18-Jul-2019

ADTRAN, Inc. (ADTN)

Q2 2019 Earnings Call

CORPORATE PARTICIPANTS

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

Michael K. Foliano
Senior Vice President-Finance & Chief Financial Officer, ADTRAN, Inc.

OTHER PARTICIPANTS

Ashwin Kesireddy
Analyst, Goldman Sachs & Co. LLC

Paul Silverstein
Analyst, Cowen & Co. LLC

Richard Valera
Analyst, Needham & Co. LLC

Michael E. Genovese
Analyst, MKM Partners LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to ADTRAN's Second 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 reflects management's best judgment based on factors currently known. However, these statements involve risks and uncertainties including the impact of the company's assessment and of its excess and obsolete inventory reserve, the successful development and market acceptance of core products, the degree of competition in the market for such market, the product and channel mix, components 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 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
Chairman & Chief Executive Officer, ADTRAN, Inc.

Thank you, Julianne. Good morning everyone. We appreciate you joining us for our second quarter 2019 conference call. With me today is ADTRAN's CFO, Mike Foliano. Following my opening remarks, Mike will review the quarterly financial performance in detail and then we will take your questions. During the quarter, we were pleased with our continued progress and solid performance for the second quarter of 2019. During the quarter, we achieved strong execution towards our goals to meet our financial objectives, strengthen our customer, product and geographic diversification, and accelerate customer traction with our fiber, broadband and subscriber experience solutions.

From a topline perspective, revenue for the quarter was $156.4 million, up 22% on a year-over-year basis. Network Solutions accounted for the majority at $139.2 million, a 21% increase over the same quarter in 2018. Global Services & Support revenue contributed $17.2 million or 11% of the total company revenue for the quarter, a 33% year-over-year increase.

During the quarter, 52% of our revenue came from international markets due to the timing of key customer infrastructure products. Similar to last quarter, we finished the second quarter with three, 10% revenue customers located in three different regions LATAM, Europe and U.S., underscoring the impact ADTRAN is having as we help our customers around the world build their best networks.

Expanding our customer base internationally has been a strategic focus for ADTRAN over the past several years. We believe that our market-leading 10-gig fiber access platforms will play a fundamental role in how next-generation networks are built for the next decade. Our open and flexible 10-gig platforms offer scalable service offerings, which is one of the key considerations that operators are looking for as they move to enhance their customers' broadband experience. The portfolio investments we have made over the last two years are paying off as our fiber business grew 34% first half-over-first half.

To that end, we continued to gain significant market traction during the quarter as we secured awards with new customers and new awards with existing customers in our target regions around the globe. In particular, the momentum and market traction of our 10-gig PON solutions continues to ramp activity in Europe with a number of key wins during the quarter. As a highlight, we secured an award with the European Tier 1 operator for our SDX, Software Defined Access platform which is expected to roll out next year.

Further, we will play a strategic role for solutions integration for a next-generation SDN initiative with another European Tier 1 operator. Additionally, we entered two significant trials for SDX, the first is a field trial with a third European Tier 1 operator and the second is a live trial with a North American Tier 1 cable MSO service provider.

We also released during the quarter, the general availability of the SDX 6010 fiber access solution. This innovative solution is hardened and cabinet-ready, purpose-built to help customers expand the range and reach of PON with an open, disaggregated architecture more deeply into the network. We also continue to invest heavily in our field-proven widely deployed Total Access 5000 platform and are winning new fiber customers month-after-month. Q2 included a significant new release for this platform and we have some exciting new capabilities expected to be announced at our upcoming Broadband Summit and [ph] present it (05:01) here in Huntsville.

As many of you know the path to gigabit taken by operators varies based on their individual infrastructure, market service portfolio and operational goals. I am pleased to report that our second-generation Gfast portfolio continues to be recognized for its excellence in gigabit service delivery innovation as the industry's leading fiber extension portfolio.

