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ADTN - Q3 2019 ADTRAN Inc Earnings Call

EVENT DATE/TIME: OCTOBER 31, 2019 / 2:30PM GMT

OVERVIEW:

Co. reported 3Q19 revenue of $114.1m and GAAP net loss of $46.1m or $0.96 per share. Expects 4Q19 revenue to be flat to slightly down sequentially.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to ADTRAN's Third Quarter 2019 Earnings Release Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer period. (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 impact of the company's successful development and market acceptance of core products, the degree of competition in the market for such products, the product and channel mix, component costs, manufacturing efficiencies and other risks detailed in our annual report on Form 10-K for the year ended December 31, 2018. 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.

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 & CEO*

Thank you, Lisa. Good morning, everyone. We appreciate you joining us for our third quarter 2019 conference call. With me today is ADTRAN CFO, Mike Foliano. Following my opening remarks, Mike will review the quarterly financial performance in detail. And then we will take your questions.

Our progress in the quarter was overshadowed by a pause and shipments to a large customer in Latin America and the slowdown in spending by a large customer in Europe. With the exception of these 2 Tier 1 international customers, our business grew 20% over the previous period. From a topline perspective revenue for the quarter was $114.1 million, down 19% on a year-over-year basis. Network Solutions accounted for the majority at $94 million a 22% decrease over the same period in 2018. Global Services Revenue contributed $20.1 million, up 17% over the previous period and up 4% year-over-year. Our domestic revenue increased 10% over the previous quarter, largely driven by sales of our PON fiber access and CPE solutions and we continue to gain traction globally with our 10 gig XGS PON and Gfast solutions while we continue to see a high level of fiber and broadband extension opportunities across most of Europe, Australia and Latin America and even in some emerging markets. Our domestic business continues to be slow as major operators contemplate their 5G and fixed wired investments.

In Europe, the investment in fiber infrastructure is being led by emerging alternative network operators, which in turn are pushing incumbent providers to invest. In Australia the national network build is now into a mixed technology phase where we'll see some fiber-to-the-node migration to fiber to the premise and we'll start seeing the ramp of CPE deployments. In LATAM we expect to continued broadband deployment in Mexico from the restart a year earlier or earlier this year. In North America Despite headwinds in some of the largest operators there are some positive trends in fiber broadband deployment with Tier 2 and regional service provider segments and some rural electric co-ops and rural communities building their own fiber networks.

We're in a good position to capitalize on global fiber densification opportunities supporting MDUs in 5G rollouts. We are also well positioned with customers looking to leverage existing network infrastructure to deliver gigabit or near gigabit services with our G faxed -- Gfast and fixed wireless access products. We remain cautiously optimistic about returning to growth in the next few quarters and are aligning our organization to an operating model that focuses on our growth opportunities, allows us flexibility to adjust to market conditions and returns us to profitability. During the third quarter, ADTRAN introduced a range of new products, services and technology innovations that we believe will be instrumental in our success moving forward. First, we announced several key additions to our market leading 10 gig PON portfolio. These additions included the ADTRAN 600 series of 10 gig PON ONTs that will enable any type of service provider or cable operator serving residential business and retail customers to deliver multi-gigabit services.

Operators will be able to utilize this expanded portfolio to rollout services faster, monitor and optimize service quality and make better decisions about network operations as they look to meet growing customer demands for gigabit services. Our 10 gig PON technology leadership has grown over the past year as network operators in major markets have leveraged our xG's PON solutions to deliver multi-gigabit services for residential, commercial, industrial and government Broadband programs. According to IHS Markit's trend is a leading supplier based on ports shipped in North America, EMEA, South and Central America regions for carriers in cable MSO 10 gig PON solutions. With our leadership position in Gfast fiber extensive solutions ADTRAN has deployment in multiple Tier 1 operators in North America, Europe and the Pacific Rim. Our market momentum continues with our second-generation solutions and we are recently awarded a network Gen 2 Gfast project with a European operator. We should acquire gen2 Gfast approvals with a Tier 1 operator for deployment in the U.S. market and we're in the lab with a Tier 1 in LatAm.

