

AVIAT NETWORKS, INC.
Form 10-Q
February 11, 2019

UNITED STATES
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 December 28, 2018

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File Number 001-33278

AVIAT
NETWORKS,
INC.
(Exact name of
registrant as
specified in its
charter)

Delaware 20-5961564
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

860 N. McCarthy Blvd., Suite 200, Milpitas, California 95035
(Address of principal executive offices) (Zip Code)

(408) 941-7100
(Registrant's telephone number, including area code)

No changes
(Former name, former address and former fiscal year, if changed since last report)

Indicate by checkmark 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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Edgar Filing: AVIAT NETWORKS, INC. - Form 10-Q

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the registrant's Common Stock as of January 31, 2019 was 5,380,128 shares.

AVIAT NETWORKS, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarterly Period Ended December 28, 2018
Table of Contents

	Page
<u>Part I. Financial Information</u>	<u>3</u>
<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets (Unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations (Unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows (Unaudited)</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>24</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>31</u>
<u>Item 4. Controls and Procedures</u>	<u>32</u>
<u>Part II. Other Information</u>	<u>33</u>
<u>Item 1. Legal Proceedings</u>	<u>33</u>
<u>Item 1A. Risk Factors</u>	<u>33</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>33</u>
<u>Item 3. Defaults upon Senior Securities</u>	<u>33</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>33</u>
<u>Item 5. Other Information</u>	<u>33</u>
<u>Item 6. Exhibits</u>	<u>34</u>
<u>Signatures</u>	<u>35</u>

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AVIAT NETWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except share and par value amounts)	December 28, 2018	June 29, 2018
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 31,542	\$37,425
Restricted cash	3	3
Accounts receivable, net	48,624	43,068
Unbilled receivables	32,336	14,167
Inventories	8,593	21,290
Customer service inventories	1,113	1,507
Other current assets	4,873	6,006
Total current assets	127,084	123,466
Property, plant and equipment, net	17,016	17,179
Deferred income taxes	5,127	5,600
Other assets	11,957	9,816
TOTAL ASSETS	\$ 161,184	\$156,061
LIABILITIES AND EQUITY		
Current Liabilities:		
Short-term debt	\$ 9,000	\$9,000
Accounts payable	34,777	30,878
Accrued expenses	22,663	25,864
Advance payments and unearned revenue	15,846	19,300
Restructuring liabilities	1,567	1,426
Total current liabilities	83,853	86,468
Unearned revenue	7,721	6,593
Other long-term liabilities	1,346	1,250
Reserve for uncertain tax positions	3,403	2,941
Deferred income taxes	1,534	1,293
Total liabilities	97,857	98,545
Commitments and contingencies (Note 11)		
Equity:		
Preferred stock, \$0.01 par value, 50,000,000 shares authorized, none issued	—	—
Common stock, \$0.01 par value, 300,000,000 shares authorized, 5,399,357 shares issued and outstanding at December 28, 2018; 5,351,155 shares issued and outstanding at June 29, 2018, respectively	54	54
Additional paid-in-capital	815,392	816,426
Accumulated deficit	(739,176)	(746,359)
Accumulated other comprehensive loss	(12,943)	(12,605)
Total equity	63,327	57,516
TOTAL LIABILITIES AND EQUITY	\$ 161,184	\$156,061

See accompanying Notes to unaudited Condensed Consolidated Financial Statements

AVIAT NETWORKS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (Unaudited)

(In thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Revenues:				
Revenue from product sales	\$41,956	\$ 37,719	\$81,081	\$ 72,786
Revenue from services	23,132	24,004	44,511	45,119
Total revenues	65,088	61,723	125,592	117,905
Cost of revenues:				
Cost of product sales	26,159	23,784	52,958	47,447
Cost of services	16,439	16,049	32,219	31,272
Total cost of revenues	42,598	39,833	85,177	78,719
Gross margin	22,490	21,890	40,415	39,186
Operating expenses:				
Research and development expenses	5,316	5,144	10,253	9,942
Selling and administrative expenses	14,291	14,104	27,997	27,826
Restructuring charges	—	(252)	796	(250)
Total operating expenses	19,607	18,996	39,046	37,518
Operating income	2,883	2,894	1,369	1,668
Interest income	43	42	94	100
Interest expense	(76)	(13)	(81)	(19)
Other (expense) income, net	—	(136)	—	(166)
Income before income taxes	2,850	2,787	1,382	1,583
Provision for (benefit from) income taxes	540	(2,564)	(178)	(3,203)
Net income	2,310	5,351	1,560	4,786
Less: Net income attributable to noncontrolling interest, net of tax	—	280	—	372
Net income attributable to Aviat Networks	\$2,310	\$ 5,071	\$1,560	\$ 4,414
Net income per share of common stock outstanding:				
Basic	\$0.43	\$ 0.95	\$0.29	\$ 0.83
Diluted	\$0.41	\$ 0.90	\$0.28	\$ 0.79
Weighted-average shares outstanding:				
Basic	5,397	5,329	5,382	5,323
Diluted	5,627	5,624	5,663	5,616
See accompanying Notes to unaudited Condensed Consolidated Financial Statements				

AVIAT NETWORKS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)

(In thousands)	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Net income	\$2,310	\$ 5,351	\$1,560	\$ 4,786
Other comprehensive (loss) income:				
Net change in cumulative translation adjustments	(204)	556	(338)	621
Other comprehensive (loss) income	(204)	556	(338)	621
Comprehensive income	2,106	5,907	1,222	5,407
Less: Comprehensive income attributable to noncontrolling interest, net of tax	—	280	—	372
Comprehensive income attributable to Aviat Networks	\$2,106	\$ 5,627	\$1,222	\$ 5,035

See accompanying Notes to unaudited Condensed Consolidated Financial Statements

AVIAT NETWORKS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)

(In thousands)	Six Months Ended	
	December 28,	December 29,
	2018	2017
Operating Activities		
Net income	\$1,560	\$ 4,786
Adjustments to reconcile net income to net cash (used in) provided by operating activities		
Depreciation and amortization of property, plant and equipment and capitalized software	2,384	2,590
(Recovery from) provision for uncollectible receivables	(212)	14
Share-based compensation	938	1,154
Deferred tax assets, net	169	(2,737)
Charges for inventory and customer service inventory write-downs	156	205
Loss on disposition of property, plant and equipment, net	15	28
Changes in operating assets and liabilities:		
Accounts receivable	(3,336)	3,490
Unbilled receivables	(9,533)	2,626
Inventories	962	(2,098)
Customer service inventories	(23)	(83)
Accounts payable	4,628	(381)
Accrued expenses	(2,735)	(1,672)
Advance payments and unearned revenue	4,205	3,801
Income taxes payable or receivable	139	(232)
Other assets and liabilities	117	(2,320)
Net cash (used in) provided by operating activities	(566)	9,171
Investing Activities		
Payments for acquisition of property, plant and equipment	(3,236)	(3,342)
Net cash used in investing activities	(3,236)	(3,342)
Financing Activities		
Proceeds from borrowings	18,000	18,000
Repayments of borrowings	(18,000)	(18,000)
Payments for repurchase of Company stock	(1,436)	—
Payments for taxes related to net settlement of equity awards	(536)	—
Proceeds from issuance of common stock under employee stock plans	—	11
Net cash (used in) provided by financing activities	(1,972)	11
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	(164)	72
Net (decrease) increase in cash, cash equivalents, and restricted cash	(5,938)	5,912
Cash, cash equivalents and restricted cash, beginning of period	37,764	36,569
Cash, cash equivalents and restricted cash, end of period	\$31,826	\$ 42,481

See accompanying Notes to unaudited Condensed Consolidated Financial Statements

AVIAT NETWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. The Company and Basis of Presentation

The Company

Aviat Networks, Inc. (the “Company,” “we,” “us,” and “our”) designs, manufactures and sells a range of wireless networking solutions and services to mobile and fixed telephone service providers, private network operators, government agencies, transportation and utility companies, public safety agencies and broadcast system operators across the globe. Due to the volume of our international sales, especially in developing countries, we may be susceptible to a number of political, economic and geographic risks that could harm our business as outlined in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended June 29, 2018. Our products include broadband wireless access base stations and customer premises equipment for fixed and mobile, point-to-point digital microwave radio systems for access, backhaul, trunking and license-exempt applications, supporting new network deployments, network expansion, and capacity upgrades.

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP) and with the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial information. Accordingly, the statements do not include all information and footnotes required by U.S. GAAP for annual consolidated financial statements. In the opinion of our management, such interim financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of financial position, results of operations and cash flows for such periods. The results for the three and six months ended December 28, 2018 are not necessarily indicative of the results that may be expected for the full fiscal year or future operating periods. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Consolidated Financial Statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended June 29, 2018.

The unaudited Condensed Consolidated Financial Statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. All intercompany transactions and accounts have been eliminated. We operate on a 52-week or 53-week year ending on the Friday closest to June 30. The first two quarters of fiscal 2019 and fiscal 2018 included 13 weeks in each quarter. Fiscal year 2019 will be comprised of 52 weeks and will end on June 28, 2019.

Use of Estimates

The preparation of unaudited condensed consolidated financial statements in accordance with U.S. GAAP requires us to make estimates, assumptions and judgments affecting the amounts reported and related disclosures. Estimates are based upon historical factors, current circumstances and the experience and judgment of our management. We evaluate our estimates and assumptions on an ongoing basis and may employ outside experts to assist us in making these evaluations. Changes in such estimates, based on more accurate information, or different assumptions or conditions, may affect amounts reported in future periods. Such estimates affect significant items, including revenue recognition, provision for uncollectible receivables, inventory valuation, valuation allowances for deferred tax assets, uncertainties in income taxes, restructuring obligations, product warranty obligations, share-based awards, contingencies, recoverability of long-lived assets and useful lives of property, plant and equipment.

Summary of Significant Accounting Policies

There have been no material changes in our significant accounting policies as of and for the six months ended December 28, 2018, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended June 29, 2018, with the exception of our revenue recognition policy. Effective June 30, 2018, we adopted Accounting Standards Update (ASU) No. 2014-09 (Accounting Standards Codification 606 or ASC 606), Revenue from Contracts with Customers, as amended. See Note 3, “Revenue Recognition” to the Notes to unaudited Condensed Consolidated Financial Statements for discussion of the impact of the adoption of this standard on our

policies for revenue.

7

Comparability

We adopted ASC 606, effective June 30, 2018, using the modified retrospective method. Prior-period financial statements were not retrospectively restated. The Consolidated Balance Sheet as of June 29, 2018 and results of operations for the three and six months ended December 29, 2017 were prepared using accounting standards that were different than those in effect for the three and six months ended December 28, 2018. As a result, the balance sheets as of December 28, 2018 and June 29, 2018 are not directly comparable, nor are the results of operations for the three and six months ended December 28, 2018 and December 29, 2017.