Development of the ADTRAN Gfast fiber extension solutions are currently underway in multiple Tier 1 carrier networks in the Pacific Rim, North America and Europe where we during the quarter added a new award with a large Tier 1 carrier. We advanced trials underway in LATAM and we have seen renewed interest in a key U.S. Tier 1 as network operators globally seek methods to accelerate the delivery of symmetrical gigabit service capabilities maximizing the revenue potential of their fiber investments and ensuring all premises passed can economically and efficiently transition to becoming a connected premise.

Further we expanded our business with the strategic Pacific Tier 1 operator with a new award that now includes CPE solutions that build upon our SmartRG capabilities and our Gfast leadership in that carrier.

Our acquisition of SmartRG is already having a positive impact on our customers' ability to leverage their investments in broadband, and delivers a clear path to higher value over-the-top services that have previously been provided by third parties. For instance, ATC Communications, a rural local exchange carrier based in the Midwest that has been a customer of ADTRAN for over 20 years recently implemented the full suite of SmartRG software including device manager and smart home analytics.

They now have a view, shared by many of our customers that the home network should be considered an extension of their broadband service. With ADTRAN SmartRG deployed, they now have real-time insight into network performance, usage and management that is greatly impacting their customers' broadband experience in a positive way.

I am pleased to report that we have secured a record number of SmartRG device manager contracts added during the quarter. We have a strong backlog of customers that are in the process of installations to support applications such as the FCC's mandatory, Connect America Fund, performance measurement testing requirement that goes into effect in January of 2020. These contracts will have a positive impact on SRG's growth and recurring revenue in 2020 and beyond.

During the quarter, we also expanded the portfolio with the SmartRG SR 6520ac residential and small business gateway. This product is the first in North America that is able to leverage super vectoring to deliver a near gigabit speeds to deliver ultra-broadband Wi-Fi services to the home or business. With it, deployed operators can now expedite the delivery of ultra-fast Internet services, leveraging recent investments and building multi-gigabit access networks so that customers can have the richest broadband experience independent of location, device or infrastructure.

In addition this gigabit-capable wireless gateway allows for an easy migration to Fiber-to-the-Home deployments to the Fiber-to-the-Home deployment model of the future eliminating the disruptive customer device swaps and application reintegration and testing.

With that Mike, I'll let you go over the financials and we will be happy to answer any questions anybody may have.

Michael K. Foliano

Senior Vice President-Finance & Chief Financial Officer, ADTRAN, Inc.

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

Before I get into the numbers, I'd like to discuss the preliminary nature of the information. As was announced in our press release, we are assessing the reasonableness of our reserves for excess and obsolete inventory. We're working to finalize this assessment and determining if corrections are necessary to our reported results.

Please note that any potential changes would not affect revenue, operating expenses or other income, but could affect gross profit, gross margin, operating income, tax, rates, net income and earnings per share on the income statement and net inventory total current assets, total assets and shareholders' equity on the balance sheet. If changes are required, an updated release will be issued.

With that let's move on to the numbers. As Tom stated, ADTRAN's second quarter revenue came in at $156.4 million compared to $143.8 million last quarter and $128 million for the second quarter of last year. Breaking this down across our divisions, our Network Solutions revenue for the second quarter was $139.2 billion versus $125.8 million reported for Q1 of 2019 and $115.1 million in Q2 of last year.

Our Global Services & Support revenue in Q2 of this year was $17.2 million compared to $18 million reported for the first quarter of 2019 and $13 million in the second quarter of last year. Across our revenue categories, Access & Aggregation revenue for quarter two of 2019 was $109.4 million compared to $99.8 million last quarter and $84.7 million in quarter two of 2018.

Revenue for our Subscriber Solutions & Experience category was $40.5 million for the quarter versus $36.8 million for quarter one of 2019 and $34.6 million for quarter two of last year. Traditional & Other Products revenue for the quarter was $6.5 million compared to $7.3 million for quarter one of 2019 and $8.7 million for Q2 of 2018.

Looking at our revenues geographically, domestic revenue for Q2 2019 was $75.3 million versus $72.5 million reported in quarter one of 2019 and $68.2 million in quarter two of last year. Our international revenue for quarter two of 2019 was $81.1 million compared to $71.3 million for quarter one of 2019 and $59.8 million in quarter two of 2018.