We continue to expand the role ADTRAN plays and helping rural carriers deploy 10 gig networks as part of our enabling communities connecting lives program. During the quarter ADTRAN announced all-fiber build or the rural operator and a 10 gig communications backbone along the Eastern Shore of Maryland to connect underserved communities and drive overall economic development in the region. We expect this momentum to continue as the FCC will soon be issuing an order for the next decade of CAF called the rule digital opportunity fund, which will provide $20.4 billion of federal subsidies for broadband deployment to 4 million homes in rural America.

As I mentioned, we have seen more utilities and municipalities playing a role in delivering broadband services in rural communities and over a dozen new utility providers in the U.S. and Canada have recently selected our TA-5,000 excess platform as the foundation for a rich set of gigabit services in their communities. Our integration of the smart our team and technologies inter portfolio continues to progress. During the quarter we announced the Intellifiber system, a whole Home turnkey mesh WiFi solutions tailored for service providers designed to create an immersive whole home WiFi experience. Intellifiber delivers ultrafast intuitive and reliable broadband to every corner of the home.

ADTRAN's open network efforts are also key part of the SmartRG strategy. Last week ADTRAN announced that the SmartOS 11 is the first commercial software solution for customer premises equipment-based completely on purple WRT project helping to accelerate open and scalable standards technology and networks. With smartOS 11 fully open source approach we facilitate differentiation and create competitive opportunities as surface prior look to add innovative revenue-generating services to their offerings.

Finally, during the quarter, we announced a new SD-WAN cloud solution designed to help small Dominion business and distributed enterprise take advantage of cloud-based networking while keeping existing voice and security solutions in place. We are excited about the future for ADTRAN. Our customers in the market as the market transitions to 10 gigabit and it starts to unfold. Our focus remains on helping our customers deliver an unmatched broadband experience over any network to any customer over any device. And with that Mike will you provide an overview of the financials and following this will be happy to ask any questions you may have. Mike?

Michael K. Foliano - *ADTRAN, Inc. - Senior VP of Finance, CFO & Corporate Secretary*

Sure. Thank you, Tom. Good morning to all. I will review our third quarter results and also provide our view for the fourth quarter. During my report, I will be referencing both GAAP and non-GAAP results. The differences between reported GAAP and non-GAAP includes stock-based compensation, acquisition-related amortizations and other expenses, restructuring expenses, gain on bargain purchase of a business and other contingencies, amortization of pension actuarial losses, non-cash changes in the fair value of equity investments for our deferred compensation plan, asset impairments, deferred tax asset valuation allowance and a reimbursement from a claim settlement.

As Tom stated, ADTRAN's third quarter revenue came in at $114.1 million compared to $156.4 million last quarter and $140.3 million for the third quarter of last year. Breaking this down across our divisions, our Network Solutions revenue for the third quarter was $94 million versus $139.2 million reported for Q2 of 2019 and $121 million in Q3 of last year. Our services and support revenue in Q3 of this year was $20.1 million compared to $17.2 million reported for the second quarter of 2019 and $19.3 million in the third quarter of last year. Across our revenue categories access and aggregation Revenue for Quarter 3 of 2019 was $65.1 million compared to $109.4 million in the prior quarter and $91.9 million in the third quarter of 2018. Revenue for our subscribers solutions and experienced category was $42.5 million for the quarter versus $40.5 million for Quarter 2 of 2019 and $38.6 million for Quarter 3 of last year.

Traditional and other products revenue for the quarter was $6.5 million compared to $6.5 million for Quarter 2 of 2019 and $9.9 million for Quarter 3 of 2018. Looking at our revenues, geographically domestic revenue for Q3 2019 was $83.1 million versus $75.3 million reported in Quarter 2 of 2019 and $83.7 million in Quarter 3 of last year. Our international revenue for Quarter 3 of 2019 was $30.9 million compared to $81.1 million for Quarter 2 of 2019 and $56.6 million in Quarter 3 of 2018. We published the reporting of each of these categories on our Investor Relations web page at www.adtran.com. We had one 10% of revenue customer during the quarter.

Our GAAP gross margins for the third quarter of this year were 40.6% compared to 41.6% last quarter and 41.6% reported in the third quarter of 2018. Non-GAAP gross margins for Quarter 3 were 41% versus 41.4% in the prior quarter and 42% in the third quarter of last year. The quarter-over-quarter and year-over-year decreases and non-GAAP gross margins were driven by reduced product volume, partially offset by an improvement in our services gross margins. Total operating expenses were $62.7 million for Quarter 3 of 2019, compared to $65.7 million reported last quarter and $60.6 million for Quarter 3 of last year. On a non-GAAP basis, our third quarter operating expenses were $59.4 million compared to $61.2 million last quarter and $57.4 million in Quarter 3 of 2018.

