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ADTN.OQ - Q1 2023 ADTRAN Holdings Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to ADTRAN Holdings Inc. First Quarter 2023 Earnings Release Conference Call. (Operator Instructions). After the speakers' remarks, there will be a question-and-answer period. (Operator Instructions). During the course of the conference call, ADTRAN representatives expect to make forward-looking statements that reflect management's best judgment based on factors currently known. However, these statements involve risks and uncertainties, including 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 logistics costs, manufacturing efficiencies or ability to effectively integrate mergers, and acquisitions and other risks detailed in our annual report on Form 10-K for the year ended December 31, 2022, and our quarterly report on Form 10-Q for the quarter ending March 31, 2023. 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. The investor presentation found on ADTRAN Investor Relations website has been updated and is available for download. It is now my pleasure to turn the call over to Tom Stanton, Chief Executive Officer of ADTRAN Holdings. Sir, please go ahead.

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

Thank you, Rob. Good morning, everyone. We appreciate you joining us for our first quarter 2023 earnings conference call. With me today is ADTRAN Holdings CFO, Uli Dopfer, and also joining us today is Christoph Glingener, ADTRAN CTO. Following my opening remarks, Ulrich will review the quarterly financial performance in detail, and then we'll take any questions that you may have. I'll stop by offering a high-level summary of what happened in the quarter and our views of the market going forward. As I mentioned in our pre-release, the results of the quarter were impacted by slowing revenue, predominantly in our Subscriber Solutions category. While we did have more than enough backlog to cover this gap, supply chain constraints hindered our ability to overcome these challenges during the quarter. We believe the slowdown in Subscriber Solutions was the result of increased scrutiny of inventory levels with our customers, driven by a combination of reduced lead times in the market and uncertainty in the broader economic environment. Looking ahead, while we do expect higher inventory management to continue to impact us in the near term, our longer-term growth outlook remains unchanged given the historically high demand for fiber networks, our diversified customer base, and the progress we have made with fiber footprint capture. With that background, let me provide some additional context. ADTRAN has built a comprehensive fiber network portfolio built upon three key pillars: Optical Network Solutions, Access & Aggregation Solutions, and Subscriber Solutions. Each of these categories are ultimately tied to the build-out of fiber networks, which continue to have a positive outlook given the investments planned in fiber networks in the years ahead. In addition to market growth trends, we are also benefiting from cross portfolio synergies as we integrate our teams and processes and are better positioned to cross-sell our larger fiber portfolio. In the Optical Networks and Solutions, we have had back-to-back record quarters, and we experienced growth across all regions in this past quarter. Our strongest region for this portfolio

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has been Europe with the strength of the combined company, we have been the biggest beneficiary of share shift away from high-risk vendors. Vendor selection activities in the metro optical space remained at their highest levels in many years, highlighted by our involvement in eight large carrier opportunities right now. In our Access & Aggregation Solutions, we continue to see good progress in wrapping our large carrier customers in Europe while also being well positioned in six new large carrier investments selections in that area. Like the optical transport segment, this elevated vendor selection activity is accelerated by the shift away from high-risk vendors and ADTRAN continues to be a key beneficiary in this market shift. Within our existing large fiber access customers in Europe, there has been one notable customer that was publicized to have CapEx reductions in their current plans. We continued collaboration with these customers and others in this region. We are assured that their long-term fiber deployment plans remain in place, and in some cases, we've actually seen an acceleration in these plans into this year, reinforcing this long-term strength in fiber network investments that we see going on in Europe. In the U.S. market, we had 47% quarter-over-quarter growth with our fiber access platforms, driven by success in the regional service provider market, reinforcing our continued growth in capturing new fiber footprint. We now have over 600 operators globally deploying our fiber access platforms, including 11 new operators that we added this quarter. On the Subscriber Solutions category, we did experience high volatility during the past quarter. However, as we capture new fiber footprint and more customers upgrade to 10-gig fiber access networks and multi-gig WiFi networks, we expect to see this category return to higher growth. The same is true for business and wholesale services that continue to shift to higher speed fiber services. This fiber network and portfolio spanning the metro core to the customer premises is complemented by a comprehensive software and services offering that simplifies engineering, deployment and ongoing operations associated with these fiber networks. On the software side, we see continued demand for SaaS applications with over 200 service providers already adopting our Mosaic One offering, up from 150 customers at the end of last quarter. In summary, the long-term demand for fiber networks has not changed despite near-term inventory adjustments and economic uncertainties. Our progress in capturing new footprint for our optical infrastructure platforms, including both optical transport and fiber access has us well positioned to benefit from the long-term investment in infrastructure, software and services to support these fiber networks. Our ability to grow our customer base and cross-sell our combined portfolio will continue to improve as we further integrate our sales teams and processes. While we remain confident in the long-term outlook, we will be cautious in our spending as we diverse this period of uncertainty in the market. We are on track with our previously stated synergy goals, and we expect to see meaningful improvements in our operational expenses this quarter as compared to last. Before I hand things over to Uli, I'd like to thank Mike Foliano. Mike, as all of you -- many of you on the call know, has been our CFO for several years, and he's been with the company for 17 years with ADTRAN. Mike has been a very, very dedicated, very professional, just a fantastic teammate. And I'm really extremely grateful for Mike for all the years of service that he contributed and I wish him all the best as we move forward into his new life. We, of course, transitioned that role -- we are transitioning that role from Mike to Uli. And with that, I'm going to turn things over to Ulrich to go over the financials. After that, we'll open up for any calls you may have.

