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<<Rich Valera, Analyst, Needham & Co>>

All right, we're going to kick off the next session. I am Rich Valera. I cover communications and software for Needham and Company. And very pleased to have our next presenters Roger Shannon, ADTRAN's Senior Vice President of Finance and their CFO to tell you the ADTRAN's story this afternoon.

<<Roger D. Shannon, Senior Vice President of Finance, CFO, Secretary & Treasurer>>

Thank you, Rich, and good afternoon everybody. Thank you so much for coming to this session. We appreciate your interest in ADTRAN. Timing is good. As you may have seen we announced Q4 earnings yesterday. So we're off and running in 2018, but happy to have the opportunity to speak to everyone. As you see on the screen, we have the obligatory Safe Harbor statement. I will spare you from reading all that, but just note that that we are making forward-looking statements that reflect our best judgment at this time based on things that we currently know and I'll talk more about that around some uncertainties that we have going forward.

For anyone who may be new to the story on ADTRAN, just a brief reminder. ADTRAN is a broadband access company. The company was founded in 1985, went public in 1994 and we're headquartered in Huntsville, Alabama, which if you're following the news is one of the fastest growing tech cities in the country, just awarded actually the large Toyota Mazda plant as well. So a lots of great things going on in Huntsville and we're very blessed to have the engineering talent that we have.

ADTRAN provides the products and services that enable high-speed data, voice, video, internet to thousands of customers in more than 68 countries. Our revenue for 2017 was $667 million. It was the second largest revenue year in the history of the company. In the U.S., we sell to every major telecom and MSO. So the Tier 1s, Tier 2s and Tier 3s, many hundreds of smaller players and I'll talk about that some more. Our international focus is in Europe, Middle East, Latin America and Australia.

I'll cover some of the products and what our strategy is. We have a very strong array of products that provide services over fiber, copper, wireless and coax. So when we talk about broadband access, we really are somewhat agnostic to the medium. The value that we bring is we're able to help the carriers and the MSOs either leverage the existing plant that they have or move to next generation networks. All of that enabled and driven forward by our SDN, award winning SDN mosaic cloud platform.

We have over 2,000 employees. We have R&D centers in the U.S. and Huntsville and in Germany and in India. Our major production sites are in the U.S. where we manufacture

in Huntsville, Vietnam, Ukraine, Mexico and China. And I'm going to talk some more about how we continue to develop and deploy new technologies to support the growing need and bandwidth globally and I think that really is going to be the theme of my comments in that we do believe that we're still in the early stages, in early innings of a broadband upgrade cycle that has been brought on one hand by the consumer with your CORD cutting over the top Netflix, becoming IoT, all the things that you can imagine that are coming. There was some supply side factors that are Google Fiber a couple years ago that really all the actual deployment had some challenges, the impact in effect certainly didn't. So got a lot of people thinking about fiber, a lot of people thinking about access.

So let me start with thinking about our corporate strategic plan, what we're working on and where we're focused. And we break that out into near-term and a medium to longer term. So in the near-term, we want to capitalize on the cycle that I just described and expand our position and we're going to work with our service provider customers in the carrier side, where we've traditionally historically had a strong relationship and also growing with the MSO side to help them improve their competitiveness through advanced broadband speeds and capacity.

And that really is what it's all about is this availability of the demand of the consumer, they wanting their information and their entertainment, their access anywhere, all the time and very quickly. And we are working as a company developing and expanding our product sets to move into adjacent markets. As I mentioned cable/MSO is a prime example of that to where we see tremendous opportunity and have a number of initiatives going on with the major players as you may have read about.

So I am going to talk a bit more about the longer-term strategic focus that would fall into the three and a half year period. And we see two what we call distinct and major shifts in the environment. The evolution of the service delivery platform and that's being led by – you'll hear things like the CORD initiative. You hear lots of talk about SDN and NFV. And in ADTRAN, we are leading that effort and leading that initiative to help the carriers and the service providers reduce cost, be able to scale quickly and meet the demands of their customers. And then secondly, the expansion of the wireless network and specifically we're all hearing a lot about the coming 5G both in mobility and in fixed wireless. So I'll talk about how we see that benefiting ADTRAN.

