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ADTN.OQ - Q1 2024 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 2024 Earnings Release Conference Call.

(Operator Instructions)

As a reminder, today's call is being recorded. 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 the risks the risks detailed in our earnings release, our annual report on Form 10-K and our filings with the SEC. 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.

We undertake no obligation to update any statements to reflect the events that occur after this call. During the course of today's call, we will refer to certain non-GAAP financial measures. Reconciliations of non-GAAP to GAAP measures and certain additional information are also included in our investor presentation and our earnings release. 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, Julianna. Good morning, everyone. We appreciate you joining us for our first quarter 2024 earnings conference call. With me today is ADTRAN Holdings CFO, Uli Dopfer. Following my opening remarks, Uli will review the quarterly financial performance in detail, and then we will take any questions you may have. Our first quarter revenue came in as expected with revenue just above the midpoint of our guidance range and non-GAAP operating margin within guidance. Our focus on managing expenses and reducing inventory levels helped us achieve positive free cash flow during the quarter despite the near-term headwinds that continue to impact service provider spending.

While we do see signs that the market will improve as we move through the year, we will continue to focus on managing our expenses and further reducing our inventory levels. Taking a closer look at the results in the first quarter, the overall revenue and geographical mix was very close to the results from the previous quarter, with 63% of our revenues coming from outside the U.S. On the product mix, we were well balanced in revenue across the 3 categories, with 31% of our revenue coming from subscriber solutions 36% of revenue from access and aggregation solutions, and 33% of our revenue coming from optical networking solutions. Our subscriber solutions category was down 7% quarter-over-quarter after posting a strong quarter in Q4. The Access and Aggregation solutions category was up 27% quarter-over-quarter, driven by an increase in shipments of our fiber access platforms for both the European and U.S. customers.

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Optical Networking Solutions continued to be impacted by inventory reduction initiatives with customers. We had 2 primary areas of sequential growth in the quarter. In the U.S. market, we had a strong quarter with our small to midsized service provider customers purchasing our fiber access platforms and residential fiber CPE. This customer segment was up both sequentially was -- up sequentially for both direct purchases and indirect purchases through our distribution partners. The second area of strength was our large customers in Europe. This customer segment had a strong quarter with purchases of our fiber access platforms and Ethernet CPE. These 2 customer segments, the small to midsized surplus providers in the U.S., and the larger service providers in Europe are the segments where we continue to see the highest growth potential moving forward, given their close alignment with our strategic initiatives and portfolio investments.

These 2 key strategic initiatives to maximize the investment opportunity in fiber-based broadband networks in the U.S. and high-risk vendor replacements in Europe, continues to drive our corporate focus. Taking a closer look at these market segments, I will start with the U.S. market. This past week, we hosted our broadband Business Solutions Summit at our corporate headquarters here in Huntsville. This is a multi-day event that we host twice per year with attendees primarily being small to midsized U.S. broadband service providers. These are the customers that are leading the charge in building out fiber across the U.S. and the energy there was high. It's as high as it's ever been, and we had a record attendance with over 180 customers and partners at the event. That excitement and energy really comes from 2 areas. For one, despite some recent challenges, it is still a good time to be in the market. Nearly half of the U.S. households still lack a fiber connection and the government stimulus programs funding further investment in these networks are still in their early stages.

During our event last week, a quick poll of the audience showed that more than 80% of customers in attendance we're participating in broadband stimulus programs. The second driver for this excitement comes from the broader set of needs that we can meet with this customer segment. We have been very intentional in creating a more comprehensive fiber networking portfolio that is optimized for the needs of these small and midsized U.S. service providers. These customers ideally want to buy in-home networking solutions, business networking solutions, fiber access platforms, optical transport platforms, network automation software and cloud-based monitoring tools from a single vendor that they can trust to deliver reliable solutions and support them throughout their deployments.

