

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

EXF.TO - Q4 2019 EXFO Inc Earnings Call

EVENT DATE/TIME: OCTOBER 09, 2019 / 9:00PM GMT



CORPORATE PARTICIPANTS

Philippe Morin *EXFO Inc. - CEO & Director*

Pierre Plamondon *EXFO Inc. - CFO & VP of Finance*

Vance Oliver *EXFO Inc. - Director of IR*

CONFERENCE CALL PARTICIPANTS

Robert Young *Canaccord Genuity Corp., Research Division - Director*

Thanos Moschopoulos *BMO Capital Markets Equity Research - VP & Analyst*

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

Todd Adair Coupland *CIBC Capital Markets, Research Division - MD of Institutional Equity Research*

PRESENTATION

Operator

Good day, and welcome to EXFO's Fourth Quarter and Year-end Conference Call for Fiscal 2019. Today's conference is being recorded. At this time, I'd like to turn the conference over to Vance Oliver, EXFO's Director of Investor Relations. Please go ahead.

Vance Oliver - *EXFO Inc. - Director of IR*

Good afternoon, and welcome to EXFO's Fourth Quarter and Year-end Conference Call for Fiscal 2019.

With me on the line today are Philippe Morin, EXFO's Chief Executive Officer; and Pierre Plamondon, CFO and Vice President of Finance. Germain Lamonde, EXFO's Founder and Executive Chairman, will also be available to answer questions during the Q&A period.

A reminder that this conference call will include certain forward-looking statements and/or estimates concerning our intents, beliefs or expectations regarding future events that may affect EXFO. Please note that such comments will be affected by risks and/or uncertainties, which may cause the actual results of the company to be materially different from those expressed or implied today. For more information about EXFO, I encourage you to review our form 20-F, which is on file with the Securities and Exchange Commission. Our Annual Information Form is available with Canadian Securities Commissions as well.

Please note that non-IFRS numbers may be used during this conference call. A reconciliation of these non-IFRS numbers to our IFRS results is available on our website at www.exfo.com/investors. All dollar amounts in this conference call are expressed in U.S. dollars, unless otherwise indicated.

At this point, I will turn the call over to Philippe.

Philippe Morin - *EXFO Inc. - CEO & Director*

All right. Thanks, Vance, and good afternoon, everyone. So EXFO reported a strong fiscal 2019 on all of our key financial metrics with growth in revenue, in bookings, in earnings and as well on cash flow from operations.

Now to highlight some of our key financial numbers. I'll start with revenue, they increased by 6.4% to a record high \$287 million in 2019, and bookings improved 11.2% to a high of \$298 million. Obviously, we benefited from a full year contribution from the Astellia acquisition in 2019. It's



also important to note that the double-digit increase in booking year-over-year reflects 4 monitoring contract wins now related to 5G deployment, including a multiyear \$4 million booking order in our fourth quarter of 2019.

Now these multiyear multimillion dollar deals are essential for EXFO to achieve the necessary scale to better absorb our fixed costs. And with recurring revenues representing now 15% of our total revenues in 2019 and that's up from low double-digit growth -- low double-digit numbers we had in our prior years.

Turning to the bottom line, our IFRS net loss was reduced by nearly 80% to \$2.5 million in 2019. Our adjusted EBITDA surged 49% to \$25.6 million, surpassing our annual profitability target of \$24 million. And our cash flow from operations improved 20% year-over-year to \$17.2 million.

So in addition, we fully integrated our transformative acquisitions of Astellia, we completed our reorganization plan to boost -- bolster efficiency and profitability, all while maintaining a sound operational discipline.

Overall, EXFO delivered a solid performance in 2019 with a heightened degree of predictability, including sales results above the midpoint of management guidance for now 4 conservative quarters.

So let's take a quick look on how we performed on a product line basis in 2019. In terms of our Test & Measurement product family, our sales increased 3.7% year-over-year while our bookings improved 8.4%. As the #1 supplier now in the optical test equipment market, EXFO took advantage of ongoing fiber deployments on a global basis while gaining market share to deliver record sales and bookings in our T&M business in 2019. We see growth at -- when we look at our 4 -- 3 key customer segments, number one, the communication service providers, they are continuing fiber build-out at high-speed deployment in metro, regional and access network to meet growing bandwidth. Our second group, the cable companies, are following suit with fiber deep initiatives to remain competitive. And our third customer segment, the webscale operators, they are building data centers closer to the network edge to ensure a superior quality of experience for end users.

