

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

ADTN - Q4 2017 ADTRAN Inc Earnings Call

EVENT DATE/TIME: JANUARY 17, 2018 / 3:30PM GMT

OVERVIEW:

Co. reported 4Q17 revenue of \$126.5m, GAAP net loss of \$11.1m and GAAP loss per share, assuming dilution, of \$0.23.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

CORPORATE PARTICIPANTS

Roger D. Shannon *ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary*

Thomas R. Stanton *ADTRAN, Inc. - Chairman and CEO*

CONFERENCE CALL PARTICIPANTS

Douglas Clark *Goldman Sachs Group Inc., Research Division - Research Analyst*

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

Matthew W. Dhane *Tieton Capital Management, LLC - Senior Research Analyst and Principal*

Michael Edward Genovese *MKM Partners LLC, Research Division - MD & Senior Analyst*

Paul Jonas Silverstein *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

Richard Frank Valera *Needham & Company, LLC, Research Division - Senior Analyst*

W. Chiu *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

William J. Dezellem *Tieton Capital Management, LLC - President, CIO, and Chief Compliance Officer*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to ADTRAN's Fourth Quarter 2017 Earnings Release Conference Call. (Operator Instructions)

During the course of the conference call, ADTRAN representatives expect to make forward-looking statements, which reflect management's best judgment based on factors currently known. However, these statements involve risks and uncertainties, including the successful development and market acceptance of core products, the degree of competition in the market for such products, the product and channel mix, component cost, manufacturing efficiencies and other risks detailed in our annual report on Form 10-K for the year ended December 31, 2016. 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. In addition, ADTRAN will webcast this conference call live through the Q4 Inc. webcasting service.

It is now my pleasure to turn the call over to Tom Stanton, Chief Executive Officer of ADTRAN. Sir, please go ahead.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Thank you, Roxanne. Thank you for joining us for our fourth quarter 2017 conference call. With me this morning is Roger Shannon, Senior Vice President and Chief Financial Officer.

I'd like to begin this morning by discussing the details behind our fourth quarter results, and I will end with some comments on what we anticipate going forward. Roger will then discuss our quarter 4 performance in more detail. And we'll then open the call up for any questions that you may have.

As we stated in our earlier press release, revenues for the quarter were \$126.5 million, down 22% over the fourth quarter of last year. Our Network Solutions revenue, including both international and domestic markets, came in at \$96.1 million, down 20% over the same period last year. Total Services & Support revenues were \$30.5 million in the fourth quarter, down 16% over last year. The revenue for our domestic markets came in at \$93.7 million or 74% of the total, while our international revenues were \$32.8 million for the quarter or 26% of the total. On a year-over-year basis,



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

our domestic revenues decreased 24% due to a merger-related spending pause by a Tier 1 operator. Our international business decreased 17% year-over-year due to unseasonably strong European Tier 1 spending in the second half of last year.

Moving down a little deeper, our Access & Aggregation category was down 30% over the same period last year, primarily due to the merger-related spending pause by the Tier 1 U.S. operator previously mentioned. Customer Devices revenue was up 4% over the same quarter last year, led by domestic growth in both our carrier and MSO fiber-to-the-home ONTs and our business CPE products.

Lastly, our Traditional Products & Other categories were up 25% versus the same quarter last year. As we noted in our December 28 press release, our results were significantly impacted by merger-related slowdown at a Tier 1 here in the U.S. It is our understanding that this carrier is reviewing major capital programs, and our vectoring program is part of this review. We have been told that this review would take approximately 60 to 90 days, and we expect our review to be complete in the first quarter 2018.

While this consolidation impacted and will continue to impact our results in the near term, we're extremely proud of the year overall. We had a record first half revenue. And even with the mentioned substantial slowdown in Q4, we have the second-best revenue performance in our company's history. We realized record Services revenue and made great strides in driving acceptance of our Mosaic Cloud Platform.

For the year, Services revenue was up 13%, which combined with our 17% year-over-year international revenue growth, gives us some level of assurance that our programs and processes that we have put in place are having a positive impact in our going as we projected. Globally, we continue to deepen relationships and strengthen engagements with Tier 1 service providers around the world. Not only is there continued interest in our flagship Total Access and hiX platforms for their ability to deliver Gigabit services and beyond, the interest in and deployment of our SD-Access solutions continue to grow.

Our G.fast solutions have moved to full production status with leading Tier 1 operators in the U.S., Europe and Asia Pacific and are ramping in commercial deployments. We continue to have a broad breadth of opportunities ahead of us, demonstrated by announced wins and deployments by leading carriers such as NBN and DT, and in 2017, we brought in well over 40 new infrastructure customers. We have introduced developmental breakthroughs with our Gigabit-to-the-Basement and millimeter wave backhaul and access solutions, designed specifically to help carriers realize the opportunities created by the ramp up to 5G.

