

ADC TELECOMMUNICATIONS INC
Form 10-Q
June 13, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

☒

**QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended April 30, 2003

OR

☐

**TRANSACTION REPORT PURSUANT TO SECTION 13 or 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from N/A to N/A

Commission file number 0-1424

ADC Telecommunications, Inc.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of incorporation or
organization)

41-0743912

(I.R.S. Employer Identification No.)

13625 Technology Drive, Eden Prairie, MN 55344-2252

(Address of principal executive offices) (Zip code)

(952) 938-8080

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-Q

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☒

NO ☐

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common stock, \$.20 par value: 804,130,856 shares as of June 9, 2003

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ADC TELECOMMUNICATIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS UNAUDITED

(In millions)

**April 30,
2003**

**October 31,
2002**

ASSETS:

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-Q

CURRENT ASSETS:			
Cash and cash equivalents	\$	374.5	\$ 278.9
Available-for-sale securities		3.1	0.5
Accounts receivable, net		110.1	114.6
Unbilled revenue		29.1	25.8
Inventories, net		83.7	94.9
Prepaid income taxes		23.3	126.6
Prepaid and other current assets		30.9	44.5
Total current assets		654.7	685.8
PROPERTY AND EQUIPMENT, net		170.9	206.8
ASSETS HELD FOR SALE		24.5	20.0
RESTRICTED CASH		67.8	177.0
OTHER ASSETS		33.9	54.6
Total assets	\$	951.8	\$ 1,144.2

LIABILITIES AND SHAREOWNERS INVESTMENT:

CURRENT LIABILITIES:			
Accounts payable	\$	49.2	\$ 73.0
Accrued compensation and benefits		61.8	74.1
Restructuring accrual		40.1	124.2
Other accrued liabilities		122.3	110.8
Notes payable		8.6	15.7
Total current liabilities		282.0	397.8
LONG-TERM NOTES PAYABLE			10.8
OTHER LONG-TERM LIABILITIES		3.4	3.4
Total liabilities		285.4	412.0
SHAREOWNERS INVESTMENT (804.1 and 799.6 shares outstanding, respectively)		666.4	732.2
Total liabilities and shareowners investment	\$	951.8	\$ 1,144.2

See accompanying notes to condensed consolidated financial statements.

ADC TELECOMMUNICATIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS UNAUDITED

(In millions, except per share amounts)

	Three months Ended		Six Months Ended	
	April 30,		April 30,	
	2003	2002	2003	2002
NET SALES:				

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-Q

Product	\$	142.1	\$	235.1	\$	293.9	\$	463.8
Service		49.8		63.2		97.9		128.0
TOTAL NET SALES		191.9		298.3		391.8		591.8
COST OF SALES:								
Product		78.3		170.9		162.4		311.9
Service		40.2		53.7		85.3		111.4
TOTAL COST OF SALES		118.5		224.6		247.7		423.3
GROSS PROFIT		73.4		73.7		144.1		168.5
EXPENSES:								
Research and development		27.4		51.4		59.7		95.6
Selling and administration		61.0		108.1		124.9		219.2
Impairment charges		4.3		16.8		14.6		18.7
Restructuring charges		12.1		47.4		20.2		50.4
In process research and development				10.5				10.5
Total Expenses		104.8		234.2		219.4		394.4
OPERATING LOSS		(31.4)		(160.5)		(75.3)		(225.9)
OTHER INCOME, NET		2.0		27.5		4.4		23.0
LOSS BEFORE INCOME TAXES		(29.4)		(133.0)		(70.9)		(202.9)
BENEFIT FOR INCOME TAXES				(43.8)				(68.9)
NET LOSS	\$	(29.4)	\$	(89.2)	\$	(70.9)	\$	(134.0)
AVERAGE COMMON SHARES OUTSTANDING (BASIC AND DILUTED)		802.7		794.9		801.9		794.2
LOSS PER SHARE (BASIC AND DILUTED)	\$	(0.04)	\$	(0.11)	\$	(0.09)	\$	(0.17)

See accompanying notes to condensed consolidated financial statements.