So if you take that strategic plan and break it down into to how we see the market dynamics, this first now to three year out period, it's we're focused on broadband availability and moving to this competitive positioning. And when we talk about the availability, you're all familiar with the Connect America Fund that started in 2016 with the Tier 1 and Tier 2s. The Tier 3s of the rate of return carriers has begun to rollout. There's been over 100 Tier 3 carriers have accepted funding under what that's called the Alternative Connect America Model or the ACAM model. And that is a six-year multi-year $9 billion program to get at least 10 Meg down, 1 Meg up service to under-served and un-served areas.

Outside the U.S., you may be familiar with the Digital Agenda with European Commission is following and we have a major Tier 1 customer in Germany that I'll talk about more where we have recently helped them to finish their 100 Meg vectoring program and starting with the beginning of 2018. As we've talked about regularly over the course of the last few quarters have begun rolling out their super vectoring, which gets up to a 300 Meg to 500 Meg availability over copper looking ahead even into some awards they've given us out beyond that and in leveraging that super vectoring into G.fast deployments.

So as it comes to competitive positioning, it is this need for speed and expansion of wireless in the network and as well as the expansion of fiber in the network. We all believe that the network is moving to all IP all fiber. The question is that how fast and it's different across different providers, different carriers. I think what Google and others have learned in the process is that it's not cheap to immediately deploy fiber to the prim. And when you have this large installed base of twisted pair copper and COAX and you can continue to get the speeds that we're seeing like 100 Meg through vectoring or 300 Meg to 500 Meg super vectoring up to a gig over short distances with G.fast. It's of certainly cost savings for them while they continue to work toward on all fiber all IP network.

So the next moving forward out the strategic plan, the scale and agility that refers to the comments I made about SDN and NFV. You have Tier 1 carriers in the U.S., who are aggressively promoting open source white box. We at ADTRAN have certainly embraced that. We're part of that standard setting process and are leading away toward an SDN white box environment with our mosaic cloud platform.

So if you take that strategic plan and those market dynamics that I just talked about and so say how does that translate into the different customer basis where ADTRAN sells into and I'll just start up at the top and kind of go through some of the initiatives that we have underway. So with the domestic Tier 1s, their focus is this SDN transformation. AT&T has talked a lot about that with their CORD initiatives, Verizon with NG-PON2 that we're a finalist and driven by this Netflix, Amazon, Google CORD cutting over the top need. So where we're playing a leadership position is as you've heard a lot about with 10 gig PON, NG-PON2 with Verizon, G.fast where we're rolling out with – have begun rolling out earlier in the year with a major U.S. Tier 1 and expect to come out of FFA later in the first half and they're in region and again deploying that more broadly.

Vectoring, we have currently a program underway and this has been a topic of a lot of conversation in our fourth quarter results and fourth quarter earnings, but this vectoring program had started in early 2017 by domestic Tier 1, three year program to deliver speeds of up 100 megabits across a large number of cities. And I am sure in the Q&A there will be more conversation about that, but as part of merger related activities they currently have put a hold on that and are looking at capital plans, looking at how they want to move forward.

I think the positive takeaway for us is whether it is a scenario of resuming the vectoring under the program as it currently had been deployed since 2017 is one scenario whether it would be more of a targeted approach and there's been some commentary by new leadership about not quite having the positive customer uptake in the 20 to 40 gig range as they would want to have for that investment. But focusing on where they're getting 80 and 100 Meg and had targeted approach in cities, in the neighborhoods to where they see the opportunity for uptake at speeds closer to the 100 Meg. And even working with them like we are currently working with our international Tier 1 was super vectoring initiatives where we are in the lab with them to help them understand even going beyond vectoring at 100 Meg up to super vectoring at 300 to 500 Meg.

SD-Access services, our G.fast deployment with the large domestic Tier 1 is the first broad based SDN deployment. And of course if you're following the story, you've seen the tremendous growth that ADTRAN has had in its services business over the past couple years with double and even triple digit growth. That's a business we like it creates a level of trust and level of stickiness and level of engagement with our customer that that we embraced and are pursuing. Just to go quickly through rest of these and domestic Tier 2s obviously large recipients of CAF. They are dealing with competitive challenges with cable and keeping their customer base. They do tend to be more of a rapid follower than the Tier 1s. So in those customers, the fiber to the node vectoring, PON and of course that's where we see the bulk of our services domestically.