The Non-GAAP quarter-over-quarter decrease in operating expense was primarily the result of decreased personnel-related expenses and decreased incremental operating expense related to the SRG acquisition, partially offset by increases in lease and legal expenses. The non-GAAP expense year-over-year increase is primarily attributable to incremental expenses related to the SmartRG acquisition as well as increased legal and contract services expenses, offset by a decrease in personnel-related expense. Operating income on a GAAP basis for the third quarter was a loss of $20.3 million compared to an operating income of $600,000 in the prior quarter and an operating loss of $2.2 million reported in Q3 of last year.

Non-GAAP operating income for Q3 2019 was a loss of $12.6 million compared to income of $3.6 million in Q2 of 2019 and $1.5 million in quarter three of last year. The quarter-over-quarter decrease in non-GAAP operating income was mainly driven by decreased sales volume, partially offset by improved gross margins in our services business and decreased operating expenses. The decrease in our Q3 non-GAAP operating income as compared to Q3 of 2018, is it attributable primarily to lower sales volume and lower gross margin mix in our product portfolio. Other income for quarter 3 of 2019 was $1.9 million compared to $2.8 million last quarter and $5.4 million for quarter three of 2018.

Other income in the quarter was primarily driven by favorable exchange rates. Our non-GAAP other income for the quarter that just ended, was $2.7 million compared to $2.4 million in the prior quarter and $4.6 million in quarter three of 2018, the shifts in non-GAAP other income were primarily driven by fluctuations in our equity investment portfolio and foreign exchange rates.

The company's GAAP tax provision for quarter three 2019 was $27.7 million as compared to a benefit of $588,000 in the second quarter and a benefit of $4.4 million in the third quarter of 2018. The Q3 2019 tax expense as a result of a valuation allowance against our deferred tax assets, partially offset by a tax benefit as a result of the losses incurred in 2019.

GAAP net income for quarter three of this year was a loss of $46.1 million compared to income of $4 million in the prior quarter and income of $7.6 million in the third quarter of last year. Non-GAAP net income for the 3rd quarter of 2019 was a loss of $2.8 million compared to an income of $5.9 million last quarter and an income of $9.9 million in quarter three of 2018.

Earnings per share on a GAAP basis, was a loss of $0.96 per share compared to earnings of $0.08 per share last quarter and earnings of $0.16 per share in the three quarter of 2018. Non-GAAP earnings per share for the third quarter of this year. It was a loss of $0.06 per share Compared to earnings of $0.12 per share last quarter and earnings of $0.21 per share in quarter three of 2018. We've provided reconciliation between diluted GAAP earnings per share and diluted non-GAAP earnings per share and our operating results disclosure.

Turning to the balance sheet Unrestricted cash and marketable securities, net of debt totaled $169.1 million at quarter end after paying $4.3 million in dividends. For the quarter, we used $900,000 of cash for operations. Net trade accounts receivable was $90.6 million at quarter end, resulting in a DSO of 73 days compared to 68 days last quarter and 67 days at the end of the third quarter of 2018.

The increase in DSOs versus last quarter is mainly attributable to timing of shipments during the quarter. And customer mix. Net inventories were $104.9 million at the end of the third quarter compared to $95.1 million last quarter and $106.1 million at the end of quarter three 2018.

Looking ahead to next quarter, the book and ship nature of our business. The timing of revenue associated with large projects, the variability of order patterns and the customer base into which we sell as well as the fluctuation in currency exchange rates in our international markets may cause material differences between our expectations and actual results.

We expect that our fourth quarter 2019 revenue will be flat to slightly down from Q3 2019. After considering the potential effect of currency exchange rates and the anticipated mix, we expect that our 4th quarter gross margins on a non-GAAP basis will be consistent with the third quarter. We also expect that non-GAAP operating expenses for the fourth quarter of 2019 will be in the range of $55 million to $56 million. Finally, we anticipate that the consolidated tax rate for the fourth quarter of 2019 on a non-GAAP basis, will be in the mid '20s percentage rate we believe the significant factors impacting revenue and earnings realized in 2019 will be the following.