We've published reporting of each of these categories on our Investor Relations webpage at www.adtran.com. As Tom said we had three, 10% of revenue customers during the quarter. Our GAAP gross margins for the second quarter of this year are estimated at 42.4% compared to 42.2% last quarter and 39% reported in the second quarter of 2018.

Non-GAAP gross margins for quarter two are estimated at 42.2% versus 43% in the prior quarter and 39.8% in the second quarter of last year. The quarter-over-quarter decrease in non-GAAP gross margins was driven by product mix, partially offset by improvements in our services margins. The year-over-year increases in our non-GAAP gross margins were primarily driven by increases in product volume. Total operating expenses were $65.7 million for quarter two of 2019 compared to $66.8 million reported last quarter and $62.8 million for quarter two of last year.

On a non-GAAP basis, our second quarter operating expenses were $61.2 million compared to $60.5 million last quarter and $59.6 million in quarter two of 2018. The non-GAAP quarter-over-quarter increase in operating expense was primarily the result of increased legal expenses and contract services related to IT systems. The non-GAAP expense year-over-year increase is primarily attributable to incremental expenses that we picked up related to the SmartRG acquisition.

Operating income on a GAAP basis for the second quarter is estimated at $1.8 million compared to an operating loss of $6.2 million in the prior quarter and a loss of $12.8 million reported in Q2 of last year. Non-GAAP operating income for quarter two of 2019 is estimated $4.9 million compared to $1.4 million in Q1 of 2019 and a loss of $8.7 million in quarter two of last year. The quarter-over-quarter increase in non-GAAP operating income was driven by improved gross margins in our services business and increased sales volumes, partially offset by incremental operating expenses.

The increase in our Q2 non-GAAP operating income as compared to Q2 a year ago, the operating loss is attributable to primarily higher sales volumes with higher gross margins in our product portfolio both domestically and internationally. All other income for quarter two of 2019 was $2.8 million compared to $7.2 million last quarter and $1.6 million for quarter two of 2018. The other income in the quarter was primarily from market-driven unrealized gains in our equity investment portfolio.

Our non-GAAP other income for the quarter that just ended was $2.4 million compared to $5.3 million last quarter and an income of $1.5 million for quarter two of 2018. The shifts in non-GAAP other income were primarily driven by fluctuations in our equity investment portfolio. The company's GAAP tax provisions for quarter two 2019 is estimated to be a benefit of $385,000 as compared to an expense of $308,000 in the first quarter of 2019 and a benefit of $3.6 million in the second quarter of 2018. The Q2 2019 tax benefit was the result of a provision to return adjustment that was recorded in the quarter offset by tax expense as a result of our return to profitability in 2019.

GAAP net income for quarter two of the year is estimated at $5.1 million compared to $800,000 in the prior quarter and a loss of $7.7 million for the second quarter of last year. Non-GAAP net income for the second quarter of 2019 is estimated to be $6.9 million compared to $4.9 million last quarter and a loss of $4.6 million in quarter two of 2018.

Earnings per share on a GAAP basis is estimated to be $0.11 compared to $0.02 per share last quarter and a loss of $0.16 per share in the second quarter of 2018. Non-GAAP earnings per share for the second quarter of this year is estimated at $0.14 compared to $0.10 last quarter and a loss of $0.10 per share in quarter two of last year. 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 $177.6 million at quarter end after paying $4.3 million in dividends. For the quarter, we generated $2.3 million of the cash from operations. Net trade accounts receivable were $116.7 million at quarter end, resulting in a DSO of 68 days compared to 62 days last quarter and 54 days at the end of the second quarter of 2018. The increase in DSOs versus the last quarter is mainly attributable to the timing of international shipments during the quarter and customer mix.

Inventories are estimated at $96.4 million at the end of the second quarter, compared to $93.6 million in the prior quarter and $120.5 million at the end of the quarter two in 2018.

Looking ahead to the 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.