Accounting Standards Adopted

In May 2014, the Financial Accounting Standards Board (FASB) issued ASC 606 which supersedes nearly all current U.S. GAAP guidance on this topic and eliminates industry-specific guidance. Revenue recognition under ASC 606 depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Additional disclosures are required to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. In addition, the FASB amended its guidance related to the capitalization and amortization of the incremental costs of obtaining a contract with a customer. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized in retained earnings as of the date of adoption. We adopted ASC 606 using the modified retrospective method as of June 30, 2018 with the cumulative effect recognized as an adjustment to the opening balance of our accumulated deficit (net of tax). Prior periods have not been retroactively adjusted and will continue to be reported under the accounting standards in effect for those periods. See Note 3, "Revenue Recognition" to the Notes to unaudited Condensed Consolidated Financial Statements for more information.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. This guidance retains the current accounting for classifying and measuring investments in debt securities and loans but requires equity investments to be measured at fair value with subsequent changes recognized in net income, except for those accounted for under the equity method or requiring consolidation. The guidance also changes the accounting for investments without a readily determinable fair value and do not qualify for the practical expedient to estimate fair value. A policy election can be made for these investments whereby estimated fair value may be measured at cost and adjusted in subsequent periods for any impairment or changes in observable prices of identical or similar investments. This ASU is effective for fiscal years beginning after December 15, 2017. We adopted this update during the first quarter of fiscal 2019. The adoption had no material impact on our unaudited Condensed Consolidated Financial Statements.

Accounting Standards Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) and subsequent amendments to the initial guidance: ASU 2018-10, Codification Improvements to Topic 842, Leases, and ASU 2018-11, Leases (Topic 842) Targeted Improvements, each issued in July 2018 (collectively, Topic 842), all of which provides guidance on the recognition, measurement, presentation, and disclosure of leases. Topic 842 requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance. This standard will become effective for fiscal years beginning after December 15, 2018 including interim periods within those years, with early adoption permitted. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee have not significantly changed from previous guidance. Although we are currently evaluating the impact the pronouncement will have on our unaudited Condensed Consolidated Financial Statements and related disclosures, we expect that most of our operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon adoption.

In June 2018, the FASB issued ASU 2018-07, Compensation-Stock Compensation: Improvement to Nonemployees Share-Based Payment Accounting (ASU 2018-07), which expands the scope of Topic 718 to include all share-based payment transactions for acquiring goods and services from nonemployees. ASU 2018-07 specifies that Topic 718 applies to all share-based payment transactions in which the grantor acquires goods and services to be used or consumed in its own operations by issuing share-based payment awards. ASU 2018-07 also clarifies that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in

conjunction with selling goods or services to customers as part of a contract accounted for under ASC 606. ASU 2018-07 will be effective for fiscal years beginning after December 15, 2018, including interim periods within those years, with early adoption permitted. We do not expect the adoption of this guidance will have a material impact on our unaudited Condensed Consolidated Financial Statements.

In August 2018, the SEC adopted the final rule under SEC Release No. 33-10532, Disclosure Update and Simplification, amending certain disclosure requirements that were redundant, duplicative, overlapping, outdated or superseded. In addition,

the amendments expanded the disclosure requirements on the analysis of stockholders' equity for interim financial statements. Under the amendments, an analysis of changes in each caption of stockholders' equity presented in the balance sheet must be provided in a note or separate statement. The analysis should present a reconciliation of the beginning balance to the ending balance of each period for which a statement of comprehensive income is required to be filed. Our first presentation of changes in stockholders' equity will be included in our Form 10-Q for the quarter ending March 29, 2019.

In August 2018, the FASB issued ASU 2018-15, Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract. This guidance aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. This standard will become effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted. The standard can be adopted either using the prospective or retrospective transition approach. We are evaluating the effect the adoption of the standard will have on our unaudited Condensed Consolidated Financial Statements.

Note 2. Net Income Per Share of Common Stock

Net income per share is computed using the two-class method, by dividing net income attributable to us by the weighted-average number of shares of our outstanding common stock and participating securities outstanding. Our restricted shares contain rights to receive non-forfeitable dividends and therefore are considered to be participating securities and included in the calculations of net income per basic and diluted common share. Undistributed losses are not allocated to unvested restricted shares as the unvested restricted shares are not contractually obligated to share our losses. The impact on earnings per share of the participating securities under the two-class method was immaterial. The following table presents the computation of basic and diluted net income per share attributable to our common stockholders:

(In thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	December 29, 2018	December 29, 2017	December 29, 2018	December 29, 2017
Numerator:				
Net income attributable to Aviat Networks	\$2,310	\$ 5,071	\$1,560	\$ 4,414
Denominator:				
Weighted-average shares outstanding, basic	5,397	5,329	5,382	5,323
Effect of potentially dilutive equivalent shares	230	295	281	293
Weighted-average shares outstanding, diluted	5,627	5,624	5,663	5,616
Net income per share of common stock outstanding:				
Basic	\$0.43	\$ 0.95	\$0.29	\$ 0.83
Diluted	\$0.41	\$ 0.90	\$0.28	\$ 0.79

The following table summarizes the weighted-average equity awards that were excluded from the diluted net income per share calculations since they were anti-dilutive:

(In thousands)	Three Months Ended		Six Months Ended	
	December 29, 2018	December 29, 2017	December 29, 2018	December 29, 2017
Stock options	412	357	376	341
Restricted stock units and performance stock units	52	—	32	—
Total shares of common stock excluded	464	357	408	341

Note 3. Revenue Recognition

Effective June 30, 2018, we adopted ASC 606, using the modified retrospective method applied to those contracts that were not completed as of June 29, 2018. Results for the reporting periods after June 29, 2018 are presented under ASC 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historical accounting under ASC 605.

We recognize revenue by applying the following five-step approach: (1) identification of the contract with a customer; (2) identification of the performance obligations in the contract; (3) determination of the transaction price; (4) allocation of the transaction price to the performance obligations in the contract; and (5) recognition of revenue when, or as, we satisfy a performance obligation.

Revenue from product sales is generated predominately from the sales of products manufactured by third-party manufacturers to whom we have outsourced our manufacturing processes. Printed circuit assemblies, mechanical housings, and packaged modules are manufactured by contract manufacturing partners, with periodic business reviews of material levels and obsolescence. Product assembly, product testing, complete system integration and system testing may either be performed within our own facilities or at the locations of our third-party manufacturers. Revenue from services includes certain installation, extended warranty, customer support, consulting, training and education. It also can include certain revenue generated from the resale of installation materials purchased on behalf of customers for installation service contracts we perform for customers. Maintenance and support services are generally offered to our customers over a specified period of time and from sales and subsequent renewals of maintenance and support contracts.

Contracts and customer purchase orders are used to determine the existence of an arrangement. In addition, shipping documents and customer acceptances, when applicable, are used to verify delivery and transfer of control. We typically satisfy our performance obligations upon shipment or delivery of product depending on the contractual terms. Payment terms to customers generally range from net 30 to 120 days from invoice, which are considered to be standard payment terms. We assess our ability to collect from our customers based primarily on the creditworthiness and past payment history of the customer.

While our customers do not have the right of return, we reserve for estimated product returns as an offset to revenue based primarily on historical trends. Actual product returns may be different than what was estimated. These factors and unanticipated changes in economic and industry condition could make actual results differ from our return estimates.

We present transactional taxes such as sales and use tax collected from customers and remitted to government authorities on a net basis.

ASC 606 Adoption

We recorded a net reduction to the opening balance of our accumulated deficit of \$5.6 million as of June 30, 2018 due to the cumulative impact of adopting ASC 606, with the impact primarily related to our bill-and-hold and services revenue. Our revenue was \$65.1 million and \$125.6 million for the three and six months ended December 28, 2018, respectively, under ASC 606, compared to \$63.0 million and \$112.9 million, respectively, under ASC 605. The details of the significant changes and quantitative impact of our adoption of ASC 606 are set out below:

Bill-and-Hold Sales: Certain customer arrangements consist of bill-and-hold characteristics under which transfer of control has been met (including the passing of title and significant risk and reward of ownership to the customers). Therefore, the customers can direct the use of the bill-and-hold inventory while we retain physical possession of the product until it is installed at a customer site at a point in time in the future. The change under ASC 606 requires consideration of the indicators of when control has been transferred and sets forth additional criteria to be met in a bill-and-hold arrangement potentially resulting in revenue being recognized earlier than under ASC 605. Upon adoption of ASC 606, we recorded a cumulative effect adjustment to June 30, 2018 opening accumulated deficit consisting of bill-and-hold backlog of \$10.5 million that will not be recognized as revenue, less related cost of product sales and income taxes, resulting in a net decrease to accumulated deficit of \$1.7 million.

•

Professional Services Revenue: We historically recognized certain professional services revenue upon completion under ASC 605 which changed to over time revenue recognition under ASC 606. We use the input method based on costs incurred, where revenue is calculated based on the percentage of total costs incurred in relation to total estimated costs at completion of the contract. The input method is reasonable because the costs incurred best reflect our efforts toward

10

satisfying the performance obligation over time. The use of the input method requires us to make reasonably dependable estimates. Upon adoption of ASC 606, we recorded a cumulative effect adjustment to June 30, 2018 opening accumulated deficit of \$4.7 million that will not be recognized as revenue, less related cost of services and income taxes resulting in a net decrease to accumulated deficit of \$1.6 million.

Transfer of Control: Certain of our contracts include penalties, acceptance provisions or other price variability that precluded revenue recognition under ASC 605 because of the requirement for amounts to be fixed or determinable. ASC 606 requires us to estimate and account for variable consideration as a reduction of the transaction price. Upon adoption of ASC 606, we recorded a cumulative effect adjustment to June 30, 2018 opening accumulated deficit of \$0.6 million that will not be recognized as revenue, less related cost of revenues and income taxes resulting in a net decrease to accumulated deficit of \$0.4 million.

In addition, revenue allocation under ASC 606 requires an allocation of revenue between deliverables, or performance obligations, within an arrangement. Under ASC 605, the allocation of revenue was restricted to the amount which was not contingent on future deliverables; however, ASC 606 removes this restriction. Upon adoption of ASC 606, we recorded a cumulative effect adjustment to decrease June 30, 2018 opening accumulated deficit by \$0.5 million.

Under ASC 605, we deferred revenue for stand-alone software licenses where vendor-specific objective evidence (VSOE) of fair value had not been established for undelivered items, and revenue was recognized straight line over the term of the maintenance agreement. Under ASC 606, software revenue is allocated to delivered and undelivered elements based on relative fair value resulting in more software arrangement revenue being recognized earlier. Upon adoption of ASC 606, we recorded a cumulative effect adjustment to decrease June 30, 2018 opening accumulated deficit by \$0.7 million.

Previously, we expensed the majority of our commission expense as incurred. Under the new standard, we capitalize and amortize incremental commission costs to obtain the contract over a benefit period. We elected a practical expedient to exclude contracts with a benefit period of a year or less from this deferral requirement. Upon adoption of ASC 606, we recorded a cumulative effect adjustment to decrease June 30, 2018 opening accumulated deficit by \$0.7 million.

Termination Rights

The contract term is determined on the basis of the period over which the parties to the contract have present enforceable rights and obligations. Certain customer contracts include a termination for convenience clause that allows the customer to terminate services without penalty, upon advance notification. We concluded that the duration of support contracts does not extend beyond the non-cancellable portion of the contract.