On the wireless side, the network operators are deploying small cells connecting with optical fiber in densely populated areas to deliver the next-generation services that subscribers are demanding. All these market trends contributed to the strong performance of our Test & Measurement business, and this is where EXFO shines with our unmatched optical test portfolio.

Turning to our SASS product family. Sales and bookings increased 16.2% and 21%, respectively, mainly due again to the full year contribution from Astellia and more than 5 multiyear multimillion dollar contract wins, which are proof points of our successful growth strategy. From one of these contracts, we recognized in revenue a \$4.9 million order for our network topology solution in 2019 coupled with a services deal extended over 3 years. This contract win is at the heart of what differentiates EXFO from other players in the service assurance and analytic space.

Our network topology solution allows EXFO to apply a very unique lens to network performance, service reliability and subscriber experience. As such, we're deploying software that maps the relationship between network resources and the related services across multiple domains. The end result is a holistic view of the network with the ability to detect and troubleshoot and fix issues in the shortest of time. And that's precisely what our customers are demanding as they want to offer a better end-user experience despite network operations that are becoming more and more complex with the virtualization of their network. So we're, therefore, providing them with an extra set of eyes or relevant context as they move forward with massive fiber and 5G deployments.

We're also pleased to see that EXFO is now ranked second in global market share for probe-based monitoring systems, behind NetScout, according to Analysys Mason, it's a well-respected research firm specializing in the telecom industry. In their report, in their latest market report on automated assurance systems, we've now achieved 9% market share in our calendar 2018, placing EXFO ahead of Viavi and Anritsu. The report also highlighted our comprehensive portfolio and stated that we're well positioned to support the communication service providers' evolution to 5G. These latest findings strongly support the growth strategy EXFO has implemented in recent years.

So looking ahead to fiscal 2020, EXFO is well prepared to execute its growth strategy, leveraging both fiber and 5G secular growth drivers across several geographies.



In the Americas, U.S. network operators are embroiled in a heated race to deliver the 5G-related services first to their customers on a nationwide basis. The competitive landscape is such that optical spending will continue on fiber densification, fiber-to-the-home and data center interconnect initiatives, while RAN optimization and monitoring solution should increasingly gain traction when commercial rollouts of 5G networks become mainstream in 2020.

In the EMEA, we're anticipating a stronger emphasis on fiber deployments deeper in the network, since 5G spectrum auctions are still not completed in several countries. But there are some mobile network operators in Europe and Middle East who have now begun limited deployment of 5G networks. And so as mentioned earlier, we've already had a handful of contract wins related to 5G monitoring in our books and the funnel is widening with an increasing focus on virtualization architecture. Consequently, we're expecting an inflection in our SASS business into our second half of fiscal 2020 in both the Americas and EMEA.

Now finally in the Asia Pac region, we're expecting major investment in core fiber networks to support and enhance mobile broadband services such as virtual and augmented reality and video gaming application. And for EXFO's part, we have established ourself as a trusted partner for leading network equipment manufacturers in that region, especially for our high-end optical test solutions.

So now let me provide you with our financial outlook for the first quarter of our fiscal year 2020. We're forecasting sales between \$70 million and \$75 million for the first quarter ending November 30, while our IFRS net loss should range between negative 5 to -- negative \$0.05 to negative \$0.01 per share. IFRS net loss includes \$0.04 per share in after tax amortization of intangible assets and stock-based compensation costs. This guidance was established by EXFO management based on existing backlog as of the date of this conference call, the seasonality in expected bookings for the quarter and the exchange rates as of the day of this call. For fiscal 2020, we're targeting adjusted EBITDA of \$33 million based on the newly adopted IFRS 16 standard for leases.

And at this point, I would like to turn the call over to Pierre, who will discuss in more details our financials.

Pierre Plamondon - EXFO Inc. - CFO & VP of Finance

Thank you, Philippe. Good afternoon, everybody. Annual sale increased 6.4% to \$286.9 million in fiscal '19 from \$269.5 million in 2018. As previously mentioned, EXFO benefited from a full year contribution from Astellia acquisition in 2019 and a \$4.9 million contract win from network topology software. These factors were partially offset by currency fluctuation year-over-year.

