

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.