue for the second quarter of 2021 was $91 million compared to $69.1 million in the prior quarter and $82.8 million in quarter 2 of 2020. Revenue for our subscriber solutions and experience category was $47.8 million for the quarter versus $54.6 million in quarter 1 of 2021 and $40.4 million for quarter 2 of 2020. Traditional and other products revenue for the quarter was $4.5 million compared to $3.9 million in Q1 and $5.5 million for quarter 2 of 2020.

Looking at our revenues geographically. U.S. revenue for Q2 2021 was $94.7 million versus $86.5 million reported in Q1 and $84.5 million in Q2 of 2020. Our international revenue for Q2 of 2021 was $48.6 million compared to $41 million for the prior quarter and $44.3 million in quarter 2 of 2020. In the second quarter, we had 3 10% of revenue customers, 2 were domestic and one was international. Our GAAP gross margin for the second quarter was at 43.8% as compared to 42% in the prior quarter and 41.5% in the second quarter of 2020. Non-GAAP gross margin for the quarter was 43.8%, which compares to 42.1% in the prior quarter and 41.6% in the second quarter of 2020. The quarter-over-quarter and year-over-year improvement in both GAAP and non-GAAP gross margins were attributable to an international product and customer mix as well as improvement in our services gross margin.

During the quarter, we continued to experience extreme constraints in the electronic component market, which worsened during Q2. We expect this to continue to tighten further during Q3 and for the remainder of the year, potentially affecting product availability and component and logistics costs. Total operating expenses on a GAAP basis were $58.7 million for Q2 of 2021 compared to $54.9 million reported in the prior quarter and $59.5 million for Q2 of 2020. The quarter-over-quarter increase was a result of market-driven increases in our deferred compensation plans and higher professional services costs. The year-over-year decrease in operating expenses was a result of lower market-driven gains in our deferred comp plans, reduced restructuring charges and reduced legal-related expenses, partially offset by higher professional services costs.

On a non-GAAP basis, our second quarter operating expenses were $52.7 million compared to $51.4 million in the prior quarter and $52.3 million in Q2 of 2020. The increase quarter-over-quarter and year-over-year in non-GAAP operating expenses were primarily due to increases in contract services costs partially offset by decreases in legal expenses. Operating income on a GAAP basis for the second quarter of 2021 was $3.9 million compared to an operating loss of $1.3 million in the prior quarter and a loss of $6 million reported in Q2 of 2020. Non-GAAP operating income for quarter 2 of 2021 was $10.1 million compared to $2.4 million in the prior quarter and $1.3 million in Q2 of 2020.

The quarter-over-quarter improvement in profitability on a GAAP basis was attributable to increased sales volume and a more favorable gross margin mix, partially offset by higher operating expenses. The year-over-year increase in GAAP operating profitability was driven by increased sales volumes, stronger gross margins and lower operating expenses. The non-GAAP quarter-over-quarter and year-over-year increases in operating income were driven by increased sales volume and improving gross margins.

Other income on a GAAP basis for the second quarter of 2021 was $2.3 million compared to other income of $3.3 million in the prior quarter and $8.4 million for Q2 of 2020. Our non-GAAP other income for the quarter was $1.1 million compared to non-GAAP other income of $3.3 million in Q1 of 2021 and $5.7 million for quarter 2 of 2020. The quarter-over-quarter decreases in both the GAAP and non-GAAP other income were related to realized foreign currency exchange fluctuations, offset by favorable market-driven fair value changes in our investment portfolio. The decreases

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in both the GAAP and non-GAAP other income on a year-over-year basis were related to lower gains in the market-driven fair value of our investment portfolio, offset by lower realized foreign currency exchange losses.

The company's tax provision for the second quarter of 2021 was an expense of $1.1 million, as compared to $1 million in the prior quarter and $1.6 million in the second quarter of 2020. The current quarter's tax expense was primarily driven from profits in our international operations as the deferred tax expense generated by our domestic operations continue to be offset by additional changes in the valuation allowance.