On top of that, the solutions need to integrate seamlessly with their existing systems without a lot of custom IT integration activities. There is only one vendor that can check all of these boxes and that's ADTRAN. You can go through each segment of our portfolio and see where our investment, more comprehensive and integrated portfolio are paying off. In our residential portfolio, we have launched Intellifi, along with our latest SDG series of WiFi 7. We have already signed up dozens of customers for Intellifi, making it the highest growth application in our Mosaic SaaS application suite and hoping to push the total number of service providers adopting Mosaic 1 to 400. We have added 36 new Mosaic 1 customers this past quarter.

On the network infrastructure side, we have taken the best fiber access platform in the industry, our SDX Series and integrated into the leading billing systems targeting the U.S. regional service providers. These efforts have led to a surge of deployments over the last 6 months, helping us add 9 new fiber-to-the-home operators just this past quarter. These customers were a mix of new operators and vendor swap-outs. As operators build out these higher-capacity fiber access networks, they need to upgrade their transport networks as well. We have spent the past 2 years developing an optical network solution that is optimized for the needs of regional networks. Regional middle mile, backhaul networks need the capacity and reach enabled by technologies like Coherent, DWDM, widely deployed in core networks, but they need these technology to be optimized for regional network deployments.

This network optimization means integrated temperature hardened pluggables, enabling up to 800 gig speed instead of the traditional large overlay systems. That also means you need end-to-end service automation and precision monitoring of the fiber infrastructure. After a sizable and well-thought-out investment, we have launched an optical portfolio that is tailored to address all these needs and is the perfect complement to our fiber access and subscriber solutions portfolio. Reinforcing that progress over the past 2 quarters, we have had over 20 U.S. broadband service providers start to purchase our Ethernet and optical portfolio that were previously broadband-only customers for ADTRAN. We see this segment continue to accelerate as these customers increase their builds with stimulus funding.

Our fiber networking solution set, covering everything a small and midsized operator needs to deploy fiber to every home, business and 5G site is paired with an increasingly integrated management suite that simplifies the deployment of operation of these networks. We believe the progress in selling our complete portfolio offering paired with our strong regional capabilities that include local manufacturing has us well positioned to succeed in upcoming BEAD project in the U.S. One notable milestone that are local with our local manufacturing is that we have now shipped over

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1 million OLT ports that comply with the latest build America by America rules that is part of BEAD, highlighting our long history of U.S.-based manufacturing.

Moving to Europe. The theme around investments in our portfolio, our portfolio beginning to pay off as is consistent with what we are seeing in the U.S. market. But that customer segmentation and market drivers are a bit different. In Europe, many of these service providers are migrating away from high-risk vendors, and they are making the shift as they upgrade their fiber network infrastructure. Also, while we are very successful with smaller alt nets in Europe, the bulk of the investment is still coming from larger service providers in the region. These customers value a trusted secure partner with a broad portfolio and scale deployment in the region.

It is also just as important to have an in-region R&D sales installation and support services and supply chain capabilities as well. ADTRAN is really 1 of only 2 vendors that can address these needs. As I mentioned earlier, this past quarter was very successful with our large European customers deploying our fiber access platforms. For our 2 largest customers in the U.K. and Germany, we continue to ramp deployments of our latest high-density 10-gigabit fiber access platform, the SDX 6330, which was the key catalyst for this growth this quarter. We were also selected as a vendor in the latest Ethernet aggregations service offering at one of these customers.

The technical superiority of the SDX 6330, which has better power efficiency and density than competitive solutions, while also building on a more modern architecture has us well positioned for sustainable success with these customers and other operators in the region. One of these operators is a multinational Tier 1 operator where we have already been deployed in 3 countries. We have recently launched customer trials in a fourth and much larger country that they operate in, opening new growth opportunities for us later this year.

In another Tier 1 fiber access operator that we won last year with the SDX 6330, we continue to make great progress through the lab and remain on track for scale deployments next year. In addition to these projects, we have recently awarded a strategic software award for MPLS Edge routers with a multinational Tier 1 operator. This MPLS software suite for our packet aggregation platforms has experienced high demand in the past 6 months, providing another growth opportunity for us moving forward. On the optical transport side, where we have traditionally been very strong in Europe, we remain on track to start deployments late this year with our recent Tier 1 optical wins.