Bookings meanwhile improved 11.2% to \$297.8 million in 2019 for a book-to-bill ratio of 1.04, which allow us to build our backlog year-over-year. This is -- this increase in backlog has been expected as we transition to more system-based solution.

In the fourth quarter of 2019, sales reached \$70.2 million while bookings attained \$70.9 million for a book-to-bill ratio of 1.01. Gross margin before depreciation and amortization amounted to 58.6% of sale in fiscal '19 compared to 61% in 2018. In the fourth quarter 2019, gross margin reached 66.9% of sales. Our gross margin decreased in 2019 mainly due to a full year contribution from Astellia. Astellia delivers lower margin than our typical company margin as a portion of its sale includes professional services contract. Our gross margin was also negatively affected by a less favorable mix of the same mix year-over-year. We believe that our gross margin will range between 58% and 60% in fiscal 2020.

Moving to operating expenses. Selling and administrative expenses totaled \$98.6 million in fiscal '19, flat compared to the \$98.8 million in 2018. In the fourth quarter 2019, SG&A expenses totaled \$23 million. Although SG&A expenses were relatively flat year-over-year in dollar, it should be recalled that we add Astellia in our books for a full year in 2019 compared to 7 months in 2018. Consequently, our reorganization plan and cost control measure proved be very effective during the past year. SG&A expenses as a percentage of sales dropped to 34.4% in 2019 from 36.7% in 2018. We expect for 2020 our SG&A expenses will range between 32% and 34%.

Net R&D expenses totaled \$50.6 million in fiscal '19 compared to \$57.2 million in 2018. In the fourth quarter 2019, net R&D expenses amounted to \$11.1 million. The 6.6 decrease -- the \$6.6 million decrease in net R&D expenses in 2019 can be mainly attributed to our restructuring plan, which was completed at the end of Q2 '19, and decrease their -- decrease the -- and to a decrease of restructuring expenses compared to previous year.



This factor were partially offset by adding Astellia into our book for full year in 2019. As a percentage of sales, net R&D expenses reached 17.6% in 2019 compared to 21.2% in 2018. We expect that net R&D expenses will range between 16% and 18% of sales in 2020.

IFRS net loss in 2019 totaled \$2.5 million or \$0.04 per share. In the fourth quarter 2019, IFRS net loss amounted to \$0.2 million or \$0.00 per share.

In terms of geography, sales in EMEA, America and Asia Pacific region increased 9.5%, 6.2% and 1.6%, respectively, in 2019. Looking at the sale split, the Americas accounted for 50% of sales, America represented 32% while Asia Pacific totaled 18%.

Turning to customer diversification. Our top customer accounted for 6.9% of sale in 2019 while our top 3 represented 18.1% of sale.

Moving on to a few key points on the balance sheet. Our cash position increased \$4.4 million year-over-year to \$19.4 million at the end of 2019. We generated \$17.2 million in cash flow from operation and received \$3.3 million for the disposal of capital assets. These elements were partially offset by \$7.5 million for depreciation of capital asset and \$8 million for the repayment of bank loan and long-term debt.

Finally, in terms of IFRS 16, it's the new accounting standard for leases that became effective for EXFO as of September 1, 2019. Going forward, operating leases will be recognized as a long-term asset and the debt on the balance sheet. On our statement of earning, former lease expenses will be recorded as depreciation expenses instead of prior expenses allocated in cost of sale, SG&A and R&D line items. Therefore, for fiscal 2020, we anticipate that adjusted EBITDA of \$33 million will be positively affected approximately by \$4 million by this new accounting standard. We do not expect a material impact to IFRS net earning.

At the time, I will now turn the call over to the operator for the start of the Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question today from Thanos Moschopoulos with BMO.

Thanos Moschopoulos - BMO Capital Markets Equity Research - VP & Analyst

I know that you alluded to it in your prepared remarks, but just to maybe go back to gross margins. So to be clear, that was primarily -- the gross margins dipping this quarter was primarily due to higher professional services mix, is my understanding. And so -- or was there anything specific to Q4? Like we should we expect to see a bit of a recovery into Q1 or not?

Philippe Morin - EXFO Inc. - CEO & Director

Yes. So Thanos, as Pierre highlighted, so it's a combination of 2 things. One is the -- as you talked about, as we go through the Astellia transformation, there is some aspects of professional services that we'll continue to work and transform, but it did impact in terms of our overall gross margin. And in addition, there's also mix on some of the products on the T&M side. So that's bringing that to that level. Now when we look at our range for 2020, we're going to get back to the 58% to 60% gross margin level.