Finally, ADTRAN remains in the center of the developing SD-Access marketplace. Our Mosaic platform has quickly become the centerpiece of the Mosaic Open Network Alliance, where member companies are collaborating on SDN and NFV solutions that will underpin a new approach to access.

I'd now like Roger Shannon to review our results for the fourth quarter of 2017 and provide some comments on the first quarter of 2018 as well. We'll then open the call up to any questions you may have. Roger?

Roger D. Shannon - ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary

Thank you, Tom, and good morning. I'll speak about our fourth quarter results and discuss what we see for the next quarter. During my report, I'll be referencing both GAAP and non-GAAP results.

Also, as stated in our earnings press release, our GAAP results reflect the impact to the recently enacted Tax Cuts and Jobs Act, which resulted in a charge to our Q4 income tax expense.

As Tom stated, ADTRAN's fourth quarter revenue came in at \$126.5 million, down 22% compared to the \$163 million for quarter 4 of last year, and 32% below the \$185.1 million we reported last quarter. Our Network Solutions revenues for the fourth quarter were \$96.1 million, down 24% from the \$126.8 million for quarter 4 of last year, and down 34% from \$145.5 million reported for Q3 of 2017.

Our Global Services & Support revenue in Q4 2017 was \$30.5 million, down 16% compared to the \$36.2 million earned in quarter 4 of 2016, and down 23% versus \$39.6 million reported for the third quarter of 2017.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Across our revenue categories, Access & Aggregation revenues for quarter 4 of 2017 were \$78.9 million, down 34% compared to \$119.7 million for quarter 4 of 2016. Customer Devices revenues for the quarter were \$32.8 million, up 4% compared to \$31.4 million for quarter 4 of 2016. Traditional & Other Products revenues for quarter 4 of 2017 were \$14.9 million, up 25% compared to \$11.9 million for quarter 4 of 2016.

Looking revenues geographically, domestic revenues for quarter 4 of 2017 were \$93.7 million, down 24% from the \$123.7 million we reported in quarter 4 of last year. Our international revenues for quarter 4 of 2017 were \$32.8 million, down 17% compared to \$39.3 million in quarter 4 of last year. We've published the reporting of each of these categories on our Investor Relations web page at adtran.com.

For the quarter, we had 2 10% of revenue customers. Our GAAP gross margins for the fourth quarter of this year were 46.5% compared to 43.4% for the fourth quarter of 2016 and 46.7% last quarter. The year-over-year increase in our gross margins was driven primarily by higher-margin product mix internationally, a favorable mix in our domestic services business and favorable foreign exchange movements. The slight decrease in our quarter-over-quarter margins was attributable to the increased waiting of our international business and our domestic customer mix.

Total operating expenses on a GAAP basis were \$62.9 million for quarter 4 of 2017, a decrease of \$3.6 million compared to \$66.5 million for quarter 4 of 2016 and \$5.3 million less than the \$68.2 million reported for quarter 3 of 2017. On a non-GAAP basis, our Q4 operating expenses were \$60.6 million compared to \$63.4 million in quarter 4 of last year and \$65.8 million last quarter. The year-over-year decrease in operating expenses is primarily attributable to lower performance and equity-based compensation, lower R&D expenses and reduced intangible amortization related to acquisitions. The quarter-over-quarter decrease in operating expenses was a result of reduced performance and equity-based compensation, a reduction in contract services and lower R&D expenses.

The difference between GAAP versus non-GAAP operating expenses in Q4 is due to amortization expenses associated with our active EPON and RFoG products acquisition in the third quarter of last year, equity-based compensation and restructuring expenses.

Operating income on a GAAP basis for the quarter just ended was a loss of \$4.1 million compared to operating income of \$4.3 million reported in Q4 of last year, and \$18.3 million reported in quarter 3 of 2017. The decrease in Q4 GAAP operating income as compared to Q4 2016 is attributable to lower revenues, partially offset by more favorable margins, favorable foreign exchange movements and lower operating expenses. The quarter-over-quarter decrease in operating income was driven by lower revenues, partially offset by lower operating expenses. Non-GAAP operating income or adjusted EBIT for quarter 4 of 2017 was a loss of \$1.7 million compared to income of \$7.5 million for quarter 4 of last year and \$20.8 million earned in quarter 3 of 2017. Our adjusted EBIT margin was 1.3% for the quarter just ended compared to 4.6% in quarter 4 of last year and 11.3% last quarter.

As described in the supplemental income provided in our operating results disclosure, stock-based compensation expense, net of tax, was \$1.4 million for quarter 4 of 2017 compared to \$1.8 million reported in quarter 4 of last year and \$1.4 million in quarter 3 of this year.

Expenses related to acquisitions were \$297,000 net of tax compared to \$724,000 in Q4 of last year and \$299,000 last quarter. Restructuring expenses net of tax were \$36,000 for quarter 4 of this year compared to \$10,000 reported in quarter 4 of last year and \$131,000 last quarter.

