ADC TELECOMMUNICATIONS INC
Form 10-Q
June 07, 2007

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended May 4, 2007

OR

o **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	**41-0743912**
(State or other jurisdiction of incorporation or organization)	(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)

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 þ NO o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated file, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES o NO þ

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: 117,406,627 shares as of June 4, 2007

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
ADC TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS UNAUDITED

	May 4, 2007	October 31, 2006
	(In millions)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 118.9	$ 142.3
Available-for-sale securities	537.2	395.4
Accounts receivable, net of reserves of $8.8 and $10.2	175.3	169.3
Unbilled revenue	30.2	23.8
Inventories, net of reserves of $34.2 and $35.1	172.8	165.5
Assets of discontinued operations	2.6	14.9
Prepaid and other current assets	29.7	31.5
Total current assets	1,066.7	942.7
Property and equipment, net of accumulated depreciation of $384.0 and $370.3	204.3	206.5
Restricted cash	13.1	14.0
Goodwill	239.0	238.5
Intangibles, net of accumulated amortization of $75.8 and $66.5	131.2	142.0
Available-for-sale securities	7.2	10.7
Long term assets of discontinued operations	0.4	0.3
Other assets	54.6	56.7
Total assets	$ 1,716.5	$ 1,611.4
LIABILITIES AND SHAREOWNERS INVESTMENT		
Current Liabilities:		
Accounts payable	$ 96.6	$ 88.4
Accrued compensation and benefits	53.8	43.6
Other accrued liabilities	55.8	60.6
Income taxes payable	18.1	17.7
Restructuring accrual	20.5	28.4
Liabilities of discontinued operations	8.2	21.4
Total current liabilities	253.0	260.1
Pension obligations and other long-term liabilities	83.5	77.8
Long-term notes payable	400.0	400.0
Total liabilities	736.5	737.9
Shareowners Investment:		
(117.3 and 117.2 shares outstanding, respectively)	980.0	873.5
Total liabilities and shareowners investment	$ 1,716.5	$ 1,611.4

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ADC TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS UNAUDITED

	Three Months Ended		Six Months Ended	
	May 4, 2007	April 28, 2006	May 4, 2007	April 28, 2006
	(In millions)			
Net Sales:				
Product	$ 312.0	$ 320.7	$ 573.8	$ 562.8
Service	37.4	37.4	72.8	68.1
Total net sales	349.4	358.1	646.6	630.9
Cost of Sales:				
Product	195.9	207.5	364.7	367.3
Service	33.0	28.9	66.4	55.7
Total cost of sales	228.9	236.4	431.1	423.0
Gross Profit	120.5	121.7	215.5	207.9
Operating Expenses:				
Research and development	18.1	19.0	35.3	38.0
Selling and administration	69.2	75.7	139.5	143.9
Restructuring and impairment charges	(0.9)	1.8	(0.3)	3.2
Total operating expenses	86.4	96.5	174.5	185.1
Operating Income	34.1	25.2	41.0	22.8
Other income, net	61.7	2.5	65.3	4.9
Income before income taxes	95.8	27.7	106.3	27.7
Provision for income taxes	2.7	2.6	3.8	3.9
Income from continuing operations	93.1	25.1	102.5	23.8
Discontinued Operations, Net of Tax				
Loss from discontinued operations	(1.2)	(2.3)	(1.9)	(3.4)
Gain (loss) on sale of discontinued operations, net	0.2		(4.9)	
Total discontinued operations	(1.0)	(2.3)	(6.8)	(3.4)
Earnings before the cumulative effect of a change in accounting principle	92.1	22.8	95.7	20.4
Cumulative effect of a change in accounting principle				0.6
Net Income	$ 92.1	$ 22.8	$ 95.7	$ 21.0
Weighted Average Common Shares Outstanding (Basic)	117.3	117.1	117.3	116.9

