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Doug Clark: Okay, perfect. Well we go ahead and get started. Thanks for joining. My name's Doug Clark, Goldman Sachs Com Tech team. Really pleased to be joined by Roger Shannon, Mike Foliano of ADTRAN. Maybe just digging into it, service provider CapEx explodes, name in particular, could you just give us kind of your perspective first on beginning-of-the-year budget releases. It's always kind of a key question around this time and I know you guys get a little bit of a unique look at it, particularly for the US.

Roger Shannon: So, thank you for the invitation. We appreciate the opportunity to be here and represent ADTRAN. You know as we've talked about over the, over the years, we have more visibility into the beginning-of-year capital budgets and CapEx spend in some carriers than others. For example, in our large European tier one, we tend to have a pretty direct line of sight fairly well into the year. Some others, such as LATAM, tends to be more come and go and lesser notice, but can be, you know, quite meaningful when those come up.

In, in the US, it's, again, different. The larger players tend to take a little more time at the, at the beginning of the year to finalize their budgets and to get that rolling. You know we are involved in a very large vectoring rollout in North America. And, you know, certainly are having ongoing conversations in seeing that continue to ramp. So we expect to, you know, that to be a meaningful contributor to us this year. And then again, as you mentioned others are, are continuing to be finalized. But, but we continue to feel very positive about the, you know, the domestic environment for, for fixed access.

Doug Clark: Okay, and, and this, this'll kind of be an umbrella question and we can dive more deeply into it, but there are few flavors of access technology that seems to come up a lot or are potentially exciting including you mentioned one vectoring, G.fast and actually super vectoring and then NG-PON2. Either going into detail on each of those, you know, which is, of those, which are the most exciting? Which is kind of near term? Which should we expect to see more meaningfully in 2017?

Roger Shannon: That's a great question and I would say in short answer, all the above. You know what, what we'd like people to know about ADTRAN is we are a broadband access company,

whether that be over optical, over twisted pair or over coax, we, we really are agnostic to the technology. We have pivoted a great deal of our R&D efforts towards software and we think that fits in very well with the, the disruption models that you're seeing from folks like the larger US tier one's where they're disaggregating more of the proprietary hardware into best-of-breed, open source, white box. And we have quite a bit of effort around that.

But to mention, you know, to get to the technologies that you specifically asked about, you know we have been very successful in helping carriers continue to get the most out of their installed twisted pair infrastructure, continue to increase the speeds toward the theoretical limits through technologies like vectoring, which enable 100 meg speeds over 3,000 foot loops. And then super vectoring, which takes that to 300 meg speeds. We're part of the world's largest vectoring project, which is going on in Europe where we have the majority of the footprint. Also I mentioned the large vectoring project in the US.

The way vectoring works for those less familiar, it is -- it's a technology that allows carriers to use their existing twisted copper pair and the best way to think about it is like noise-canceling headphones. So when you, when you're moving data over twisted pair, you have this kind of traffic congestion and that friction that hitting into each other tends to be a limiter in the speed. And vectoring and super vectoring with VDSL2 is a noise-cancelling type of technology, which, which allows to get that 100 meg and 300 meg speed.

NG-PON2 is an exciting opportunity where we've been short listed at Verizon on the next-gen PON. And that is a technology that takes a 40 gig line and splits the optical into four, four two gig bands that are tunable and through software control the carrier can turn that up, turn that down and, and really dictate how much the customer is demanding. We see that, you know, as, as a great opportunity not with, just with Verizon. What we think it has, excuse me, certain exceptional adaptability with the advent of the, the growth in wireless that we're going to see. So, you know, when you think about 5G and the expansion, the deployment of small cell and millimeter wave, each of those have a termination of fiber. So you're talking about, you know, fiber backhaul, front haul and we think that's ideally suited for that and we're, we're excited about that opportunity.