Our current expectations include the effect of a temporary slowdown in capital spending for access at a Tier 1 European carrier customer. We have been informed that normal spending will resume at the beginning of 2020. As the full effect of this slowdown has not yet been determined, we've widened the range of our current revenue expectations to accommodate this variability. We expect that our third quarter 2019 revenue will be in the range of $130 million to $150 million.

After taking into account the potential effect of currency exchange rates and anticipated mix, we expect that our second quarter gross margins on a non-GAAP basis will be consistent with the prior quarter – sorry I meant the third quarter there, I said second quarter, our third quarter gross margins on a non-GAAP basis will be consistent with the second quarter. We also expect that non-GAAP operating expenses for the third quarter will be down slightly over the second quarter amount.

Finally, we anticipate the consolidated tax rate for the third quarter of 2019 on a non-GAAP basis will be in the low to mid-teens 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 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 projects, the adoption rate of our broadband access platforms, and inventory fluctuations in our distribution channels as well as the resolution and possible adjustment to our E&O inventory reserve estimates. Additional financial information is available at ADTRAN's Investor Relations website by going to www.adtran.com and to follow the Investor Relations link.

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

Thomas R. Stanton

Chairman & Chief Executive Officer, ADTRAN, Inc.

Thanks Mike. Julianne, we're ready to open up for any questions people may have.

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] Your first question comes from Rod Hall from Goldman Sachs. Your line is open.

Ashwin Kesireddy

Analyst, Goldman Sachs & Co. LLC

Q

Hi, thank you for taking my question. This is Ashwin on behalf of Rod. I was wondering, if you could comment further on the internal control deficiencies you're currently assessing, any sort of comments on what triggered the process and your worst-case expectations. I guess what I'm trying to understand is whether or not this could result in just like a one-time impact or are we talking about some potential structural cost increases and then I have a follow-up?

Michael K. Foliano

Senior Vice President-Finance & Chief Financial Officer, ADTRAN, Inc.

A

Okay Ashwin, this is Mike, let me start with just a little bit of background. For quite a while here we've used a fairly detailed method and a tool to develop our excess and obsolete inventory reserves. It looks at more than 20,000 SKUs that we use throughout the business, everything from raw materials through all of our finished goods.

And on a real-time basis, it calculates what we believe the reserve for that inventory to be that would bring it back to net realizable value. What that tool actually requires, because it is fairly complicated, is a significant number of inputs. When we went back and looked at the inputs we did not have on all of those inputs the validation level that may have been necessary to make sure that all of those were exactly right.

Now the output of the tool is a reserve at a high level for all of our inventories. And we believe by looking at what we've seen out in the market for other companies in our space that that reserve is reasonable, but we are not certain at this time as we simplify the tool and move to a process that is much more like what other companies do, that there won't be some fluctuations in the inventory value. So that's kind of the background on it. And I think your other question was around what, whether or not it would be a long-term issue versus just a one time? I don't see the amount that would be reserved in any period changing significantly from what we've seeing in the past.

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Having said that we still have to go through the completion of the audit to make sure that everything – once the audit is done we will know, but if you look at everything that we've looked at from external companies and from really, kind of, what our historical place has been, I would agree with Mike?

Ashwin Kesireddy
Analyst, Goldman Sachs & Co. LLC

Q

Got it. So those are related issues?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Does that answer your question?

Ashwin Kesireddy
Analyst, Goldman Sachs & Co. LLC

Q

Yeah it does thank you. And my follow-up is really is on this Tier 1 European slowdown. I guess it's not completely surprising given the amount of money they spend on spectrum, but I was wondering if you could comment more on, what gives you confidence that some of this spending could come back, are there projects in pipeline that you see or opportunities you think that they have to deploy to?

Michael K. Foliano
Senior Vice President-Finance & Chief Financial Officer, ADTRAN, Inc.

A

Yeah sure, so with that carrier – the thing that gives us confidence is this carrier has typical been very forthright with us, and the timing of, the resumption at the beginning of next year is the feedback that we've gotten directly from the carrier. And we also know that the requirement for the product itself continues. So, they still have things that they have to get done and so that's not going to go away. As far as incremental pieces, I did mention the larger Gfast award with a Tier 1 European carrier, and without getting into names, that's the same carrier.