Ulrich Dopfer - *ADTRAN Holdings, Inc. - Senior VP & CFO*

Thank you, Tom, and hello, everybody. I will cover our first quarter 2023 final results and provide our expectations for the second quarter of 2023. Please note that Q1 2023 results include a full quarter consolidation of the ADVA financials, which affect year-over-year comparisons. Since this is the case, I will refrain from repeating the consolidation effects when discussing the year-over-year comparisons of our results. I will be referencing non-GAAP information with reconciliations to the most directly comparative GAAP financial measures presented in our press release and also certain revenue information by segment and category, which is available on our Investor Relations web page at investors.adtran.com. In addition, we have updated the investor presentation to the site, which is available for download. Unless stated otherwise, all financials are presented in U.S. dollars. Let's move to the revenues. Q1 2023 revenue came in at $323.9 million, up 109.6% year-over-year and down 9.6% quarter-over-quarter. As already presented in our pre-announcement, we missed the lower end of our guidance range of $355 million to $375 million by 8.8%. Our Network Solutions segment accounted for 87.2% of revenues in Q1 2023 compared to 89.6% in Q1 2022, and 89.4% in Q4 2022. Our Services & Support segment contributed 12.8% of revenues in Q1 2023 compared to 10.4% in the year ago quarter and 10.6% in the previous quarter. Year-over-year and quarter-over-quarter revenue decline was primarily driven by inventory management in our customer inventory for ONTs and Ethernet needs in the Subscriber Solutions category. While this category was up 39.9% year-over-year, it was down 34.1% quarter-over-quarter. Supply constraints also limited our flexibility to clear past due backlog across all product categories. However, Optical Networking and Access & Aggregation performed as expected. Optical Networking Solutions category contributed 45.6% of revenue and was up 3.9% quarter-over-quarter. Access & Aggregation revenue share was 29.9% and was slightly down 1% year-over-year and increased by 1.1% compared to Q4 2022. On a regional basis, for year-over-year, first quarter domestic revenue grew by 32.7%, international revenue increased by 246.9%. International revenue made up 59.4% of our revenue and domestic revenue contributed 40.6% of Q1 2023 revenues, similar to Q4 2022. We had two 10% or more revenue customers in Q1. Q1 non-GAAP gross margin was 37.3% and increased by 200 basis points year-over-year and decreased 180 basis points sequentially. The year-over-year increase