With the recent launch of the M-Flex 800 and our latest 800-gig optical platform, we are still well positioned to benefit from the next upgrade cycle from 400 gig to 800 gig across our broad optical customer base in that region. In summary, we have introduced key enhancements across our portfolio, enabling us to be more competitive in landing new customers and expanding our business with existing customers. These portfolio enhancements paired with our strong regional presence and progress in selling our complete portfolio offering have us well positioned for success in the ongoing investment cycle and fiber networks across both the U.S. and Europe.

While we remain confident in our long-term outlook, we see a path to growth in the quarters ahead. We continue to see cautious spending from service provider customers, driving us to continue our cautious approach to our forecast and operating model. As a result, we will continue our focus on becoming a leaner, more efficient and more profitable company with a best-in-class fiber networking portfolio.

With that, I will turn things over to Uli to provide a review of our financial results. And following Uli's remarks, we will answer any questions you may have. Uli?

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

Thank you, Tom, and hello, everybody. I will cover our Q1 2024 results and provide our expectations for the second quarter of 2024. I will be referencing non-GAAP information with reconciliations to the most directly comparable 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.

Q1 2024 revenue came in slightly above midpoint of our guidance at $226.2 million and were down 30% year-over-year, but slightly up sequentially. Our Network Solutions segment accounted for 80.1% of revenues in Q1 2024 compared to 87.2% in Q1 2023 and 80% in Q4 2023. Our Services &

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Support segment contributed 19.9% of revenues in Q1 compared to 12.8% in the year ago quarter and 20% in the previous quarter. Access and Aggregation contributed 36% of revenue and was down 16% compared to the year ago quarter, but grew 26.6% sequentially. Our optical networking solutions category contributed 33.2% of revenues and was down 49% year-over-year and down 12% -- 12.7% quarter-over-quarter. Subscriber Solutions contributed 30.8% and was down 12.1% year-over-year and down 7.3% quarter-over-quarter.

International revenue made up 63.2% of total revenue and domestic revenue contributed 36.8%. We had two 10% or more of revenue customers in Q1 2024. Q1 non-GAAP gross margin was 41.6% and increased by 429 basis points year-over-year, and was slightly below Q4 2023. The year-over-year improvement is mainly driven by lower manufacturing and transportation costs and a more favorable customer product mix. Q1 non-GAAP operating expenses were $102.7 million, 18% down year-over-year and slightly up quarter-over-quarter. The sequential increase was mainly due to unfavorable currency exchange rates as well as two seasonal effects. Year-over-year, we reduced non-GAAP R&D spend by 20% and SG&A expenses by 16%. Non-GAAP operating loss was $8.8 million which translates into a non-GAAP operating margin of negative 3.9% compared to negative 1.4% in Q4 2023.

Our operating margin was within our guidance range of between minus 7% and 0% of revenues. The sequential decline in operating margin was attributable to higher OpEx and slightly lower gross margins. The year-over-year decrease in operating profitability was due to lower sales volume, partially offset by improved gross margins and operating expense reduction. The company's non-GAAP tax benefit for the first quarter of 2024 was $13 million. Total non-GAAP loss was $1.7 million and after adjusting for minority shareholder interest in Adtran Networks SE. This resulted in non-GAAP diluted loss per share attributable to the company of $0.02 per share compared to $1.09 in Q4 2023 and $0.14 in Q1 2023.

Turning to the balance sheet and cash flow statement. In Q1 2024, we made significant improvements to our working capital. Trade accounts receivables were $187.6 million at quarter end, resulting in DSO of 75 days compared to 88 days in the prior quarter. We reduced our inventories by $40.1 million compared to Q4 2023. The improved working capital resulted in positive operating cash flow of $36.6 million compared to a negative operating cash flow of $16.3 million, an increase of $52.9 million quarter-over-quarter. Consequently, we generated $23.2 million of free cash flow. This resulted in a noticeable increase in cash and cash equivalents which came in at $106.8 million, a quarter-over-quarter increase of $19.6 million or 22%.