Ashwin Kesireddy
Analyst, Goldman Sachs & Co. LLC

Q

Understood thank you.

Michael K. Foliano
Senior Vice President-Finance & Chief Financial Officer, ADTRAN, Inc.

A

Okay.

Operator: Your next question comes from Paul Silverstein from Cowen. Your line is open.

Paul Silverstein
Analyst, Cowen & Co. LLC

Q

Thanks guys. A couple of questions if I may, first off I know there is sensitivity about individual carrier disclosure, but on the 10% customers can you tell us what the three collectively constitute as a percentage of revenue?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

I don't know when that comes out, but we typically don't give that Paul.

Paul Silverstein
Analyst, Cowen & Co. LLC

Q

I know you don't, but Tom it ties into the second question which is, it strikes me that you all quarter-after-quarter, year-after-year, you typically have a lot of opportunities, you get a nice number of awards or at least awards that represent big potential opportunities, whether telMAX, the AT&T, Gfast opportunity and a slew of others that we've all been talking about for a while; and so I guess my question to you is twofold; one, the new awards that you've now referenced today, are there any – I get it that it's really hard to predict, to forecast revenue flow in terms of timing and magnitude of these awards, given the nature of your customers, but do you have any insight as to the timing and magnitude of these opportunities and how does that relate to the current revenue concentration of the company.

You've always been a very fine competitor in broadband access, a leader; you've always had prominent projects. There's also been a healthy degree of revenue concentration to one degree or another historically, that has plagued the company, trying to decipher to what extent in the revenue diversifying with these new awards, to what extent is this still highly concentrated among three or four opportunities?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Without a doubt, the diversification of the revenue stream because in any one quarter as we've just seen, any one quarter can impact you materially. And one of the problems we have is, typically the larger the opportunity, it's typically with a larger carrier and that doesn't really necessarily help. So, the example is the one that we're facing right now, right. So, we have a slowdown because of a capital issue at that company, I shouldn't call it an issue, but a capital shift at that company and that same company is one of the largest Gfast opportunities that we have globally. So, that's not going to help my diversification come a year from now.

Our big push has been and continues to be to look at markets outside of the traditional carrier market, more specifically the MSO market and I did reference one of those opportunities there, as you know, we're right now working with the top three MSOs in the U.S. to try to broaden that. We have in Europe since the beginning of the year landed approximately 10 new 10-gig PON customers.

And those customers will start shipping, let's say, towards the tail end of this year and into next year. The problem is that most of them which is the makeup of the market itself are Tier 2 or alt carriers, so it takes four of those to make a Tier 1. We're continuing to work on that and that is the focus of diversification outside of our traditional carrier base, but it's not something that's going to go away near term and to the extent that you have a Tier 1 come in and place a material order with you, it's hard to get upset about it, but that does lead to the lumpiness that you're talking about.

Paul Silverstein
Analyst, Cowen & Co. LLC

Q

All right one last question, one quick one if I may. I've heard you talk more about fiber-based solutions in this call I think than I ever heard you talk about before, maybe that just reflects the ongoing shift in the market, albeit the market has been shifting to fiber and optic space for a while now. Can you give us any sense for what portion of your revenue is now fiber PON-based as opposed to your traditional various DSL flavored solutions?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Yeah, I don't have that breakout in front of me in front of me. I will speak to that on an ongoing basis, but I don't want to just come off the cuff, but it is a material portion and it is, as you know and we've talked about – and I talked about them in my notes, the fastest growing portion that we have. The opportunity, the reason – we talked about fiber last time, the reason I think that we're highlighting it more than we have historically is the 10-gig opportunity, it's really the penetration into Europe that is a more definitive and more broadened than it had been historically with what we were trying to do with our vectoring and copper-based solutions.

But that really has opened a door to us, which has led to some diversification albeit not enough, but has led to some diversification, so we see the opening in Europe. In the U.S. there has always been, kind of, this slow push towards fiber and that continues on and we've got 10-gig opportunities in the traditional carrier base here in the U.S., but our biggest opportunity near-term in that space is going to be with 10-gig EPON fiber going to the MSOs which will here again help our diversification.