ADC TELECOMMUNICATIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED

(In millions)

	Six Months Ended April 30,	
	2003	2002
OPERATING ACTIVITIES:		
Net loss	\$ (70.9)	\$ (134.0)
Adjustments to reconcile net loss to net cash from operating activities:		
Purchased in process research and development		10.5
Inventory and fixed asset impairments	15.9	19.4
Depreciation and amortization	33.5	58.0
Provision for losses on receivables	1.4	2.1
Inventory reserves	(0.8)	8.3
Non-cash stock compensation	2.1	5.4
Change in deferred income taxes		(1.5)
Loss on write-down of investments		22.3
Gain on sale of investments	(2.0)	(31.2)
Loss on sale of business	2.8	
Loss on sale of fixed assets and sale leasebacks	1.0	2.3
Other	2.1	1.5
Changes in operating assets and liabilities, net of acquisitions and divestitures:		
Accounts and unbilled receivables	8.7	117.6
Inventories	9.3	52.0
Prepaid and other assets	143.0	152.5
Accounts payable	(30.8)	(57.1)
Accrued liabilities	(101.3)	(13.6)
Total cash provided by operating activities	14.0	214.5
INVESTING ACTIVITIES:		
Acquisitions, net of cash acquired		(4.3)
Divestitures, net of cash disposed	0.5	
Property and equipment additions, net of disposals	(16.1)	(21.8)
Change in restricted cash	109.1	(260.1)
Sale of available-for-sale securities, net		32.2
Sale (purchase) of long-term investments, net	4.0	(1.8)
Total cash provided by (used) for investing activities	97.5	(255.8)
FINANCING ACTIVITIES:		

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-Q

Repayments of debt	(18.4)	(3.9)
Common stock issued	2.8	6.3
Total cash provided by (used for) financing activities	(15.6)	2.4
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(0.3)	(0.2)
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	95.6	(39.1)
CASH AND CASH EQUIVALENTS, beginning of period	278.9	348.6
CASH AND CASH EQUIVALENTS, end of period	\$ 374.5	\$ 309.5

See accompanying notes to condensed consolidated financial statements.

ADC TELECOMMUNICATIONS, INC. AND SUBSIDIARIES

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED

Note 1 Basis of Presentation:

The interim information furnished in this report is unaudited but reflects all normal recurring adjustments which are necessary, in the opinion of our management, for a fair statement of the results for the interim periods. The operating results for the quarter ended April 30, 2003 are not necessarily indicative of the operating results to be expected for the full fiscal year. These statements should be read in conjunction with our most recent Annual Report filed on Form 10-K.

Reclassifications. Certain prior year amounts have been reclassified to conform to the current year presentation.

Recently Issued Accounting Pronouncements. In June 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS No. 146 superseded Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The principal difference between SFAS No. 146 and EITF No. 94-3 relates to when an entity can recognize a liability related to exit or disposal activities. SFAS No. 146 requires that a liability be recognized for a cost associated with an exit or disposal activity when the liability is incurred. EITF No. 94-3 allowed a liability related to an exit or disposal activity to be recognized on the date an entity commits to an exit plan. We adopted this standard on January 1, 2003, which was the standard's effective date. The standard did not materially impact our consolidated financial results or financial position upon adoption.

In November 2002, the FASB issued Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of the Indebtedness of Others, which requires a guarantor to recognize and measure certain types of guarantees at fair value. In addition, Interpretation No. 45 requires the guarantor to make new disclosures for these guarantees and other types of guarantees that are not subject to the initial recognition and initial measurement provisions. The disclosure requirements are effective for financial statements with interim or annual periods ended after December 15, 2002, while the recognition and measurement provisions are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. We adopted the initial recognition and measurement provision as well as the disclosure provision of Interpretation No. 45 during the first quarter of fiscal 2003. The initial recognition and measurement provisions did not have a material impact on our consolidated financial results or financial position. See Note 10 for guarantee disclosure information.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure. The provisions of SFAS No. 148 amend SFAS No. 123, Accounting for Stock Based Compensation, to provide alternative methods of transitioning to a fair value-based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 also expands the disclosure requirements of SFAS No. 123 by requiring more detailed disclosure in both annual and interim financial statements. The transition provisions of SFAS No. 148 will not have a material impact on our financial results, as we do not plan to adopt the fair value-based accounting provisions