The macro spending environment for carriers and Enterprises, currency exchange rate movements, the variability of mix and revenue associated with large project rollouts, the proportion of international revenue relative to our total revenue. Professional services activity levels, both domestic and international. The timing of revenue related to Connect America Fund projects, the adoption rate of our Broadband Access platforms, and fluctuations in inventory in our distribution channels.

Additional financial information is available at ADTRAN's Investor Relations website by going to www.adtran.com and follow the Investor Relations link. With that I will turn the call back over to Tom.

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

Great. Thanks, Mike. Please with that, we're ready to open up to any questions people may have.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Rod Hall from Goldman Sachs. Your line is open.

Ashwin Kesireddy - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Hi, thanks for taking my question. This is Ashwin on behalf of Rod. Tom, I think you mentioned about growth probably in the next few quarters be in Q4. Can you just talk about visibility pretty clear in the first half of next year? And generally for full year 2020 can you talk about your initial planning for the year and maybe elaborate on some of the opportunities in the business either on a geographical basis or product level that could be exciting in 2020?

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

Sure. Well, let me start by saying, as you know, historically, and this won't be any different. We typically give next year's guidance more fully on the fourth quarter call, because we have greater visibility at that point in time. And this quarter is no different than the previous quarters in that regard. I will tell you what we typically see is a rise towards the middle of the year and then the two ends of the years. The first part of the year, end of last quarter are typically lower than the center in that basis. We don't see any difference in what we typically would typically expect. But we fully expect to be, we don't have guidance yet for Q1, but we fully expect to see profitability in Q2. The areas of interest for us, have been kind of consistent over the last year, the biggest opportunity set that we see in Europe today, where there is an awful lot of activity going on with 10 gig PON and vendors looking for, customers looking for new vendors as some of the vendors per fallen out of favor that continues on today just as strong as it was throughout this entire year.

The US we have pockets; there is a lot of cloudiness in some of the larger carriers in the US with some changes going on. In our customer base, our largest customer Century Link here in the US that continues to go well actually had a very good quarter this quarter. I mean, we expect that to can you on through next quarter, or excuse me through next year in the Tier 2 space we've had a couple of customers that have been kind of dormant for a while.

We've seen some activity pick up with one of those already this year and some planning for next year. So we're positive about the tier 2 space and the Tier 3 space. I think the other larger Tier 1. There's still a little bit of cloud in us about and Latin America, there is a multi-year project going on and we expect that to continue on through next year at least.

Our problem with that customer has been the variability in ordering pattern in inventory levels that of course plagued us this last quarter, but that doesn't at all change the trajectory of the program itself. Then the last piece I would say it would be Australia where as you know we're the fast provider to the large carrier there. And in that case, that program is continuing to go on and we expect good results from that next year as well as they shift some of their fiber-to-the-node to fiber-to-the current deployments and we just recently received approval for selling CPE equipment into that customer space as well. Mike, did I miss anything.

Ashwin Kesireddy - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Thank you. Got it. Just on the LATAM customer point and the inventory situation there. Is it -- are you expecting that to come back maybe in first half of next year, are you have no visibility into that at this point?

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

I have visibility to plans and so there are fairly vocal about what it is they are wanting to do on a macro level down to a number of ports. The visibility, where the visibility gets more difficult is timing of purchase orders. So they may draw down their inventory before they order. Sometimes they don't draw down their inventory before the order, so it's not about the macro level on a kind of on a broader time basis. The issues we have with them are typically more around individual quarter by quarter plans.

Ashwin Kesireddy - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

Got it. And one last question, you briefly mentioned about domestic operators contemplating 5G and fixed wireless access plans. Can you elaborate on what you're seeing there and give us more color on what you're thinking there in terms of 5G fixed wireless opportunities in the US. Thank you.

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

In my estimation, the way that I'm doing this is, there is a lot of them -- the largest carriers are trying to figure out how it plays in five years is going to impact our capital plans and then kind of re-apportioning their fixed plans based off of that and then to the extent that the fixed plans with something like the (inaudible) or NG-PON2 may play into that and a lot of that is up in the year. To the extent is being deployed today, it's pretty much point to point, but there's still a lot of variability before it really gets off to a solid footing with real numbers behind it. So that's got some of the larger carriers just kind of in a pause mode. On the fixed plan, we do see carriers and it's really the ones that I've talked about already, where they have definitive plans to grow their GPON deployment. They have definitive plans to grow their XGS and start there XGS deployments and that's really more associated with the non-wireless -- traditional wireless carriers where we're seeing that activity. So that's moving forward. The ones that I'm talking about where you're kind of seeing this consternation is really more around the wireless carriers.