Paul Silverstein
Analyst, Cowen & Co. LLC

Q

Got it. I'll pass it on thank you.

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Okay thank you.

Operator: Your next question comes from Rich Valera from Needham & Co. Your line is open.

Richard Valera
Analyst, Needham & Co. LLC

Q

Thank you. Tom, a follow-up on the European Tier 1 that has kind of paused spending; my understanding was that they were going to do, kind of, a nationwide super vectoring upgrade to the, kind of, the vectoring that they had done initially. Can you say if that's still the case and if so have they completed that and then just talk about the scope of the G.fast win with that carrier, is that nationwide, is that going to be as broad as the prior vectoring and super vectoring rollouts, or is that for like selected business customers, just wondering how they're targeting that? Thanks.

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Yeah sure. So, as far as super vectoring, yes that continues on, albeit now a little delayed, but it continues on and the plans are for that to continue on into next year and in fact we're very hopeful that we'll not only continue on with the rollout, but actually broaden our footprint next year within that customer base.

The Gfast rollout is nationwide. It is – our view of it right now is it's multiple tens of millions a year and it is not just for business, it's basically to lower the cost of gigabit service; residential is the biggest piece, but it would include MDUs and businesses as well. So, it's not a specific small project. It is a – their migration has been stated to be and continues to be a move from VDSL, vectored VDSL, super vectoring, Gfast and then ultimately fiber.

Richard Valera
Analyst, Needham & Co. LLC

Q

Got it. And I know this one will be a tough one to answer, but when you think of your annualized revenue run rate with that customer. When things resume now that you've actually got another program, the G.fast program, would you expect that run rate to be similar or higher, lower than it's been, kind of, in the last few years?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

I hate to speculate into next year. I mean they're very good about giving us forecast as we get towards the end of the year. And if I try to overlay Gfast then I have to think about the timing of IP integration at Gfast which as you know is a no-win game. So, I don't see a major trajectory change, but I will tell you that we don't have a solid forecast yet, that won't happen until towards the middle to end of the fourth quarter.

Richard Valera
Analyst, Needham & Co. LLC

Q

Fair enough. I was hoping to also delve into a couple of other historically, recently large customers. So, you're Latin American customer. It looks like they're been strong now for a couple of quarters in a row and it didn't sound like there was anything in your comments to suggest they're slowing, but can you give us any sense of how things are looking in Latin America for the second half of this year. And any sense at all you have of the continuity of that since they, kind of, turned on recently, but have been historically kind of an on and off customer?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Well our history with that customer, I would tell you that they are different in the way that they plan their demand, but they have a goal of – a specific goal of VDSL vectored footprint expansion. I would tell you they're not to that goal, they have to buy significant more amount of material in order to meet that – which is the first phase goal. So, we're just continuing to operate with them and try to meet their demand and their timelines and things like that.

Richard Valera
Analyst, Needham & Co. LLC

Q

Got it. And then just on NBN which I do not think – you didn't mention them by name, but I think you may have referred to them indirectly. It sounds like maybe you've got another win with them that includes CPE, is that accurate?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Yeah without naming the customer, it is true that in Australia we picked up a fairly significant CPE award as well as an expansion of our current G.fast business.

Richard Valera
Analyst, Needham & Co. LLC

Q

Got it. And when would those be expected to start shipping?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

The CPE won't – there's some dependencies on that, but my guess would be sometime in the first half, maybe as early as the first quarter.

Richard Valera
Analyst, Needham & Co. LLC

Q

Got it. And then putting aside that – we understand that your European Tier 1 is going to be softer in the entire second half it sounds like. How about the rest of your business from a seasonality perspective in 4Q? Is there anything going on in the non-EU Tier 1 customer that would make us think that seasonality in the fourth quarter would be otherwise different than it's been historically?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

No. If I look at – the problem is that the European customer is a material portion. And if I look at the rest of the customer base and what our forecasts are at this point in time. I would say everything else looks in line with what we would expect.