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-Q

of SFAS No. 123, which is commonly referred to as expensing of stock options. The disclosure provisions of SFAS No. 148 are effective for interim periods beginning after December 15, 2002. Accordingly, we adopted the disclosure provisions of this standard during the second quarter of fiscal 2003.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51, which requires companies to consolidate certain types of variable interest entities. A variable interest entity is an entity that has inadequate invested equity at risk to meet expected future losses, or whose holders of the equity investments lack any of the following three characteristics: (i) the ability to make decisions about the entity's activities; (ii) the obligation to absorb the entity's losses if they occur; or (iii) the right to receive the entity's future returns if they occur. Interpretation No. 46 is applicable immediately for all variable interests created after January 31, 2003. For all variable interest entities created before February 1, 2003, the provisions of this interpretation are effective in the first fiscal year or interim period beginning after June 15, 2003 (our fourth quarter of fiscal 2003). In accordance with Interpretation No. 46, we will be required to consolidate an operating lease related to our world headquarters facility, generally known as a synthetic lease, beginning in the fourth quarter of fiscal 2003. Interpretation No. 46 is not expected to have a material impact on our consolidated financial position or results of operations as we intend to purchase this property from the lessor during the third quarter of fiscal 2003.

Summary of Significant Accounting Policies. A detailed description of our significant accounting policies can be found in our most recent Annual Report filed on Form 10-K. As noted above, we recently adopted the disclosure provisions of SFAS No. 148, but we did not adopt the transition provisions of SFAS No. 148. As a result of adopting the disclosure provisions of SFAS No. 148, we

are required to disclose the method we use to account for stock based compensation on a quarterly basis. Stock compensation is awarded to certain key employees in the form of stock options and restricted stock. We account for our stock compensation in accordance with APB Opinion 25, Accounting for Stock Issued to Employees, and related interpretations. All stock options are issued at fair market value on the date of grant. Accordingly, we did not recognize stock compensation expense for stock options granted during the periods presented. The following table summarizes what our operating results would have been if we had utilized the fair value method of accounting for stock options (in millions):

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-Q

As reported	\$	(29.4)	\$	(89.2)	\$	(70.9)	\$	(134.0)
Stock compensation expense fair value based method		(19.0)		(35.3)		(37.5)		(69.4)
Pro Forma Net Loss	\$	(48.4)	\$	(124.5)	\$	(108.4)	\$	(203.4)
Loss Per Share Basic and Diluted								
As reported	\$	(0.04)	\$	(0.11)	\$	(0.09)	\$	(0.17)
Pro forma	\$	(0.06)	\$	(0.16)	\$	(0.14)	\$	(0.26)

We have issued restricted stock as part of employee incentive plans as well as in conjunction with our fiscal year 2000 purchase of Broadband Access Systems, Inc. The fair market value of the restricted stock is amortized over the projected remaining vesting period. During the three and six months ended April 30, 2003, we incurred \$1.2 million and \$4.6 million, respectively, of non-cash stock compensation expense related to restricted stock issuances. Non-cash stock compensation expense for the three and six months ended April 30, 2002, was \$3.7 million and \$7.5 million, respectively.