All other income, net of interest expense, for quarter 4 of 2017 was \$3.3 million compared to \$2.6 million for quarter 4 of 2016 and \$889,000 last quarter. The year-over-year and quarter-over-quarter increases in all -- in other income this quarter was a result of higher gains on investments and dividend income and favorable foreign exchange fluctuations.

The company's tax provision for quarter 4 of 2017 was a tax expense of \$10.4 million. Our fourth quarter 2017 GAAP tax expense reflects the impact of the recently enacted Tax Cuts and Jobs Act, which resulted in a onetime charge of \$11.9 million due to the write-down of deferred tax assets and the deemed repatriation tax on our accumulated foreign earnings in cash. We've excluded this onetime charge from our non-GAAP earnings. Excluding this onetime charge, our GAAP fourth quarter tax provision would have been a benefit of \$1.6 million or an effective tax rate of 209.4% compared to a tax provision rate of negative 10.6% for quarter 4 of 2016 and 17.2% in quarter 3 of this year.

In addition to the onetime Tax Cuts Act charge, the change in tax rate versus quarter 4 of last year and quarter 3 of this year was primarily related to the recognition of additional research and development tax credits this year, expiration of tax reserves and a greater mix of international income.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

GAAP net income for quarter 4 of 2017 was a loss of \$11.1 million due to the previously mentioned \$11.9 million Tax Cuts Act charge compared to income of \$7.6 million for the fourth quarter of 2016 and \$15.9 million last quarter. Non-GAAP net income for the fourth quarter of 2017 was \$2.5 million compared to \$10.1 million in quarter 4 of 2016 and \$17.8 million last quarter.

Earnings per share on a GAAP basis, assuming dilution, was a loss of \$0.23 compared to income of \$0.16 for the fourth quarter of 2016 and earnings of \$0.33 per share for quarter 3 of 2017.

Non-GAAP earnings per share for the fourth quarter of this year were \$0.05 compared to \$0.21 per share for quarter 4 of last year and \$0.37 per share for quarter 3 of this year. Non-GAAP earnings per share excludes the effects of the Tax Cuts Act charges, stock compensation expense, acquisition-related expenses and restructuring expenses. We've provided a reconciliation between diluted GAAP earnings per share and diluted non-GAAP earnings per share in our operating results disclosure.

Now turning to the balance sheet. Unrestricted cash and marketable securities net of debt totaled \$184.6 million at quarter end after paying \$4.3 million in dividends during the quarter. For the quarter, ADTRAN used \$64.4 million of cash in operations. There were no stock repurchases in the fourth quarter.

Net trade accounts receivable were \$143.8 million at quarter end, resulting in a DSO of 105 days compared to 52 days at the end of the fourth quarter of 2016 and 51 days at the end of quarter 3 2017. The increase in our current quarter DSO as well as the decrease in our cash flow from operations is primarily related to a customer-specific payment term arrangement that will become due early in quarter 1 2018 and the timing of shipments within the quarter. Inventories were \$122.5 million at the end of quarter 4, up from \$116.2 million last quarter.

Looking ahead to the next quarter, the book-and-ship nature of our business, the timing of revenues associated with large projects, the variability of order patterns of the customer base into which we sell and the fluctuation in currency exchange rates in international markets we sell into may cause material differences between our expectations and actual results. However, taking into account the previously discussed merger-related review and slowdown in spending at a domestic Tier 1 customer, our current expectations are that first quarter 2018 revenues will be flattish with the quarter just ended.

Also taking into account the potential impact of currency exchange rates and anticipated mix, we expect that our first quarter gross margins on a GAAP basis will be around 40%, provided that the Q1 revenue profile remains as expected and there is not a material change in our domestic Tier 1 shipments related to the aforementioned merger review. We expect that GAAP operating expenses for quarter 1 of 2018 will be down in the range of \$64 million to \$65 million. Finally, we anticipate that the consolidated tax rate for the first quarter will be in the low 20% range.

We believe that the significant factors impacting revenue and earnings realized in 2018 will be the following: The macro spending environment for the carriers and enterprises; currency exchange rate movements; the variability of mix and revenue associated with project rollouts; professional services activity levels, both domestic and international; the timing of revenue related to the Connect America Fund projects; the adoption rate of our Broadband Access platforms; and inventory fluctuations in our distribution channels.

I would like to again encourage our listeners to visit ADTRAN's Investor Relations website by going to www.adtran.com and following the Investor Relations link, take advantage of user-friendly resources such as interactive financials to provide additional insight into our performance.

With that, I'll now turn the call back over to Tom.

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Thanks, Roger. Roxanne, we're now ready to open up for any questions people may have.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And we'll take our first question from Doug Clark with Goldman Sachs.