GAAP net income for quarter 2 of 2021 was $5.1 million compared to $900,000 in the prior quarter and $800,000 for the second quarter of 2020. Non-GAAP net income for the second quarter was $8.1 million as compared to $6.3 million in the prior quarter and $1.6 million in quarter 2 of 2020. For the quarter that just ended, earnings per share, assuming dilution on a GAAP basis were $0.10 per share as compared to $0.02 per share in both the prior quarter and in the second quarter of 2020. Non-GAAP earnings per share, assuming dilution for the second quarter of 2021 was $0.16 compared to $0.13 per share in the prior quarter and $0.03 per share in Q2 of 2020.

On the balance sheet, unrestricted cash and marketable securities totals $128.2 million at quarter end after paying $4.4 million in dividends during the quarter. For the quarter, we generated $7.5 million of cash from operations. Net trade accounts receivable was $122.7 million at quarter end, resulting in DSOs of 78 days compared to 73 days in the prior quarter and 67 days at the end of the second quarter of 2020. The variability in DSOs quarter-over-quarter and year-over-year is mainly attributable to timing of shipments during the quarter, customer mix of those orders and sales volumes.

Net inventories were $119 million at the end of the second quarter compared to $122.9 million in the first quarter of this year and $106.1 million at the end of second quarter 2020. While our inventories were down quarter-over-quarter, we continue to carry higher inventory levels in preparation from new product ramp-ups and strategic buffer inventory purchases that are designed to assist us with supply continuity in the currently challenging electronic component market.

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 order patterns from which the customer base and to which we sell as well as the fluctuation in currency exchange rates in our international markets may cause material differences between our expectations and the actual results. With that in mind, we expect our third quarter 2021 revenue will be in the range of $138 million to $158 million. Note that this wider than usual range better reflects both the strength we're seeing in demand and the current issues with the component supply.

After considering the projected sales mix, we expect that our third quarter gross margin on a non-GAAP basis will be in the range of 41% to 43%. We also expect non-GAAP operating expenses for the third quarter of 2021 will be between $53 million and $54 million.

And finally, we anticipate the consolidated tax rate for the third quarter on a non-GAAP basis will be at a low to mid-20s percentage rate. We believe the significant factors impacting revenue and earnings realized in 2021 will be component availability and costs, a macro spending environment for carriers and enterprises, the 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, professional services activity levels, both domestically and internationally, 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, additional financial information is available at ADTRAN's Investor Relations web page at investors.adtran.com.

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

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

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

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QUESTIONS AND ANSWERS

Operator

Your first question comes from the line of Rod Hall with Goldman Sachs.

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

This is Bala on for Rod. So to kick it off, I want to touch on the wider revenue guidance, which is not surprising given the supply constraints that everybody in the industry are seeing. But maybe to give further color, are you seeing more constraints on the RGs and ONTs side of the business or more the access and aggregation part of the business?

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

About both. We're -- yes. I mean I would -- it's both. So there's not really a single material product set that we have that doesn't have some constraints. And on -- although sometimes they're different chips that are causing those constraints, I would say there's really no difference between the 2.

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

And on the larger projects, the RFPs, et cetera. So you mentioned some lab exits that you expect in the near future, and it looks like some customers are already placing orders. So I just wanted to understand or get some color on how do we expect the second half, and more importantly, this next year would look like apart from the supply constraints with this because…

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

Yes. I mean we're expecting good things next year. So the lab exits, so I mentioned we've exited one lab at this point. They're still doing -- we're still going through early field kind of deployments that will pick up through this year. And we expect it to be going at a strong clip next year. But the other 2, they're not far behind. And like I said, one of those 2 that we don't have lab exits, they're kind of accelerating order placement, just to make sure they're in good stead for next year. So I feel very good about those.