Operator

And our next question comes from the line of George Notter from Jefferies. Your line is open.

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

Hey, guys. Thanks very much. I guess I wanted to ask about the international business. I understand certainly the commentary about the Latin American customer. But obviously the step down was pretty significant from June to September and certainly I would imagine in the European business was part of the story. I guess I'm wondering kind of what's the picture is right now in your large European customer in terms of run rates and spending here and into the balance of the year.

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

Sure. So we don't think that is that in our large European customer we told you that we expected slowness through this second half of the year and we still our expectation hasn't changed. Although the numbers really don't get finalized with them towards the till the middle of fourth quarter, we expected a pickup in the first quarter and then traditionally we would see that continue to pick up to the third quarter of next year. So we don't see a change in that ordering pattern. Although the exact numbers are in play right now, are in place right now. We do see a stronger let's say Q1 than we did in Q3 and Q4. You're right, it was a -- from a Q2 to Q3 perspective, it was a fairly significant drop is the 10s of millions of drop which I kind of explained on the last call. And that's, although it came in lower than we expected. I think it was rational as to why they did what they did and kind of turn out the way it turned out. Latin America is similar big drop from Q2 to Q3 that is more about ordering inventory levels and contract negotiations and just for that customer. Then it is about any demand profile change at all. They are still absolutely going out and installed in these things and moving forward their network build plan.

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

Got it. So then was the delta relative to your original topline expectation for September, the delta then it sounds like was Latin America or were there other?

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

Let me be clear about that. It was Latin America definitely, and our European revenue came in lower than was initially anticipated it was both. But the larger decline was in Latin America.

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

Got it, okay. And then with some offset from stronger North American business.

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

Rest of the business was up 20% Right. So yes.

Michael K. Foliano - *ADTRAN, Inc. - Senior VP of Finance, CFO & Corporate Secretary*

And then the margin of 41%. I thought that was pretty good given the size of the step down in topline. Is there something unusual in that gross margin line this quarter or just you could work on the cost side, any story there you could talk to you.

I think there is good work on the cost side plus and might be I think it may be working.

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

We have been working a lot on the cost side. We also had some improved margins in our services business that I mentioned in my read out. Some of that is the mix of the type of services we're doing some of that also is just becoming more efficient in the way that we're operating and slightly increased volume flowing through there as well. And needless to say with the European customer being down, that's typically a lower margin region, George. So that helped us some.

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

Got it. Okay, great, thank you very much.

Operator

Our next question comes from the line of Rich Valera from Needham. Your line is open.

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

Thank you, Tom you mentioned you expected to be profitable by 2Q of next year and doing the rough math. It seems, it could be -- need to be around the mid-130s , if you kind of run rate out the expenses you're projecting for the fourth quarter and similar gross margins. And I'm guessing from your prepared remarks that you expect at least the European customer to be back in a meaningful way. Do you also sort of to get to that level, need to see the Latin American customer come back or is it just sort of one or the other of those customers can come back and you could potentially get to that revenue level.

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

Without giving an extra guidance, I want to be a little bit careful here. We expect to be profitable. I don't want to narrow in on the particular revenue number because -- but the answer to your question is in that operating range that you're talking about the general business is typically larger in Q2 than in Q1 or in Q4. So we feel solid about that. And we would not have to have both of them come back. In fact, we would not have to have both of them come back to the level they were in order to achieve that kind of level of revenue.

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

Got it. And then just on the OpEx run rate that is a pretty big cut from Q3 to Q4. So just I wanted to try to understand sort of where those cuts were made and kind of what might you be giving up by cutting those expenses. And then is that the right run rate to assume going into next year, or could it be lower or does it bounce back up at some point?