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is due to improved purchasing and transportation costs. The quarter-over-quarter decline in gross margin was primarily attributable to an increase of our inventory reserves as well as lower absorption credit compared to the previous quarter. In addition, an unfavorable customer and product mix contributed negatively to our gross margins. Our non-GAAP operating expenses were $125.9 million, increasing by 137% year-over-year and 6% quarter-over-quarter, which were primarily driven by increased labor costs and higher R&D expenses. Non-GAAP operating expenses were 39% of revenues compared to 34% of revenue in Q1 2022 and 33% of revenue in Q4 2022. Non-GAAP operating loss was $5.2 million, which translates into a non-GAAP operating margin of negative 1.6% compared to positive 1% in Q1 2022 and 6% in the previous quarter. The decrease in profitability was driven by the low revenue volume at lower margins and an increased cost base. Let me emphasize that we are striving to significantly lower our cost base in the near term to adjust for the lower-than-expected revenues by accelerating our synergy efforts and optimizing discretionary spending. Non-GAAP other expenses was negative $3.3 million and mainly driven by higher interest expense. The company's non-GAAP tax provision for the first quarter of 2023 was $1 million or 12%. The company's GAAP tax was a benefit of $11.3 million or 22%. The difference between the GAAP and non-GAAP rates was primarily driven by the jurisdictional mix of the non-GAAP adjustments during the quarter. Closing out our income statement results. Total non-GAAP net loss was $9.5 million and a net loss of $5 million after adjusting for minority shareholder interest in ADVA. This results in diluted loss per share attributable to the company of $0.06 per share. I will discuss the details of the EPS calculation later in this call. Let's move to the balance sheet. Turning to the balance sheet and cash flow statement. Cash and cash equivalents totaled $136.5 million at quarter end. For the fourth quarter, operating cash flow for the quarter, operating cash flow was negative $19.9 million due to lower earnings and increased working capital. Trade accounts receivables were $262 million at quarter end, resulting in DSO of 73 days compared to 72 days in the prior quarter. Inventories were $116.3 million at the end of the first quarter, resulting in terms of 2.2 compared to 2.4 in Q4 2022. Accounts payables were $198.6 million, resulting in DPO of 69 compared to 80 in the previous quarter. Q4 2022 was an unusual back-end-loaded quarter, which resulted in higher trade accounts payables and explains the drop in DPO in Q1. Working capital management and free cash flow generation is one of our focus areas during 2023. We expect that we will continue to carry a high amount of inventory in 2023, which should improve during the second half of the year. Paired with improvements in operating results and strict cost controls, we expect free cash flow to turn around in 2023. Following the DPLTA registration in January 2023, ADTRAN and ADVA can now fully integrate and work on utilization of revenue and cost synergies. As of today, ADTRAN owns 65.4% of ADVA shares, which results into outstanding ADVA minority shares of $18 million. ADVA minority shareholders still have the option to tender their shares for a cash compensation of EUR 17.21 or to receive EUR 0.59 fixed annually recurring compensation payment from ADTRAN for the duration of the DPLTA. As of today, 62,435 shares were tendered. On April 18, ADVA applied for a segment change from prime to general standard to reduce complexity and costs. Our focus is on successful integration of both companies, combined with achieving our cost targets on the increase of operational efficiency and as a result, free cash flow generation. A potential delist offer is not a priority for 2023. Since the DPLTA was registered on January 16, the accounting treatment of minority shareholder for Q1 is a combination of the previously applied method, a percentage of adverse loss or profit for the time prior to the DPLTA plus the recurring cash compensation of $2.8 million. In Q2 2023 and beyond, only the recurring cash compensation of approximately $2.8 million will be applied. Quick update on synergies. We remain committed to realize cost synergies of $52 million, as already communicated previously, of which we expect to materialize approximately 40% in 2023 and 60% in 2024. 30% of cost synergies can be allocated to cost of revenue sold and referred to synergies in purchasing and logistics. 2023 cost synergies were already identified, and we are on track to achieve them during the year. Further, $31.2 million cost synergies are expected to be achieved in 2023. Now to the guidance. Looking ahead to the second quarter of this year, the ability of component supplies to align with customer demand, the book ship nature of a large portion 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 and any additional required purchase accounting adjustments related to the business combination may cause material differences between our expectations and the actual results. We continue to focus on the supply side, optimize our cost base and our merger integration. We anticipate further improvements in the semiconductor supply chain and expect our backlog to moderate and to decrease inventories over the next few quarters. We will continue to focus on cost management and operational efficiencies while investing in key areas to drive growth. As Tom already stated, we believe that the inventory reductions that we experienced with our customers and across the industry is transitory, and we expect to see some improvements to both the oversupply of CPE products and the backlog of products across all categories in the coming quarters. The fundamental growth catalysts remain intact, and we remain confident to be ideally positioned for sustainable growth due to the ongoing demand to upgrade and deploy new fiber networks. While we are confident in regards to our long-term outlook, we remain cautious in the near term due to tighter inventory management of our customers. Consequently, we guide for our second quarter 2023 revenues to range between $325 million and $335 million, and we expect a non-GAAP operating margin of between 1% and 2% of revenues. Once again, additional financial information is available at ADTRAN's Investor Relations web page at investors.adtran.com. And with that, thank you, and now we'll turn over back to Tom, and we will take your questions.