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

And one more question, if I may, on the gross margins. So pretty good margins, obviously, despite constraints here. So given the cost inflation that you are seeing and also, on the other hand, increasing fiber portion of the revenues, which I would assume carry higher margins and also Tier 3, which is growing strong. So how should we think about gross margins as we go through next year or so?

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

Let me modify your backdrop just a little bit because I think there are several things that are affecting gross margins. One is, like you said, your strong fiber demand. And the customer base that we're selling into, both in Europe and in the U.S. and then we've also had some pickup in our software platforms or SaaS offering, which has got fairly strong gross margins, really strong gross margins. So I think those are all positives to it. And I know that Mike will kind of take the backend of that question.

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

And I think the backend, what we've been seeing, and I think we're still on the same plan that we're expecting our gross margins to trend toward the mid-40s. Like in the past, we've said low to mid-40s, but as we start to transition over to our new products and make additional efficiency changes in our business. We're expecting that we'll, over time, we'll be able to work our way to the mid-40s.

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

Let me just add one other thing on gross margin. It's -- who knows exactly when this thing will -- the supply constraints will work themselves out. But we have been seeing in this quarter was no different. We've been seeing material impacts to our gross margins throughout this year. So the fact that they've held up as well as they had and have actually picked up is actually very good towards us getting to our targets.

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

And it's driven by both expedite costs, price pressures and also freight and logistics costs. It's a pretty tight market out there for moving things.

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

And last follow-up, what's the impact from these supply constraints, higher logistic costs, et cetera, Mike, for the quarter, gross margin impact?

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

I'd say it is more than a full point and less than 2.

Operator

Your next question comes from the line of George Notter with Jefferies.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

Did you mention how much revenue impact you are seeing in the quarter? What -- are you unable to ship product? How much might that be? Just out of curiosity. And then I have a follow-up.

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

Yes. That's a -- if I look at request dates -- if you look at this request dates where people wants the product, it was tens of millions of dollars. I mean if I look at just like this quarter, I have enough orders right now where people want the product or I wouldn't have to sell another thing and I can take this quarter. So it's all about supply. It's not about demand.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

And then the Tier 1 progress that you're talking to, I assume we're talking about European Tier 1s. Is that correct?

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

Plus we have one here in the U.S. Yes. So I guess I'm not sure which one you're talking about. So we have some that we've already secured that we're going through lab exit with, 2 of those are in Europe, one of those who are in the U.S. And we have other ones that we're in contract negotiations with. One MSO that we talked about where we have finished that contract negotiations. And then 2 others that are ongoing, I'll say, those are in Europe.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

And then the -- I guess I'm referencing the situations where you guys have left the labs and are in field trials. And then I think you mentioned 2 other cases where you're starting to get orders, but you're still kind of working through the labs. I guess my question for you is, are those projects being driven by the Huawei replacement exercises? Are they driven by more organic infrastructure stimulus type of activity? I guess I'm trying to understand what the motivations are there. And then do these turn into really significant revenue opportunities for the company? Or are these situations that will kind of trickle in over time? Like how do you think about the potential ramp?

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

So let me just kind of clarify the first part of that. So where we are is we've exited the lab with one of the 3 that we were talking about, although we have received orders for 2 of the 3, which means lab exit is pretty certain. And let's say, the cases where Huawei is entrenched or has been selling, there is a component, and I don't want to speak for the customer, but their carriers are wanting to replace the equipment that's in there. So that is one driver. And that's all through Europe. There's not a single major carrier that we're talking to because Huawei is very well entrenched where they don't have some type of mitigation plan for the equipment that's there. Secondarily and in Europe, most probably specifically because they've been very clear about it and certainly in the U.K. and in Germany, they have very much accelerated their fiber deployment plans and are expecting to deploy roughly, let's say, $20 million a piece of new homes passed within the next 3 to 4 years. So you have both of those things going on. And those numbers, by the way, are very public. I mean they're -- the companies themselves, the carriers themselves speak about what their targets are.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

Right. Yes. And we've seen those numbers. Got it. And then how quickly does that turn into a more significant revenue stream for ADTRAN? Is that a 2022 event? Is that a 2023 event? Like how do you think about materiality to your business?