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

I don't expect it to bounce back up. I expect us to continue to scrutinize where we're spending. So if anything I would expect it to continue a downward trajectory through the first half of next year. What we're doing is basically recalibrating across the board on where we're spending money and how we're spending money and what's the real is -- what's the risk associated with that particular spend in the overall outcome. That's something that we do periodically. When we are in downtime we do it much more stringently than when you're in up times and you adjust your revenue. The key are -- our premise on this is a key opportunity sets that we believe are going to be that have a high likelihood revenue potential. We want to make sure we keep those in place. Having said that we had been growing some of the areas of our business over a long period of time in order to capitalize on some of these. Some of these have not happened. And in those cases, we're going to take a real hard look at them and see whether or not we want to continue to spend on them. That's what we did over the last quarter in a very diligent but expeditious way. And that's what we will continue to focus on in the first half of the year.

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

Okay. Thanks for taking my questions. Appreciate it.

Operator

And our next question comes from the line of Fahad Najam from Cowen. Your line is open.

Fahad Najam - *Cowen and Company, LLC, Research Division - Associate*

Thanks for taking my questions. I had a couple of high-level questions if I may. In terms of the revenue concentration, can you help us understand how much revenue is contributed by your top 5 customers -- by your top 10 customers?

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

Actually, I don't think we've -- you can typically do that based off of our 10% customers. And we typically have 2 or 3 10% customers. Is very rare for us to have 1 and you can imagine, the reason we had 1 is because of, we kind of discuss that in broader terms earlier in this call and some of the questions. We don't expect -- there is a strong concentration typically in the quarter. At this revenue level that concentration dissipates substantially. So this is not a revenue level we want to be at, but at this revenue level, we don't have a lot of concentration. And then as we move forward into next year we fully would expect there is a good and bad of it that we would expect it to be 2 and 3 going into next year.

Fahad Najam - *Cowen and Company, LLC, Research Division - Associate*

Got it. And staying in line with this team that I'm trying to get my hands around with a diversification. Can you help us understand in terms of how much of your customers or how much of your revenue is positively level to say 5G versus cable MSOs versus just traditional telecom revenue?

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

On a quarter-by-quarter not a lot in 5G today. There is some there, but it's not heavily weighted there. The majority of our revenue tends to be traditional telcos and then the concentration happens with the Tier 1s within those telcos, especially with the status of the Tier 2 market here in the U.S. being depressed. We expect that to actually start coming out. Has actually started this last quarter. Those markets will actually pick up next year. From time to time the MSOs can come in strong for us as a segment but that's kind of hit or miss on a quarter-by-quarter basis.

Fahad Najam - *Cowen and Company, LLC, Research Division - Associate*

Got it. And just last question if I may. In the U.S. AT&T highlighted that they're largely done with the fiber to the home rollout and that's partly one of the reasons for the lower CapEx outlook. Are you seeing any kind of capital reallocation -- CapEx reallocation away from traditional fiber to the home deployment and going more into 5G it maybe that's impacting your revenue?

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

Well, we don't do fiber to the home business with them, so I would believe what you're saying to be accurate. But we don't do a lot of business in that area. Our focus with them, has been and continues to be and we are kind of waiting to see how their capital budget rolled out on a product-by-product basis, but it has been around G.fast and their willingness or they're wanting to actually go after the MDU market within their footprint outside of their footprint. That hasn't been funded at the level that I think either of us expected. That is kind of low hanging fruit for them and that's something that we'll be working with them continuing on into next year, but we're not directly in the fiber-to-the-prem business with them.

Fahad Najam - *Cowen and Company, LLC, Research Division - Associate*

Got it. Tom, I wasn't asking specific to AT&T. I was more I think directionally if there is any kind of shift in CapEx away from fiber-to-the-prem, fiber to the edge kind of [Multilple Speakers].

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

I think in the wireless carriers my belief would be that that is accurate.

Operator

Our next question comes from the line of Matt Dane from Titan Capital, your line is open.

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

Great, thank you. I was hoping you could discuss the shift away from Huawei that's taking place right now and how much of an impact you would expect that to have on 2020. And then I don't think I fully understand the timing or how long it takes for an RRP to go from being put out there to actually contributing revenue in Europe. Can you walk me through that whole process?