Douglas Clark - *Goldman Sachs Group Inc., Research Division - Research Analyst*

I guess, the key one is going to be on visibility. I believe the customer that you said is a Tier 1 domestic customer. Can you talk about the range of possibilities that you expect coming out of this 60- to 90-day review process?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Yes, sure. So as you know, I think -- well as I mentioned anyways, we have several things going on with that customer. We have kind of traditional fiber GPON shipments. We have normal adds and footprint expansion. And then we have a large project centered around vectoring into bringing 100 meg service. That is the project right now. All of them are going over some level of review, but the big impact is on the vectoring project, which they put in hold until after this review. My sense right now is, is that the customer will come out of this wanting to do something. So I can imagine that, one is, we go on as we are. The other is, is that, we go on with a more targeted approach towards where -- which cities are built. I think it's a fairly broad-brush approach today, and I wouldn't be surprised to see us kind of reemphasize particular markets, which would necessarily have a negative impact on us. Thirdly, I could see them shifting more towards a fiber deployment in certain targeted cities and trying to increase their fiber-to-the-prem footprint. And then, fourth, they could just slow down. I think that, that has longer term implications for them, but I haven't been told that is or isn't part of the process.

Douglas Clark - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Okay. That's helpful. And then maybe outside of this particular customer, can you talk a little bit about the domestic carrier CapEx environments, beginning of your budget flushes -- budget releases and how that's trending?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Yes, so let me just add one last thing to your last question. There has been some news that's come out where they have talked about potentially being more targeted in where their deployment is for 100 meg services. So my sense is that that's where they're heading, although we are, of course, having ongoing dialogue with them. As far as outside of the U.S., and it's really early to talk about budgets in this year. So I haven't seen anything that's undue. There are programs at Tier 2s here in the U.S. that are just kind of starting to ramp up. The activity in Europe is what we would typically see, which is we typically see a stronger European presence in the first half. Our European shipments in the first half, that's on track. As you probably are aware, we've won some new business in Australia. And we actually have received a very material purchase order for that. That will be shipping through this year, including in the first quarter. So we'll start seeing that ramp up this year. We had a very strong -- relatively speaking, a very strong quarter with our G.fast customer here in the U.S. So we're kind of excited about what the possibilities are there. And there are a couple of different phases of that, but the first phase is shipping. Does that answer your question?

Douglas Clark - *Goldman Sachs Group Inc., Research Division - Research Analyst*

Yes.

Operator

And we'll take our next question from Simon Leopold with Raymond James.

JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

W. Chiu - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

This is Victor Chiu for Simon Leopold. I wanted to ask about (inaudible)

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Thank you. Sorry about that.

Operator

We'll take our next question from Rich Valera with Needham & Company.

Richard Frank Valera - *Needham & Company, LLC, Research Division - Senior Analyst*

I know it's early to be talking about the second quarter, but it seems like in at least 3 of the 4 scenarios that you highlighted, you should see a nice quarter-over-quarter improvement with the customer in question, which would suggest you would see a stronger-than-typical seasonal ramp from 1Q to 2Q because you've effectively got nothing from them, I guess, in vectoring in Q1. Is it reasonable to kind of assume that at this point? Or you still just don't feel like you got enough visibility to make sort of any call on 2Q?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Well, let me just say that we don't have visibility on that particular customer. In general, we would expect a ramp from Q2 -- from Q1 to Q2 just because of our seasonal trends and the Tier 2s really start kicking in, in Q2. We would expect our G.fast shipments to pick up in Q2. DT is typically kind of -- I shouldn't say that customer. Europe is typically flattish Q1 to Q2, typically coming in strong in first half. Our carrier win in Australia will ramp up in Q2. So in general, yes. On this particular customer, I think you're correct. We have right now factored into Q1 effectively no change. And now what we have been told is 60 to 90 days. We are already roughly 45 days, maybe a little bit longer at this point, into that period of time. And so there is that potential that, that would kick in towards the end of this quarter. But what you said makes sense to me, which is there is very little activity in Q1, we would expect more activity in Q2.

Richard Frank Valera - *Needham & Company, LLC, Research Division - Senior Analyst*

Fair enough. And then you didn't mention anything about the ongoing trial with Verizon, the GPON trial. If you could -- the NG-PON trial. Can you just kind of say where that is? And have your expectations changed at all on that?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Our expectations haven't changed. We still have a lot of work that we're doing with them. We have not slowed down the R&D associated with that project. We have some specific lab dates that we need to meet in both this quarter and the next quarter. And we would expect that to pick up in the -- we would expect to see shipments really kind of potentially starting in the second half. I don't want to get overhung there, but no, nothing has changed there.

Richard Frank Valera - *Needham & Company, LLC, Research Division - Senior Analyst*

Got you. And then just probably for Roger. Just want to understand how we should think about gross margin and OpEx for the balance of the year. I mean, gross margin taking a pretty big hit sequentially on similar revenue and, I guess, just a pretty significant adverse mix shift, I guess. But



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

presumably that should normalize back to maybe more some kind of historical levels as we move through the year and then OpEx also bumping up quarter-over-quarter on flat revenue. Just wondering sort of what's going on there? And how should we think of OpEx for the balance of the year?