You mention G.fast also. G.fast is again a copper or coax based technology where the fibers actually run deeper to the building, either the, the basement, the riser inside of the building, curb to a distribution point unit. And from there, the -- it picks up the installed coax or twisted pair and delivers up to 1 gig speed into particularly MDUs where it's very well suited for in the US as well as in Europe. So if you think about Europe and the challenges of delivering fiber across 4, 5, 600-year old streets, cobblestone, very dense demographics where that existing twisted pair infrastructure is already installed. We think it's very well suited for that.

We have 108 trials going on around the world, 26 countries on 6 continents. And have been selected by large US tier one in, in the US as well as flagship carrier in Israel that's rolling out and, and we expect to see further deployments as those come out of trial going forward.

And then lastly the technology I'd mention is PON, the G-PON has been the fastest-growing technology within our portfolio. And last year, we acquired certain Active

EPON assets from CommScope, excuse me, which kind of deepens our reach into the MSO space through EPON as well as RF over Glass product. So, so I, you know, it's, it's very fair to say that we are focused on broadband and, and helping our customers, you know, get the most out of their existing infrastructure as well as the next generation. All right.

Mike Foliano: And each of those, Doug, are kind of in different level of their life cycle and maturity, right. In vectoring, the end of the last year we had shipped our 10 millionth port.

Roger Shannon: Right.

Mike Foliano: So vectoring is pretty deeply embedded in Europe and in the US now growing significantly. And you look at some of the newer technologies like G.fast. We just had our first commercial deployment but it is in 100 trials plus. You see those are kind of in the early stages of life cycles.

Doug Clark: And I mean that's an interesting statistic and I know you guys have publicly talked about the Israeli company and then the large US North American carrier. Of those 100 plus, 110 or so extra trials, I mean is the timeline where we could start to see more announcements, more customer wins, more commercial deployments in 2017 or does it ramp over the next few years?

Roger Shannon: I would expect it would start to ramp beginning next year. We expect to see more coming out of, you know, the trial into deployment perhaps over the end of this year. But, outside the ones that you mentioned, that are going to be deploying, that are here in deployment or are starting this year.

Mike Foliano: Yeah, you may see announcements later in the year, but I think the ramp really starts in --

Doug Clark: And you mentioned 5G, which is kind of an interesting topic. Two potential perspectives on it and I'd like to get your opinion on this. You kind of mentioned the mobile backhaul element of it where NG-PON2 could be a good approach or good technology for that. What about the other side that fixed wireless is kind of an alternative for a wire line fixed broadband connection? So is there a little bit of risk and opportunity going on here?

Roger Shannon: So we are, you know, we are involved in some you know evaluations of fixed wireless. There are, you have some carriers who have -- who are looking at that and I think you're right. It's -- we do see it as an opportunity. We don't -- you know have not yet seen an instance or situation despite all the talk over many generations to where wireless displaces fixed access -- (inaudible). There -- that it's come up a number of times through each generation and, and what you generally see is, is fixed access continues to evolve itself and, and be the most cost effective way.

But you know again, it's -- as an access provider that's something that's on our radar and that we're looking at as well.

Mike Foliano: It definitely makes sense if you're somewhere like Alaska or where there's -- you're in a remote, remote location and you have to do the complete build to make it work. The economics are already there for that.

Roger Shannon: Right.

Mike Foliano: I think what Roger's talking about is trying to put that up en masse where you already have other access technologies that are in the ground or on a pole. It's hard to make the economics work.

Doug Clark: Yeah, that's a fair point. One thing that stood out to me in 2016, particularly for the first three quarters, was just how strong US business was and, and I imagine it relates to kind of a lot of things that we just talked about, kind of vectoring technologies in particular. But there are a fair number of significant and large customers within that US based business. What are your expectations for 2017 in general, especially when we start to think about some of the CapEx budgets from guys like CenturyLink? Is there still a business where you expect growth over the next year or so?

Roger Shannon: And so I would, you know, I would lead by saying we, we don't give guidance out past the next quarter. But that said, we are -- we do remain positive on the, on the domestic environment. You mentioned the, we've talked several times already about the, the vectoring rollout with the tier one in the US. That, that is continuing on. We do have the start of the G.fast with the tier one in the US in region, out of region, also in region. So, you know, so we do, we do remain positive on the US. We think these initiatives across all these different technologies that we've just talked about, you know, including the work on the NG-PON2 is, is very promising going forward. So we are optimistic about new -- the continuation in the cycle in the US.