Pierre Plamondon - EXFO Inc. - CFO & VP of Finance

And maybe I would add that, really -- maybe, Thanos, I would add that we have more seen an impact this quarter, okay, about 19% compared to 17% last year. That explain also the fact that the margin in that territory tend to be lower as well.



Thanos Moschopoulos - BMO Capital Markets Equity Research - VP & Analyst

That makes sense. As Astellia starts to show stronger revenue growth and hits the inflection point you're looking for, would there be much operating leverage in the gross margin line or not, especially. I'm wondering if whether, for example, your professional services staff might be underutilized at the moment in anticipation of deals that are coming.

Philippe Morin - EXFO Inc. - CEO & Director

You're bang on, and we're starting to see that with the multiyear and multimillion contract that we've got. As we're showing that -- it's being more software going forward and it's really impacting -- it's going to start leveraging our overall gross margin flow through the EBITDA. And when you look at where we stand, just to give you a bit some more data point, we've got more than \$65 million of backlog already in our SASS business that we know we're going to be able to recognize at least 50% of that into our 2020. And that's giving us as well the confidence in terms of where we stand with regards to our margin going forward for 2020.

Thanos Moschopoulos - BMO Capital Markets Equity Research - VP & Analyst

And sort of on a related question. In terms of, for example, the four 5G deals that you called out, you said they're multiyear deals, and so would the revenue recognition typically be more front-end loaded, as is the case with the \$4.9 million deal you called out? Or how does the linearity look over the 3 year -- over the multiyear term?

Philippe Morin - EXFO Inc. - CEO & Director

Yes. They tend to be spread out fairly evenly over the multiyears, they tend to be 2 or 3 years. Sometimes the software licenses will come in, in the first year, like in some of the -- what happened this year on the \$4.9 million deal that we've announced. But they tend to have deliverables associated with some of the key features and deployments and acceptance by our customers. And they tend to go over the -- kind of being spread over the multiple years evenly.

Thanos Moschopoulos - BMO Capital Markets Equity Research - VP & Analyst

Okay. Maybe one last one for me in terms of maybe just expending in terms of the, as you said, the inflection point you're expecting in the second half and your visibility there. So it sounds like in recent months, you're seeing an ongoing progression in RFP activity. I guess as expected, as operators get closer to 5G deployment. Is that what's happening?

Philippe Morin - EXFO Inc. - CEO & Director

Yes. And also we started to see -- as I mentioned earlier, so we're starting to see the wins coming in. As I mentioned, we've now got four 5G wins that -- 5G contracts, and we're starting to see the number of activities RFQs continuing to gain momentum. And so it -- yes, it -- and it touches on -- we have a very rich portfolio that takes into account, as an example, active service assurance to monitor lower latency that 5G will -- if they're going to deploy small cell, how do you make sure that latency is at the spec of the 5G. We're starting to look at RAN optimization for the new spectrum and the new small cell deployment, and we expect that momentum to gain even more steam as we head into our second half of our 2020 fiscal year.

Operator

Next we'll hear from Robert Young with Canaccord Genuity.



Robert Young - *Canaccord Genuity Corp., Research Division - Director*

The inflection that you're talking about, is that fiscal H2 or is that calendar H2 2020?

Philippe Morin - *EXFO Inc. - CEO & Director*

Fiscal, Robert.

Robert Young - *Canaccord Genuity Corp., Research Division - Director*

Okay. And last quarter, you were highlighting some architectural decisions and virtualization that were causing some pause. And now it sounds like you're talking about seeing some momentum in 5G. And so is that pause -- are you through that pause? You no longer see that? Or am I mixing up 2 different drivers here?

Philippe Morin - *EXFO Inc. - CEO & Director*

Yes. When you look at the monitoring of this -- or the capability we can provide from a service assurance portfolio, there are some aspects of -- that we can start seeing some momentum now. So fiber deployment, as an example, is where small cells need fiber, and we're seeing the benefit of that on T&M. Some monitoring capability, as an example, I just talked about being able to monitor and assure a particular latency spec that we're starting to do that as people deploy small cell.

