ADTRAN INC
Form 10-Q
May 03, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______ to _______

Commission File Number: 000-24612

ADTRAN, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	63-0918200
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

901 Explorer Boulevard

Huntsville, Alabama 35806-2807
(Address of principal executive offices) (Zip Code)
Registrant's telephone number, including area code: (256) 963-8000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a small reporting company)	Small reporting company
Emerging growth company		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of April 20, 2017, the registrant had 48,323,754 shares of common stock, $0.01 par value per share, outstanding.

ADTRAN, Inc.

Quarterly Report on Form 10-Q

For the three months ended March 31, 2017

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FORWARD LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by or on behalf of ADTRAN. ADTRAN and its representatives may from time to time make written or oral forward-looking statements, including statements contained in this report, our other filings with the Securities and Exchange Commission (SEC) and other communications with our stockholders. Generally, the words, “believe,” “expect,” “intend,” “estimate,” “anticipate,” “will,” “may,” “could” and similar expressions identify forward-looking statements. We cau you that any forward-looking statements made by us or on our behalf are subject to uncertainties and other factors that could cause such statements to be wrong. A list of factors that could materially affect our business, financial condition or operating results is included under “Factors that Could Affect Our Future Results” in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” contained in Item 2 of Part I of this report. They have also been discussed in Item 1A of Part I in our most recent Annual Report on Form 10-K for the year ended December 31, 2016 filed on February 24, 2017 with the SEC. Though we have attempted to list comprehensively these important factors, we caution investors that other factors may prove to be important in the future in affecting our operating results. New factors emerge from time to time, and it is not possible for us to predict all of these factors, nor can we assess the impact each factor or a combination of factors may have on our business.

You are further cautioned not to place undue reliance on these forward-looking statements because they speak only of our views as of the date that the statements were made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ADTRAN, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except per share amounts)

	March 31, 2017	December 31, 2016
ASSETS		
Current Assets		
Cash and cash equivalents	$72,558	$ 79,895
Short-term investments	52,458	43,188
Accounts receivable, less allowance for doubtful accounts of $— at March 31, 2017 and December 31, 2016	85,396	92,346
Other receivables	13,398	15,137
Income tax receivable, net	—	760
Inventory, net	112,774	105,117
Prepaid expenses and other current assets	17,816	16,459
Total Current Assets	354,400	352,902
Property, plant and equipment, net	83,514	84,469
Deferred tax assets, net	39,085	38,036
Goodwill	3,492	3,492
Other assets	12,274	12,234
Long-term investments	174,413	176,102
Total Assets	$667,178	$ 667,235
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	$74,300	$ 77,342
Unearned revenue	16,969	16,326
Accrued expenses	15,035	12,434
Accrued wages and benefits	12,199	20,433
Income tax payable, net	3,126	—
Total Current Liabilities	121,629	126,535
Non-current unearned revenue	5,675	6,333
Other non-current liabilities	30,861	28,050
Bonds payable	26,800	26,800
Total Liabilities	184,965	187,718
Commitments and contingencies (see Note 14)		
Stockholders' Equity		
Common stock, par value $0.01 per share; 200,000 shares authorized; 79,652 shares issued and 48,321 shares outstanding at March 31, 2017 and	797	797

79,652 shares issued and 48,472 shares outstanding at December 31, 2016		
Additional paid-in capital	254,965	252,957
Accumulated other comprehensive loss	(9,477)	(12,188)
Retained earnings	923,116	921,942
Less treasury stock at cost: 31,331 and 31,180 shares at March 31, 2017 and December 31, 2016, respectively	(687,188)	(683,991)
Total Stockholders' Equity	482,213	479,517
Total Liabilities and Stockholders' Equity	$667,178	$ 667,235

See notes to consolidated financial statements

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ADTRAN, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended March 31, 2017	2016
Sales		
Products	$143,597	$123,883
Services	26,682	18,321
Total Sales	170,279	142,204
Cost of sales		
Products	76,659	64,073
Services	19,905	12,337
Total Cost of Sales	96,564	76,410
Gross Profit	73,715	65,794
Selling, general and administrative expenses	34,767	30,785
Research and development expenses	31,916	29,488
Operating Income	7,032	5,521
Interest and dividend income	933	855
Interest expense	(141)	(145)
Net realized investment gain	470	1,728
Other income, net	51	119
Income before provision for income taxes	8,345	8,078
Provision for income taxes	(1,694)	(3,064)
Net Income	$6,651	$5,014
Weighted average shares outstanding – basic	48,430	49,220
Weighted average shares outstanding – diluted	48,939	49,389
Earnings per common share – basic	$0.14	$0.10
Earnings per common share – diluted	$0.14	$0.10
Dividend per share	$0.09	$0.09