Doug Clark: Okay, and, and there's even a little bit of customer consolidation amongst your customers, in particular, some, some non-customers. Is that having any impact either from a pricing competitive or kind of deployment standpoint?

Roger Shannon: That's always a valid concern when the customer gets involved in M&A, if there's some change to the, to the CapEx spend or distraction. You know with, with the recently-announced consolidations, I guess we're in the fortunate position that our customers have been the acquirers and the businesses that they've acquired we've generally had little to no exposure to and sometimes as outside of the area that we're focused on. So, again, we at this point, we've not seen anything over it concerning in terms of changes in the budget or disruptions in, in our sales or products that we look at customers.

Mike Foliano: And there is a lot of talk about infrastructure builds in the US, especially with the new leadership in government. And if you think about infrastructure builds, the, the biggest one that first pops into my mind is broadband. So, in addition to what we've seen in the rural broadband that's been happening, you got to expect that there's going to be some renewed interest in investing.

Doug Clark: Yeah, and that was actually going to be my next question/topic that the new FCC chairman has definitely taken kind of a pro-broadband approach. (inaudible) in his commentary we haven't necessarily seen that translate yet to, to new kind of regulatory enforcements.

Mike Foliano: Two weeks, three weeks --

Doug Clark: Yeah, give him time.

Mike Foliano: He's not moving as fast as his boss.

Doug Clark: We, we obviously have the Connect America Fund in place which is now maturing, really hitting its stride. Do you think that there's a potential for more pro-broadband type initiatives coming from the FCC and I would think that that would have to be fairly positive?

Roger Shannon: No, we do and I think, you know, we take our lead from the carriers. And I believe the carriers are seeing this as, as a positive for their, you know, for their environment as well as opportunity for, for investment. So, you know, anytime you're looking at situation with less regulation, they're going to view that as positive. So, you know, I think we see it the same way. So, you know, we'll just wait and see but the things that we've heard coming out of the FCC have been, have been supportive. We think, you know, we've had -- in addition to that we've had CAF2 funding for the tier one, tier two price indicators that that did ramp throughout 2016 and will be going on through, through 2020. They have their first measurement for build outs and this year in 2017, where they have to meet the 40% benchmark. And, as well as the rate of return carriers, which will be starting -- I would expect to be starting with it later this year as those rules are just getting finalized.

Doug Clark: And, and on Connect America, the fund and kind of the larger carriers, it seemingly ramped throughout 2016, the deployment of those funds. Are we at kind of a normalized run rate at this point or is there the propensity for CAF associated spending to move higher? Are we peak? Are we early stage? What is your take?

Roger Shannon: Yeah, it's -- I think it was a ramp over 2016. We probably will see run rate, run rate in 2017. You could -- I think you could make the case that -- that the actions of the carriers took in 2016 maybe on in 2017 was the easier deployment. So, it's not like the money comes in directly and they have to spend it on, on the infrastructure. They receive the money from the -- from the government and they have to meet their build out. So, you know, you could argue that the, the lower-hanging fruit, the easier build outs are probably getting done first so they could meet those, those first milestones. And then there will be continued, the more challenging build outs toward the backend as they meet the 60, 80, 100% requirements.

Doug Clark: That makes sense. And, one perhaps consequence of the Connect America Fund projects is we've seen a step up in terms of services, related revenues, particularly as a percentage of your total revenues. Should we expect services to continue to rise as a percentage of revenues? Are you doing more on the services side?

Roger Shannon: Services has been a great opportunity for us. It's been something that really started from customer demand and, and the customers tell us that they're not in the construction business. And, so we've really seen our, our services business grow from what was more maintenance contracts to engineering network implementation, full turnkey, test and turn up, my recordkeeping, permitting. And, and as you point out, that grew, almost doubled from 2015 to 2016.