The RAN optimization is starting to gain momentum as they're now looking at new spectrum, new small cell deployments on it. The virtualization of the core and virtualization of the network, that is the same that I've talked about, Robert. More of the second half in 2021 deployment, and that would require, as I mentioned, a completely new architecture on our behalf on the customers operations side. And that's what's -- we continue to see that inflection point being more into the second half fiscal year and moving into 2021.

Robert Young - *Canaccord Genuity Corp., Research Division - Director*

Okay. So there is a second driver on the horizon that you see sort of clearing up as these architectural decisions go away and you've got a reference customer in Three UK that proves that point out for you. But that's an inflection maybe 2 years from now.

Philippe Morin - *EXFO Inc. - CEO & Director*

I wouldn't say as long as 2 years because we're going to -- like there are going to be -- other customers are going to go in with what we call the Three UK architecture with a cloud-native virtualized network. And you're going to start seeing more and more of these accounts starting to -- in the second half of 2020 and then real volume and market momentum into the 2021, and we expect to win those as we get new accounts going into this cloud-native network deployment.

Robert Young - *Canaccord Genuity Corp., Research Division - Director*

Okay. And then lastly, I want to push you a bit on the EBITDA guide of \$33 million. If I exclude the \$4 million benefit from IFRS 16, it's \$29 million. I think last quarter, you said you'd expected to get an incremental benefit from the restructuring, maybe \$2.5 million. And so that doesn't leave a lot of growth from 2019 what you reported today to 2020. And so I'm curious, like what sort of growth do you expect in that EBITDA line driven by top line growth rather than the restructuring?



Philippe Morin - EXFO Inc. - CEO & Director

Yes. So effectively, when you look at what we've -- so we've delivered \$25.6 million this year. If you take the IFRS impact of \$4 million, it means we would be looking at a \$29 million EBITDA target before the IFRS adjustment. That's representing a 13% improvement in terms of where we -- versus where we did deliver in 2019. I'm really confident that we will deliver that number. And I think where we see -- where we're at the beginning of the year, this is where we are willing to commit. And again, as we move through the year, if we feel that there are some adjustments that we -- need to be made, we'll obviously announce it.

But as where we stand now, this is the visibility that we're looking for. And that's based on roughly a mid-single-digit revenue growth that we're also forecasting, Robert. So it's a combination of those. Well, you can call it a bit of prudence as well, but it's really making sure that -- like we've now shown, we've delivered 4 quarters in a row of what we said we were guiding. We've delivered on EBITDA growth that we guided for. We want to make sure we have the same predictability in our business model for 2020 as well.

Robert Young - Canaccord Genuity Corp., Research Division - Director

Maybe if I look at it from a slightly different angle, the single digits growth, then you expect EBITDA margins to be relatively similar to this year, notwithstanding any unexpected growth. Is -- would that be a good way to think of it? Or do you think you can expand EBITDA margins?

Philippe Morin - EXFO Inc. - CEO & Director

Again, the -- when you look at, again, what we're guiding and then if you assume kind of single digit, we would be increasing our EBITDA percentage on a revenue percentage point of view. When we factor in our outlook, we also have to include obviously all of the inflation costs and all of the other things that we're seeing. One thing I could, again, reiterate is both on the T&M, we have a good view or visibility of what's going to happen in the next 6 to 9 months.

And on the SASS side, let me reiterate again, our backlog is giving us -- with the backlog at \$65 million, where we believe we can be -- well, we've recognized about 50% of that, it is giving us also a good visibility of where we think we can land with the SASS revenue and margin associated with it.

Robert Young - Canaccord Genuity Corp., Research Division - Director

Okay. And maybe one last thing. Just maybe an update on how your business is doing in China with all -- you've got some exposure to Huawei and some other parts. There's lots of issues there. Maybe you could just update us there? And I'll pass the line.

Philippe Morin - EXFO Inc. - CEO & Director

Yes. No. On China, Robert, as you asked last quarter, Huawei is a customer of ours. It's less than 5% of our -- in terms of our revenue. And even though with all the challenges and macroeconomics associated with China, we're not seeing any material impact -- negative material impact to -- on the China side.

Operator

(Operator Instructions) We will hear from Tim Savageaux with Northland Capital Markets.