Domestic Tier 3s, as I mentioned, the rate of return in CAF money has started flowing this year. We talked in our call yesterday that we picked up about forty new names over the course of 2017 as we continue to develop kind of one stop shop in turnkey services for these smaller Tier 3 carriers to be able to leverage their CAF funding. Also dealing with the same cable competition, but they are slower than the Tier 1s and also Tier 2s on SDN.

Cable/MSO is an area of focus for us. Going back to our acquisition some months back of active EPON and RFoG products, we've talked about on our calls and in some press releases. EPON deployments that we expect to start this year with a large U.S. MSO and then with the largest MSO we're currently in the lab on a remote OLT development. So certainly have a lot of engagement going on with the MSOs. And then lastly on the international also looking at SDN transformation, we've talked quite a bit about our deployment that is starting this quarter with nbn in Australia, G.fast. There are different regulatory things that we're dealing with internationally particularly in the TAM where TELMEX has been rather quiet for the past couple years as they deal with competitive issues. But looking at Europe and beyond as we've talked about for several quarters that transition into super vectoring at our large German Tier 1 is beginning this quarter.

Just quickly on this, I've presented this slide before, but we continue to push it out to the right. Going back to the start of the company, in the mid 1980s, going through the Internet era, the IP transition era, we see ourselves in kind of in parallel paths of the gigabit and the SDN era and a number of innovations that we continue to have thought leadership and product leadership on.

We'll talk more about our mosaic cloud platform, which is the most awarded. You can see over to the right top, 13 industry awards including the Gold in STEVIE award earlier this – later in 2017, first system level CORD demo, second generation G.fast and the list just continues. This is the quick graphic of what that can look like. And this is – you're just using that mosaic moniker of how we can deploy across different mediums and different technologies. So coming out of the central office at about 10 o'clock there, you see the fiber feed into the cabinet. I'm sure many of you familiar with our kind of ubiquitous TA 5000 platform in the U.S. to hiX platform in Europe and that continues to have just an amazing life of being flexible, versable, upgradable to our customers.

So coming out at the left bottom, as an example of fiber to the home using GPON at the right bottom, G.fast which involves running a fiber to the basement or utility cabinet of an MDU for example placing our distribution point there and then picking up the already, previously installed twisted pair of copper or co-ax and running that into the units, delivering gig speeds over copper co-ax, over those last few hundred feet. At the right top super vectoring, like we just started doing in Europe, deliver speeds of 200 megabits to 500 megabits and then up at the very top vector, 100 meg which is what we have been doing with the domestic Tier 1 in the U.S.

So when you think about this innovation leadership that we have it really breaks down into two areas, the first being broadband access. I've hit on a lot of this again I'd rather be just listing it I won't go into any more detail on that, but we do see our ourselves as the market leader in ten gig optical. We're standards setting leadership in XGS PON, there is a major domestic Tier 1 in the U.S. that's moving forward with XGS PON trials. Of course, I think, anyone who is following the ADTRAN story is certainly familiar with our finalist position with the U.S. Tier 1 on the NG-PON2.

I'll continue to talk about our G.fast trials, over 100 on six continents. And we have five nationwide deployments or approve for deployments that are currently going on four continents, two in the U.S., Australia, Croatia and Israel.

This is just some of the awards along the timeline in our G.fast leadership. I kind of apologize. Up through 2017 in the five deployments that I have talked about, very much on the frontline is award winning and recognized by the larger Tier ones as the leader in G.fast.

So then second is SDN. I mentioned that with the Mosaic Cloud Platform at 13, picked up its 13th award in late 2017 and it is the most awarded SDN platform in the market, complete cloud-edge to subscriber-edge. That is both backwards compatible with legacy equipment, as well as the move to dis-remediated white box going forward, only vendor with a complete SD-Access built around a CORD architecture, built in a modular DevOps environment, so you'll continue to hear more and more about this going forward.

And again this is just some of the recognition that's been given to our term Mosaic platform. I just say that ADTRAN is a broadband company, there's a lot of comments

around the company that ADTRAN is a software company. And when you look at the work going into Mosaic it's a very high percentage of our R&D spend is certainly software-based now, both in the Mosaic SDN in level, as well as equipment enablement.