In summary, near-term headwinds continued to impact service private spending throughout the quarter. We continue to focus on the execution of our business efficiency program and as a result, managed to significantly increase our cash flow quarter-over-quarter, resulting in positive free cash flow. Even as we continue to see cautious spending from our service provider customers, we remain confident in our long-term outlook as we see a path to growth in the quarters ahead. We are convinced that the long-term growth drivers for our business are fully intact. We expect that the investment in data-driven infrastructure and the fiber everywhere future will continue, supported by stimulus funding and the desire to reduce exposure to high-risk vendors.

We continue on capturing fiber footprints with our upgraded fiber access and optical transport platforms while driving the adoption of our latest subscriber platforms, software solutions and high-value services. We maintain our focus on becoming a leaner, more efficient and more profitable company with a best-in-class fiber networking and software portfolio. Consequently, for the second quarter of 2024, we are narrowing our guidance range to between $215 million and $235 million and we expect a non-GAAP operating margin between negative minus 3% and positive 2% of revenues.

Once again, additional information is available at Adtran's investor web page at investors.adtran.com. I will now turn it back over to the operator, and we will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from George Notter from Jefferies.

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

I guess I would like to just step back and kind of, I guess, better understand the bigger narrative here on the business. Obviously, over the last year, 1.5 years, we've been talking a lot about excess inventories at customers. I know that your CPE business kind of went through that excess inventory and digestion phase. I think we're out of it now, but I'd love to hear your comments there.

And it seems like we're still in that phase with optical, but, just give us the picture on excess customer inventories? What do you see? What parts of the business are getting better? What parts of the business are still going through it? What's the picture?

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

Yes, sure. So let me start with where I think the least amount of inventory is, and that's in our access and aggregation and predominantly our fiber-to-the-prem OLT product line. So there's just not a lot out there at this point in time. So that one has been the least impacted and I think you can kind of see that in the numbers and the growth that we saw on fiber-to-the-prem, middle of the road would be subscriber.

I think there are many customers that no longer have inventory situations, but there are some that still do. I mean we kind of did I talked to some customers this last week, and there are some that still have a buildup of inventory because they just got too many in. But I would say it's a mixed bag with more -- every month that gets better. And then optical, I think you're correct. I think that's probably the least one where we're through that inventory situation. If there are some larger customers that just have some, and those impact the numbers kind of disproportionately, but that itself is getting better, but it's -- yes, it's got the longest path ahead of it. Does that answer your question?

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

Any expectation on when you would get through that inventory on the optical side of the business?

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

I think it's going to end up being a lot like the other three. So we'll see some pickup and the pickup will be muted because of the ones that do have it. But they'll -- we'll see some improvement in the second half of the year. We may get most of the way through it. If I look at the inventory situation today at those larger customers, our expectation is we get through that in the second half.

But you'll see some, I think, that will come on stronger. So I would expect better numbers going forward. Let me caution that a little bit. I mean, we feel like we're at the lowest level at this point in time, but we could be surprised. But at this point in time, we feel like we're -- the pluses and minuses even themselves out in history. On the other two, we expect those just to get stronger through the second half.

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

Okay. Great. And then you also made some comments about just softer service provider spending, cautious service provider spending. I guess I want to delineate between what is a byproduct of excess inventory versus what is just genuinely softer consumption rates by customers. Do you have a perspective on that?

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

In -- it depends. There are so many different ways to dissect that. So in Europe, especially with larger customers on the access side, they're just moving ahead with their plans. So one of the reasons we had a strong European quarter. In the U.S., I'd say there's some caution, but it's spotty. And you talk to customers, I'm sure as well. It depends on which customer you're talking to.

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So there's some that are moving forward. There are some that are equity backed that are moving forward that have aggressive plans. There are some that are trying to see how the stimulus thing is going to roll out. And then there are some that are kind of in both camps. We want to see how stimulus is going to roll out, but they're going ahead with their plan. So it's -- I think it's a mixed bag. I'd say demand is there, but I mean there's no doubt that demand has been impacted by the current environment, but trying to figure out how much is inventory or not. I would say still inventory is the bigger -- by far, the bigger hangover.