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

All right. Thanks, Uli. Rob, with that, we're ready to open up for questions.

QUESTIONS AND ANSWERS

Operator

And your first question comes from the line of Michael Genovese from Rosenblatt Securities.

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

Great. Thanks for that. Tom, I mean so in terms of the business of infrastructure, broadband infrastructure and optical, I mean, the results came in good. So I'm just trying to understand your forward-looking commentary in those businesses. I know I think ADVA this morning guided to high single-digit revenue to low double-digit revenue growth for 2023. So could you talk -- I guess, give us color on that. And -- on the broadband infrastructure portion, what you're seeing here in the U.S. and in Europe and maybe expand on some of those comments you made earlier about the macro and about specific carriers, please?

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

Yes, sure. So you're right. As far as infrastructure business had a good quarter, the trepidation that we have is the fact that it's not very clear where inventory pockets are. So I think there's two things going on that are kind of creating that nervousness. One is people are bringing their inventory levels down. So they have been buying inventory or trying to effectively stockpile inventory during the supply chain crisis. And in certain areas, they talk they sold more inventory than others. So on CPE, if you think about how a network is built, the one thing you don't want -- and I've talked myself to tens of different carriers, and as a company, we've talked probably to 50 or 60 different customers. And in general, one thing that ran through is you did not want to not have CPE gear because that was the area that you actually start generating revenue at. So you can always forego other things, but that's one piece you don't want to forego. So that inventory buildup was various levels of different carriers, but in general, everybody was building inventory. So I think that was the one that was the most exacerbated. I think the thing that we're also being cautious of though, is that although there may not be large inventory builds in other areas of the business, people are going to readjust to the current lead times, which are down materially from where they were 6 months ago. So lead times used to be 52 weeks, they're probably closer to 3 to -- excuse me, maybe 4 months-ish or something like that. So not only do you have more inventory on your shelves, but your ordering will also now reflect that lower lead time. So trying to figure out how much inventory in the field, how much do they have to burn through and then adjusting for that impact as they actually lean that inventory off just gets us to a position or we just need to be cautious going through this and plan with that cautious mindset. And if it burns off quicker, we're fine, right? I mean no problem, but we just need to make sure that we actually manage the company for an environment that is a little bit right now murky because of that inventory situation. Underlying demand really nothing has lightened up. I would say, in fact, we were talking here over the last week or so about the activity going on in Europe right now in both fiber access and in optical transport, and it just has not slowed down. In fact, it's probably -- I think I mentioned on my notes that in optical transport is the highest we've seen in a very, very long time, maybe in 10 years or more. So really when there was the last big upgrade cycle. So activity hasn't slowed down and none of the plans of the major carriers have slowed down. And I mentioned in my note that there's been some acceleration in some of them, most specifically in Europe. So that hasn't changed a bit. The U.S., there are a couple of pockets where you have people that are slowing down. Tier 3s still had a good quarter. They still seem to be going well. In the U.S., it's more about inventory adjustment as well. I would say they're similar, although I would say the thing going on in Europe seems to have been less impacted than what we saw in the U.S. I don't know if I answered your question or not, Michael, I hope so.

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

You did actually. You hit on every point, and that was an extensive answer, so I appreciate that. But I do want to follow up and then I want to ask one more question. The follow-up is on the piece of inventory that you really came to your attention this quarter on the CPE in the channel or at the customers as well. I think there was some commentary on the call that you really don't expect that to get very much worse. It sounds like it may be impacting part of this quarter, but you don't expect -- but my question is, if you say for WiFi routers, lead times already went from 30 weeks to 16 weeks, I'm just roughly, I hope those are in the ballpark. I mean could they go down again to 8 or -- so could there be more to go on that inventory, it seems like you're more worried about other inventory you might not know about and less worried about the CPE now. Is that fair?

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

Yes, that's fair. That's true. I mean we think that the -- we've checked the inventory levels. I think at the revenue projections that we have right now, we actually -- right now, our outlook, this is getting beyond what our typical guidance would be. But our outlook is for subscribers to actually tick up slightly this quarter. And that's because there are so many different variants and some people have some and some people don't have others. But yes, that's -- we think that's kind of -- that bubble is kind of -- we've gotten the biggest piece of that bubble. It will take some time for it to play out until it gets back to its last year levels. And we're kind of projecting that to take the next 6 to 9 months before it gets back to that level. So we will see improvement. And we think at the end of that we hit the big pocket this quarter. So yes, I hope that answered.