Roger D. Shannon - ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary

Sure. So let -- what you said on your assumption to gross margin is correct. We expect it to ramp back up significantly over the course of the year. The decrease going into Q1 is particularly driven by the pickup in the European Tier 1. So there is going to be a much higher mix of the international business in Q1 compared to Q4, which is kind of the seasonal normal there. And then like we said in my comments, it just kind of assumes the flattish revenue levels, but there is some mix changes in the customers that has some impact from Q4 to Q1. On the OpEx changes from Q4 to Q1, we had some fairly material reversals in Q4 of some prior accruals, particularly on variable comp and then similar things like that. So that brought that down in Q4. So Q1 is kind of really more of a controlled normalized level.

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Yes. Just to give you a little color, I think we're running around \$68-ish million right now -- excuse me, in Q3. We've got that down fairly dramatically in Q4. It will pick up a little bit, but it will be nowhere near the 64 -- \$68-ish million number.

Richard Frank Valera - Needham & Company, LLC, Research Division - Senior Analyst

Got it. And just one more on the tax rate. I mean, you mentioned kind of a low 20s tax rate for Q1. Is that how we should think of your tax rate going forward with the new tax regime in place?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Yes. Based on what we see right now, that is how you should think about it going forward.

Roger D. Shannon - ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary

There's going to be some mix variability between the U.S. income and the international income, because international is not changed, the U.S. will be at the lower 21% corporate rate. So we -- over the course of the year, obviously, the bulk of our income does come from the U.S. So that will weight that. But in Q1, it is slightly higher from the international, been more tilted that way. But I would think about it as you said.

Operator

And we'll take our next question from Paul Silverstein with Cowen and Company.

Paul Jonas Silverstein - Cowen and Company, LLC, Research Division - MD and Senior Research Analyst

I've got a number of clarification. I trust from the responses to the previous questions that I heard correctly, the gross margin guidance for Q1 that it was GAAP 40%. I just want to make sure I heard that right?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

That's right. We said around 40%. That's correct.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

All right. And I did hear the response, Roger, to the previous question, but, again, I want to make sure I understand the primary driver of that downtick is the expected seasonal increase at DT in particular without the benefit of offsetting U.S., so the change in the mix. Is that the primary driver?

Roger D. Shannon - *ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary*

Other than we didn't say the customer name, that's correct.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

Okay. I appreciate that. Bear me for a second, I apologize. So on the non-U. S., the decline -- the year-over-year decline, did I hear you say that, that was due to extraordinarily strong year ago quarter. Is that the only driver of that over 15% year-over-year decline?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Yes. If you remember, Paul, the last year's number, 2016, we saw an unexpected uptick due to basically them running out of ports. But it was literally the quarterly flow for this year with international revenues was exactly what we expected.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

And Tom, on the upside, if you could remind us, there is the new project you spoke about. And I know there is customer sensitivity but -- at DT or at least the big non-U. S. Tier 1 that's been driving your revenue for some time. Can you remind us of the nature of that project, the magnitude of the timing of the new project in terms of the impacted revenue?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Yes. The biggest and nearest one right now is super-vectoring. And super-vectoring will start shipping this year. In fact, it will ship in the first half of this year. So we do expect on a year-over-year basis that customer would actually increase on what was actually a good year last year.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

So first revenue -- first half of this year ramps right. Do you think it will be meaningful in the first half or any (inaudible)

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

It has -- it definitely has that potential.

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

Okay. And going back to your comments on the NBN rollout, I think I heard you say that you received a meaningful order. You expect that to begin ramping. But it sounds like you are not expecting meaningful impact until Q2. Is that an accurate portrayal?



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

That's kind of what we were having -- we will see shipments in Q1. But I think just the logistics of being able to get to the ramp level that we want to get to, that is somewhat self-driven. But yes, I would expect some in Q1 and I would expect it to pick up in Q2 and Q3 and just the normal pattern you would see.

Paul Jonas Silverstein - Cowen and Company, LLC, Research Division - MD and Senior Research Analyst

Got it. Just a couple of quick more, if I may. Going back to your comments about the different options at that U.S. Tier 1, can you remind me what is the customer getting in terms of maximum throughput with VDSL vectoring?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

What they are offering is, I believe, up to 100 meg. With that...

Paul Jonas Silverstein - Cowen and Company, LLC, Research Division - MD and Senior Research Analyst

So in that 100 meg scenario that, if the customer in the targeted scenarios, they could -- they won't have to necessarily go to fiber. They could continue to deploy the VDSL vectoring, albeit perhaps on a more targeted basis. Is that accurate?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

That is absolutely accurate. So there is -- and there is another piece there, which is we have also introduced -- I got to -- we've also introduced super-vectoring, which materially increases the speed capability of that product.