Operator

Our next question comes from Michael Genovese from Rosenblatt Securities.

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

I guess, first, I sort of understand what's going on in access and aggregation. And then it sounds like we need a couple more quarters of inventory burn off for optical platforms before we see an uptick there. I guess could you comment more specifically on subscriber solutions and experiences? What's going on with inventory versus demand there? And also just roughly, like how much of that is related to how much of that category is related to access and how much is related to optical -- and if there's any differentiation to answer the first question between optical and access in subscriber that would be interesting to hear about.

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

Well, let me just give you some things that just come off the top of my head here that I think may help share some light on it. If you look at -- so first of all, subscribers had a pretty strong quarter last quarter, especially if I look at the residential piece of subscribers. So it was down a little, but it was not a bad quarter for that residential piece of the business, which makes you feel like that inventory piece is working itself through the system.

And I think for most people, it's a past event versus still an upcoming event for most customers. So that piece as well. The only piece -- the piece on subscriber, even on a year-over-year basis, right, Subscriber Solutions was down on a year-over-year basis. But I can pinpoint that residential was actually up, right? ONT shipments were actually up. CPE Ethernet net shipments were actually up. The only thing that was down was some legacy products that we sell to 2 large carriers well, one large carrier in Europe and one large carrier here in the U.S. who are who we know have inventory situations. If I look -- if I were to subtract those 2 customers from the mix, that whole category would be up sequentially and year-over-year for that matter. So we are definitely getting through that bubble..

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

Okay is there -- meaning -- I guess -- I mean, I don't know if you have this number or will give this number, but I mean I assume most of subscriber solutions is related to the access business, but I think there's probably also a meaningful piece that's related to the optical business. Could you help us understand that breakout at all?

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

On the optical side, it's the Ethernet knit piece is kind of the traditional, I'll call it, Adva piece that we're talking about here. And that business is actually doing pretty good. And then the other pieces of that are the subscriber piece is broken up multiple areas, right? One is residential, and that's kind of the ONTs, RGs, the things that are driven by fiber to the prem shipments. That business is up on a year-over-year basis.

Piece that is down is we have if you remember, traditional switches and routers, but those typically go through carriers, and they go along with service offerings from those carriers. And we have 2 big customers that drive that business, and both of those customers were down. That's the whole totality of subscriber solutions.

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

Got it. That's helpful. And then my other question is I mean it just -- you guys are clearly doing a lot on the management front, too, I think, as you say, make it a more profitable company even at -- if revenues are lower than before for a period of time. And we can see that, but I think that -- I want to make sure I'm not missing anything, right? Because there's restructuring and there's working capital management, bringing down inventory.

I guess I look -- my question really is -- am I missing anything there that I should be focusing on? And -- but then also, can you give us an update on anything related to the real estate portfolio transactions?

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

Yes. So we have -- we do have some real estate here in Huntsville that is for sale. We have two different, think about it as two different pieces. We have a tower that at this point in time, we're at 90% unoccupied. We're moving the rest of that. I think this quarter, we should be done with that. That's on the market right now. We do have interest in that. We haven't closed anything.

We also have the sale leaseback potential on the other building here in Huntsville. That is what we're putting off and just try that we're doing the right thing at the right point in time on that. So that we may or may not execute on that one.

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

And were there any other categories of kind of like the OpEx restructuring, working capital management? Any other kind of big categories of what you're thinking about to improve the market.

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

These are the main categories, Mike. Our business efficiency program includes getting more efficient as a company, bring optimizing costs, optimizing physical footprint. And then, of course, the working capital measures you mentioned, the big piece here is the management of inventory.

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

We did also announce the closure of a site in Germany earlier in the quarter.

Operator

Our next question comes from Ryan Koontz from Needham & Company.