Variable Consideration

The consideration associated with customer contracts is generally fixed. Variable consideration includes discounts, rebates, refunds, credits, incentives, penalties, or other similar items. The amount of consideration that can vary is not a substantial portion of total consideration.

Variable consideration estimates will be re-assessed at each reporting period until a final outcome is determined. The changes to the original transaction price due to a change in estimated variable consideration will be applied on a retrospective basis, with the adjustment recorded in the period in which the change occurs. Changes to variable consideration will be tracked and material changes disclosed.

Stand-alone Selling Price

Stand-alone selling price is the price at which an entity would sell a good or service on a stand-alone (or separate) basis at contract inception. Under the model, the observable price of a good or service sold separately provides the best evidence of stand-alone selling price. However, in certain situations, stand-alone selling prices will not be readily observable and the entity must estimate the stand-alone selling price.

When allocating on a relative stand-alone selling price basis, any discount provided in the contract is allocated proportionately to all of the performance obligations in the contract.

The majority of products and services that we offer have readily observable selling prices. For products and services that do not, we estimate stand-alone selling price using the market assessment approach based on expected selling price and adjust those prices as necessary to reflect our costs and margins. As part of our stand-alone selling price

policy, we review product pricing on a periodic basis to identify any significant changes and revise our expected selling price assumptions as appropriate.

11

Shipping and Handling

Shipping and handling costs are included as a component of costs of product sales in our unaudited Condensed Consolidated Statements of Operations because they are also included in revenue that we bill our customers.

Costs to Obtain a Contract

We have assessed the treatment of costs to obtain or fulfill a contract with a customer. Sales commissions have historically been expensed as incurred. Under ASC 606, we capitalize sales commissions related to multi-year service contracts and amortize the asset over the period of benefit, which is the estimated service period. Sales commissions paid on contract renewals, including service contract renewals, is commensurate with the sales commissions paid on the initial contracts.

We elected ASC 606's practical expedient to expense sales commissions as incurred when the amortization period of the related asset is one year or less. These costs are recorded as sales and marketing expense and included on the unaudited Condensed Consolidated Balance Sheet as accrued expenses until paid.

Contract Balances

The following table provides information about receivables and liabilities from contracts with customers (in thousands):

	December 28, 2018	At Adoption on June 30, 2018
Contract Assets		
Accounts receivable, net	\$ 48,624	\$ 45,571
Unbilled receivables	\$ 32,336	\$ 22,794
Capitalized commissions	\$ 627	\$ 656
Contract Liabilities		
Advance payments and unearned revenue	\$ 15,846	\$ 12,700
Unearned revenue, long-term	\$ 7,721	\$ 7,295

As of December 28, 2018, we had \$23.6 million in advance payments and unearned revenue and long-term unearned revenue, of which approximately 40% is expected to be recognized as revenue in the next six months of fiscal year 2019 and the remainder thereafter. During the three and six months ended December 28, 2018, we recognized approximately \$2.4 million and \$5.4 million, respectively, in maintenance service revenue, which was included in unearned revenue at June 29, 2018.

Impacts on Financial Statements

The following tables summarize the impacts of adopting ASC 606 on the unaudited Condensed Consolidated Statements of Operations for the three and six months ended December 28, 2018 and our Consolidated Balance Sheet as of June 29, 2018 (in thousands):

	Three Months Ended December 28, 2018		
	As Reported	Adjustments	Balances without Adoption of ASC 606
Income Statement			
Revenues:			
Revenue from product sales	\$41,956	\$ (1,574)	\$ 40,382
Revenue from services	23,132	(519)	22,613
Total revenues	\$65,088	\$ (2,093)	\$ 62,995
Cost of revenues:			
Cost of product sales	\$26,159	\$ (357)	\$ 25,802
Cost of services	16,439	(744)	15,695
Total cost of revenues	\$42,598	\$ (1,101)	\$ 41,497
Selling and administrative expenses	\$14,291	\$ 52	\$ 14,343
Net income	\$2,310	\$ (1,241)	\$ 1,069

	Six Months Ended December 28, 2018		
	As Reported	Adjustments	Balances without Adoption of ASC 606
Income Statement			
Revenues:			
Revenue from product sales	\$81,081	\$ (10,519)	\$ 70,562
Revenue from services	44,511	(2,143)	42,368
Total revenues	\$125,592	\$ (12,662)	\$ 112,930
Cost of revenues:			
Cost of product sales	\$52,958	\$ (5,728)	\$ 47,230
Cost of services	32,219	(1,530)	30,689
Total cost of revenues	\$85,177	\$ (7,258)	\$ 77,919
Selling and administrative expenses	\$27,997	\$ (35)	\$ 27,962
Net income (loss)	\$1,560	\$ (5,320)	\$ (3,760)

See Note 9, "Segment and Geographic Information" to the Notes to unaudited Condensed Consolidated Financial Statements for discussion on the impact of additional information, including disaggregated revenue disclosures.

	Balances as of June 29, 2018	Adjustments due to ASC 606	As Adjusted Balances at June 30, 2018
Balance Sheet			
Assets			
Accounts receivable, net	\$43,068	\$ 2,503	\$45,571
Unbilled receivables	\$14,167	\$ 8,627	\$22,794
Inventories	\$21,290	\$ (11,516)	\$9,774
Other current assets	\$6,006	\$ 476	\$6,482
Deferred income taxes	\$5,600	\$ (545)	\$5,055
Other assets	\$9,816	\$ 180	\$9,996
Liabilities			
Advance payments and unearned revenue	\$19,300	\$ (6,600)	\$12,700
Unearned revenue - long term	\$6,593	\$ 702	\$7,295
Equity			
Accumulated deficit	\$(746,359)	\$ 5,623	\$(740,736)

The effects of the adoption of the new revenue recognition guidance on our December 28, 2018 unaudited Condensed Consolidated Balance Sheet were as follows:

	As of December 28, 2018		
	As Reported	Adjustments due to ASC 606	Balances without adoption of ASC 606
Balance Sheet			
Assets			
Accounts receivable, net	\$48,624	\$ (4,505)	\$44,119
Unbilled receivables	\$32,336	\$ (15,177)	\$17,159
Inventories	\$8,593	\$ 18,785	\$27,378
Other current assets	\$4,873	\$ (375)	\$4,498
Deferred income taxes	\$5,127	\$ 545	\$5,672
Other assets	\$11,957	\$ (252)	\$11,705
Liabilities			
Accrued expenses	\$22,663	\$ (80)	\$22,583
Advance payments and unearned revenue	\$15,846	\$ 11,138	\$26,984
Unearned revenue - long term	\$7,721	\$ (1,055)	\$6,666
Reserve for uncertain tax positions	\$3,403	\$ (39)	\$3,364
Equity			
Accumulated deficit	\$(739,176)	\$ (10,943)	\$(750,119)

Note 4. Balance Sheet Components

Cash, Cash Equivalents and Restricted Cash

The following table provides a summary of our cash, cash equivalents and restricted cash reported within the Condensed Consolidated Balance Sheets that reconciles to the corresponding amount in the Condensed Consolidated Statement of Cash Flows:

(In thousands)	December 28, 2018	June 29, 2018
Cash and cash equivalents	\$ 31,542	\$37,425
Restricted cash	3	3
Restricted cash included in Other assets	281	336
Total cash, cash equivalents, and restricted cash in the Statement of Cash Flows	\$ 31,826	\$37,764

Accounts Receivable, net

Our net accounts receivable are summarized below:

(In thousands)	December 28, 2018	June 29, 2018
Accounts receivable	\$ 50,642	\$44,656
Less: Allowances for collection losses	(2,018)	(1,588)
Total accounts receivable, net	\$ 48,624	\$43,068

Inventories

Our inventories are summarized below:

(In thousands)	December 28, 2018	June 29, 2018
Finished products	\$ 5,371	\$15,496
Work in process	—	3,246
Raw materials and supplies	3,222	2,548
Total inventories	\$ 8,593	\$21,290
Deferred cost of revenue included within finished goods	\$ 432	\$3,667
Consigned inventories included within raw materials and supplies	\$ 1,700	\$1,492

We record recovery or charges to adjust our inventory and customer service inventory due to excess and obsolete inventory resulting from lower sales forecast, product transitioning or discontinuance. During the three and six months ended December 28, 2018, we recorded a net recovery of \$221,000 and \$246,000, respectively, in each case related to previously reserved inventory due to sell through. Such recovery or charges during the three and six months ended December 28, 2018 and December 29, 2017 were classified in cost of product sales as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Excess and obsolete inventory (recovery) charges	\$(221)	\$ 106	\$(246)	\$ (143)
Customer service inventory write-downs	200	158	402	348
Total inventory (recovery) charges	\$(21)	\$ 264	\$156	\$ 205

Property, Plant and Equipment, net

Our property, plant and equipment, net are summarized below:

(In thousands)	December 28, June 29,	
	2018	2018
Land	\$ 710	\$710
Buildings and leasehold improvements	11,644	11,597
Software	17,130	15,498
Machinery and equipment	47,990	48,076
Total property, plant and equipment, gross	77,474	75,881
Less accumulated depreciation and amortization	(60,458)	(58,702)
Total property, plant and equipment, net	\$ 17,016	\$17,179

Depreciation and amortization expense related to property, plant and equipment, including amortization of software developed for internal use, was as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Depreciation and amortization	\$1,096	\$ 1,308	\$2,384	\$ 2,590

Accrued Expenses

Our accrued expenses are summarized below:

(In thousands)	December 28, June 29,	
	2018	2018
Accrued compensation and benefits	\$ 7,479	\$8,574
Accrued agent commissions	1,925	1,774
Accrued warranties	3,416	3,196
Other	9,843	12,320
Total accrued expenses	\$ 22,663	\$25,864

Accrued Warranties

We accrue for the estimated cost to repair or replace products under warranty. Changes in our warranty liability, which is included as a component of accrued expenses in the unaudited Condensed Consolidated Balance Sheets were as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Balance as of the beginning of the period	\$3,216	\$ 2,964	\$3,196	\$ 3,056
Warranty provision recorded during the period	620	797	1,166	1,228
Consumption during the period	(420)	(593)	(946)	(1,116)
Balance as of the end of the period	\$3,416	\$ 3,168	\$3,416	\$ 3,168

Advance payments and Unearned Revenue

Our advance payments and unearned revenue are summarized below:

(In thousands)	December 28, June 29,	
	2018	2018
Advance payments	\$ 2,166	\$7,151
Unearned revenue	13,680	12,149
Total advance payments and unearned revenue	\$ 15,846	\$19,300

Note 5. Fair Value Measurements of Assets and Liabilities

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal market (or most advantageous market, in the absence of a principal market) for the asset or liability in an orderly transaction between market participants as of the measurement date. We maximize the use of observable inputs and minimize the use of unobservable inputs in measuring fair value and establish a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. The three levels of inputs used to measure fair value are as follows:

Level 1 — Observable inputs such as quoted prices in active markets for identical assets or liabilities;

Level 2 — Observable market-based inputs or observable inputs that are corroborated by market data;

and

Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The carrying amounts, estimated fair values, and valuation input levels of our assets and liabilities that are measured at fair value on a recurring basis as of December 28, 2018 and June 29, 2018 were as follows:

(In thousands)	December 28, 2018		June 29, 2018		Valuation Inputs
	Carrying Fair Amount	Fair Value	Carrying Fair Amount	Fair Value	
Assets:					
Cash and cash equivalents:					
Money market funds	\$14,079	\$14,079	\$13,871	\$13,871	Level 1
Bank certificates of deposit	\$1,577	\$1,577	\$1,645	\$1,645	Level 2
Other current assets:					
Foreign exchange forward contracts	\$3	\$3	\$—	\$—	Level 2
Liabilities:					
Other accrued expenses:					
Foreign exchange forward contracts	\$7	\$7	\$158	\$158	Level 2

We classify items within Level 1 if quoted prices are available in active markets. Our Level 1 items mainly are money market funds. As of December 28, 2018 and June 29, 2018, these money market funds were valued at \$1.00 net asset value per share.

