Extreme Networks Q2’19 CFO Commentary

Revenue Trends

Q2’19 total revenue was $252.7M, a 5.3% increase sequentially and a 9.3% increase from a year ago in Q2’18. Total product revenue in Q2’19 was $189.6M, a 6.7% increase sequentially and an 8.4% increase from a year ago Q2’18. Total services revenue in Q2’19 was $63.1M, a 1.5% increase sequentially and a 12.2% increase from a year ago Q2’18. Non-GAAP gross margin of 58.2% increased 0.2% sequentially and decreased by 1.2% year over year from Q2’18. As a result of purchase accounting adjustments resulting from our campus fabric and data center acquisitions, we recognized $1.2 million less revenue on service maintenance contracts, down quarter over quarter from $1.7 million in FQ1’19.

The geographical split of revenues was as follows: The Americas contributed 45% to total revenue; EMEA contributed 44%; and APAC contributed 11%.

Gross margin and operating expenses

In Q2, GAAP gross margin was 55.9% compared to 55.8% Q2 last year and 55.1% in Q1. Non-GAAP gross margin was 58.2%, compared to 59.4% in Q2 last year and 58.0% in Q1. Purchase accounting adjustments were a 20 basis point headwind to overall Non-GAAP gross margin.

Q2 GAAP operating expenses were $136.5 million compared to $160.1 million in Q2 last year and $137.1 million in Q1. Q2 GAAP operating income includes, amortization of intangibles of $6.4 million, stock-based compensation charges of $8.7 million, income tax adjustments of $7.3 million, restructuring charges of $0.5 million, and acquisition related expenses of $0.1 million.

Q2 non-GAAP operating expenses were $126.7 million and compare to $117.0 million in Q2 last year and $125.3 million in Q1. The sequential increase in non-GAAP operating expenses was mainly attributable to higher research and development as well as general and administrative expenses.

Second quarter GAAP operating income was $4.8 million, compared to an operating loss of $31.1 million in Q2 last year and an operating loss of $5.0 million, in Q1.
Second quarter non-GAAP operating income was $20.3 million, or 8.0% of total revenue, compared to $20.3 million, or 8.8% of total revenue, in Q2 last year and to $13.9 million, or 5.8% of total revenue, in Q1.

**Net Income and Earnings Per Share**

GAAP net income for Q2 was $7.2 million, or $0.06 per share compared a net loss of $31.9 million or ($0.28) per share, in Q2 last year and to a net loss of $9.1 million, or ($0.08) per share in Q1.

Non-GAAP net income for the quarter was $15.5 million per diluted share, or $0.13 per share, compared to $16.4 million or $0.14 per share in Q2 last year and $9.4 million or $0.08 per diluted share in Q1.

**Balance Sheet and Cash Flow**

Q2 total cash and investments ended the quarter at $141.1 million, up from $128.2 million at the end of Q2 last year and flat from $141.1 million at the end of Q1. Please refer to slide 8 in our Earning Release presentation posted in the Investor Relations section of our website for additional details.

During the quarter, cash flow from operations was an inflow of $27.3 million, compared to an outflow of $4.4 million in Q2 last year and inflow of $34.3 million in Q1. Free cash flow was an inflow of $23.6 million compared to an outflow of $10.2 million in Q2’18 last year and inflow of $26.9 million in Q1.

Account receivables fell to $144.9 million at the end of Q2, down from $154.9 million from the end of Q2 last year and down from $164.7 million at the end of Q1 on strong collections. DSO of 53 days decreased from 62 days in Q2 last year and decreased from 63 days in Q1. Year-over-year, our DSO benefited from final collections from Avaya following the completion of our Transition Services Agreement related to our acquisition of the campus fabric business, while on a quarter-over-quarter basis, better linearity throughout the quarter drove DSO lower.

Inventory ended at $58.3 million, down from $83.4 million at the end of Q2 last year and up from $55.6 million at the end of Q1, as we strive to achieve industry-leading inventory turns following our transition to a single hub procurement process.
Total debt outstanding at the end of Q2 was $185.3 million, up from $183.1 million at the end of Q2 last year but down from $187.6 million in Q1.

Total deferred revenue of $186.1 million grew from $152.4 million in Q2 last year and from $183.9 million from Q1 on greater scale and strong growth of our services bookings.

**FQ3’19 Guidance and Outlook**

Revenue is expected to be in a range of $247.0 million to $257.0 million for Q3.

GAAP gross margin is anticipated to be in a range of 55.2% to 57.3% and non-GAAP gross margin is targeted between 57.5% and 59.5% for Q3.

Operating expenses are targeted to be between $139.7 million and $143.0 million on a GAAP basis and $129.9 million to $133.2 million on a non-GAAP basis for Q3.

Interest expense / other is expected to be $3.0 million and Tax expense is expected to be $2.0 million for Q3.

GAAP net loss is expected to be in a range of $8.3 million to net profit of $0.7 million or a net loss of $0.07 per share to net profit of $0.01 per share for Q3.

Non-GAAP net income is expected to be in a range of $7.2 million to $14.9 million, or $0.06 to $0.13 per diluted share for Q3.

We expect average shares outstanding to be approximately 117.1 million on a GAAP basis and 118.7 million on a non-GAAP basis for Q3.