Paul Jonas Silverstein - Cowen and Company, LLC, Research Division - MD and Senior Research Analyst

All right. Just one clarification on the scenarios you laid out. I think you laid out 4 scenarios. And the second one was a more targeted version of what they're doing now. But I thought I heard you say that, that would not adversely impact you. And I'm just wondering...

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

The question is, it has the potential. That one is -- it's all about the budget that they put towards it, of course. So that one in and of itself, just saying, instead of doing broad brush, which was -- always been an option. Let's take that money and do it targeted in particular cities where the take rate is higher or there may be some competitive issue associated with that city is definitely an option. In and of itself, making that decision does not adversely affect us. The question is going to be in any of these scenarios is, what's the total capital budget they put towards the build?

Paul Jonas Silverstein - Cowen and Company, LLC, Research Division - MD and Senior Research Analyst

Tom, do you have any sense for what your portion of that VDSL vectoring on the Broadband Access equipment?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

I do. It's very high.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Paul Jonas Silverstein - *Cowen and Company, LLC, Research Division - MD and Senior Research Analyst*

That's what I would assume. One last question, I apologize to you and others on the call. But all -- with respect to AT&T, correct me if I'm wrong, but I think they did some XGS-PON trials recently or not so long ago. And I'm just wondering if you have any thoughts if that has any potential implications with the G.fast opportunities? Does it take away potentially from that G.fast? Or is that totally different?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Totally different. Totally different price point. Totally -- it's absolutely targeted, something different.

Operator

And we'll take our next question from Michael Genovese with MKM Partners.

Michael Edward Genovese - *MKM Partners LLC, Research Division - MD & Senior Analyst*

First of all on the 10% customers in the quarter, were they the same as in the prior quarter? Or was one of them different?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

We typically just give the origin, which is 1 international, 1 domestic.

Michael Edward Genovese - *MKM Partners LLC, Research Division - MD & Senior Analyst*

Okay. I guess what I'm trying to get out of here is, I'm trying to understand with your domestic Tier 1, traditionally largest customer, the one that's having the review, are they -- were they very weak in 4Q and staying as weak in the first quarter? Or were they not so bad in 4Q? And then basically we're assuming about a 0 in the first quarter? So that's what I'm trying to get at.

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Yes, and I understand. Let me try to give you some help. So we pointed out that the expected performance versus the performance was predominantly driven by that customer. And in effect from what we have projected to where we ended up, I could tell you that if we were to hit our projections there, we would have been fine, if that gives you some sense. And right now in Q1, we're expecting -- so yes, very material, not a good performance in Q4. And we are expecting slightly down in Q1.

Michael Edward Genovese - *MKM Partners LLC, Research Division - MD & Senior Analyst*

Okay. So that's helpful. But that being said, I guess, where is the incremental U.S. weakness beside that customer coming from in Q1. If you're having this big mix shift in gross margins on flat revenue, the European customers going to be much higher in the first quarter than the fourth quarter, I guess, what else in U.S. are we expecting to be down in the third quarter?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

These are typically -- well, typically -- I mean, typically that offsets the weakness in Q1 associated with just Tier 2 ramp-ups. And we are going to see a weaker Q1 in that particular vectoring customer than we did in Q4, and we typically expect some weakness in Tier 2s.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Paul Jonas Silverstein - Cowen and Company, LLC, Research Division - MD and Senior Research Analyst

So everything is -- so basically typical...

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

That's just -- that's totally dependent on when their budgets -- that's when their budgets get. They usually miss the first 2 months of Q1 in trying to figure out what their budgets are.

Michael Edward Genovese - MKM Partners LLC, Research Division - MD & Senior Analyst

Right. Okay. So the negative impacts from this review happened in the fourth quarter and then we're basically expecting normal seasonality in the first quarter, would be the summary?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

That is -- yes, that is the summary except that I'm expecting a lower Q1 in that one customer as well, right. And that is because the timing of when the notification happened, it wasn't at the beginning of the quarter. We were already kind of a month into the quarter and then we started hearing that they may -- it took a while for it to play itself out.

Michael Edward Genovese - MKM Partners LLC, Research Division - MD & Senior Analyst

Okay, great. I guess, the other question I wanted to ask about was, on NG-PON2, I mean are there any additional trials, labs trials, and competing for any deals beyond the big U.S. Tier 1 opportunity? Or is that really the first one to focus on and rollout from there to other carriers after that one?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Yes. It's the latter. There are people that are talking about it. But there is one customer in the world that is kind of driving that product set. That's not atypical for this customer, by the way, as you're aware. So people tend to follow that.