We classify items in Level 2 if the observable inputs to quoted market prices, benchmark yields, reported trades, broker/dealer quotes or alternative pricing sources are available with reasonable levels of price transparency. Our bank certificates of deposit and foreign exchange forward contracts are classified within Level 2. Foreign currency forward contracts are measured at fair value using observable foreign currency exchange rates. The changes in fair value related to our foreign currency forward contracts were recorded in cost of revenues on our unaudited Condensed Consolidated Statements of Operations.

As of December 28, 2018 and June 29, 2018, we did not have any recurring assets or liabilities that were valued using significant unobservable inputs.

Our policy is to recognize asset or liability transfers among Level 1, Level 2 and Level 3 as of the actual date of the events or change in circumstances that caused the transfer. During the first six months of fiscal 2019 and 2018, we had no transfers between levels of the fair value hierarchy of our assets or liabilities measured at fair value.

Note 6. Credit Facility and Debt

On June 29, 2018, we entered into a Third Amended and Restated Loan Agreement with Silicon Valley Bank (the SVB Credit Facility). The SVB Credit Facility expires on June 29, 2019. The SVB Credit Facility provides for a \$30.0 million accounts receivable formula-based revolving credit facility that can be borrowed by our U.S. company, with a \$30.0 million sublimit that can be borrowed by our Singapore subsidiary. Loans may be advanced under the SVB Credit Facility based on a borrowing base equal to a specified percentage of the value of eligible accounts of the borrowers under the SVB Credit Facility. The borrowing base is subject to certain eligibility criteria. Availability under the SVB Credit Facility can also be utilized to issue letters of credit with a \$12.0 million sublimit. We may prepay loans under the SVB Credit Facility in whole or in part at any time without premium or penalty. As of December 28, 2018, available credit under the SVB Credit Facility was \$15.7 million, reflecting the calculated borrowing base of \$25.5 million less existing borrowings of \$9.0 million and outstanding letters of credit of \$0.8 million.

The SVB Credit Facility carries an interest rate computed, at our option, based on either (i) at the prime rate reported in the Wall Street Journal plus a spread of 0.50% to 1.50%, with such spread determined based on our adjusted quick ratio; or (ii) if we satisfy a minimum adjusted quick ratio, a LIBOR rate determined in accordance with the SVB Credit Facility, plus a spread of 2.75%. Any outstanding Singapore subsidiary borrowed loans shall bear interest at an additional 2.00% above the applicable prime or LIBOR rate. During the first six months of fiscal 2019, the weighted-average interest rate on our outstanding loan was 5.89%. As of December 28, 2018 and June 29, 2018, our outstanding debt balance under the SVB Credit Facility was \$9.0 million, and the interest rate was 6.00% and 5.50%, respectively.

The SVB Credit Facility contains quarterly financial covenants including minimum adjusted quick ratio and minimum profitability (EBITDA) requirements. In the event our adjusted quick ratio falls below a certain level, cash received in our accounts with Silicon Valley Bank may be directly applied to reduce outstanding obligations under the SVB Credit Facility. The SVB Credit Facility also imposes certain restrictions on our ability to dispose of assets, permit a change in control, merge or consolidate, make acquisitions, incur indebtedness, grant liens, make investments, make certain restricted payments and enter into transactions with affiliates under certain circumstances. Certain of our assets, including accounts receivable, inventory, and equipment, are pledged as collateral for the SVB Credit Facility. Upon an event of default, outstanding obligations would be immediately due and payable. Under certain circumstances, a default interest rate will apply on all obligations during the existence of an event of default at a per annum rate of interest equal to 5% above the applicable interest rate. As of December 28, 2018, we were in compliance with the quarterly financial covenants, as amended, contained in the SVB Credit Facility. The \$9.0 million borrowing was classified as a current liability as of December 28, 2018 and June 28, 2019.

On September 28, 2018, we entered into Amendment No. 1 (the Amendment) to the Third Amended and Restated Loan and Security Agreement with Silicon Valley Bank. Among other things, the Amendment provides for the definition of Quick Assets set forth in the Agreement to be modified to include up to the lesser of (a) 50% of unbilled accounts receivable or (b) \$7.0 million.

In addition, we have a short-term line of credit for up to \$0.4 million from a bank in New Zealand to support the operations of our subsidiary located there. This line of credit provides for up to \$0.3 million in short-term advances at various interest rates, all of which was available as of December 28, 2018 and June 29, 2018. The line of credit also provides for the issuance of standby letters of credit and company credit cards, of which \$0.1 million was outstanding as of December 28, 2018. This line of credit may be terminated upon notice, is reviewed annually for renewal or modification, and is supported by a corporate guarantee.

Note 7. Restructuring Activities

The following table summarizes our restructuring-related activities during the first six months of fiscal 2019:

(In thousands)	Severance and Benefits				Facilities and Other	Total
	Fiscal 2018-2019 Plan	Fiscal 2016-2017 Plan	Fiscal 2015-2016 Plan	Fiscal 2013-2014 Plan	Fiscal 2015-2016 Plan	
Accrual balance, June 29, 2018	\$ 1,532	\$ 14	\$ 36	\$ 64	\$ 266	\$ 1,912
Charges, net	796	—	—	—	—	796
Cash payments	(227)	(12)	(36)	—	(23)	(298)
Foreign exchange impact	—	—	—	—	2	2
Accrual balance, September 28, 2018	2,101	2	—	64	245	2,412
Cash payments	(242)	—	—	—	—	(242)
Foreign exchange impact	—	—	—	—	(6)	(6)
Accrual balance, December 28, 2018	\$ 1,859	\$ 2	\$ —	\$ 64	\$ 239	\$ 2,164

As of December 28, 2018, \$1.6 million of the accrual balance was in short-term restructuring liabilities while \$0.6 million was included in other long-term liabilities on the unaudited Condensed Consolidated Balance Sheets. We expect to substantially complete the restructuring activities under our fiscal 2018-2019 restructuring plan (Fiscal 2018-2019 Plan) by the end of fiscal 2019. Payments related to the accrued restructuring liability balance for this plan are expected to be fully paid by the end of fiscal 2020.

For further information, see “Note 7. Restructuring Activities” in Part II, Item 8 of our 2018 Form 10-K.

Note 8. Equity

Stock Repurchase Program

In May 2018, our board of directors approved a repurchase program, which does not have an expiration date, for the repurchase of up to \$7.5 million of our common stock.

The following table summarizes the repurchases of our common stock:

(In thousands, except share amounts)	Three Months Ended	Six Months Ended
	December 28, 2018	December 28, 2018
Number of shares repurchased	68,006	91,585
Aggregate purchase price, including commissions	\$ 1,049	\$ 1,439

All repurchased shares were retired. As of December 28, 2018, \$6.1 million remained available under our stock repurchase program.

Stock Incentive Programs

As of December 28, 2018, we had two stock incentive plans (both Plans) for our employees and nonemployee directors, the 2018 Incentive Plan and the 2007 Stock Equity Plan, as amended and restated effective November 13, 2015. The 2018 Incentive Plan was approved by the stockholders during the fiscal year 2017 Annual Stockholders’ Meeting and it added 500,000 shares to the equity pool of shares available to grant to employees. During the three months ended December 28, 2018, we issued 15,584 restricted stock units. During the three months ended September 28, 2018, we issued 78,236 performance restricted stock units and 156,466 options to purchase shares of our common stock.

Total compensation expense for share-based awards included in our unaudited Condensed Consolidated Statements of Operations was as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
By Expense Category:				
Cost of revenues	\$ 52	\$ 55	\$ 100	\$ 99
Research and development	45	39	81	78
Selling and administrative	405	486	757	977
Total share-based compensation expense	\$ 502	\$ 580	\$ 938	\$ 1,154
By Types of Award:				
Options	\$ 116	\$ 34	\$ 155	\$ 68
Restricted and performance stock awards and units	386	546	783	1,086
Total share-based compensation expense	\$ 502	\$ 580	\$ 938	\$ 1,154

As of December 28, 2018, there was approximately \$1.3 million of total unrecognized compensation expense related to nonvested stock options granted under both Plans. This expense is expected to be recognized over a weighted-average period of 2.69 years. As of December 28, 2018, there was \$1.4 million of total unrecognized compensation expense related to nonvested stock awards and units granted under both Plans. This expense is expected to be recognized over a weighted-average period of 1.08 year.

Note 9. Segment and Geographic Information

We operate in one reportable business segment: the design, manufacturing and sale of a range of wireless networking products, solutions and services. We conduct business globally and our sales and support activities are managed on a geographic basis. Our Chief Executive Officer is our Chief Operating Decision Maker.

We report revenue by region and country based on the location where our customers accept delivery of our products and services. Revenue by region for the three and six months ended December 28, 2018 and December 29, 2017 was as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
North America ⁽¹⁾	\$37,316	\$ 36,985	\$65,079	\$ 67,987
Africa and the Middle East ⁽¹⁾	13,832	12,682	27,979	26,144
Europe and Russia ⁽¹⁾	3,233	3,814	6,945	8,260
Latin America and Asia Pacific ⁽¹⁾	10,707	8,242	25,589	15,514
Total revenue	\$65,088	\$ 61,723	\$125,592	\$ 117,905

⁽¹⁾ Prior-period amounts have not been adjusted under the modified retrospective method for the adoption of ASC 606. During both the three and six months ended December 28, 2018, Mobile Telephone Networks Group (MTN Group) accounted for 12% of our total revenue. During the three and six months ended December 29, 2017, MTN Group accounted for 11% and 13%, respectively, of our total revenue. As of December 28, 2018 and June 29, 2018, MTN Group also accounted for 20% and 13%, respectively, of our accounts receivable. No other customers accounted for more than 10% of our revenue or accounts receivable for the periods presented. We have entered into separate and distinct contracts with MTN Group, as well as separate arrangements with their various subsidiaries. The loss of all business from MTN Group, or any other significant customers, could adversely affect our unaudited Condensed Consolidated Financial Statements.