You know I wouldn't expect to keep that same growth rate but we do expect services to continue to grow. As, you know, as we see opportunities with more customers and again with, with the tier threes that that we expect to, you know, start their CAF build outs.

Who, who would also like some of the customers we're working with, not have the, the onsite infrastructure. We can certainly help out with that.

So, it's, it's a great business for us. It is, you know, as we continually talk about on our calls, it is -- tends to be dilutive to gross margins. It'll lower gross margin. But is accretive at the operating income level and it builds kind of stickiness and a deeper relationship with the customer that we think is very positive.

Mike Foliano: And I think it helps overall to just understand where they're going. Your first question was around what are we seeing in the CapEx forecast? And some of our customers that provide us the most minimalist forecast that you can imagine on the product side, when you're in there and doing a service work with them, you can see the sites lined up out into the future and you get a much better view of what's going to happen.

Doug Clark: Makes sense. One kind of offshoot of the services comment and you alluded to this is the implication for gross margin. So, it has been a bit of an over hanger drag on overall gross margins in the context of what you just said with, which is services continue to grow from here. Can we get back to or maybe a level head, we're kind of at the low point gross margin level now. Can we get back to mid to high 40% gross margins with services remaining a fairly significant piece of the overall mix?

Roger Shannon: Yes, I think when you, when you look at how quickly our services business has grown, again doubling from 2015 to 2016. There was a significant amount of, of ramp and scaling up just to meet the demand that was there. So, you know, we believe there's opportunity to, to continue to refine that, improve that and make that more efficient as we go forward.

You know we are, we are always assessing the opportunities on both the pricing front as well as the, as the cost, the bill of materials front, which you know is, is in Mark's area, and could speak to much more deeply. But, you know, we, we think that gross margin should increase and we are certainly working toward that end to be, you know, higher than where we are now.

Doug Clark: And perhaps maybe the other biggest swing back on margins is, is kind of the international versus the domestic mix. Can you just compare expectations between the two? I mean maybe even for the first quarter but perhaps longer kind of is there more growth opportunity domestically or internationally at this point?

Roger Shannon: Well, you know, we've talked about that we're, we're positive on the US environment. We are also positive on the international environment. We talked about the, the large European tier one that's in the process of wrapping up the vectoring and be rolling into super vectoring, which comes back into our footprint. There are opportunities that we've talked about over time in LATAM as well as Asia Pacific, which we, you know, expect and hope to see materializing over, you know, over the, the fairly near term. So we'd see some further diversification in, you know, our international business. Certainly, especially within Europe and in areas where the Chinese competitors compete, there is more pricing pressure. And even within that international business, what we've seen over the past couple quarters is the mix itself with that customer at any point in time has some variability.

For example, in the third quarter when we had an uptick in our European business, it was resulted more from customer uptake and their vectoring program, which resulted in, in lack hard sales for us. Whereas now, with this new footprint award that started shifting at the beginning of the year, we're shipping really chassis system level vectoring cards, those things that tend to be at a lower margin. And then as customers sign up, they start to fill up those cabinets and chassis with line cards, the margin will, will improve.

So, it's -- I think for this year, you know, we talked about quarter one gross margins, you know, being in the, in the low 40's. And that, I think that is, you know, certainly a reflection of, of where we are in this rollout in our European customer. But we expect to see that. You know, we, we hope that -- that that would improve over the course of the year as that kind of transitions away from the startup kits and components into more in the line card business.

Mike Foliano: And we continue to work both in R&D and across our supply chain to reduce the ongoing cost in our hardware products. And then at the same time, I think as Roger said, that huge growth in services drove some inefficiencies. You'll never see network installed type services have the same type of margins that we get on hardware. But they are definitely some points to squeeze out there, by being able to be much more efficient in the way that the business is run.

Doug Clark: On, on, maybe final question on the gross margins, is there any discernible difference in, in margin structure among kind of the things that you first alluded to? So, G.fast, super, super vectoring, NG-PON2?

Roger Shannon: No, not really it's more on a, on a customer basis and it's on a per-port basis. So it -- there, you know, there tends to be more variation across customers, across geographies. But, at this point in time, really not necessarily see a lot of variation on a product basis.