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

Okay. Great. And then at this revenue level, margins aren't very good, but supply, we see lead times, clearly supply is getting better. We expect some of these expenses -- excess expenses to go away. So should we see from where gross margins are right now meaningful improvement in the back half of the year, both because of revenue but lower supply chain expenses?

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

Yes. Let Uli touch on that.

Ulrich Dopfer - *ADTRAN Holdings, Inc. - Senior VP & CFO*

Yes. So supply chain expenses obviously are going down as we speak. We've seen it in the first quarter, and we assume that this will continue to drop. And then, of course, it's a matter of economies of scale and also product and customer mix. But yes, to answer your question, we assume increased gross margins in the second half of the year.

Operator

And your next question comes from the line of George Notter from Jefferies.

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

I guess I wanted to just ask about -- you mentioned that the fiber access business had a strong quarter. The optical business had a strong quarter. I mean could you just give us a sense for where lead times are in those products right now? Where were they, say, in the summer of last year? And then do you think there's some possibility of excess inventory build in those areas of the business as well?

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

Yes, I think there is some possibility. So let me start with lead times. So lead times, those tended to have the most difficult chip situations because they tend to be very complex, chips that are using those typically higher priced chips. And then in some cases where you're buying optical sub-assemblies, those lead times also extended out as well. And in general, you can say 52 weeks. And so the thing that's kind of a little bit harder to figure out is, okay, at 52 weeks, does this cycle less than over 52 weeks. So we were forecasting out 52 weeks. We were still getting delays in that. I'm just talking about, let's say, a year ago or even a year ago, let's say, second half of second quarter of last year. Yes, so 52 weeks plus, I guess, as you could say. But we were forecasting out 52 weeks when we're replacing orders, in some cases, for 52 weeks ahead. So you would think that would start getting better. And that's really kind of the benefit that we're seeing right now in some of these complex chips, that is getting better and those lead times are coming down; one, because of orders that we place and two, because lead times in general are diminishing. We still have this issue. There are a few chips that still hold up things. But I would say that's materially better today than where it was even this time last quarter. So that's just getting better. I don't -- did I answer your question, George?

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

Yes. I'd just be curious about where your product lead times are now?

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

Yes, I would say for optical and then OLTs.

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

Yes, yes.

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

I would say, so we were asking for 52 weeks. I think in general, we were getting solid commitments out there with some customers. I would say, in general, we are probably getting 6 to 8 months, and this is just off the top of my head kind of solid commitments and then some flexibility beyond that. That's, let's say, 6- to 8-month period is probably now down to 2 to 4 months. In general, there are still pieces that you got to -- that are still constrained, but in general, I would say it's half.

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

Got it. Okay. And then also, I know you started shipping the 6330 in the last few months. I'm just curious about how that product is doing. What are early customer receptivity look like for that product?

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

Yes. So we have started shipping that predominantly in Europe, although we started shipping a few here. It is still a bar to build. We are still -- I mean we're not at full production, but we are shipping -- we shipped some last quarter as well. So we're not meeting demand yet, but we're getting there. And a majority of that is just refining the operation process. I can't stress you enough how complex of a product that is. We've got it down right now, and we're continuing to improve the yield on that.

Operator

And your next question comes from the line of Ryan Koontz from Needham & Company.

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Ryan Boyer Koontz - *Needham & Company, LLC, Research Division - MD & Senior Analyst*

I wonder if you could update us on your latest view on the U.S. and European government subsidy programs and whether you're hearing much pushback in terms of interest rates and kind of ROI hurdles that's impacting customer programs? It sounds like from your initial comments, Tom, there's not much of that, but any color you can share in that regard would be helpful.