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

We ask for some feedback from your customer summit you had there. we heard one of your peers in the U.S. here talk about BEAD really stalling customer activities, customer planning for '24 we've also heard -- I've heard my work, a lot of concern from the smaller customers about the regulatory requirements around BEAD, maybe some pushback there. Any feedback for us on either of those topics from your Summit?

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

Yes. So we talked a lot about that. And there are -- what BEAD for the most part, hasn't started flowing yet. It's real clear that some states are better at implementing than others. There was a lot of interest there. There are a lot of people I mentioned like 80% so that they were taking stimulus dollars. They were getting ARPA funds today. There are different buckets out there, but most of them are participating in some form or fashion.

There was skepticism on BEAD, but in the regulatory piece of that, and we had some breakout sessions on that. But you got to -- you have this group that's just going to do it and think they can do it and don't see -- they see it as a headache, but they see it as a manageable headache. And then you have people that are -- you have some that are saying no, but those are typically have different financing arrangements. I would say the majority of people there were very open to it, and we're kind of just waiting to see how the state rules, roll out and where they get in line at. So I think that's very fluid. The money feels like it's definitely going to be taken, it's just who's going to take it. But there was -- it was way more like I said, 80% I'm saying they were going to take some point or fashion to see this funding order are we taking it.

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

Got it. Helpful, Tom. And on the OpEx efficiency, I understand there's some -- something some onetime impacts on FX and probably seasonal kind of payroll type things that hit Q1. Where are we headed to there in terms of OpEx efficiency? Any more you can share in terms of how you think about that line for the rest of the year?

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

Well, we haven't gotten to our -- I think we laid out a plan where we -- Q2 was going to be kind of where we kind of hit our ultimate target that we want to get to, and that's actually below the Q1 level, and that's where we're headed to this quarter. Uli I don't know if you had any more things granular.

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

We said not the last earnings call, the earnings call before, if you recall it, Ryan, we said our target is to reduce our 2024 expenses by $90 million compared to 2023, and this is still our target.

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

All right. Thanks. I think we have any more industry regards.

Operator

We do have one more question from Tim Savageaux from Northland Capital.

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

Okay. Great. We had a couple of questions. First one is on the outlook, which is sort of flattish, but I wonder if you might give us a little more color on your expectations by segment. It sounds like and especially after a nice quarter in access and aggregation -- that maybe that growth is likely to continue, maybe even subscriber to and be offset by optical continued inventory work down there. But I'd like you to kind of comment on whether directionally that's accurate or if there's something else going up?

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

Yes. I think yes, the answer is yes, directionally, that is accurate. We would the other -- just the way you said it is accurate.

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

Great. And I assume you had some pretty sharp moves sequentially in Q1, would you expect those movements by segment to be a little more modest in Q2?

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

I guess I don't know what you mean by sharp moves.

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

I mean, access and aggregation was up 30% sequential almost in Q1. I mean those type movements.

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

Yes. We're not modeling for that type of sequential increase on a quarterly basis. Yes. We would expect them to just -- to get to the numbers that we're talking about, right? We were expected to be modestly up on a sequential basis and then optical to be modestly down.

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

Great. Just what I was looking for. On the 10% customer front, can you comment on -- did you have anybody in the U.S.? Or should we assume those are both international.

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

They're both international.

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

Great. And last question on the Q2 guide. Obviously, your gross margins were up pretty sharply. And you mentioned the drivers there, OpEx just reiterated the target there was certainly higher than I was looking for. I mean, to some degree, as you look at the Q2 guide for modestly negative operating margins, should we expect that to reverse a little bit maybe with gross margins backing off and along with OpEx coming down pretty solidly.

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

I mean as you know, gross margin is always subject to customer mix and product mix, especially when it comes to the last month of the quarter, there's many moving parts. But as you -- if you look into your model, right, Tom just said, OpEx, we expect OpEx to come down in the second quarter, which would then mean that if you model the midpoint of the guidance, that gross margin would come down slightly, a little bit as well.

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

Well, I think we're through the call queue. So thank you very much for joining us on our conference call this quarter, and we look forward to talking to you next quarter. Thank you.

Operator

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

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