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

I wanted to ask a few questions focused on the Test & Measurements side and on fiber-optic test in particular. And I guess the first one would be focused on what look to be pretty solid results, I think your book to bill is back above 1 here, in an environment that appears it maybe a little unsettled in terms of fiber-to-the-home. Saw a warning in a recording recently from smaller fiber-optic systems suppliers. You seem to be looking at a little more stable demand environment. I wonder if you might be able to comment on some of that broader volatility relative to what EXFO has seen or is seeing in the market.

Philippe Morin - EXFO Inc. - CEO & Director

Yes. From a fiber deployment point of view, Tim, we see 2 major growth vectors. One is, again, the 5G small cells requires fiber densification is predominantly out of the -- in North America is continuing to be giving us some strong growth and continuing good business with what I would call data center connectivity and within the data center as well.

So the second growth vector is predominantly in -- coming out of Europe with fiber-to-the-home, fiber-to-the-building. We ended up having about 8% year-on-year overall T&M booking, and that's mainly driven out of fiber deployment. But I really like what we're hearing out of Europe, predominantly out of the U.K. and out of Germany, where we're seeing a much more aggressive fiber-to-the-home deployment plan than we've seen in the past years.

And again, this is our -- where we shine. This is where EXFO is really well positioned to capture market share. So those 2 growth vectors are really what's really fueling our on-demand. And as I mentioned, we had record-breaking year and over \$200 million of bookings for our Test & Measurement business. And what I would call this fiber deployment is a big part of that record-breaking year.

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

Great. And to follow up, you mentioned the 8% bookings growth, revenue growth below 4%, clearly building some backlog there. I wonder if you could address any drivers between -- looking at that delta between bookings and revenue in T&M for fiscal '19.

Philippe Morin - EXFO Inc. - CEO & Director

Yes. No. Again, on T&M, we have -- we are able to, again, increase our backlog with -- this year. We didn't -- obviously, we didn't spend too much time with our decision to go and invest into the NEMs or MDR, so the manufacturing, development and research center with Yenista acquisition more than a year ago is really paying dividends for us. And that's where some of the backlog has been. So that's optical spectrum analyzer -- high-end optical spectrum analyzers. And we had some really nice large orders coming in for manufacturing for labs, and the 400-gig is gaining momentum as well. That tends to be, Tim, where we do increase a bit of the backlog.

While on the physical kind of types of product, our fiber probes and OTDRs, we tend to be able to recognize fairly quickly the revenue there. So your question, therefore, your observation on our backlog is it reflects our success with regards to our business in labs and manufacturing where we have a bit of longer lead time and, therefore, a bit more backlog.

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

Any way to size that R&D in production type of business relative to carrier as you look at your total Test & Measurement? How significant is that getting?

Philippe Morin - EXFO Inc. - CEO & Director

It's -- from a point of view, so just at a high level, we don't break that -- we don't provide that breakdown. But if I were to tell you, our business still represents -- the carrier, the service provider still represents about 85% of our business. So the remaining 15% comes from what I would call our NEMs/MDR, which -- now some of that NEMs piece will go into field deployment. But the highest growth percentage for us in our T&M businesses actually came from the manufacturing lab and research piece of our business.

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

Got it. And one more for me. Thinking back to last quarter, or last year in your fiscal first quarter, you saw whether it was catch up or budget flush, but you saw very strong bookings in that November quarter last year. I wonder as you contemplate your guidance here, what kind of assumptions are built-in with regard to any whether seasonal or otherwise driven uptick in T&M on the carrier side. Or are you looking at last year as kind of an anomaly?

Philippe Morin - EXFO Inc. - CEO & Director

So that's a very good observation, Tim. Last year, exactly in Q1, we benefited from year-end bookings on the Test & Measurement, but if you recall, our Q4 was a bit weaker. So there was a bit of pent-up demand with combination of year-end. When we are forecasting our business for Q1, we do expect, again, some year-end money but we don't expect at the same level at this point from our North American customers. Now we could be pleasantly surprised, but we did not assume the same level of year-end bookings that we achieved last year.

Operator

Our next question will come from Todd Coupland with CIBC.

Todd Adair Coupland - CIBC Capital Markets, Research Division - MD of Institutional Equity Research

I feel like there's confusing signals, mixed signals in the 5G market. Baylin called out a drastic reduction in, I guess, densification in small cell. I understand that's not pure 5G, but maybe a transition. AT&T has its activist shareholder issues. And then you have other customers in the U.S.