Michael Edward Genovese - MKM Partners LLC, Research Division - MD & Senior Analyst

Right. And then, I'm increasingly picking up indications that, that particular technology could be very, very important in fixed 5G, mobile 5G, fronthaul, backhaul and have a really strong multiyear 5G story for that technology, in general. Is that -- can you talk about how you see it going forward?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

I think that's exactly right. I think initially you will see that being deployed kind of in the trial phase just to make sure everything is worked out in different markets for different business customers and maybe some replenishment of traditional GPON. But I think the longer-term goal and aspiration for the technology and for this customer, without speaking for the customer, is that it can play a role in their 5G network rollout because of the capabilities. I mean, it is fantastic for that type of rollout.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Michael Edward Genovese - MKM Partners LLC, Research Division - MD & Senior Analyst

Okay. Sorry, 2 more quick ones. Just clarifying the 10% customer, again. Can you tell us if it was 1 international, 1 domestic?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Yes, that's right.

Michael Edward Genovese - MKM Partners LLC, Research Division - MD & Senior Analyst

Okay. And then as the major U.S. Tier 1 customer, we're talking about these 4 scenarios. Obviously, you just said your share of vectoring is very high. What about your share of fiber. I mean, do you have any fiber share right now? If they decide to do more fiber and less copper going forward, is that going to be a negative market share for you or will benefit you?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

That will benefit us, absolutely.

Operator

And we will try the line of Simon Leopold (sic) [Victor Chiu] with Raymond James, again.

W. Chiu - Raymond James & Associates, Inc., Research Division - Senior Research Associate

Can you hear me better now.

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Much better. Thank you.

W. Chiu - Raymond James & Associates, Inc., Research Division - Senior Research Associate

Great. I just wanted to follow up off of that last question. Regarding the stalled Tier 1 customer, so other than the strategic considerations around target deployments that you mentioned, would share shifts or vendor consolidation be another dynamic that they're potentially reviewing? Is that...

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

I have not -- I've had no indication that that's the case.

W. Chiu - Raymond James & Associates, Inc., Research Division - Senior Research Associate

Okay. Because of the discussion that you have had or it's just an assumption or kind of...



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Well, I've had a discussion. I mean, this is literally just driven by the -- being driven by the strategy review.

W. Chiu - Raymond James & Associates, Inc., Research Division - Senior Research Associate

Okay. I guess, I know you said it was early -- kind of early to think about 2018 budgets. But I think the -- from looking at facts that I think the current consensus estimates for DT are calling for spending growth to drop into kind of the flattish low single digits next year. Is that -- without going into specifically what they're spending, is that kind of consistent with what you think? Or do you think that those estimates are too conservative and that the spending...

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Yes, it's kind of -- honestly, it's always difficult to bury -- to take a total capital budget and say it will fall evenly across technology fields. So the way that we're thinking about it is that we're -- our indications are that we will see an up year over what was a strong year and that is driven by the increased deployment of super-vectoring.

W. Chiu - Raymond James & Associates, Inc., Research Division - Senior Research Associate

Okay. But relative -- up but relative to spending this year, it's going to be mature relative to this year. I guess is that kind of...

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

We are expecting a year-over-year increase with that customer for the total year.

W. Chiu - Raymond James & Associates, Inc., Research Division - Senior Research Associate

Okay. Great. And actually just one quick housekeeping question. The tax charge that you noted this quarter, is that some sort of like prepayment, I think. Is that what that was or...

Roger D. Shannon - ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary

No. When the new Tax Cuts law was signed, every company you're seeing release the earnings is kind of go in through these calculations. There is 2 aspects to it. There's -- you have to revalue your deferred tax assets, which is the lower marginal tax rate going forward more or less. So there is an adjustment there. And then each company has to go through a calculation of their unrepatriated foreign earnings in cash. So there's really 2 aspects to the number. But it's -- the first one, the deferred tax asset adjustment is a noncash charge. It's just simply the difference between GAAP and tax deductions when they were taken. And then on the repatriation, that payment can be spread over 8 years with no interest.

W. Chiu - Raymond James & Associates, Inc., Research Division - Senior Research Associate

Okay. So we're not expecting any similar charges like this going forward, right? Is that...

Roger D. Shannon - ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary

No, it's a onetime thing and in fact the tax law will benefit us going forward with bulk of our income is from the U.S. and with the tax rate going down to 21% going forward, that's absolutely a significant benefit for us.



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Operator

And we'll take our next question from George Notter with Jefferies.

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

I guess, I was wondering if you could help us with the 10% customers. Any change you could tell us what those customers were and the percentages for the full year or maybe we just need to wait for the 10-K? Any help there would be great. And then also -- I guess I also wanted to ask about Windstream and Frontier, some of the Tier 2s. I mean, obviously, in the past, they've been significant customers for ADTRAN. Some of those balance sheets, I think, are becoming more stressed. I mean, did you think about the full year with those kinds of customers? I mean, do you think they would be flat, up, down for the year? How do you sort of think about them going forward?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Those -- sure, George. So those right now are probably the more difficult for us to see, notwithstanding the review that we previously talked about. They have very specific things that they want to get done. There are some new projects that we know are launching this year, with at least one of them. And then we have trials going on in a couple of different technologies, actually with both of them. So I would agree that it's kind of a challenging time for them right now. But I think all of these people still have capital that they need to spend this year. And I think it's a matter of us getting a fair share of what they do spend. So on a year-over-year basis, I mean, we -- they had definitely less strong in 2017 than they were in 2016, and we're not hanging out there for a material change in kind of the environment that they're in until we actually see it.