Doug Clark: Okay. And then another financial question more on the OpEx side, with all these new flavors of technology come out, typically when we see kind a diversification of a product portfolio, there is an associated OpEx spend with it. ADTRAN actually does a pretty good of, of maintaining its OpEx levels. Could there be more spend associated as we get, you know, trial activity, new deployments, product availability, things like that?

Roger Shannon: Well, you know, appreciate the comment and I think anyone who follows ADTRAN would agree that we are very much focused on our operating expenses and our controlling costs and continuing to find ways to take costs out. We, you know, we've alluded to the, the kickoff for the NG-PON2 project that started in 2016 and we, you know, specifically mentioned that in a couple of our quarterly calls as it related to topics. At this point in time, we're not really seeing, you know, anything significant in terms of an uptick in those. So we had some project-related specific costs in 2016. There will be some, I'm sure some ongoing but right now where we sit, there's nothing that that we would deem to be, you know, really material in that respect.

Doug Clark: And then with respect to, to tax rates, pretty much a US taxpayer, I know you do a lot of business in the US, any, any viewpoints on, you know, political implications of, of tax rates or are you keeping an eye on that? Or do you have any thoughts?

Roger Shannon: No, we, we certainly are keeping an eye on it. It's, you know, we, we finished 2016 at a

better position in our tax rate than we had originally projected despite the fact that we, at least for the first half of the year, were more domestically focused. We were able to do some things on a project basis looking at our R&D credits as well as some, some initiatives coming out of Europe that that both had positive benefits over the course of the year. You know it's -- we're very much taking a wait and see. We're looking at everything that comes out. We're talking with our tax advisors about what's likely to come out of the US. You know certainly we'd be supportive of a rate cut in the US. We think that's overdue and it would be very positive. It's, you know, would free up you know capital not, not just for us but for, you know, more importantly for our customers and as well as a benefit for our shareholders.

You know there is some aspects about it that we question, the border adjustment one in particular. Unlike some others, we do have a strong US manufactured presence. So to the extent that there is you know particular incentive or benefit to produce domestically versus internationally, we can certainly scale that very quickly. But another advantage that that we believe we have is, is our global deployment of our manufacturing operations. So not only in the US, but in, in Latin America and in Europe and in, and in the Far East as well. So we take kind of a territorial approach, cost effectiveness approach. But we have a lot of flexibility to, you know, to manage that geographically.

Doug Clark: Okay, that makes sense. One most customer base that actually I want to come back to was the US kind of tier three, the smaller rural carriers. Anecdotally, kind of had a nice step up in the fourth quarter, which is perhaps earlier than we would have anticipated considering that the CAF kind of kicks in a little bit later. So, can you help explain why we saw this step up? Is it, is it temporary? Is it something that's more sustainable?

Roger Shannon: You know, I mentioned CAF2 and the fact that funds were flowing in 2016 on the, the price cap, the tier one, tier two carriers. As you point out for the tier three determinations were made within the last month about how they're going to proceed as it relates to, you know, selecting the, the model approach. Like the price cap, from what we gather from the FCC site, just under 200 carriers representing about 206 projects have, have selected model approach funding for somewhere in the area of just above 500 million a year. I believe, which, which the FCC points out is 200 million a year or 2 billion over the 10 years more than those carriers were receiving under, under USF. So we see that as, as a positive and certainly as an opportunity.

We have, going back to the fourth quarter and going forward, we have increased our focus on those opportunities and that's something that we see as, as an area to improve our market share. We think our products are very well suited for that market and especially as, as the CAF funds start to rollout, we, you know, we intend to remain focused on trying to optimize those.

Doug Clark: I have a few more questions, but I will turn it over to see if anyone has questions in the audience. But before I do that, maybe capital allocation, ADTRAN sitting on a, on a reasonable amount of cash. And I know you've historically said, kind of priority of buybacks. Is that still the case? And if so, any, any potential getting more aggressive on that front?

Roger Shannon: No, at this point in time our board has determined that share repurchases is, is best use of that capital. We, we monitor that continually. And, you know, it's really no change in

our policy at this point in time.