So what I'm hear -- so with that sort of like backdrop, what I'm hearing from you is you're expecting to start to see U.S. 5G orders in the March time frame, so it hits your June and September quarters. Is that what you're saying? And can you maybe just talk about some of those dynamics and how much I guess puts and takes are still in the market for that to happen. Or there's a big plus, minus factor around that starting to happen in the March time frame?

Philippe Morin - EXFO Inc. - CEO & Director

Yes. So Todd, just to be clear, right, so today, we see our positive impact on our T&M business for fiber small cell densification, and that could be related to 5G, but it could also be related to 4G, where customers are just looking at getting better bandwidth and better throughput of -- with the 4G-plus type of network -- of deployment. And we're seeing the benefit mainly, I would say, out of Americas and U.S. on that, and we don't -- and we see that continuing for this year on our fiscal 2020.

To your point around what's going to happen in the second half, so now moving forward to the SASS business, the good news now is we're starting to see in our multiyear bookings some components around -- associated with 5G. And these components could be even doing today, leveraging our capability to test capability specs that 5G will require, I mentioned earlier on the call, latency.



We are starting to see customers looking at how do they optimize and start -- in the context of small cell as they start deploying the new spectrum for 5G. How do you make sure that you monitor and optimize the coverage in a more complex deployment associated with 5G, and we have already components and secure business around that. And then when we see behind that is an upgrade to 5G that will include much more of a deeper virtualization of the core and the edge of the network.

And that, we call that telco cloud, and we're now deploying that into Three UK, as you know. But we do expect that there are going to be more customers starting to deploy these new architecture on a global basis with that new end architecture. And as I said, that should take -- start coming in more into the second half 2020 fiscal.

Todd Adair Coupland - *CIBC Capital Markets, Research Division - MD of Institutional Equity Research*

And is it a gradual uptick, so it'll go with, I guess, subscriber growth and then pick up momentum over the next 2 or 3 years? Or they're putting in a significant amount of capacity? How are the carriers thinking about planning around that?

Philippe Morin - *EXFO Inc. - CEO & Director*

Yes. No. I think to -- one of the advantage we have is as we go through that transition with Three UK, there's a lot of learnings that we're getting out of that. And the transition, by the way, is as you scale the network, we're gradually scaling that network. You don't do that in one big bang, so it's a gradual transition. And I do expect that's what we're going to see with other customers as they move into telco cloud because it is a more complex deployment, more complex operations that -- and new technology associated with it when you move everything into the cloud. And again, I think the learnings we're going through right now with Three UK will benefit us as we start looking at other deployments with other customers.

Todd Adair Coupland - *CIBC Capital Markets, Research Division - MD of Institutional Equity Research*

And sorry, one last question. You were going to use your experience there for hopeful market share gains in the U.S., has that actually happened or do you need to go out and win that business still?

Philippe Morin - *EXFO Inc. - CEO & Director*

We still need to -- I mean again, in North America, so when we look at -- I think your question was around the acquisition around Astellia as how do we take their portfolio and integrate it into EXFO assets and then go in and leverage that into North America, where we have obviously strong go-to-market presence. And in the case of -- yes, so that's your question, so yes, we're starting to -- we've got to win those. This is about winning.

Now leveraging our existing relationship, as you know, we're into CenturyLink, Verizon, Comcast, some of the key accounts. We have strong relationship. And that's the idea is to leverage the strength of our portfolio now, leverage the fact that we've got professional services capability as well to start going in and winning not necessarily new logos because these are existing logos for us, but winning new opportunity, new deployment with our new and rich portfolio that we have.

Operator

That will conclude today's question-and-answer session. I will now turn the conference over to CEO, Philippe Morin, for final remarks.



Philippe Morin - EXFO Inc. - CEO & Director

All right. Thank you. And so just a few key takeaways before we conclude this call today. So first, EXFO delivered a strong fiscal year with revenue, bookings, earnings and cash flow from operation increasing across all the Board in 2019.

Second, we're well positioned for the fiber and 5G growth drivers that we're seeing with a highly differentiated offering, both on our T&M side and as well on SASS.

And finally, we are targeting \$33 million in adjusted EBITDA for our fiscal 2020 after surpassing our annual profitability target in 2019. So this conclude our Q4 2019 conference call. On behalf of the entire EXFO team, thank you very much for joining us today.

Operator

That will conclude today's conference call. Thank you for your participation. You may now disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2019, Thomson Reuters. All Rights Reserved.