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

Sure. It's not dissimilar to what happens in the U.S. at least, and that the larger the carrier typically the larger the -- the longer the time frame. In the U.S. and in Europe, for that matter, Tier 1 carrier would make a selection in an RFP and it can be 18 to 24 months before that turns into revenue. And then the smaller the carrier the quicker it gets and there are some cases where it can be a matter of a month. But those are typically small carriers without an awful lot of infrastructure that you're having to test against. As far as the move away from and different suppliers that has been a push that's been going on since the beginning of the year. We have started shipping Gfast to a European carrier that actually decommissioning equipment. We've been in communications with several carriers including some of our incumbent carriers in Europe and there is a desire to continue to look at their infrastructure. And in some cases decommission and in some cases cap. So I think that on a net, that's a very positive for us, because if you think about what that does to the market share pie it's pretty material. It's going to take some time because depending on the carrier if they want to cap or they want to replace. First of all as a large capital expense for them. And the second of all, it takes an awful lot of time just to make that transition smooth from a customer basis. So I expect it to be over on new awards. I expect there to see probably in today's environment, less competition for removal or removing equipment. I think that that's going to take a few years. Did that answer your question?

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

That is helpful, Tom. And so as you sit here today, would you expect this shift away to be more impactful on 2020 or is it more of a 2021 phenomenan as your currently looking at the landscape?

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

What we have seen some impact already honestly, although it's just now starting. So there'll be some incremental impact in 2020. I think the bigger impact from -- for 2020 is you'll see new awards and there'll be continuous decommissioning. But I think like I said, I think that's going to take a long time. So I think there is a positive lift because of that, but not a big -- not an inflection point lift in 2020, but you will see and we are already seeing a change in the RFP profiles and the competitive base that we're bidding against.

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

Great, that's helpful. Thank you.

Operator

And our next question comes from the line of Paul Silverstein from Cowen. Your line is open.

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

Tom, I apologize for (inaudible) was just to warm me up. If I could ask you -- so in the 20 plus years I've been covering your company, it's always been about just the nature of your business. Is always come down to 2 to 5-ish in that range of customers, 2 to 5-ish projects that dominated revenue, that dominated your growth for better or worse in thereby your profitability. Putting aside seasonality the rhythm of the year in near term trying to look longer term. I know it's hard -- partner forecasting quarter out. I'd appreciate that. So that being wind up. If we look at your big European carrier understand that will that appearance of -- a handful of years ago and it's been down or flat, ever since. If we go project by project -- well I apologies. Let me take a step back. Is there any hope any reason to believe that at some point a year from now, 2 years from now, 3 years from now that the model will have changed appreciably in terms of meaningful less reliance on 1 or 2 customers? In broadening you cited the 20% growth in the balance of your customer base exiting out the South American and European carrier. Obviously that's good from a quarter perspective but it'd be even better if that were from a prolonged long-term perspective and getting away from these 1 or 2 big projects with a throw-away. And then I've got some specific questions for that.

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

Yes. Sure. So I think that's a good question. I can tell you what we have been doing. So if you go back the whole we had a big push into the Tier 2 and Tier 3 space, which has been successful. That market itself has been depressed. But there are periods of time where that really offset any particular Tier 1 revenue downtick. When we have a macro environment like in my mind, what's kind of happening in the U.S. today that's difficult for anybody in. Paul, I think you'll agree that regardless of size. We've seen that impact other companies just in the last week that are very large. So I think the macro piece is always difficult. And we have the additional burden that our revenue is concentrated with a handful of large Tier 1s to concentrate --- handful of Tier 1s. Our push has been twofold. One is after the Tier 2, Tier 3 move into international markets. And that is where we picked up some customers, including a large European Tier 1 but other customers that was the push into Australia was all about diversification of revenue. We have pushed into several different pockets within Latin America although the largest one still ends up being a dominant force in that area. So we're continuing to try to drive our business to international pockets so that we can actually offset that concentration. Hello, it's difficult, when we have to go down like we did or decrease like we did. Just look at the customer count. The customer count outside of the U.S. has been we seen very strong growth. And then the other push that we had is in the MSO market. That will long term payoff. The MSO market isn't going gangbusters today. But that's also a time to go in and prove yourself as a vendor and pick up market share for when that market does pick up. I still think on a macro basis, we'll still be affected by downturns, but I think if you look at the number of customers we do business with and the segments that we do business with, it's much broader than it was 3 years ago or 5 years ago. That won't say that macro things won't impact us, but we have to get through that piece and we have to continue to focus on that diversification.

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

I appreciate that. Before I ask you about some individual projects going back to that 20% growth, how much of that is deeper penetration in your projects from the most in the existing customer base? How much of that is a function of new service providers new customers?