Doug Clark: And, I mean M&A is kind of popped up here and there in small bits and pieces. Is that an ongoing consideration if the right opportunity presents itself as well?

Roger Shannon: No, certainly, you know we were excited to be, participated with CommScope and acquiring those EPON RF products. We think it strategically improves our relationships with the MSO customers. It kind of deepens that that opportunity. And, and we continually look for things like that. There are, you know, there are different types of opportunities that are out there, whether it be different reasons, whether it be technology gaps or, or adjacencies or, you know, or what have you. So, again, there's, there's nothing specific that I would point to at this point in time. But, but we do stay very much abreast of, of the market and the opportunities.

Doug Clark: Okay. Um, I just want to check if there are any questions? Please.

Unidentified Audience Member: (inaudible) The services, how much of that is outsourced or contract labor? And what are kind of the ways you can get some leverage on that?

Mike Foliano: It's a mix. It's a mix of both. So on the front end services, look the front end is really order engineering, where you're actually doing a site survey. You're developing engineering documentation of what the site would look like. And then that drives the order for all the materials to actually build out that node. That front end piece is, is probably mostly internal to us and some of it is outsourced to give us some flex up and down. But when you actually get out into the field and it's the people that are turning the wrenches, dropping the cabinet in place, those guys are pretty much fully outsourced. So we have program managers that oversee them that are our employees. And the rest of that are, you know, hiring partners. And they tend to be regionally based, as you can imagine if you're working with a customer that's across 30 states, you got to be able to move them all around. So that piece of it is outsourced.

And then on the back end of it, where you do test and turn up and then updating the customers' records and optimizing it, that tends to be done by internal resources as well. So you kind of have a mix on the front end and the back end but the actual feet on the street that are doing the real hard work of, of building the products out there are tend to be third parties.

Roger Shannon: And I'd say to your point, I'm sorry, but to your point that it's a very challenging business and it's, you know, it's not something that you just easily start up and, and, and make a go of it. We really put a lot of emphasis, focus and effort to -- I mean we're, were very pleased with how our services business has developed.

Unidentified Audience Member: And the second question, just cause I've lost track of like NetVanta, some of the older gear kind of where, where is that in life cycle? How are you managing it? And how do we think about that going forward?

Mike Foliano: So, so we did -- most of the NetVanta products are, are business type products that were in our, our former enterprise division. So things like switches, routers, fire walls, those products are all still available and many of them are actually coming out into next generation. So we still are producing the latest generation of power over Ethernet

switches. And, and we also have a full suite of Wi-Fi products that are set up mostly for business Wi-Fi applications. So, that is still sold today.

We tend to look at most of those things that are in that business though as a customer endpoint. When we, when we redid our financial structure, we had the piece that's really the access and aggregation piece. And we had the other piece that's customer devices. And we really look at them as two different endpoints of the link, where you're sitting out at the customer site, whether it's an ONT or a switch or router or whatever, it's connecting back into our access gear back here in the network.

Roger Shannon: Yeah, and that's what we realized when we did the reorganization in 2015 that that followed into the re-segmenting that we did in 2016. So in the past, we've had a carrier networks and enterprise networks. So if you think about it logically, the, the amount of infrastructure you have to have and the brand name that you have to have to go out, you know, across the country and sell to enterprises is, you know, can be challenging. So what we realized is that, you know, by going through the carriers, the carriers are delivering business services, you know, across their customer base. So we're able to go to the carriers and deliver the, the both ends of the network, really kind of on a, on a full scale basis, which is, you know, the customers may recognize a, you know, I'm not going to say any of the brand names that that you all know, but the carriers obviously recognize the reputation of our product, are able to take our product and deliver that both ends of the network to their customers, which has been, you know, it's been very positive and, and again a lot of the rationale for, for how we've reorganized and kind of focused our business.

Doug Clark: (inaudible) that we're out of time. Appreciate it guys, very much, for being here. Thank you.

Roger Shannon: Thank you.

Mike Foliano: Thanks for coming out.