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

We expect those awards will be impactful next year. Definitely going to.

Operator

Your next question comes from the line of Michael Genovese with West Capital Park.

Michael Edward Genovese - *WestPark Capital, Inc., Research Division - MD & Senior Research Analyst of Communications Equipment*

A few things. I think you said it was in the 40s, maybe 44% total order growth year-over-year for the quarter. And I just wanted more color and context on that. And particularly, did the 2 Tier 1s placing orders, were they a major piece of that? Or was it more broad-based?

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

It was way more broad-based than that. It was way more broad-based to that. We're just getting kind of initial orders right now for those 2. We have forecast that go further, but order placement is just starting with those 2. So it's much more broad-based than that.

Michael Edward Genovese - *WestPark Capital, Inc., Research Division - MD & Senior Research Analyst of Communications Equipment*

And then what about the 44%? I mean, is that -- have you seen that in previous product cycles? I mean, obviously, that's a really strong number. But is that something that when you launch more -- launch new products, in the past you've seen that kind of growth rate or is this something extraordinary?

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

I would say the booking -- you can -- so first of all, yes, it's extraordinary. I don't recall ever seeing order growth of that magnitude other than it being maybe one project like Telmex could drop in a big order or whatever, that's not the case here. It's very much broad. It's broader than that. The mitigating thing that you could maybe throw a little water on that as well, are they ordering ahead because of supply chain issues? There is some of that going on. But as I mentioned earlier on in one of the questions, I mean, like backlog for this quarter is incredibly strong. I mean we could literally hit our guidance numbers today. We can beat our guidance numbers today with just the backlog we have right now in place with request dates for this quarter. Unfortunately, I'm not going to ship all of that.

Michael Edward Genovese - *WestPark Capital, Inc., Research Division - MD & Senior Research Analyst of Communications Equipment*

And then a couple of other things. I mean I noticed in the quarter that sequential growth, more than a 100% of it was access and aggregation, which was very strong. So it seems like, were you able to get pretty good supply of that product or those products in the quarter? I mean, I haven't seen sequential growth like that. It was up double digits year-over-year and up more than 30% sequentially. So it was pretty strong performance. So just more color on that. And then related or somewhat related, my last question on gross margins. I guess I just want to understand more why you did well in the second quarter, even though there's supply constraints and you're being conservative for the third quarter in the outlook? I understand supply constraints are getting worse, but why the upside in the second quarter? And why wouldn't that repeat in the third quarter?

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

I think in the second quarter, it was -- you have to say mix had an impact on it, that mix being both the product mix as well as target the segment mix. I mean we're just seeing really strong growth out of the Tier 3s, both in Europe and in the U.S., and that plays a part in that.

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

And our services business improved.

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

Yes. Service business improves. But materiality of that was probably -- it's mix. It's mix is what's driving it. And as far as endpoints, that is 100% supply availability, which from -- once a month can change, right? So I mean, it feels like there's always this big truckload of chips that's supposed to arrive a week after the end of the quarter. And then sometimes they slip those out. So it just -- it's all about supply.

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Michael Edward Genovese - *WestPark Capital, Inc., Research Division - MD & Senior Research Analyst of Communications Equipment*

Yes. So last question on that then. Does that just imply looking at numbers that just for -- just reasons of the supply chain that there was more availability of access and aggregation this quarter than there was in the in-home…

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

Yes, exactly. Yes. It's a 100% that. And honestly, I can tell you exactly which chip it was that we got more than we were hoping for and which chip we got less. So yes, it's absolutely that. And a lot of times, it's down to one specific chip.