Richard Valera
Analyst, Needham & Co. LLC

Q

Okay. Fair enough. Well thanks for taking my questions gentlemen.

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Okay.

Operator: [Operator Instructions] . Your next question comes from Michael Genovese from MKM Partners. Your line is open.

Michael E. Genovese
Analyst, MKM Partners LLC

Q

Great thanks. Tom I wanted to ask first of all about the risk of this issue with this one customer leading to lower guidance, if there's broader implications and if it could spread. So, if the narrative is, that that carrier – they had to spend a lot on spectrum and it is pausing infrastructure spend this year, what do you see happening with other sort of Tier 1 carriers in Europe along those lines. I know you don't have any other customers that big, but you have some other customers and you're pursuing opportunities, so can you just talk about whether we need to worry about spreading beyond just one carrier?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

You can take a look at – let me just directly answer your question. The answer is no. So, the carriers where we're seeing – the European base right now today notwithstanding any awards that we have is a very concentrated. So the impact of any potential slowdown would be relatively immaterial at this point in time, unfortunately. Then the other piece of that is, there has been no talk of any material changes in their deployment plans with us for the awards that we've had based off of any recent activity.

Michael E. Genovese
Analyst, MKM Partners LLC

Q

Okay. I guess just as you analyze the market, do you worry about European CapEx [ph] weakness (40:38) on infrastructure. Maybe going to – it sounds like not, but just if there's any, sort of, analysis that even though you don't quite have exposure and that this could impact the market or is that something you don't think we should be worried about?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Any $1 billion checks everybody should be worried about, and so I don't want to underplay that. I can just tell you what the direct conversations that we're having with right now. So the direct answer is, we don't see that and I don't see – the auctions have pretty much played themselves out at this point in time for what's available, so we don't see an impact.

Michael E. Genovese
Analyst, MKM Partners LLC

Q

Great. And then I just wanted to ask you just for update, touch a little bit on this, but I just wanted to, sort of, just directly get updates on three things. Number one, the cable MSO space, is it 10% of revenues combined yet. How close are we to having a 10% customer in that area? And then the two Tier 1s in the U.S. who are not your 10% customers, if you could just, sort of, specifically update us where we are with those two carriers please?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

One, we continue...

Michael E. Genovese
Analyst, MKM Partners LLC

Q

So, cables and the two Tier 1s?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

Yeah cable is. Mike I don't know if I have that in front of me. I don't believe it's at 10% yet. In fact if I just kind of do the math in my head I don't think we're quite at 10% yet, but we're not far off. And the big uptick there, we're still going through the lab with the largest one of those customers with our new [indiscernible] (42:26) our new Remote OLT solution, so that's still progressing through and we still expect deployment, my guess would be at this point in time with where we are in the lab, it would be sometime in the first half of next year where that will actually start kicking in a more material way and that's really true with the top two customers, the top two MSOs.

So, they're, kind of, buying existing products, existing EPON products, and the real trigger to a movement in that is going to be the new remote product coming up for both of those customers. We now have a third customer that we're in the trial stage with, which is the third largest here, and that's just still early. We do some business with that customer, but it's relatively small. As far as the other two carriers; actually we're in negotiations with both of those carriers right now. One for a project that has been – both of these projects have been ongoing for quite some time. So, they're not 10% today, I would expect – to the extent that there is a material change in that, it would be towards the tail end of the first half.

Michael E. Genovese
Analyst, MKM Partners LLC

Q

Is it still GPON at one and NG-PON2 at the other, that's where the focus is?

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

A

I hate to say this, but NG-PON at one and Gfast at another.

Michael E. Genovese
Analyst, MKM Partners LLC

Q

That's what I meant Gfast, right. Okay perfect. I appreciate the update. Thanks for the time.

Thomas R. Stanton
Chairman & Chief Executive Officer, ADTRAN, Inc.

Okay. All right with that we'll end our session today, I look forward to talking to you all next time during the end of the quarter, thanks.

Operator: This concludes today's conference call. You may now disconnect.