See notes to consolidated financial statements

ADTRAN, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended March 31,	
	2017	2016
Net Income	$6,651	$5,014
Other Comprehensive Income, net of tax:		
Net unrealized gains (losses) on available-for-sale securities	1,335	(255)
Net unrealized gains on cash flow hedges	79	—
Defined benefit plan adjustments	55	45
Foreign currency translation	1,242	1,228
Other Comprehensive Income, net of tax	2,711	1,018
Comprehensive Income, net of tax	$9,362	$6,032

See notes to consolidated financial statements

ADTRAN, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Three Months Ended March 31, 2017	2016
Cash flows from operating activities:		
Net income	$6,651	$5,014
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,323	3,347
Amortization of net premium on available-for-sale investments	124	220
Net realized gain on long-term investments	(470)	(1,728)
Net (gain) loss on disposal of property, plant and equipment	(16)	3
Stock-based compensation expense	1,883	1,558
Deferred income taxes	(1,947)	435
Changes in operating assets and liabilities:		
Accounts receivable, net	7,247	4,752
Other receivables	1,884	10,200
Inventory	(7,399)	163
Prepaid expenses and other assets	(2,413)	(3,083)
Accounts payable	(1,713)	(6,520)
Accrued expenses and other liabilities	(3,166)	902
Income tax payable/receivable, net	4,049	413
Net cash provided by operating activities	9,037	15,676
Cash flows from investing activities:		
Purchases of property, plant and equipment	(3,872)	(3,166)
Proceeds from disposals of property, plant and equipment	16	—
Proceeds from sales and maturities of available-for-sale investments	24,471	60,586
Purchases of available-for-sale investments	(29,517)	(52,053)
Net cash provided by (used in) investing activities	(8,902)	5,367
Cash flows from financing activities:		
Proceeds from stock option exercises	1,377	247
Purchases of treasury stock	(5,559)	(11,003)
Dividend payments	(4,369)	(4,453)
Net cash used in financing activities	(8,551)	(15,209)
Net increase (decrease) in cash and cash equivalents	(8,416)	5,834
Effect of exchange rate changes	1,079	1,225
Cash and cash equivalents, beginning of period	79,895	84,550
Cash and cash equivalents, end of period	$72,558	$91,609
Supplemental disclosure of non-cash investing activities:		
Purchases of property, plant and equipment included in accounts payable	$509	$485

See notes to consolidated financial statements

ADTRAN, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements of ADTRAN®, Inc. and its subsidiaries (ADTRAN) have been prepared pursuant to the rules and regulations for reporting on Quarterly Reports on Form 10-Q. Accordingly, certain information and notes required by generally accepted accounting principles for complete financial statements are not included herein. The December 31, 2016 Consolidated Balance Sheet is derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States.

In the opinion of management, all adjustments necessary to fairly state these interim statements have been recorded and are of a normal and recurring nature. The results of operations for an interim period are not necessarily indicative of the results for the full year. The interim statements should be read in conjunction with the financial statements and notes thereto included in ADTRAN's Annual Report on Form 10-K for the year ended December 31, 2016, filed on February 24, 2017 with the SEC.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expense during the reporting period. Our more significant estimates include the obsolete and excess inventory reserves, warranty reserves, customer rebates, determination of the deferred revenue components of multiple element sales agreements, estimated costs to complete obligations associated with deferred revenues, estimated income tax provision and income tax contingencies, the fair value of stock-based compensation, impairment of goodwill, valuation and estimated lives of intangible assets, estimated pension liability, fair value of investments, and the evaluation of other-than-temporary declines in the value of investments. Actual amounts could differ significantly from these estimates.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. In August 2015, the FASB issued ASU 2015-14, which deferred the effective date of ASU 2014-09 to fiscal years beginning after December 31, 2017, and interim periods within those fiscal years, with early adoption permitted for reporting periods beginning after December 15, 2016. Subsequently, the FASB issued ASUs in 2016 containing implementation guidance related to ASU 2014-09, including: ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), which is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations; ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which is intended to clarify two aspects of Topic 606: identifying performance obligations and the licensing implementation guidance; ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which contains certain provisions and practical expedients in response to identified implementation issues; and ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, which is intended to clarify the Codification or to correct unintended application of guidance. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. We plan to adopt ASU 2014-09 and the related ASUs on January 1, 2018, and we are currently evaluating the transition method that will be elected. We are continuing to evaluate the potential impact of these ASUs, and we believe the most significant potential impact relates to our accounting for software license and installation services revenues. We do not believe there will be a significant impact to product or maintenance revenues.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases (Topic 842) (ASU 2016-02). ASU 2016-02 requires an entity to recognize lease assets and lease liabilities on the balance sheet and to disclose key information about the entity's leasing arrangements. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. A modified retrospective approach is required. We anticipate the adoption of ASU 2016-02 will have a material impact on our financial position; however, we do not believe adoption will have a material impact on our results of operations. We believe the most significant impact relates to our accounting for operating leases for office space and equipment.