Operator

Your next question comes from the line of Paul Silverstein with Cowen.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

First off, I recognize we've addressed this in previous quarters, but given the very strong growth in your Tier 3s, I'm hoping that Tom and Mike, you all can update us on what percent of total revenue does now account for? Obviously it's going up, but can you give us a number?

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

Let me see if I have something here that I can give you. I'm trying to think about the way that we have paraphrased it before. I don't want to particularly broaden ourselves to get ourselves the -- because I think we need to be consistent on the way that we think about it.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

And Tom, if it helps, I'm going to ask you the same question every quarter.

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

It's the majority of the business.

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

Yes. That's a good way to say it.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

So Tier 3s are now over 50%. And Mike, how long have they been over 50%?

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

Well, let me make sure we say that. I mean sometimes Tier 2s versus Tier 3s, but I think even if we were just to say Tier 3s, Tier 2s are a little lumpier. But I would say, just if you say Tier 3s, my guess would be, we're over 50%.

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Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

And Tom, is that -- if I look back a quarter ago or 2 quarters ago, were they meaningfully less than 50%?

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

It's -- I think we first started talking about it being 1/3 of the business or over 1/3 of the business is the way we had characterized it before. I know it was continuing to grow at a 30% to 40% clip. So I think, I mean, we, a lot of times, just explicitly lay out the Tier 2 and Tier 3 growth. So I think you could really hone in on that number. But it's been growing at a fast clip pretty much every quarter. And if I look back at the Tier 3 business here in the U.S., it has been growing solidly for almost 2 years now. I mean solidly by being in the 30% to 40% range.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Tom, I know that it's less than 10% of your revenue at present. And I know the announcement was only made this morning, so it's hot off the presses. But I'm hoping you could share with us some initial thoughts on -- given that [Lumen], I think is one of those 3 customers that you've already secured that you've been talking about for the past year in terms of incremental business. Any thoughts on what the asset sale to [Apollo] will mean? Have they given you any heads up, any insight in terms of, does that change your expectations for whatever revenue growth you're expecting from them over the next 12 to 18 months and beyond?

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

No explicit guidance from them. I can just go by historical what has happened. Whenever we've seen this happen, I think the last big ones were like Verizon some time ago divesting properties. In every single case where we've seen that divestiture happen, we've seen an increased focus on improving their network. Sometimes that's regulatory driven. Many times that's just market share driven. So my hope would be that we would see actually an increased focus on what it is we're doing with them. There's no change in the product approval cycles or anything like that.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

I'm not surprised with what you're indicating. You haven't -- they haven't communicated to one way or the other relative to…

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

They haven't given us numbers. We are in communication with them, but they haven't given us numbers, no.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

Last question, if I may. With respect to the European opportunities, historically, you've cited around half a dozen incremental opportunities that had not been awarded, but some of which you were expecting to be awarded around the midpoint this year. I assume the cable MSO, European opportunities, one of those 6. Any insight you can provide regarding the others. And just to be clear, I assume also that the 2 carriers you referenced that one -- 2 which are in labs, one of which has placed orders, notwithstanding that they're still in the labs. Those are 2 of the 3 opportunities you've referenced historically, i.e., the Lumen and DT. In DT, I assume, with respect to the other sets, if I have that right, can you give us any incremental insight on where those RFPs awards are at?

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

Yes. I mentioned one, the MSO, which some people count and some people don't. We've finalized contract negotiations with that. And I also mentioned that we are in contract negotiations with 2 others.

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Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

So those are 2 of the other 6 you're in contract negotiations with, 1 of the 6, you've now secured the contract. The other 3, is there any visibility as to when those awards would be made?

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

I don't have that at this point, no.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD & Senior Research Analyst*

And Tom, with respect to the 3 you just referenced, are you expecting those to be meaningful in calendar '22 on top of the other 3 you've been talking about for the last year?