Weighted Average Common Shares Outstanding (Diluted)	131.8	117.9	131.6	117.6
Basic Earnings (Loss) Per Share:				
Continuing operations	$ 0.79	$ 0.21	$ 0.87	$ 0.20
Discontinued operations	$ (0.01)	$ (0.02)	$ (0.05)	$ (0.03)
Cumulative effect of a change in accounting principle	$	$	$	$ 0.01
Net income per share	$ 0.78	$ 0.19	$ 0.82	$ 0.18
Diluted Earnings (Loss) Per Share:				
Continuing operations	$ 0.73	$ 0.21	$ 0.83	$ 0.20
Discontinued operations	$ (0.01)	$ (0.02)	$ (0.05)	$ (0.03)
Cumulative effect of a change in accounting principle	$	$	$	$ 0.01
Net income per share	$ 0.72	$ 0.19	$ 0.78	$ 0.18

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ADC TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED

	Six Months Ended	
	May 4, 2007	April 28, 2006
	(In millions)	
Operating Activities:		
Income from continuing operations	$ 102.5	$ 23.8
Adjustments to reconcile income from continuing operations to net cash provided by (used for) operating activities from continuing operations:		
Impairments	0.1	0.6
Depreciation and amortization	34.2	33.6
Change in bad debt reserve	(0.9)	0.2
Non-cash stock compensation	4.6	6.5
Change in deferred income taxes	0.5	1.4
Loss on sale of property and equipment	0.5	0.7
Gain on sale of investments	(57.5)	
Other, net	(2.5)	(0.5)
Changes in operating assets and liabilities, net of divestitures:		
Accounts receivable and unbilled revenues increase	(7.8)	(17.4)
Inventories increase	(4.9)	(4.3)
Prepaid and other assets (increase)/decrease	4.1	(7.0)
Accounts payable increase	6.9	27.1
Accrued liabilities decrease	(3.8)	(34.4)
Total cash provided by operating activities from continuing operations	76.0	30.3
Total cash used for operating activities from discontinued operations	(9.1)	(1.9)
Total cash provided by operating activities	66.9	28.4
Investing Activities:		
Acquisitions, net of cash acquired	(2.0)	
Divestitures, net of cash disposed	0.3	
Property, equipment and patent additions	(18.3)	(13.5)
Proceeds from disposal of property and equipment	0.5	0.3
Proceeds from collection of notes receivable		2.3
Proceeds from sale of investments	59.8	
Warrant exercise	(1.8)	
Decrease in restricted cash	1.2	1.6
Purchase of available-for-sale securities	(674.3)	(240.4)
Sale of available-for-sale securities	536.0	229.6
Other		0.1
Total cash used for investing activities from continuing operations	(98.6)	(20.0)
Total cash provided by investing activities from discontinued operations	1.1	0.4
Total cash used for investing activities	(97.5)	(19.6)

Financing Activities:		
Common stock issued	2.0	9.6
Total cash provided by financing activities	2.0	9.6
Effect of Exchange Rate Changes on Cash	5.2	1.8
Increase/(Decrease) in Cash and Cash Equivalents	(23.4)	20.2
Cash and Cash Equivalents, beginning of period	142.3	108.4
Cash and Cash Equivalents, end of period	$ 118.9	$ 128.6

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ADC TELECOMMUNICATIONS, INC. AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS UNAUDITED

Note 1: Basis of Presentation

These interim unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. The interim information furnished in this report reflects all normal recurring adjustments, which are necessary, in the opinion of our management, for a fair presentation of the results for the interim periods. The operating results for the three and six months ended May 4, 2007 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 on Form 10-K/A for the fiscal year ended October 31, 2006.

During the third quarter of fiscal 2006, our Board of Directors approved a plan to divest our professional services business in France (APS France). During the first quarter of fiscal 2007, we completed this divestiture. In accordance with SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets,* this business was classified as discontinued operations for all periods presented.

Fiscal Year

Our first three quarters end on the Friday nearest to the end of January, April and July, respectively, and our fiscal year ends on October 31.