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

Yes. Yes. So there's a list of questions that we're asking people when we go into -- when we have these conversations about inventory. And that is one of the questions that we've covered. Every once a while, you hear some spotty people that say -- I say spotty. You have sporadic comments of planting builds tighter lead times. So they're kind of getting the capital and then executing when they get the capital and then kind of shortened periods for build and it's kind of a project-by-project basis versus the entire plan. I would say that's still very sporadic. In general, we just haven't heard an impact on kind of project plans. We do have a couple of -- we have one big instance where there's a lot of talk about capital plan, which really wasn't because of capital cost, it was more about capital overrun, our capital expense overrun. As I mentioned in my comments, we've got just solid reassurance that that's not impacting our program and that, if anything, they're looking to accelerate it. And I will say the big plans in Europe. We have a 22 million homes passed, the 25 million homes passed. None of those have seen -- there's been no waiver on any of those plans. So I would say that those have not been affected. In relation to the funding, we have some funding and maybe I'll even to get a bit of color on Europe, I'll ask Christoph to comment on the funding in Europe. In the U.S., those things are still on track. We are getting RDOF money at this point through some of the carriers that we have that we're expecting that the majority of the RDOF funding is still a ways off. The current forecast for that is kind of into '24/'25. So the RDOF money is where we're actually starting to see some tick-up in demand, and that will be kind of rolling through this year -- this year and the next year.

Ryan Boyer Koontz - *Needham & Company, LLC, Research Division - MD & Senior Analyst*

And capital overrun, is that more on the labor side?

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

I would say -- the answer is yes. But because of the multiplying effect as you deploy sites, labor is typically the biggest thing. Yes, but the impact is if you cut labor, you're cutting deployment. So but the direct answer is yes. And that has, of course, been impacted by other things. Christoph, any comment on the capital -- or excuse me, on the funding, government funding in Europe?

Christoph Glingener - *ADTRAN Holdings, Inc. - CTO*

Yes. So we also see going on in Europe. It's a little bit more complex, I have to say, Ryan. So we see it more in consortiums coming together, looking at underserved areas, country areas and so on. But it's different as Europe is more complex in different countries and different areas, but we see it going on and also helping to accelerate. But even outside the funding, we see some of the bigger customers even accelerating and announcing to accelerate the fiber build outs.

Ryan Boyer Koontz - *Needham & Company, LLC, Research Division - MD & Senior Analyst*

Got it. Helpful, Christoph. And Tom, one quick follow-up on feedback on kind of your joint customer engagements cross team, cross product, in terms of some of your larger accounts?

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

Yes, universally positive. We are in one big -- well, first of all, we are -- I mentioned before that the RFP situation in Europe is gangbusters right now. There is a piece of that that is directly related to the strength of the combined company and the perception within Europe of the combined company. And I'll even let -- Christoph, if you want to comment on that as well. But that has been not a single negative to that. And we have -- the earliest wins have been some cross winds here in the U.S., which is kind of as expected because smaller carriers tend to make decisions quicker. I think I saw a number we have 33 that are either closed or near closing. Majority of those are in the U.S. But the benefit that we've seen in positioning within RFPs, both for existing customers and new customers actually has been very beneficial. Christoph, you want to give any color on that?

Christoph Glingener - *ADTRAN Holdings, Inc. - CTO*

Yes. So I would basically put it in three different categories. One is what we expected, basically market reach. Like Tom just said, for the ADVA products in America, that extended market reach for those products, which we didn't have stand-alone. The other one is size. It helps with some of the bigger carriers and discussions. Obviously, we've seen as a bigger company, better supply and so on, and everything which comes with it. And the next one is market reached the other way around in Europe with a stronger, let me say, sales force on the ADVA side or more distributed one in Europe. And obviously, we can pull through ADTRAN products on the European side.

Operator

Your next question comes from the line of Greg Mesniaeff from WestPark Capital.

Gregory Mesniaeff - *WestPark Capital, Inc., Research Division - Research Analyst*

I was wondering if you can give us some color on the Mosaic One deployments and how they're ramping? And what kind of impact are they having on your gross margins, both in this current most recent quarter and how you see that playing out later this year?

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

Yes. So I mentioned before that the uptick of Mosaic One has been good. It is still early days and that it's still taking us some period of time as we fine-tune the product to be able to get turn up time. So it takes -- in many cases, and in most cases, months to actually get the product installed. It's not just a piece of software that you download. And so the uptick is right now, it's not so much demand limited. It's queue limited in getting these customers onboarded. So we have -- I think the number I had was 200 that are right now in queue or executed, and then they get executed in different phases. I will tell you, still, it's probably -- the impact of the company is nowhere near where it will be just actually if we were to monetize the number of contracts that we have today currently signed. But at this point, it's still -- until we get those customers up and running and get the subscribers on boarded, it's still a relatively small number. I will -- the uptick has been fantastic. We added 50 customers in the last quarter, which is a 20%, 30% or something like that in the last quarter. And that uptick we expect to continue, if not grow. So it will be a meaningful number, let's say, a year from now. I don't think it's a meaningful number now because we're still in the early onboarding phase of these customers.