So with that I'm going to transition to the company's financial performance for 2017, touch on the current quarter and then leave some time for Q&A. We continue nearly three decades of continuous profitability. Very strong balance sheet, basically no debt other than state incentive bond with public trading for 23 years on the NASDAQ.

Year-end, we had a position of over $230 million of cash in investments, again a very small debt layer that again is a state incentive bond that's paying down according to our schedule and is $656 million in assets at year-end. We do have a strong history of returning value to shareholders, both through dividends continuously and over the past five years just over $350 million in share buybacks.

So I mention that 2017 was the second largest revenue year in the history of the company. And what's notable about those gross margins at 45.6% is basically flat with last year, but on a higher proportion of international. So if you recall back to 2016, we had had at the beginning of the year certainly in a down period compared to a stronger 2015 out of our European business. The TAM business started to slow down.

Our large European Tier 1 came back in 2017 and even with the lower margins that we talked about in the profile we have made improvements in our product gross margins and services gross margins to basically stay flat on higher international revenues.

The GAAP EPS, at $0.49, includes as many companies are discussing in their earnings in the first quarter – $11.9 million one-time tax charge related to the Tax Cuts Act. We certainly see the Tax Cuts Act is beneficial for us going forward with 70% to 75% of our revenue currently being U.S.-based with the tax rate dropping to 21% is going to be a benefit for us going forward.

From a timing perspective we did some very good things as a company in 2017, while the tax rate is higher, looking at refreshing R&D tax credits and other things. So actually our effective tax rate over 2017 was in the low-to-mid 20s, as well. And then on non-GAAP basis increased our EPS over last year.

This is a quick view of our segments and our categories. We report segments in products. And in global services, the products include hardware and software. You can see growth in both segments from 2016 to 2017, as well as our category, so access and aggregation. Things like the TA 5000, the hiX, the OLTs from the PON side. The customer devices include things like the legacy what used to be our Enterprise Division, so switches, routers, IP business, gateways, but that would also include the customer facing side of the PON networks like ONTs. Then in traditional products being past generation equipment that is not receiving the same level of, I guess, investment and development that would naturally be expected to be on a decline.

This is a quick look at gross margins by products and services. I'd point out a 1% increase in our services gross margins over the prior year on higher level of services. When you look at the 2015 to 2016 the takeaway there is all the services margins have come down as we've talked quite a bit about the revenue increase dramatically from 2015 to 2016 and that revenue went from being more maintenance and care services, that had higher margins to actually be an engineering network implementations which is where our growth is coming from.

U.S. versus international, I talked about the resumption of growth in our international business primarily in Europe we expect that to increase again this year as we start shipping into Australia and into we're expecting as we discussed in our call yesterday, expecting an up year with our large European Tier 1.

So just to summarize, record first half revenue basically record revenue through three quarters just $1 million short of 2011 through three quarters, full year up and record revenue in services in Q3.

I touched on Q4 having a pause from the vectoring program for our domestic Tier 1 as they go through merger integration. We believe there are basically four scenarios going forward once they finish this review that's going on and we expect that review to be wrapped up around the middle of the first quarter. They could resume the vectoring program as it has been. They could pivot to looking to see where they are getting higher throughput just closer to 80 Meg to 100 Meg across the vectoring at this and having customer uptake, this is more favorable and focus on those areas.

Again for us it's not is one or two better or scenario three if they transition more to a GPON fiber network, it's not as one, two, or three better, it's going to come down to what is the capital budget, because we are certainly and are very well positioned with them to their pick up vectoring program or to transition into GPON.

Top at the gross margin improvements and the engagement with the Tier 1s globally and that we certainly expect to continue into 2018 and going forward.

So Q4 certainly was affected as we learned into the quarter. We really didn't see it until later on in two Q4. We did continue to finish things out, so that were in process, but we had received instruction kind of after the first half of the quarter kind of back half a quarter not to continue to ship more. So our services business that did work with this vectoring rollout still came in at about $30 million for Q4, down from the record $39 million in Q3, as we continue to build things out in Q4.