Note 10. Income Taxes

Our effective tax rate varies from the U.S. federal statutory rate of 21% due to results of foreign operations that are subject to income taxes at different statutory rates, certain jurisdictions where we cannot recognize tax benefits on current losses, and

tax benefit from release of valuation allowance. During interim periods, we accrue tax expenses for jurisdictions that are anticipated to be profitable for fiscal 2019.

The determination of our income taxes for the six months ended December 28, 2018 and December 29, 2017 was based on our estimated annual effective tax rate adjusted for losses in certain jurisdictions for which no tax benefit can be recognized. The tax benefit for the six months ended December 28, 2018 was primarily due to tax expense related to profitable subsidiaries, net against the release of valuation allowance due to the potential foreign tax refund to be received from the Department of Federal Revenue of Brazil. The tax benefit for the six months ended December 29, 2017 was primarily due to the foreign tax refunds received from the Inland Revenue Authority of Singapore (IRAS) and the release of valuation allowance related to the refundable alternative minimum tax credit as provided under the Tax Cuts and Jobs Act (the Tax Act), offset by tax expense related to profitable subsidiaries.

Due to the uncertainty regarding the timing and extent of our future profitability, we continue to record a full valuation allowance to offset our U.S. deferred tax assets which primarily represent future income tax benefits associated with our operating losses because we do not currently believe that it is more likely than not that these assets will be realized. In the future, if we conclude that sufficient positive evidence (including our estimate of future taxable income) exists to support a reversal of all or a portion of the valuation allowance, we expect that a significant portion of any release of the valuation allowance will be recorded as an income tax benefit at the time of release.

We entered into a tax sharing agreement with Harris Corporation (Harris) effective on January 26, 2007, the acquisition date of Stratex. The sharing agreement addresses, among other things, the settlement process associated with pre-merger tax liabilities and tax attributes that were attributable to the Microwave Communication Division when it was a division of Harris. There were no settlement payments recorded since the acquisition date.

During the first quarter of fiscal 2019, we received notification from the Department of Federal Revenue of Brazil that our withholding tax refund request had been approved. We recorded a net discrete income tax benefit of \$1.6 million for the release of valuation allowance previously recorded as a deferred tax asset for the withholding tax credits. This consisted of an income tax benefit of \$1.9 million for the refundable withholding tax credit, less tax expense of \$0.3 million from recognizing an ASC 740-10 reserve previously recorded as a reduction to the withholding tax credits. During the three months ended December 28, 2018, we reduced the refundable withholding tax credit to \$1.8 million, primarily due to foreign exchange differences, and recorded a discrete income tax expense of \$0.1 million.

We have a number of open income tax audits covering various tax years, which vary from jurisdiction to jurisdiction. Our major tax jurisdictions where audits are pending include Singapore, Nigeria, and Saudi Arabia. The earliest years that are open and subject to potential audits are as follows: U.S. - 2003; Singapore - 2011; Nigeria - 2011; Saudi Arabia - 2010, and Ivory Coast - 2016.

We account for interest and penalties related to unrecognized tax benefits as part of our provision for federal, foreign and state income taxes. Such interest expense was not material for the three and six months ended December 28, 2018 and December 29, 2017.

On December 22, 2017, the SEC staff issued Staff Accounting Bulletin (SAB) No. 118, which provides guidance on accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Tax Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in its financial statements. If a company cannot determine a provisional estimate to be included in its financial statements, it should continue to apply ASC 740 on the basis of the provisions of the tax laws that were in effect immediately before the enactment of the Tax Act.

In connection with our initial analysis of the impact of the Tax Act, we recorded provisional estimates related to the remeasurement of deferred taxes and the Deemed Repatriation Transition Tax in our financial statements for our fiscal year ended June 29, 2018. The measurement period ended in the second quarter of fiscal 2019. As of December 28, 2018, we have completed the accounting for the impact of the Tax Act based on the guidance, interpretations, and data available. No adjustments to these provisional estimates have been recorded. Although the measurement period has

closed, the accounting for the impact of the Tax Act may change to account for additional factors such as the issuance of further regulatory guidance, changes in interpretations, the collection and analysis of additional information, and any deferred adjustments related to the filing of our 2017 federal and state income tax returns. In accordance with ASC 740, we will recognize any additional effects of the guidance in income tax expense (benefit) in the period that such guidance is issued.

For tax years beginning after December 31, 2017, the Tax Act introduced new provisions of U.S. taxation of certain Global Intangible Low-Taxed Income (GILTI). As of December 28, 2018, we have not yet determined our policy election with respect to whether to record deferred taxes for temporary basis differences expected to reverse as GILTI in future periods, or account for taxes on GILTI using the period cost method. However, as of December 28, 2018, we did not expect to generate a GILTI inclusion due to a forecasted overall net loss for our foreign subsidiaries.

Note 11. Commitments and Contingencies

Operating Lease Commitments

We lease office and manufacturing facilities under non-cancelable operating leases expiring at various dates through 2026. We lease approximately 19,000 square feet of office space in Milpitas, California as our corporate headquarters. As of December 28, 2018, our future minimum lease payments under all non-cancelable operating leases with an initial lease term in excess of one year were as follows:

Fiscal Years	Amounts (In thousands)
2019 (two quarters remaining)	\$ 1,040
2020	1,323
2021	926
2022	196
2023	150
Thereafter	1,873
Total	\$ 5,508

These commitments do not contain any material rent escalations, rent holidays, contingent rent, rent concessions, leasehold improvement incentives or unusual provisions or conditions. We sublease a portion of our facilities to third parties and the total minimum rents to be received in the future under our non-cancelable subleases were \$0.1 million as of December 28, 2018. The future minimum lease payments are not reduced by the minimum sublease rents.

Rent expense for operating leases, including rentals on a month-to-month basis, was as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	December 28, 2018		December 28, 2017	
	2018	2017	2018	2017
Rent expense	\$ 1,008	\$ 959	\$ 1,921	\$ 1,898

Purchase Orders and Other Commitments

From time to time in the normal course of business we may enter into purchasing agreements with our suppliers that require us to accept delivery of, and remit full payment for, finished products that we have ordered, finished products that we requested be held as safety stock, and work in process started on our behalf, in the event we cancel or terminate the purchasing agreement. Because these agreements do not specify fixed or minimum quantities, do not specify minimum or variable price provisions, and do not specify the approximate timing of the transaction, and we have no present intention to cancel or terminate any of these agreements, we currently do not believe that we have any future liability under these agreements. As of December 28, 2018, we had outstanding purchase obligations with our suppliers or contract manufacturers of \$19.4 million. In addition, we had contractual obligations of approximately \$1.8 million associated with software licenses as of December 28, 2018.

Financial Guarantees and Commercial Commitments

Guarantees issued by banks, insurance companies or other financial institutions are contingent commitments issued to guarantee our performance under borrowing arrangements, such as bank overdraft facilities, tax and customs obligations and similar transactions or to ensure our performance under customer or vendor contracts. The terms of the guarantees are generally equal to the remaining term of the related debt or other obligations and are generally limited to two years or less. As of December 28, 2018, we had no guarantees applicable to our debt arrangements.

We have entered into commercial commitments in the normal course of business including surety bonds, standby letters of credit agreements and other arrangements with financial institutions primarily relating to the guarantee of future performance on certain contracts to provide products and services to customers. As of December 28, 2018, we had commercial commitments of \$55.8 million outstanding that were not recorded on our unaudited Condensed Consolidated Balance Sheets. We do not believe, based on historical experience and information currently available, that it is probable that any significant amounts will be required to be paid on the performance guarantees in the future.

Indemnifications

Under the terms of substantially all of our license agreements, we have agreed to defend and pay any final judgment against our customers arising from claims against such customers that our products infringe the intellectual property rights of a third party. As of December 28, 2018, we have not received any notice that any customer is subject to an infringement claim arising from the use of our products; we have not received any request to defend any customers from infringement claims arising from the use of our products; and we have not paid any final judgment on behalf of any customer related to an infringement claim arising from the use of our products. Because the outcome of infringement disputes is related to the specific facts of each case and given the lack of previous or current indemnification claims, we cannot estimate the maximum amount of potential future payments, if any, related to our indemnification provisions. As of December 28, 2018, we had not recorded any liabilities related to these indemnifications.

Legal Proceedings

We are subject from time to time to disputes with customers concerning our products and services. In May 2016, we received notification of a claim for approximately \$1.0 million in damages from a customer in Austria alleging that certain of our products were defective. We are continuing to investigate this claim, and at this time an estimate of the reasonably possible loss or range of loss cannot be made. We believe that we have numerous contractual and legal defenses to these disputes, and we intend to dispute them vigorously.

From time to time, we may be involved in various other legal claims and litigation that arise in the normal course of our operations. We are aggressively defending all current litigation matters. Although there can be no assurances and the outcome of these matters is currently not determinable, we currently believe that none of these claims or proceedings are likely to have a material adverse effect on our financial position. We expect to defend each of these disputes vigorously. There are many uncertainties associated with any litigation and these actions or other third-party claims against us may cause us to incur costly litigation and/or substantial settlement charges. As a result, our business, financial condition, results of operations, and cash flows could be adversely affected. The actual liability in any such matters may be materially different from our estimates, if any.

We record accruals for our outstanding legal proceedings, investigations or claims when it is probable that a liability will be incurred and the amount of loss can be reasonably estimated. We evaluate, at least on a quarterly basis, developments in legal proceedings, investigations or claims that could affect the amount of any accrual, as well as any developments that would result in a loss contingency to become both probable and reasonably estimable. We have not recorded any accrual for loss contingencies associated with such legal claims or litigation discussed above.

Contingent Liabilities

We record a loss contingency as a charge to operations when (i) it is probable that an asset has been impaired or a liability has been incurred at the date of the unaudited Condensed Consolidated Financial Statements; and (ii) the amount of the loss can be reasonably estimated. Disclosure in the Notes to the unaudited Condensed Consolidated Financial Statements is required for loss contingencies that do not meet both those conditions if there is a reasonable possibility that a loss may have been incurred. Gain contingencies are not recorded until realized. We expense all legal costs incurred to resolve regulatory, legal and tax matters as incurred.

Periodically, we review the status of each significant matter to assess the potential financial exposure. If a potential loss is considered probable and the amount can be reasonably estimated, we reflect the estimated loss in our unaudited Condensed Consolidated Statement Of Operations. Significant judgment is required to determine the probability that a liability has been incurred or an asset impaired and whether such loss is reasonably estimable. Further, estimates of this nature are highly subjective, and the final outcome of these matters could vary significantly from the amounts that have been included in our unaudited Condensed Consolidated Financial Statements. As additional information

becomes available, we reassess the potential liability related to our pending claims and litigation and may revise estimates accordingly. Such revisions in the estimates of the potential liabilities could have a material impact on our results of operations and financial position.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q, including "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," contains forward-looking statements that involve risks and uncertainties, as well as assumptions that, if they do not materialize or prove correct, could cause our results to differ materially from those expressed or implied by such forward-looking statements. All statements other than statements of historical fact are statements that could be deemed to be forward-looking statements, including statements of, about, concerning or regarding: our plans, strategies and objectives for future operations, including with respect to growing our business and sustaining profitability; our restructuring efforts; our research and development efforts and new product releases and services; trends in revenue; drivers of our business and the markets in which we operate; future economic conditions, performance or outlook and changes in our industry and the markets we serve; the outcome of contingencies; the value of our contract awards; beliefs or expectations; the sufficiency of our cash and our capital needs and expenditures; our intellectual property protection; our compliance with regulatory requirements and the associated expenses; expectations regarding litigation; our intention not to pay cash dividends; seasonality of our business; the impact of foreign exchange and inflation; taxes; and assumptions underlying any of the foregoing. Forward-looking statements may be identified by the use of forward-looking terminology, such as "anticipates," "believes," "expects," "may," "should," "would," "will," "intends," "plans," "estimates," "strategy," "projects," "targets," "goals," "delivers," "continues," "forecasts," "future," "predict," "might," "could," "potential," or the negative of these terms, and similar words or expressions.