Recently Issued Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board (FASB) issued SFAS No. 154, *Accounting Changes and Error Corrections-a replacement of APB Opinion No. 20 and FASB Statement No. 3* (SFAS 154). SFAS 154 replaces APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for and reporting of a change in accounting principle. APB Opinion No. 20 previously required that most voluntary changes in an accounting principle be recognized by including the cumulative effect of changing to the new accounting principle in net income in the period of the change. SFAS 154 requires retrospective application to prior periods financial statements of changes in accounting principle applied as if that principle had always been used. SFAS 154 is effective for changes and error corrections made in fiscal years beginning after December 15, 2005. We adopted the provisions of SFAS 154 on November 1, 2006. The adoption of SFAS 154 will only impact us if there are accounting changes or error corrections.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by allowing entities to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of an entity s first fiscal year that begins after November 15, 2007. We are required to adopt the provisions of SFAS 159 in our fiscal year beginning November 1, 2008. We are currently evaluating the impact, if any, that SFAS 159 may have on our financial statements.

Summary of Significant Accounting Policies

A detailed description of our significant accounting policies can be found in our most recent Annual Report on Form 10-K/A for the fiscal year ended October 31, 2006.

Warranty

We provide reserves for the estimated cost of product warranties at the time revenue is recognized. We estimate the costs of our warranty obligations based on our warranty policy or applicable contractual warranty, our historical experience of known product failure rates, and use of materials and service delivery costs incurred in correcting product failures. In addition, from time to time, specific warranty accruals may be made if unforeseen technical problems arise.

The following table provides detail on the activity in the warranty reserve accrual balance as of May 4, 2007:

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	Accrual October 31, 2006	Charged to costs and expenses	Deductions	Accrual May 4, 2007
		(In millions)		
Warranty Reserve	$9.5	$ 1.2	$ 1.6	$ 9.1

Note 2: Share-Based Compensation

Share-based compensation recognized under SFAS No. 123(R) *Share-Based Payment: An amendment of FASB Statement No. 123 and 95,* for the three and six months ended May 4, 2007 was $2.7 million and $4.6 million, respectively. Share-based compensation expense for the three and six months ended April 28, 2006 was $3.1 million and $6.5 million, respectively. The decrease for the three and six months ended May 4, 2007 compared to the three and six months ended April 28, 2006 was due to the full vesting of certain share-based awards during fiscal 2006. The share-based compensation expense is calculated on a straight-line basis over the vesting periods of the related share-based awards.

Note 3: Discontinued Operations

APS France

During the third quarter of fiscal 2006, our Board of Directors approved a plan to divest APS France. On January 12, 2007, we completed the sale of certain assets of APS France to a subsidiary of Groupe Circet, a French company, for a cash price of $0.1 million, a portion of which is held in escrow for six months. In connection with this transaction, we compensated Groupe Circet for assuming certain facility and vehicle leases. APS France had been included in our Professional Services segment. We classified this business as a discontinued operation in the third quarter of fiscal 2006. We recorded a loss on the sale of the business of $22.6 million during fiscal 2006, which includes a provision for employee severance. In the first and second quarters of fiscal 2007, we recorded an additional loss of $5.1 million and a gain of $0.2 million, respectively, resulting in a total loss on sale of $27.5 million. These adjustments were due to subsequent working capital adjustments and additional expenses related to the finalization of the sale.

The financial results of APS France are reported separately as discontinued operations for all periods presented in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The financial results of APS France included in discontinued operations are:

	Three Months Ended		Six Months Ended	
	May 4, 2007	April 28, 2006	May 4, 2007	April 28, 2006
	(In millions)		(In millions)	
Net sales	$ 1.4	$ 8.5	$ 8.5	$ 18.5
Loss from discontinued operations	$ (1.2)	$ (2.3)	$ (1.9)	$ (3.4)
Gain (loss) on sale of discontinued operations	0.2		(4.9)	
Loss from discontinued operations	$ (1.0)	$ (2.3)	$ (6.8)	$ (3.4)

Note 4: Net Income (Loss) from Continuing Operations Per Share

The following table presents a reconciliation of the numerators and denominators of basic and diluted income (loss) per share from continuing operations:

	Three Months Ended		Six Months Ended	
	May 4,	April 28,	May 4,	April 28,

	2007	2006	2007	2006
	(In millions, except per share amounts)		(In millions, except per share amounts)	
Numerator:				
Net income from continuing operations	93.1	25.1	102.5	23.8
Interest expense for convertible notes	3.4		6.8	
Net income from continuing operations diluted	$ 96.5	$ 25.1	$ 109.3	$ 23.8
Denominator:				
Weighted average common shares outstanding basic	117.3	117.1	117.3	116.9
Convertible bonds converted to common stock	14.2		14.2	
Employee options and other	0.3	0.8	0.1	0.7
Weighted average common shares outstanding diluted	131.8	117.9	131.6	117.6
Basic income per share from continuing operations	$ 0.79	$ 0.21	$ 0.87	$ 0.20
Diluted income per share from continuing operations	$ 0.73	$ 0.21	$ 0.83	$ 0.20

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Excluded from the dilutive securities described above are employee stock options to acquire 6.1 million and 3.0 million shares for the three months ended May 4, 2007, and April 28, 2006, respectively. Also excluded are employee stock options to acquire 6.2 million and 4.2 million shares for the six months ended May 4, 2007 and April 28, 2006, respectively. These employee stock options are excluded if the exercise prices of these options are greater than the average market price of our common stock for the period, or if we have a net loss for the period, both of which would have had an anti-dilutive effect.

Warrants to acquire 14.2 million shares issued in connection with our convertible notes were excluded from the dilutive securities described above for the three and six months ended May 4, 2007 and April 28, 2006. This exclusion occurred because the exercise price of these warrants was greater than the average market price of our common stock.

We are required to use the if-converted method for computing diluted earnings per share with respect to the shares reserved for issuance upon conversion of the notes. Under this method, we add back the interest expense on the convertible notes to net income and then divide this amount by outstanding shares, including all 14.2 million shares that could be issued upon conversion of the notes. If this calculation results in further dilution of the earnings per share, our diluted earnings per share will include all 14.2 million shares of common stock reserved for issuance upon conversion of our convertible notes. If this calculation is anti-dilutive, the net-of-tax interest expense on the convertible notes is deducted, and the 14.2 million shares of common stock reserved for issuance upon conversion of our convertible notes are excluded. Based upon these calculations, all shares reserved for issuance upon conversion of our convertible notes were excluded for the three and six months ended April 28, 2006 because of their anti-dilutive effect. However, these shares were included for the three and six months ended May 4, 2007.

Note 5: Inventories

Inventories consist of:

	May 4, 2007	October 31, 2006
	(In millions)	
Purchased materials	$ 72.0	$ 66.9
Manufactured products	130.8	129.2
Work-in-process	4.2	4.5
Less: Inventory reserve	(34.2)	(35.1)
Total inventories, net	$ 172.8	$ 165.5

Note 6: Property & Equipment

Property & equipment consists of:

	May 4, 2007	October 31, 2006
	(In millions)	
Land and buildings	$ 142.1	$ 141.2
Machinery and equipment	394.7	386.3
Furniture and fixtures	39.6	39.0
Less: Accumulated depreciation	(384.0)	(370.3)
Total	192.4	196.2
Construction-in-progress	11.9	10.3
Total property & equipment, net	$ 204.3	$ 206.5

Note 7: Goodwill and Intangible Assets

We recorded $239.0 million of goodwill in connection with our acquisitions of the KRONE group (KRONE), Fiber Optic Network Solutions Corp. (FONS) and an additional eleven percent of the outstanding shares in our majority-owned Indian based subsidiary KRONE Communications Ltd. (KCL). All of the goodwill derived from these acquisitions has been assigned to our Global Connectivity Solutions segment. Most of this goodwill is not deductible for tax purposes.

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On April 26, 2007, we completed the acquisition of an additional eleven percent of the outstanding shares in KCL from Karnataka State Electronics Development Corporation Limited for a purchase price of approximately $2.0 million. We now own 62% of the outstanding shares of KCL. Goodwill of $0.5 million was recorded in the transaction. KCL s results have been and continue to be fully consolidated in our results of operations.

The changes in the carrying amount of goodwill for the six months ended May 4, 2007 are as follows (in millions):

Balance as of October 31, 2006	$ 238.5
Goodwill acquired during the year	0.5