Note 2 Inventories:

Inventories include material, labor and overhead and are stated at the lower of first-in, first-out cost or market. Inventories consisted of (in millions):

	April 30, 2003	October 31, 2002
Purchased materials and manufactured products	\$ 73.2	\$ 82.5
Work-in-process	10.5	12.4
	\$ 83.7	\$ 94.9

Note 3 Other Assets:

Deferred tax assets. A deferred tax asset generally represents future tax benefits to be received when certain expenses previously recognized in our U.S. GAAP-based income statement become deductible expenses under applicable income tax laws. Thus, realization of a deferred tax asset is dependent on future taxable income against which these deductions can be applied. SFAS No. 109, Accounting for Income Taxes, requires that a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. In fiscal 2002 and for the three and six months ended April 30, 2003, we recorded a full valuation allowance against all our deferred tax assets. We expect to provide a full valuation allowance on any future tax benefits until we can sustain a level of profitability that demonstrates our ability to utilize these assets. We will not record tax benefits or significant provisions for pre-tax income (loss) until either our deferred tax assets are fully utilized to reduce future income tax liabilities or the value of our deferred tax assets are restored on the balance sheet. As of April 30, 2003 we had \$735.4 million of deferred tax assets that have a full valuation allowance against them and thus are not reflected on the condensed consolidated balance sheet. Our deferred tax assets expire through October 31, 2022.

Note 4 Comprehensive Loss:

The following table presents the calculation of comprehensive loss as required by SFAS No. 130. Comprehensive loss has no impact on our net loss, balance sheet or shareowners' investment. The components of comprehensive loss are as follows (in millions):

6

	Three months Ended April 30,		Six Months Ended April 30,	
	2003	2002	2003	2002
Net loss	\$ (29.4)	\$ (89.2)	\$ (70.9)	\$ (134.0)

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-Q

Change in cumulative translation adjustments	(1.8)	2.0	(5.6)	(6.4)
Reclassification adjustment for realized (gains) losses on securities classified as available for sale, net-of-tax		(15.2)		(19.6)
Unrealized gain (loss) from securities classified as available for sale, net-of-tax	0.4	(1.5)	2.6	(2.4)
Comprehensive loss	\$ (30.8)	\$ (103.9)	\$ (73.9)	\$ (162.4)

Note 5 Divestitures:

During fiscal 2002 and for the six months ended April 30, 2003, we sold or shut down non-strategic product lines. The net sales and operating income (loss) of the divested product lines are as follows (in millions):

	Three months Ended April 30,			Six Months Ended April 30,		
	2003	2002		2003	2002	
Net sales	\$ 0.3	\$ 4.5	\$	1.3	\$ 11.4	\$

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-Q

Operating income (loss)	0.2	(41.1)	0.8	(69.8)
-------------------------	-----	--------	-----	--------

Note 6 Segment Reporting:

The management approach required by SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires us to disclose selected financial data by operating segment. This approach is based on the way we organize segments within an enterprise for making operating decisions and assessing performance. We have identified two reportable segments based on our internal organizational structure, management of operations and performance evaluation. These segments are Broadband Infrastructure and Access, and Integrated Solutions. Segment detail is summarized as follows (in millions):

	Broadband Infrastructure and Access	Integrated Solutions	Unallocated Items	Consolidated
Three Months Ended April 30, 2003				
External sales:				
Product	\$ 119.7	\$ 22.4	\$	\$ 142.1
Service		49.8		49.8
Total external sales	119.7	72.2		191.9
Impairment, restructuring and other disposal charges(1)			(17.7)	(17.7)
Operating loss	(8.8)	(0.6)	(22.0)	(31.4)
Other income, net			2.0	2.0
Pre-tax loss	(8.8)	(0.6)	(20.0)	(29.4)
Assets	320.6	268.6	362.6	951.8
Three Months Ended April 30, 2002				
External sales:				
Product	\$ 205.4	\$ 29.7	\$	\$ 235.1
Service		63.2		63.2
Total external sales	205.4	92.9		298.3
Impairment, restructuring and other disposal charges(2)			(63.6)	(63.6)
In-process research and development			(10.5)	(10.5)
Operating loss	(78.6)	(6.1)	(75.8)	(160.5)
Other income, net			27.5	27.5
Pre-tax loss	(78.6)	(6.1)	(48.3)	(133.0)
Assets	616.3	220.5	1,453.2	2,290.0
Six Months Ended April 30, 2003				
External sales:				
Product	\$ 252.2	\$		