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

I think the Cable One, I feel really good about. I think the other 2 are too early to understand their lab cycle to be able to give you kind of -- sometimes these things take forever. Because the Cable One, I'm already through the lab, let's say, 99.9% through the lab, going into the field trial right now. So I feel good about that one because I know the timing. The other 2, we have not really entered -- we've done some lab testing, but we haven't really gone through the cycle yet. So that would be more difficult to say on those 2.

Operator

Your next question comes from the line of Bill Dezellem with Tieton Capital.

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

I'd like to dive further into the supply issues that you're dealing with. Did you earlier say it's specifically ICs? And if that is the case, are these specific to, I guess, are the ASICs of yours? Or are they more general commoditized products?

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

It is, by far, predominantly ICs, I would say everything other than ICs, is manageable in like normal course. Every once a while you run into something that's kind of strange, but not that often. I mean we ran into problems with resin that was used in plastics to make our housings, for some reason, there was a run on that for a while. But you run into those. That's typical. So it's predominantly ICs. I mean we would not have an issue if it wasn't IC issues. And as far as the type of IC, it is now down to the most benign component level IC that you can think of. It's everything.

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

Thank you for that perspective. And do you have a time frame that you are hearing or that your insights would say that these issues ought to loosen by a certain time?

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

No. In that regard, I'm kind of held to the same kind of knowledge that you have because it's really more about fab capacity than it is the chip supplier themselves. We do know that fab capacity is coming online. We are mapping fab capacity by process. The size of the process itself and where that capacity is coming in line or online so that we can do a couple of things. One, better steer, we'll see some relief. If we'll see relief and if everybody just builds, I don't know what the processing the 7-nanometer, really, really super high-end chips, and that doesn't solve some of these general component issues. So it's harder to forecast when you get down to the actual type of chip that we're talking about. But we do have the ability over time to steer our designs as well to some of these areas where we think capacity will come more online, and that's what we're trying to do now. We've redesigned several products already in order to keep customers happy, and we're going to continue to do that. But I don't have a real endpoint.

Operator

Your next question comes from the line of Tim Savageaux with Northland Capital Management.

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

Capital Markets, we haven't changed our business model. A couple of things. Tom, you mentioned Tier 2s. And it seems like new financial backers and coming out of bankruptcy, the investment there, generally, at least among a couple of them, is starting to pick up. Are you seeing that? Is that becoming -- was that a material contributor in addition to Tier 3 strength in the quarter and the outlook? Or is that maybe still in front of us?

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

I would say, I'm expecting more like next year than this year, but I would also say that this year, was good. It was actually -- and we did see that pick up. It's just a little lumpier. Where in the Tier 3s, it's just like every quarter you'll see just more variability in the Tier 2s in this because there's less of them, very project oriented, and it's just -- it's just not as consistent, but there's no doubt they've gotten stronger over the last year. And they're talking about kind of material deployments going forward. So I would expect that to be an area of strength.

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

And then you mentioned at least some initial orders in the Tier 1 side. Is that a meaningful part of your Q3 guidance at all, some of these new Tier 1 engagements?

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

No, no. No, it's not -- I mean, it's only because that there's just, here again, well, on that case, it is just now starting to ramp up. I don't expect that to be material. Maybe at the end, it's all going to be about supply constraints at the end of the year.

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

Yes, understood on supply. That's actually where I was headed. The follow-up piece of that question was going to be, could we be seeing a scenario where some combination of continued rural broadband strength and initial Tier 1 deployments serve to offset your normal Q4 seasonality?

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

It's all about supply. I have no doubt that the order flow would allow us to do that, which is all going to be what we can ship.

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

And last question for me. You mentioned the bookings up over 40% year-over-year with revenues up 11%. And I don't know if those type of -- we should look at those 2 and try and back into a book-to-bill metric or you might want to share one with us?

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

It's -- actually I don't have the book-to-bill in front me anyway, so that makes it a little bit easier. But it has been constantly above 1, the entire year.

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

All right. With that, I'd like to end the call. So thank you very much for joining us, and we look forward to talking to you next quarter.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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