Gregory Mesniaeff - *WestPark Capital, Inc., Research Division - Research Analyst*

Got it. And just a quick follow-up on the same topic. I know Mosaic One originally started as a U.S.-centric product.

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

It's still U.S.-centric.

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Gregory Mesniaeff - *WestPark Capital, Inc., Research Division - Research Analyst*

Okay. So there's no plans to migrate it beyond the U.S?

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

There are plans to migrate it beyond the U.S., but there are not plans today because we need to make sure that we execute well in the U.S. and to broaden that focus to a new customer base and there are differences, and in many cases, implementation of that is a little more difficult. So we need to get our onboarding time down as the #1 thing we've got to do. And we're rolling out some things to actually do that. So we're kind of getting it set up here. And then I think the jump over will be relatively straightforward because we'll have 90% of the required software features for the customer base. But right now, our focus is the U.S.

Operator

Your next question comes from the line of Paul Essi from William K. Woodruff Company.

Paul Essi

I wanted to talk about the 6330. The slow rollout of that, is that causing any delays in some of the larger customers you have, particularly in Europe at this point?

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

Yes, the answer is yes, but not materially. So we have another product called the 6320, which is the precursor. But to the extent people aren't getting able to deploy 6330 that they're deploying 6320s, which is a kind of a -- it's just a less density kind of less capable. It is what they -- many of them that are ongoing customers have been using for some period of time. So that whole 6300 series is a family of products with the 6330 kind of being at the top of that family. That itself was a little bit hindered during this supply chain crisis that had to be redesigned two or three times in order to continued supply. That seems to be now stable, and we're able to supply that product. So where they're not doing it, they are -- the issue where it could really hurt us is in new lab designs. I mentioned that we've got -- just on the access side in Europe, we've got six new large carriers that are in different phases of testing or RFP decisions. And what we're doing is prioritizing those. So where we have customers that are going through some selection process, we're making sure that they get those units.

Paul Essi

Okay. Second question is, are you seeing any constraints in labor in trying to deploy some of the fiber out there? And then also as some of this government money starts to roll in, what do you expect that labor market to look like 6 to 12 months from now?

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

It's going to be tied -- well, it depends on how many people that's direct -- that's kind of tied to unemployment rates and things. So where we have seen constraints has been mostly in Europe. We have seen projects that are throttled. In fact, if you look at on a project-by-project basis, a lot of deployments are throttled by labor cost -- or excuse me, by the ability to get labor. In the U.S., it's not as predominant. It does happen, but I would say it happens -- it's noticeably works in Europe. I would expect that -- I really don't know. I think people -- there have been people that have been very progressive on there. We have customers that have gone out and started training programs kind of internship programs to onboard a material amount of labor like a significant number of people and bring them into the workforce for this. These are typically the ones that have these kind of longer-term builds. And I think they're doing a good job of that, and I think they're actually seeing the fruits of that actually happening this year. But in general, it is a very tight labor market. And I think it's just going to be dependent on what's the recession, how deep of the recession, what

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does that do to the labor pool. But I mean there are more people deploying fiber today than any time in history. And that is a skilled workforce that has to do that, but I do think they're actively bringing people into that workforce.

Paul Essi

Okay. So at this point in time, you don't see that as the next bottleneck like the supply chain was?

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

I don't think it's the next model. I think it has been a bottleneck. And I don't hear people talking about -- that's not high on the list of things that they want to talk about or that's a worry. I met with a carrier here in the U.S., what, three weeks ago. And we talked a little bit about their labor pool. And they were the ones that are doing some job shifting and things. And that's just not a big worry for them. Their projects are labor limited, but they fall in line with the capital plans that they have in place and they're able to meet them. I really didn't talk about elevation in the wage base in that segment. I'm sure there has been some, but it's just not -- I think it's just kind of the ongoing tax that's been there for some period of time.

Operator

And your next question comes from the line of Tim Savageaux from Northland Capital Markets.

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

So in kind of guiding flat to a little bit up for Q2. I mean you envision a similar pattern to what we saw in Q1, which is growth in access and optical and maybe further declines in subscribers. And if that's the case, understanding inventory visibility is tough, would you expect Q2 to be a bottom on the subscriber side? And I have a follow-up.