Slightly better than expected gross margins in Q4 46.5%, I think, that is – those who follow the company would attest that we do a really strong job of managing margins and managing OpEx. You can see the OpEx down the $62.9 million from $68 million. But the percentage went up because of the revenue drop and had to up this point of history of OpEx increasing at a slower rate than earnings.

This is a quick look at revenue and gross margins by our segments, networks, and services and support and then cross access effect, customer advices and traditional products and all. In the interest of saving time for Q&A this is all in the disclosure that we put out yesterday.

And the lastly, looking at the guidance that we gave yesterday for Q1. We're projecting knowing what we know now flattish with Q4, again this recognizes that we don't know what the domestic Tier 1 is going to do, certainly once we do know that will give us a better insight visibility into the quarter and the rest of the year.

Gross margins, we expect to be in the 40% range, it's down simply is because of the fact that our European business is going to be a larger percentage of the revenues in Q1. So that business tends to increase in Q1, Q2, lower in the back half of the year. So it's just a proportion of percentage of the revenue larger in Q1, but we expect our gross margins to increase over the course of the year. OpEx will remain in $64 million to $65 million range. And as I mentioned benefiting from the recently enacted tax cuts that we expect our tax rate to be in the low 20% range.

And with that Rich I'd open it up to the floor, you for any questions.

Q&A

<Q>: Yeah you mentioned number of outcomes actually of our North American Tier 1, one of which we do that they [indiscernible] (0:29:42)? All just are in equal dollars, but you get dollars [indiscernible] (0:29:54) large perspective, if you're more conservative in one than the other, I think, you had pretty big service [indiscernible] (0:30:03)?

<A – Roger D. Shannon>: We did have a large services, that we just had with the vectoring we would certainly expect and hope to have a large services with the fiber, as well. As you mentioned the question really for us is not so much which scenario is it, but what's the capital budget going to be. And then if it does turn out to be a GPON deployment, we would expect there would be some additional timing on that. With the vectoring, with the resources we have in place, equipment we have in place, we can turn that on pretty quickly. We talked about on our call yesterday, we had the question that if it does transition to fiber what's that timing look like. We think that's sort of the 60-day to 90-day ramp up is a identified locations there'd be some trenching work, but we could get on that pretty quickly as well.

And as I mentioned, we are currently having conversations with them to educate the new leadership not only about how we can enhance the speeds in the vectoring 100 meg deployment, but to kind of accelerate this lab trial we have with them on super vectoring, which I'm not sure they've thought about yet, but we're having those conversations to get to a higher level without incurring that cost of going fully fiber.

<Q>: What about addressing the [indiscernible] (0:31:25) which companies don't wanted to go.

<A – Roger D. Shannon>: Right.

<Q>: But if you are working on technology to get lines at mostly at 40 Meg [indiscernible] (0:31:35) technology up to a 100 Meg.

<A – Roger D. Shannon>: Exactly, yeah.

<Q>: [Question Inaudible]

<A – Roger D. Shannon>: And again that's part of the discussion, its one option, as I mentioned, is super vectoring, the other is loop link, loop shortening projects grooming those are all conversations that we're currently having and we think it's addressable.

<Q>: [Question Inaudible]

<A – Roger D. Shannon>: Yeah it does, I think, I'm not speculating on where the year would have been, but if the outlook – based on where we were coming out of Q3, the full year outlook was around that seven number. The prospects and our enthusiasm hasn't changed a bit, in fact, I think, Rich would attest some – some comments that we've made kind of middle of the year that just the breadth of the projects that we see is probably larger than it has been. So new awards in Australia, we've mentioned the past that that could be a 10% customer on any given quarter, especially as it ramps.

The NG-PON2 project with U.S. Tier 1, particularly if that application is chosen to be used for wireless 5G, wireless backhaul has tremendous opportunity and we think it is ideally suited for that, G.fast domestically and in the visibility that we have into our European Tier 1. See this is a hiccup, a bump in the road, really nothing has changed from our perspective, our enthusiasm for getting back to those numbers that you're talking about. It just, I think, it just would be depending on how they – what they decide, what the timing looks like.

And I'd – without giving guidance and I'm not going to give guidance it – the question really is around 2018 at this point. Any other questions?

<Q>: No.

<<Roger D. Shannon, Senior Vice President of Finance, CFO, Secretary & Treasurer>>

Great. Well, thank you so much. Have a great conference.