These forward-looking statements are based on estimates reflecting the current beliefs of the senior management of the Company. These forward-looking statements involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. Forward-looking statements should therefore be considered in light of various important factors, including those set forth in this document. Important factors that could cause actual results to differ materially from estimates or projections contained in the forward-looking statements include, but are not limited to, the following:

- continued price and margin erosion as a result of increased competition in the microwave transmission industry;
- the impact of the volume, timing and customer, product and geographic mix of our product orders;
- our ability to meet financial covenant requirements which could impact, among other things, our liquidity;
- the timing of our receipt of payment for products or services from our customers;
- our ability to meet projected new product development dates or anticipated cost reductions of new products;
- our suppliers' inability to perform and deliver on time as a result of their financial condition, component shortages or other supply chain constraints;
- customer acceptance of new products;
- the ability of our subcontractors to timely perform;
- continued weakness in the global economy affecting customer spending;
- retention of our key personnel;
- our ability to manage and maintain key customer relationships;
- uncertain economic conditions in the telecommunications sector combined with operator and supplier consolidation;
- our failure to protect our intellectual property rights or defend against intellectual property infringement claims by others;
- the results of our restructuring efforts;
- the ability to preserve and use our net operating loss carryforwards;
- the effects of currency and interest rate risks;
- the conduct of unethical business practices in developing countries; and
- the impact of political turmoil in countries where we have significant business.

Other factors besides those listed here also could adversely affect us. See "Item 1A. Risk Factors" in our fiscal 2018 Annual Report on Form 10-K filed with the SEC on August 28, 2018 for more information regarding factors that may cause our results to differ materially from those expressed or implied by the forward-looking statements contained in this Quarterly Report on Form 10-Q.

You should not place undue reliance on these forward-looking statements, which reflect our management's opinions only as of the date of the filing of this Quarterly Report on Form 10-Q. Forward-looking statements are made in reliance upon the

safe harbor provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), along with provisions of the Private Securities Litigation Reform Act of 1995, and we undertake no obligation, other than as imposed by law, to update any forward-looking statements to reflect further developments or information obtained after the date of filing of this Quarterly Report on Form 10-Q or, in the case of any document incorporated by reference, the date of that document.

Overview of Business; Operating Environment and Key Factors Impacting Fiscal 2019 and 2018 Results

The following Management's Discussion and Analysis (MD&A) is intended to help the reader understand our results of operations and financial condition. MD&A is provided as a supplement to, and should be read in conjunction with, our unaudited Condensed Consolidated Financial Statements and the accompanying notes. In the discussion herein, our fiscal year ending June 28, 2019 is referred to as "fiscal 2019" or "2019" and our fiscal year ended June 29, 2018 is referred to as "fiscal 2018" or "2018."

We generate revenue by designing, developing, manufacturing and supporting a range of wireless networking products, solutions and services for mobile and fixed communications service providers, private network operators, government agencies, transportation, energy and utility companies, public safety agencies and broadcast network operators across the world. Our products include point-to-point microwave and millimeter-wave radio transmission systems designed for first/last mile access, middle mile/backhaul, and long-distance trunking applications. We have a portfolio of our own internet protocol routers optimized for both wireless transport and mixed optical fiber and wireless transport applications. We provide network management software tools and applications to enable the deployment, monitoring and management of our systems. Beyond the portfolio of solutions developed in-house we source, qualify, supply and, support third party equipment such as antennas, routers, optical transmission equipment and other technology and equipment necessary to build and deploy a complete telecommunications transmission network. We also provide a full suite of professional services for planning, deployment, operations and maintenance of our customers' networks.

We anticipate a return to top line growth in fiscal 2019 based on progress made in expanding our solutions portfolio, increasing addressable markets and applications, along with the gains we have already made in expanding our customer footprint. As we continue to execute on our technology roadmap we are engaging more deeply with customers on the evolution of use cases and applications as 5th Generation mobile and broadband networks edge closer to implementation and begin to factor more strongly in the vendor selection process. We are confident in our ability to address future 5G market needs. We will continue to examine our products, markets, facilities, development programs, and operational flows to ensure we are focused on what we do well and what will differentiate us in the future. We will continue working to streamline management processes to attain the efficiency levels required by the markets in which we do business.

The trend of increasing demand for bandwidth is well established and set to continue across all geographic and vertical markets creating opportunities for network enhancements, expansions and modernizations.

We expect to provide increased managed services to our customers, including but not limited to network design, network monitoring, optimization, asset tracking, inventory management, final configuration and warehousing services.

We work continuously to improve our established brands and to create new products that meet our customers' evolving needs and preferences. Our fundamental business goal is to generate superior returns for our stockholders over the long term. We believe that increases in revenue, operating profits and earnings per share are the key measures of financial performance for our business.

Within the industry there continues to be strong price competition for new business. Periodic large service provider customer consolidations can increase opportunity or intensify competition from time to time or may increase the uncertainty in the timing of purchases and vendor selections.

We continue to explore strategic alternatives to improve the market position and profitability of our product offerings in the marketplace, generate additional liquidity and enhance our valuation. We may pursue our goals through organic growth and through strategic alternatives. Some of these alternatives have included, and could continue to include, selective acquisitions, divestitures and the sale of assets or securities. We have provided and may from time to time in the future provide, information to interested parties regarding our business and operations in connection with various

potential transactions.

Operations Review

The market for mobile backhaul continues to be our primary addressable market segment and, over the long term, the

25

demand for increasing the backhaul capacity in our customers' networks continues to grow. In North America, we supported long-term evolution (LTE) deployments of our mobile operator customers, public safety network deployments for state and local governments, and private network implementations for utilities and other customers. In international markets, our business continued to rely on a combination of customers increasing their capacity to handle subscriber growth, the ongoing build-out of some large 3G deployments, and the emergence of early stage LTE deployments. Our international business continues to be affected by fluctuations in currency valuation relative to the U.S. dollar, which may limit local purchasing power and capital spending, slow the payments from customers in those affected locations and cause variations in our overall operating costs. Our position continues to be to support our customers for LTE readiness and ensure that our technology roadmap is well aligned with evolving market requirements. We continue to find that our strength in turnkey and after-sale support services is a differentiating factor that wins business for us and enables us to expand our business with existing customers in all markets. However, as disclosed above and in the "Risk Factors" section in Item 1A of our fiscal 2018 Annual Report on Form 10-K, a number of factors could prevent us from achieving our objectives, including ongoing pricing pressures attributable to competition and macroeconomic conditions in the geographic markets that we service.

Revenue

We manage our sales activities primarily on a geographic basis in North America and three international geographic regions: (1) Africa and the Middle East, (2) Europe and Russia, and (3) Latin America and Asia Pacific. Revenue by region for the three and six months ended December 28, 2018 and December 29, 2017 and the related changes are shown in the table below:

(In thousands, except percentages)	Three Months Ended				Six Months Ended			
	December 28, 2018	December 29, 2017	\$ Change	% Change	December 28, 2018	December 29, 2017	\$ Change	% Change
North America	\$37,316	\$ 36,985	\$331	0.9 %	\$65,079	\$ 67,987	\$(2,908)	(4.3)%
Africa and the Middle East	13,832	12,682	1,150	9.1 %	27,979	26,144	1,835	7.0 %
Europe and Russia	3,233	3,814	(581)	(15.2)%	6,945	8,260	(1,315)	(15.9)%
Latin America and Asia Pacific	10,707	8,242	2,465	29.9 %	25,589	15,514	10,075	64.9 %
Total revenue	\$65,088	\$ 61,723	\$3,365	5.5 %	\$125,592	\$ 117,905	\$7,687	6.5 %

During the second quarter and first six months of fiscal 2019, we recognized revenue based on ASC 606 but revenue for the first quarter and first six months of fiscal 2018 was recognized based on ASC 605. Therefore, the periods are not directly comparable. For additional information regarding the impact of the new accounting standard on our revenue, please refer to "Part I, Item 1, Financial statements - Note 3. Revenue Recognition."

Our revenue in North America increased by \$0.3 million, or 0.9%, during the second quarter of fiscal 2019 compared with the same period of fiscal 2018. Revenue in North America decreased by \$2.9 million, or 4.3%, during the first six months of fiscal 2019 compared with the same period of fiscal 2018. The decrease in North America revenue during the first six months was due to the timing of completion of customer project milestones.

Our revenue in Africa and the Middle East increased by \$1.2 million, or 9.1%, for the second quarter of fiscal 2019 compared with the same period of fiscal 2018. Revenue in Africa and the Middle East increased by \$1.8 million, or 7.0%, during the first six months of fiscal 2019 compared with the same period of fiscal 2018. The increase in revenue was primarily due to increased sales to customers in West Africa and to our large mobile operator customers in the region.

Revenue in Europe and Russia decreased by \$0.6 million, or 15.2%, for the second quarter of fiscal 2019 compared with the same quarter of fiscal 2018. Revenue in Europe and Russia decreased by \$1.3 million, or 15.9%, during the first six months of fiscal 2019 compared with the same period of fiscal 2018. The decrease was due to lower sales to mobile and private network customers in the region.

Revenue in Latin America and Asia Pacific increased by \$2.5 million, or 29.9%, during the second quarter of fiscal 2019 compared with the same period in fiscal 2018. Revenue in Latin America and Asia Pacific increased by \$10.1 million, or 64.9%, during the first six months of fiscal 2019 compared with the same period of fiscal 2018. The increase was primarily due to higher sales volume to several mobile operator customers in Asia Pacific.

Edgar Filing: AVIAT NETWORKS, INC. - Form 10-Q

(In thousands, except percentages)	Three Months Ended				Six Months Ended			
	December 28, 2018		December 29, 2017		December 28, 2018		December 29, 2017	
	\$	%	\$	%	\$	%	\$	%
Product sales	\$41,956	11.2 %	\$37,719	11.2 %	\$81,081	11.4 %	\$72,786	11.4 %
Services	23,132	(3.6)%	24,004	(3.6)%	44,511	(1.3)%	45,119	(1.3)%
Total revenue	\$65,088	5.5 %	\$61,723	5.5 %	\$125,592	6.5 %	\$117,905	6.5 %

Our revenue from product sales increased by \$4.2 million, or 11.2%, for the second quarter of fiscal 2019 compared with the same period in fiscal 2018. Product volume increased over the same quarter in fiscal 2018 in Asia Pacific, the Middle East and Africa and North America, offset by smaller decreases in Latin America and Europe. Our services revenue decreased by \$0.9 million, or 3.6%, during the second quarter of fiscal 2019 compared with the same period of fiscal 2018. Decreased sales in North America and the Middle East and Africa were offset in part by smaller increases in the other regions.