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

Yes. We do expect at this point in Q2, really, what we're expecting is subscriber to pick up slightly. So you can kind of think is slightly up across the board. And some of that will still unfortunately be in just what our delay can and can't ship, although that is less of an impact. So we think somewhere around this area is the bottom. We're being very -- the way we're looking at this quarter, as you can imagine, is we're being very cautious in the way that we're looking at it. So if I don't have a PO or near line sight to a PO. And if I don't have material or very near line sight to the material, we're throwing it out of the forecast. So some of that will just be our ability to execute in the different segments. But in general, I think you're correct. This period of time, we expect to be kind of the downside of what happens in Subscriber Solutions.

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

Great. And as I think it was mentioned before, is what ADVA's got into stand-alone is a pretty steady increase throughout the year. So it seems like the second half ought to be stronger than the first half there. I would expect the same for Access & Aggregation maybe with the caveat for some of the inventory you comments you made before, whether that's kind of spreading or not. But in general, is it reasonable to extend from the optical strength that you're looking for a stronger second half and just given the level of activity on the Tier 1 front, it seems like that should be the case for access, but I wonder what you're willing to kind of say on that right now, sort of second half versus first?

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

Yes. I'll be honest, I'm not willing to say a whole lot. I mean if the -- if you look at current projections, then -- yes, I mean it looks like because there's been the appetite for deployment of those products still is robust, and we have new projects coming in. My trepidation and the reason you won't

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hear me say that is I don't really know where inventory bubbles are until we see the bubble. I don't know what the impact of lead time adjustments is ultimately going to do to the extent that capital gets tighter. So depending on your capital cost and your appetite for inventory, you can squeeze and then try to bet on the vendor to be able to make up for shrinking lead times beyond what their stated goals are. And there will be some customers that will want to do that because the definition of normal has disappeared over the last two years. So everybody is trying to figure out what normal lead times are right now. And it is spotty. There are some areas where getting a product the next day is not a problem. And then there are some problems with getting a problem in 6 months, it's still a problem. So that adjustment of infield inventory, regardless of the segment relative is optical or whatever, I think it's still a period of time that is still something that we have to see. And so when you think about that kind of short-term view, I see no benefit, honestly. We had a huge disappointment, and internal team disappointment, a personal disappointment in what happened in Q1, and I don't want to repeat that. And we've gone through periods. We've been through cycles before where things happen and visibility looks good if you look at activity, but there are other factors that are playing into what ultimately drives near-term demand. And so I'm not going to hang ourselves out there on that near-term demand picture. What I'm going to do is make sure that we manage through the near term as we have many times in the past and that we actually keep our eye on what the bigger picture is, which is we are in a wholesale fundamental change in the network. The biggest player in that network has been kicked out, and we are absolutely positively the best company and the best product set that's available in the market, and we need to capitalize on it. And that's where our focus is.

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

And that's fair enough. A couple of quick questions, if I may, just last question. I think it was mentioned R&D spending was pretty heavy in the quarter. I'm wondering if there's anything in particular that you can call out as a driver, whether it's finishing development of certain platforms or what have you? And kind of same thing with the increased borrowing in the quarter. You seem to put some of that on the balance sheet, but any particular drivers there? And that's it for me.

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

Yes. I'll let Uli add any color to it. But in general, with the balance sheet, there are -- it's a matter of receivables and payables, and that fluctuates a little bit from quarter-to-quarter a little bit more this quarter, and there were a couple of things that were kind of one-time things that hit us that probably won't be repeated. In the R&D thing, we do have some programs that are finishing up, and we have some contractors on some programs that are finishing up. So we did see kind of an uptick there. As you can imagine, we have a very, very focused eye on expenses. And there will be rationale for anything like that on a going-forward basis, but there were some programs that, in fact, affected that, that will be in line with this quarter. Any other color on that, Christoph?

Christoph Glingener - *ADTRAN Holdings, Inc. - CTO*

Well, I would just say R&D spend across the board, like Tom said, as you know, we're still in a time where inflation hits us kind of depending on the region more or less. On the debt side, I mean, as you could see, our inventories remain high and AP went down. So obviously, we used some of the debt to finance our working capital.

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

Anything else, Tim? All right. Thanks very much. With that, I see that we are at the end of our questions. So I appreciate everybody for joining us this quarter. And we look forward to a much happier conversation next time next quarter. Thanks very much, everybody.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.

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