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

Mike, I don't know -- I haven't seen it broken out that way. I will tell you the number of customers contributing in the last quarter to that 20% is on a net basis is as big as I've seen with some of them coming in Europe and some more and actually Latin America. But I don't know if we have a broke out by existing customer versus new customer.

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

So when you look at growth is there a reason to believe that that will persist? Again, just focusing on the balance of the customer is a 20% is -- or are those one-off projects, or those projects have legs that go for a while?

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

So they have legs that go for a while. I had mentioned the old carrier business in Europe. I did mention the Tier 1s in Europe, which are, I did say that they were being pushed and as you're probably aware there several RFPs in Europe Tier-1s. I tend to discount them during this time and on this call because they do take a long time to close. But the old carriers in Europe are much quicker and moving much quicker and certifying your product are already contributing and those are multi-year projects that we're just starting on.

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

Okay, one last question from me on the same. If we look at the big opportunities. I'm asking you to look not just on a 1 quarter 1-year basis, but when you look further downfield, is there any reason to believe any hope that that big European operator will ever go back to a sustained growth trajectory for you? Not that it's a bad thing to have a big customer of that nature, but again in terms of driving growth any reason to believe that will eventually pick up on a sustained basis? As we look to the South American situation, I think you had commented the Quarter 2 ago that the business you're doing now the projects you're involved in is fundamentally different than what have been the case previously for years where they would pop up one out of every 4 to 8 quarters as North of 10% and then we go meaningfully down and got quiet from there. I think you had said there was a meaningful change in that in the nature of the business or you just referenced the cable situations. I think we all know those have been delayed relative to -- I think what a lot of us and yourself that expected a year ago. Any insight you can provide on the timing of those opportunities. And finally on NBN. I think you're now a year, maybe a little bit beyond a year until what I think originally it was going to be a big 2-year push in terms of the big revenue growth trajectory before flooding down and starting to perhaps decline to some extent. If you could give any insight on each of those or any other major projects I'm forgetting that would be appreciated.

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

That's a broad list, but let me see if I can remember. On the European base, our discussions associated with long-term potential on that are very positive. There as they go through phases. I won't quibble with your peak piece, but I'm not sure if that's would probably have looked more direct.

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I don't have that in front of me, but we go through different phases where it actually does peak and then slow down and then a new generation of technology comes out. The generation that we're on right now is super vectoring. The next generation will be G.fast when they start rolling that out. Hopefully, towards the tail end of next year or the following year. That will be a multi-faceted roll out. Along with them we now have approvals within the affiliates within that account. So there are incremental pieces that we'll be adding on in Europe over that period of time and then right after that there'll be a fiber rollout. So trying to pick the peak on any period of time is difficult, but I will tell you that there is a sustained pocket of business there, and I think that the competitive nature of that account is even more manageable than it was historically and I see really strong opportunity there. Let me go back. Let me talk about how you characterize our Latin American customer I think is right. This is a much bigger and more sustained project than anything that we've had in the past, which has been very spotty and kind of individual market-oriented.

On Australia, they are continuing to do G.fast DPU deployments. Although this was not in the original plan, now looking at going back and backfilling with some of their older infrastructure into DPU and G.fast deployments, because of the speed and the reliability of the technology that we're providing. And then on top of that, and this will be over multiple years as customers turn on, there is a new revenue potential there with CPE. I don't expect that to actually start next year. That will continue on. And then there are other phases like the DPU rework on the fiber-to-the-node which it was not in the original plan. So the ADTRAN job is to continue to go in there and work and try to pick up as much market share in those new opportunities as possible. I think I covered your base.

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

Cable operators, the 2 big ones.

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

Yes, what you're -- your feelings on the subject or very similar to mine. So it's not as fast as we had hoped. It is not as fast as we had planned. I think there's still a willingness there's still desire to do that, but it just has been very sluggish. As far as rollout of new things and some of the projects that we have been awarded have been slow to get through their process. I am not expecting a robust year next year in the cable space. That's not in our plan. I don't expect it to materially slow from where we are, because we are in many cases a sole provider. So there is new builds going in. It's going to be our equipment but I'm not expecting huge growth in that space next year.

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

I appreciate the response. Thanks, Tom.

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

Okay, all right. With that, I think we are done with our questions. So I appreciate everybody joining us and look forward to talking to you next quarter.

Operator

Thank you for joining. This concludes today's conference call. You may now disconnect.