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

Got it. And then the 10-K info?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

You will have to wait, sorry.

Operator

And we'll take our next question from Bill Dezellem with Tieton Capital.

William J. Dezellem - *Tieton Capital Management, LLC - President, CIO, and Chief Compliance Officer*

Tom, in your opening remarks, you made reference to 40 -- I'm not certain if it was 40 new customers or 40 new projects, but something in that realm. Would you please discuss that further and kind of circle back to what you're referring to? And really the implications relative to maybe in aggregate any one of your Tier 1 customers?

Thomas R. Stanton - *ADTRAN, Inc. - Chairman and CEO*

Right. So yes, I mentioned several Tier 1s that have recently selected us and then I mentioned that it was actually over 40 customers. And they range in size. So we have some larger ones both in the U.S. and in Europe, some of which you know about. And then we have -- of course, there are larger number of smaller ones. We have a particular focus on the larger -- I should say, from a sales perspective, we have a focus on all of them,



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

but the ones that are more meaningful are the larger Tier 3s, a lot of which are going through the funding, the government funding, associated, and we call them A-CAM customers, but associated with the change in the...

Roger D. Shannon - ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary

With the CAF.

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Yes, with the CAF -- the rate of return for CAF customers. And that list includes customers both in the U.S. and internationally with probably a bigger emphasis on what's going on in Europe.

William J. Dezellem - Tieton Capital Management, LLC - President, CIO, and Chief Compliance Officer

So when you aggregate those 40 customers, what's the magnitude of their potential revenue contribution relative to one of the Tier 1s that clearly is very material for you?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

Yes. So I think you'd have to take out -- that number includes several Tier 1s. So if I take those out, which I think is the gist of your question, I think in aggregate, you would be talking about the spend level of probably a Tier 1 carrier. Now that's really the hardest. I mean, that's a very difficult question. So let me try to roll that back, because there are some Tier 2 carriers in there today that Tier 2s can actually meaningfully move the number. And that's not just in the U.S., that's outside of the U.S. So that's a very difficult number. I would say in aggregate though, if I take the Tier 1s out, they have the potential to spend as much as the Tier 1 definitely.

William J. Dezellem - Tieton Capital Management, LLC - President, CIO, and Chief Compliance Officer

That's quite helpful. And did you imply that these are all customers that would be revenue contributors in 2018?

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

I would expect them to start -- without having the list in front of me, I would say the majority of them would. The smaller the carrier is, typically the more agile they are. But I would say the majority of them we would expect.

Operator

And we'll take our next question from Matt Dhane with Tieton Capital.

Matthew W. Dhane - Tieton Capital Management, LLC - Senior Research Analyst and Principal

I was curious, the recent U.S. tax bill, within it, are there changes in a customer's ability to writeoff CapEx that may impact the purchasing behavior of some of your domestic customers?



JANUARY 17, 2018 / 3:30PM, ADTN - Q4 2017 ADTRAN Inc Earnings Call

Roger D. Shannon - ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary

Matt, we haven't really dug into it to that level of specifics as how we think it might affect the customers. I know there are some incentives that would push you as producers to kind of increase their business internationally to the extent that there is cross-border opportunities. But I think there is -- overall, I think we see it as positive for the U.S. and for the U.S. environment. There has been a number of carriers -- a number of major companies already that have increased spending or announced increases. AT&T, in particular, has been fairly vocal, generally speaking, about the benefit from that and how they intend to kind of roll that into increased investment.

Matthew W. Dhane - Tieton Capital Management, LLC - Senior Research Analyst and Principal

Okay, okay. I was under the impression that, that CapEx could maybe be written off 100%. I don't know if that directly impacts...

Roger D. Shannon - ADTRAN, Inc. - CFO, Principal Accounting Officer, Senior VP of Finance, Corporate Treasurer & Secretary

I think you're right. I just know -- I haven't heard any specifics of how that might translate. I think generally speaking it's a positive and kind of we'll dig into those specifics as well. It came together so quickly over the course of the end of the year that we and every other company had to spend all the time and cycles just kind of coming up with what the year-end impact in charge was. But we're certainly focused on the benefits going forward.

Thomas R. Stanton - ADTRAN, Inc. - Chairman and CEO

All right. Well, thank you very much for joining us on the conference call today. And we look forward talking to you this time next quarter.

Operator

This does conclude today's call. You may disconnect at any time, and have a wonderful day.

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.

©2018, Thomson Reuters. All Rights Reserved.