In January 2017, the FASB issued Accounting Standards Update No. 2017-04, Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (ASU 2017-04). ASU 2017-04 simplifies the measurement of goodwill by eliminating step 2 of the goodwill impairment test. Under ASU 2017-04, entities will be required to compare the fair value of a reporting unit to its carrying amount and recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. ASU 2017-04 is effective for annual or interim impairment tests performed in fiscal years beginning after December 15, 2019, with early adoption permitted for annual or interim impairment tests performed on testing dates after January 1, 2017. The amendments should be applied prospectively. We are currently evaluating whether to early adopt ASU 2017-04, but we do not expect it will have a material impact on our financial position, results of operations or cash flows.

In March 2017, the FASB issued Accounting Standards Update No. 2017-07, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost (ASU 2017-07). ASU 2017-07 amends ASC 715, Compensation — Retirement Benefits, to require employers that present a measure of operating income in their statements of earnings to include only the service cost component of net periodic pension cost and net periodic postretirement benefit cost in operating expenses (together with other employee compensation costs). The other components of net benefit cost, including amortization of prior service cost/credit, and settlement and curtailment effects, are to be included in non-operating expenses. ASU 2017-07 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. We do not expect ASU 2017-07 will have a material impact on our financial position, results of operations or cash flows.

During the first quarter of 2017, we adopted the following accounting standards, which had no material effect on our financial position, results of operations or cash flows:

In July 2015, the FASB issued Accounting Standards Update No. 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory (ASU 2015-11). Currently, Topic 330, Inventory, requires an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. ASU 2015-11 does not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. ASU 2015-11 requires an entity to measure in scope inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. ASU 2015-11 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. The amendments should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. We adopted ASU 2015-05 in the first quarter of 2017, and there was no material impact on our financial position, results of operations or cash flows.

In January 2017, we adopted ASU 2016-09, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. As a result, beginning in the first quarter of 2017, we began recognizing all excess tax benefits and tax deficiencies as income tax expense or benefit as a discrete event. The treatment of forfeitures has changed as we have elected to discontinue our past practice of estimating forfeitures and now account for forfeitures as they occur. As a result, we recorded an increase in additional paid in capital of $0.1 million, a charge to beginning retained earnings of $0.1 million, and an increase in the deferred tax assets related to non-qualified stock options and RSUs of $10 thousand. In addition, cash flows related to excess tax benefits will no longer be separately classified as a financing activity apart from other income tax cash flows within operating activities. We elected to retrospectively apply the changes in presentation to the statements of cash flows and no longer classify excess tax benefits as a financing activity, which had no effect on our cash flows for the three months ended March 31, 2016. There was no material impact on our financial position, results of operations or cash flows as a result of these changes.

2. BUSINESS COMBINATIONS

On September 13, 2016, we acquired key fiber access products, technologies and service relationships from subsidiaries of CommScope, Inc. for $0.9 million in cash. This acquisition will enhance our solutions for the cable MSO industry and will provide cable operators with the scalable solutions, services and support they require to compete in the multi-gigabit service delivery market. This transaction was accounted for as a business combination. We have included the financial results of this acquisition in our consolidated financial statements since the date of acquisition. These revenues are included in the Network Solutions reportable segment, and in the Access & Aggregation and Customer Devices categories.

We recorded a bargain purchase gain of $3.5 million during the third quarter of 2016, net of income taxes, subject to customary working capital adjustments between the parties. The bargain purchase gain of $3.5 million represents the excess fair value of the net assets acquired over the consideration exchanged. We have assessed the recognition and measurement of the assets acquired and liabilities assumed based on historical and pro forma data for future periods and have concluded that our valuation procedures and resulting measures were appropriate.

The allocation of the purchase price to the estimated fair value of the assets acquired and liabilities assumed at the acquisition date, subject to working capital adjustments, is as follows:

(In Thousands)	
Assets	
Inventory	$3,131
Property, plant and equipment	352
Intangible assets	4,700
Total assets acquired	8,183
Liabilities	
Accounts payable	(1,250)
Warranty payable	(61)
Accrued wages and benefits	(122)
Deferred income taxes	(2,265)
Total liabilities assumed	(3,698)
Total net assets	4,485
Gain on bargain purchase of a business, net of tax	(3,542)
Total purchase price	$943

The details of the acquired intangible assets are as follows:

In thousands	Value

		Life (years)
Supply agreement	$ 1,400	0.8
Customer relationships	1,200	6.0
Developed technology	800	10.0
License	500	1.3
Patent	500	