Our revenue from product sales increased by \$8.3 million, or 11.4%, for the first six months of fiscal 2019 compared with the same period in fiscal 2018. Product volume increased over the same quarter in fiscal 2018 in Asia Pacific and in the Middle East and Africa regions, partially offset by smaller decreases in the other sectors. Our services revenue decreased by \$0.6 million, or 1.3%, during the first six months of fiscal 2019 compared with the same period of fiscal 2018. Decreased sales in North America, the Middle East Africa and Asia Pacific were offset in part by increased sales in Europe and Latin America.

Gross Margin

(In thousands, except percentages)	Three Months Ended				Six Months Ended			
	December 28, 2018		December 29, 2017		December 28, 2018		December 29, 2017	
	\$	%	\$	%	\$	%	\$	%
Revenue	\$65,088	5.5 %	\$61,723	5.5 %	\$125,592	6.5 %	\$117,905	6.5 %
Cost of revenue	42,598	6.9 %	39,833	6.9 %	85,177	8.2 %	78,719	8.2 %
Gross margin	\$22,490	2.7 %	\$21,890	2.7 %	\$40,415	3.1 %	\$39,186	3.1 %
% of revenue	34.6 %	35.5 %	34.6 %	35.5 %	32.2 %	33.2 %	32.2 %	33.2 %
Product margin %	37.7 %	36.9 %	37.7 %	36.9 %	34.7 %	34.8 %	34.7 %	34.8 %
Service margin %	28.9 %	33.1 %	28.9 %	33.1 %	27.6 %	30.7 %	27.6 %	30.7 %

Gross margin for the second quarter and first six months of fiscal 2019 increased by \$0.6 million, or 2.7%, and \$1.2 million, or 3.1%, respectively, compared with the same period in fiscal 2018. Our gross margin increased from the prior-year quarter primarily due to reduced supply chain costs and an increase in volume of product sales.

Gross margin as a percentage of revenue decreased in the second quarter of fiscal 2019 compared with the same period in fiscal 2018 primarily due to lower profitability of our service business in all regions. Product margin as a percentage of product revenue improved in the second quarter of fiscal 2019 compared with the same period in fiscal 2018 primarily due to reduced supply chain costs and an increase in volume of product sales. Service margin as a percentage of service revenue decreased in the second quarter of fiscal 2019 compared with the same period in fiscal 2018 primarily due to decreased margins on certain installation projects during the quarter.

Gross margin as a percentage of revenue decreased in the first six months of fiscal 2019 compared with the same period in fiscal 2018 primarily due to lower margin rates for services. Product margin as a percentage of product revenue was relatively flat in the first six months of fiscal 2019 compared with the same period in fiscal 2018 primarily due to lower margin rates on product sales in the Asia Pacific region. Service margin as a percentage of service revenue decreased in the first six months of fiscal 2019 compared with the same period in fiscal 2018 primarily due to decreased margins on certain installation projects during the quarter in North America and Asia Pacific.

Research and Development Expenses

(In thousands, except percentages)	Three Months Ended				Six Months Ended			
	December 28, 2018		December 29, 2017		December 28, 2018		December 29, 2017	
	\$	%	\$	%	\$	%	\$	%
Research and development	\$5,316	3.3 %	\$5,144	3.3 %	\$10,253	3.1 %	\$9,942	3.1 %

% of revenue 8.2 % 8.3 % 8.2 % 8.4 %

27

Our research and development expenses increased by \$0.2 million, or 3.3%, in the second quarter of fiscal 2019 compared with the same period in fiscal 2018. The increase was primarily due to increased product development activities. Our research and development expenses increased by \$0.3 million, or 3.1%, in the first six months of fiscal 2019 compared with the same period in fiscal 2018. The increase was primarily due to the increased level of product development activity.

Selling and Administrative Expenses

(In thousands, except percentages)	Three Months Ended				Six Months Ended			
	December 29, 2018		December 29, 2017		December 29, 2018		December 29, 2017	
	\$	%	\$	%	\$	%	\$	%
Selling and administrative	\$14,291		\$14,104		\$27,997		\$27,826	
% of revenue	22.0		22.9		22.3		23.6	

Our selling and administrative expenses were relatively flat in the second quarter and first six months of fiscal 2019 compared with the same period in fiscal 2018.

Restructuring Charges

(In thousands, except percentages)	Three Months Ended				Six Months Ended			
	December 29, 2018		December 29, 2017		December 29, 2018		December 29, 2017	
	\$	%	\$	%	\$	%	\$	%
Restructuring charges	\$—		(\$252)		\$796		(\$250)	

Expenses incurred in the first six months of fiscal 2019 were due to the implementation of the Fiscal 2018-2019 Plan. We expect to substantially complete the restructuring activities under the Fiscal 2018-2019 Plan by the end of fiscal 2019. Payments related to the accrued restructuring liability balance for this plan are expected to be fully paid by the end of fiscal 2020.

Interest Income, Interest Expense, and Other Expense

(In thousands, except percentages)	Three Months Ended				Six Months Ended			
	December 29, 2018		December 29, 2017		December 29, 2018		December 29, 2017	
	\$	%	\$	%	\$	%	\$	%
Interest income	\$43		\$42		\$94		\$100	
Interest expense	\$(76)		\$(13)		\$(81)		\$(19)	
Other (expense) income, net	\$—		\$(136)		\$—		\$(166)	

Interest income reflected interest earned on our cash equivalents which were comprised of money market funds and bank certificates of deposit.

Interest expense was primarily related to interest associated with borrowings under the SVB Credit Facility and discounts on customer letters of credit.

Other (expense) income, net during fiscal 2018 was primarily comprised of a foreign exchange loss related to a dividend declared by our Nigeria entity (a partnership for U.S. tax purposes) to our Aviat U.S. entity.

Income Taxes

(In thousands, except percentages)	Three Months Ended				Six Months Ended			
	December 29, 2018		December 29, 2017		December 29, 2018		December 29, 2017	
	\$	%	\$	%	\$	%	\$	%
Income before income taxes	\$2,850		\$2,787		\$1,382		\$1,583	
Provision for (benefit from) income taxes	\$540		\$(2,564)		\$(178)		\$(3,203)	

We estimate our annual effective tax rate at the end of each quarterly period, and we record the tax effect of certain discrete items in the interim period in which they occur, including changes in judgment about uncertain tax positions and deferred tax valuation allowances.

The tax benefit for the six months ended December 28, 2018 was primarily due to tax expense related to profitable subsidiaries, net against the release of valuation allowance due to the potential foreign tax refund to be received from the Department of Federal Revenue of Brazil. During the first quarter of fiscal 2019, we recorded a net discrete tax benefit of \$1.6 million for the release of valuation allowance on a deferred tax asset recorded for \$1.9 million of refundable withholding tax credit to be received from the Department of Federal Revenue of Brazil, less tax expense of \$0.3 million from recognizing an ASC 740-10 reserve previously recorded as a reduction against the deferred tax for the withholding tax credit. During the three months ended December 28, 2018, we reduced the refundable withholding tax credit to \$1.8 million, primarily due to foreign exchange differences, and recorded a discrete income tax expense of \$0.1 million.

During the first quarter of fiscal 2018, we received a refund of \$1.3 million from IRAS which represented a final settlement. The determination of the effective tax rate reflects tax expense and benefit generated in certain jurisdictions. However, jurisdictions with a year-to-date loss where no tax benefit can be recognized are excluded from the annual effective tax rate.

Due to the uncertainty regarding the timing and extent of our future profitability, we continue to record a full valuation allowance to offset our U.S. deferred tax assets which primarily represent future income tax benefits associated with our operating losses because we do not currently believe that it is more likely than not that these assets will be realized. In the future, if we conclude that sufficient positive evidence (including our estimate of future taxable income) exists to support a reversal of all or a portion of the valuation allowance, we expect that a significant portion of any release of the valuation allowance will be recorded as an income tax benefit at the time of release.

If we determine that it is a more likely than not that we will utilize net operating losses in the future and release a portion of our valuation allowance, a payable could potentially result from the repayment to Harris Corporation for the amount of net operating losses utilized related to Harris Corporation under the historical tax sharing agreement.

Liquidity, Capital Resources and Financial Strategies

Sources of Cash

As of December 28, 2018, our total cash, cash equivalents and restricted cash were \$31.5 million. Approximately \$15.2 million, or 48.3% was held in the United States. The remaining balance of \$16.3 million, or 51.7%, was held outside the United States. Of the amount of cash and cash equivalents held by our foreign subsidiaries at December 28, 2018, \$14.8 million was held in jurisdictions where our undistributed earnings are indefinitely reinvested, and if repatriated, would be subject to U.S. taxes which would be nominal.

Cash used in operating activities was \$0.6 million for the first six months of fiscal 2019, compared to cash provided by operating activities of \$9.2 million for the first six months of fiscal 2018. Cash used in or provided by operating activities is presented as net income adjusted for non-cash items and changes in operating assets and liabilities. Net contribution of non-cash items increased cash by \$2.2 million and net changes in operating assets and liabilities decreased cash by \$8.7 million for the first six months of fiscal 2019 as compared to the same period in fiscal 2018. The \$2.2 million increase in the net contribution of non-cash items was primarily due to a \$2.9 million net increase in deferred tax expense, partially offset by a \$0.2 million recovery for uncollectible receivables, a \$0.2 million decrease in share-based compensation expense, and a \$0.2 million decrease in depreciation and amortization.

Changes in operating assets and liabilities resulted in a net decrease of \$8.7 million to cash for the first six months of fiscal 2019, compared to the same period in 2018. Accounts receivable and unbilled costs fluctuate from period to period, depending on the amount, timing of sales and billing activities, as well as cash collections and the impact from the adoption of ASC 606. The fluctuations in accounts payable and accrued expenses were primarily due to the timing of liabilities incurred and vendor payments. The change in inventories and in customer service inventories were primarily due to demand, our focus on improving our inventory management, and the impact from the adoption of ASC 606. The increase in customer advance payments and unearned revenue was due to the timing of payment from customers and revenue recognition. We used \$0.5 million in cash during the first six months of fiscal 2019 on expenses related to restructuring liabilities.

Cash used in investing activities was \$3.2 million and \$3.3 million for the first six months of fiscal 2019 and 2018, respectively, related to the acquisition of property, plant and equipment. During the remainder of fiscal year 2019, we expect to spend approximately \$3.0 million for capital expenditures, primarily on equipment for development and

manufacturing of new products and to support customer managed services.

29

Cash used in financing activities was \$2.0 million for the first six months of fiscal 2019 primarily related to the repurchase of common stock

As of December 28, 2018, our principal sources of liquidity consisted of the \$31.5 million in cash, cash equivalents and short-term investments, \$15.7 million of available credit under our \$30.0 million SVB Credit Facility which expires on June 29, 2019 and future collections of receivables from customers. We regularly require letters of credit from some customers, and, from time to time, these letters of credit are discounted without recourse shortly after shipment occurs in order to meet immediate liquidity requirements and to reduce our credit and sovereign risk.

Historically our primary sources of liquidity have been cash flows from operations and credit facilities.

We believe that our existing cash and cash equivalents, the available line of credit under the SVB Credit Facility and future cash collections from customers will be sufficient to provide for our anticipated requirements for working capital and capital expenditures for at least the next 12 months. Our SVB Credit Facility expires on June 29, 2019. In addition, there can be no assurance that our business will generate cash flow from operations, we will be in compliance with the quarterly financial covenants contained in the SVB Credit Facility, or that we will have a sufficient borrowing base under such facility, or that anticipated operational improvements will be achieved. If we are not in compliance with the financial covenants or do not have sufficient eligible accounts receivable to support our borrowing base, the availability of our credit facility is not certain or may be diminished. Over the longer term, if we are unable to maintain cash balances or generate sufficient cash flow from operations to service our obligations that may arise in the future, we may be required to sell assets, reduce capital expenditures, or obtain financing. If we need to obtain additional financing, we cannot be assured that it will be available on favorable terms, or at all. Our ability to make scheduled principal payments or pay interest on or refinance any future indebtedness depends on our future performance and financial results, which, to a certain extent, are subject to general conditions in or affecting the microwave communications market and to general economic, political, financial, competitive, legislative and regulatory factors beyond our control.

In addition, we have an uncommitted short-term line of credit of \$0.4 million from a bank in New Zealand to support the operations of our subsidiary located there. This line of credit provides for \$0.3 million in short-term advances at various interest rates, all of which was available as of December 28, 2018 and June 29, 2018. The line of credit also provides for the issuance of standby letters of credit and company credit cards, of which \$0.1 million was outstanding as of December 28, 2018. This facility may be terminated upon notice, is reviewed annually for renewal or modification, and is supported by a corporate guarantee.

Restructuring Payments

We had liabilities for restructuring activities totaling \$2.2 million as of December 28, 2018, \$1.6 million of which was classified as current liabilities and expected to be paid out in cash over the next 12 months. We expect to fund these future payments with available cash and cash provided by operations.

Contractual Obligations and Commercial Commitments

The amounts disclosed in our fiscal 2018 Annual Report on Form 10-K filed with the SEC on August 28, 2018 include our commercial commitments and contractual obligations. During the first six months of fiscal 2019, no material changes occurred in our contractual obligations to purchase goods and services and to make payments under operating leases or our contingent liabilities on outstanding letters of credit, guarantees and other arrangements as disclosed in our fiscal 2018 Annual Report on Form 10-K. As of December 28, 2018, we had commercial commitments of \$55.8 million outstanding that were not recorded on our unaudited Condensed Consolidated Balance Sheets. This is an increase of \$4.3 million from the amount disclosed in our fiscal 2018 Annual Report on Form 10-K. Please refer to “Note 11 Commitments and Contingencies” of the Notes to unaudited Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Critical Accounting Estimates

For information about our critical accounting estimates, see the “Critical Accounting Estimates” section of “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our fiscal 2018 Annual Report on Form 10-K other than for the impact of adopting new revenue accounting standards. Effective June 30, 2018, we adopted ASC 606. See “Note 3, Revenue Recognition” of the Notes to unaudited Condensed Consolidated Financial Statements for discussion of the impact of the adoption of ASC 606 on our policies for revenue.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

In the normal course of doing business, we are exposed to the risks associated with foreign currency exchange rates and changes in interest rates. We employ established policies and procedures governing the use of financial instruments to manage our exposure to such risks.

Exchange Rate Risk

We conduct business globally in numerous currencies and are therefore exposed to foreign currency risks. We use derivative instruments to reduce the volatility of earnings and cash flows associated with changes in foreign currency exchange rates. We do not hold or issue derivatives for trading purposes or make speculative investments in foreign currencies.

We use foreign exchange forward contracts to hedge forecasted foreign currency transactions relating to forecasted sales and purchase transactions. Beginning the fourth quarter of fiscal 2015, we no longer prepared contemporaneous documentation of hedges for the new foreign exchange forward contracts we entered. As a result, the foreign exchange hedges no longer qualified as cash flow hedges. The changes in fair value related to the hedges were recorded in income or expenses line items on our statements of operations.

We also enter into foreign exchange forward contracts to mitigate the change in fair value of specific non-functional currency assets and liabilities on the balance sheet. All balance sheet hedges are marked to market through earnings every period. Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities.

As of December 28, 2018, we had foreign currency forward contracts outstanding with a total notional amount of \$2.7 million consisting of four currencies as follows:

Currency	Notional Contract Amount (Local Currency) (In thousands)	Notional Contract Amount (USD)
Canadian dollar	500	\$ 372
Euro	1,000	1,140
New Zealand dollar	900	604
Great Britain pound	500	632
Total of all currency forward contracts		\$ 2,748

Net foreign exchange (loss) income recorded in our unaudited Condensed Consolidated Statements of Operations during the three and six months of fiscal 2019 and 2018 was as follows:

(In thousands)	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Amount included in costs of revenues	\$(48)	\$ (107)	\$171	\$ (98)
Amount included in other expense	—	(136)	—	(137)
Total foreign exchange (loss) income, net	\$(48)	\$ (243)	\$171	\$ (235)

A 10% adverse change in currency exchange rates for our foreign currency derivatives held as of December 28, 2018 would have an impact of approximately \$0.3 million on the fair value of such instruments.

Certain of our international business are transacted in non-U.S. dollar currency. As discussed above, we utilize foreign currency hedging instruments to minimize the currency risk of international transactions. The impact of translating the assets and liabilities of foreign operations to U.S. dollars for the first six months of fiscal 2019 was \$0.3 million and was included as a component of stockholders' equity. As of December 28, 2018 and June 29, 2018, the cumulative translation adjustment decreased our equity by \$12.9 million and \$12.6 million, respectively.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our cash equivalents and borrowings under our credit facility.

Exposure on Cash Equivalents

We had \$31.5 million in total cash, cash equivalents as of December 28, 2018. Cash equivalents totaled \$15.7 million as of December 28, 2018 and were comprised of money market funds and bank certificates of deposit. Cash equivalents investments have been recorded at fair value on our balance sheet.

Our cash equivalents earn interest at fixed rates; therefore, changes in interest rates will not generate a gain or loss on these investments unless they are sold prior to maturity. The weighted-average days to maturity for cash equivalents held as of December 28, 2018 was 24 days, and these investments had an average yield of approximately 7% per annum. A 10% change in interest rates on our cash equivalents and short-term investments is not expected to have a material impact on our financial position, results of operations or cash flows.

Exposure on Borrowings

Our borrowings outstanding under the SVB Credit Facility incurred interest at the prime rate plus a spread of 0.50% to 1.50% with such spread determined based on our adjusted quick ratio. During the first six months of fiscal 2019, our weighted-average interest rate was 5.89% and the interest expense on these borrowings was insignificant.

A 10% change in interest rates on the current borrowings or on future borrowings is not expected to have a material impact on our financial position, results of operations or cash flows since interest on our borrowings is not material to our overall financial position.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on management's evaluation, with participation of our Chief Executive Officer (CEO) and Principal Financial Officer (PFO), as of the end of the period covered by this report, our CEO and PFO have concluded that our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, as of December 28, 2018, are effective to provide reasonable assurance that the information required to be disclosed in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Controls Over Financial Reporting

In the first quarter of fiscal 2019, we implemented certain internal controls over financial reporting in connection with our adoptions of ASC 606. There were no other changes in our internal control over financial reporting during the first six months ended December 28, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including the CEO and PFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well-designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Please refer to Legal Proceedings under “Note 11 Commitments and Contingencies” of the Notes to unaudited Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors

Investors should carefully review and consider the information regarding certain factors which could materially affect our business, operating results, cash flows, and financial condition set forth under Item 1A, Risk Factors, in our fiscal 2018 Annual Report on Form 10-K filed with the SEC on August 28, 2018.

We do not believe that there have been any other material additions or changes to the risk factors previously disclosed in our fiscal 2018 Annual Report on Form 10-K, although we may disclose changes to such factors or disclose additional factors from time to time in our future filings with the SEC. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Following is a summary of stock repurchases for the three months ended December 28, 2018:

Period	Total Number of Shares Repurchased	Average Price Paid per Share	Total Number of Shares Repurchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Repurchased Under the Program ⁽¹⁾ (in thousands)
September 29, 2018 through October 26, 2018	21,332	\$ 16.37	21,332	\$ 6,753
October 27, 2018 through November 23, 2018	23,034	\$ 15.18	23,034	\$ 6,403
November 24, 2018 through December 28, 2018	23,640	\$ 14.80	23,640	\$ 6,053
Total	68,006			

⁽¹⁾ Stock Repurchase Programs

In May 2018, our board of directors approved a repurchase program, which does not have an expiration date, for the repurchase of up to \$7.5 million of our common stock. During the three months ended December 28, 2018, we repurchased \$1.0 million of our common stock in the open market. As of December 28, 2018, \$6.1 million remained available under our stock repurchase program.

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

The following exhibits are filed herewith or incorporated by reference to exhibits previously filed with the SEC:

Exhibit Number	Descriptions
3.1	<u>Amended and Restated Certificate of Incorporation of Aviat Networks, Inc., as amended (incorporated by reference to Exhibit 3.1 to the Current Report on Form 10-Q filed with the SEC on February 10, 2017, File No. 001-33278)</u>
3.2	<u>Amended and Restated Bylaws of Aviat Networks, Inc. (incorporated by reference to Exhibit 3.2 to the Current Report on Form 8-K filed with the SEC on October 2, 2015, File No. 001-33278)</u>
4.1	<u>Tax Benefit Preservation Plan, dated as of September 6, 2016, by and between Aviat Networks, Inc. and Computershare Inc., as Rights Agent (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K filed with the SEC on September 7, 2016, File No. 011-33278)</u>
4.2	<u>Aviat Networks, Inc. 2018 Incentive Plan (incorporated by reference to Appendix A to the Registrant's Proxy Statement on Schedule 14A filed with the SEC on February 12, 2018, File No. 001-33278)</u>
31.1	<u>Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer</u>
31.2	<u>Rule 13a-14(a)/15d-14(a) Certification of Principal Financial Officer</u>
32.1	<u>Section 1350 Certification of Chief Executive Officer and Principal Financial Officer</u>
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AVIAT NETWORKS, INC.

(Registrant)

Date: February 11, 2019

By: /s/ Walter Stanley Gallagher, Jr.

Walter Stanley Gallagher, Jr.

Senior Vice President, Chief Operating Officer

(Principal financial officer and duly authorized officer)

By: /s/ Eric Chang

Eric Chang

Vice President, Corporate Controller and Principal Accounting Officer

(Principal accounting officer and duly authorized officer)