

ADC TELECOMMUNICATIONS INC
Form 10-K
January 16, 2002

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended October 31, 2001

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 No. 0-1424

ADC Telecommunications, Inc.

(Exact name of registrant as specified in its charter)

Minnesota

(State or other jurisdiction of
incorporation or organization)

41-0743912

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

**13625 Technology Drive
Eden Prairie, Minnesota**

(Address of principal executive offices)

55344-2252

(Zip Code)

Registrant's telephone number, including area code: **(952) 938-8080**

Securities registered pursuant to Section 12(b) of the Act: **None**

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$.20 par value
Common Stock Purchase Rights

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

The aggregate market value of voting stock held by non-affiliates of the registrant, as of January 4, 2002, was approximately \$4,249,267,958 (based on the last sale price of such stock as reported by the Nasdaq Stock Market National Market).

The number of shares outstanding of the registrant's common stock, \$.20 par value, as of January 4, 2002, was 793,827,998.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part II of this Form 10-K is incorporated herein by reference to portions of our Annual Report to Shareowners for the fiscal year ended October 31, 2001. The information required by Part III of this Form 10-K is incorporated by reference to portions of our definitive proxy statement for our 2002 Annual Meeting of Shareowners to be filed with the Securities and Exchange Commission on or before January 31, 2002.

PART I

Item 1. BUSINESS

ADC Telecommunications, Inc. was incorporated in Minnesota in 1953 as Magnetic Controls Company. We adopted our current name in 1985. Our world headquarters are located at 13625 Technology Drive in Eden Prairie, Minnesota.

We are a leading global supplier of broadband network equipment, fiber optics, software and systems integration services that enable communications service providers to deliver high-speed Internet, data, video and voice services to consumers and businesses worldwide. Telephone companies, cable television operators, Internet and data service providers, wireless service providers and other communications service providers are building and upgrading the broadband network infrastructure required to offer high-speed Internet access as well as data, video, telephony and other interactive multimedia services. Our product offerings and development efforts are focused on increasing the speed and efficiency of the last mile/kilometer portion of broadband communications networks, and our product and service offerings help connect communications service providers' offices to businesses and end users' homes as well as to wireless communications devices.

Our customers include local and long-distance telephone companies, cable television operators, wireless service providers, new competitive service providers, broadcasters, governments, businesses, system integrators and communications equipment manufacturers and distributors. We offer optical- and copper-connectivity components and systems, broadband access and network equipment, software and systems integration services to our customers through the following two segments of product and service offerings:

Broadband Infrastructure and Access; and

Integrated Solutions.

Broadband Infrastructure and Access focuses on Internet Protocol (IP)-based offerings for the cable industry, Digital Subscriber Line (DSL) offerings for the communications equipment industry, and optics and broadband connectivity products for a variety of communications network applications. Integrated Solutions focuses on software and systems integration services.

Broadband Infrastructure and Access products consist of:

connectivity devices that provide the physical contact points needed to connect different communications network elements and gain access to communications system channels, and

access and transport systems that provide broadband, multiservice delivery capabilities within service provider networks.

Connectivity devices assist in the installation, testing, monitoring, accessing, managing, reconfiguring, splitting and multiplexing of communications systems channels within service providers' serving offices and the last mile/kilometer portion of communications networks. These products include broadband connection and access devices for copper, coaxial cable, optical, wireless and broadcast communications networks and also include passive and active optical components. Access and transport systems deliver broadband, multiservice communications to consumers and businesses over copper, coaxial cable and optical networks. Broadband Infrastructure and Access products are used throughout the world in telephone, cable television, Internet and wireless communications networks to deliver Internet, data, video and voice services to businesses and consumers.

Integrated Solutions products and services consist of systems integration services and operations support systems (OSS) software for broadband, multiservice communications over wireline and wireless networks. Systems integration services are used to design, equip and build communications networks that deliver Internet, data, video and voice services to consumers and businesses. OSS software includes

communications provisioning, activation, billing, customer management, network performance and service-level assurance software used by service providers to operate communications networks.

Industry Background

We believe that broadband, multiservice communications networks represent a key enabling capability for meeting the information needs of businesses and consumers around the world. The rapid growth of the Internet has driven the need for broadband network infrastructure. We believe consumers increasingly find dial-up modem speeds unacceptable for current Internet and Web-based applications. Further, we believe that new or future applications such as digital video and audio programs, wireless Internet access, video conferencing from personal computers, video e-mail, video on demand, distance learning, telemedicine and high-speed imaging will drive even more people to use broadband communications services. We believe that the global deregulation of communications markets is transforming traditional communications service providers into integrated communications providers. Traditional communications service providers offer only a limited selection of Internet, data, video or voice services, each on a separate network connection and a separate customer bill. Integrated communications providers operate broadband, multiservice networks that offer faster, more cost-effective and integrated Internet, data, video and voice services over a single high-speed network connection while sending only one bill for all of the services the customer uses. Due to deregulation, communications service providers now compete for customers by offering bundles of different communications services over cost-effective networks. As a result of competition among communications service providers to obtain and retain customers with bundled services, we believe there is a large potential global market for fiber optics, broadband access and network equipment, software and systems integration services to build and upgrade broadband, multiservice networks.

Marketplace Conditions

Our operating results during fiscal 2001 were affected adversely by the downturn in general economic conditions, particularly in the communications equipment industry. In this economic environment, many of our communications service provider customers have deferred capital spending, reduced their telecommunications equipment purchases, and announced plans to further reduce capital expenditures in fiscal 2002. The effect of these developments has been most pronounced in the U.S. market. As a result of these economic conditions, we expect that our future net sales will not grow at rates experienced prior to fiscal 2001. If the current economic conditions in the United States do not improve, or if the global economic slowdown worsens, we may continue to experience adverse effects on our business, operating results and financial condition.

Our ability to grow our business is dependent on our ability to develop and commercially introduce new products successfully and on the growth of the communications equipment and services market. The communications equipment industry is highly competitive, and we cannot guarantee that our new or enhanced products and services will meet with market acceptance or be profitable. Growth in the market for broadband communications products and services depends on a number of factors, including the availability of capital to communications service providers, the amount of capital expenditures by communications service providers, new and revised regulatory and legal requirements, and end-user demands for Internet, data, video, voice and other communications services.

Our operating results may fluctuate significantly from quarter to quarter due to many factors, including but not limited to uneven or changing capital spending by our customers and the timing of significant capital expenditures, and results of operations described in this Form 10-K may not be indicative of results to be achieved in future periods. As a result of our growth in past periods, our expenses had increased substantially as we entered fiscal 2001. Throughout fiscal 2001, we implemented a cost restructuring plan through which we took steps to reduce operating expenses and capital spending as it became evident our industry was entering a prolonged economic downturn. Our

cost-saving actions included the sale of non-strategic product lines, the disposition of certain assets and a consolidation of facilities as well as reductions in our employee base, elimination of contractor positions and unreplaced attrition, which reduced our workforce by approximately 46.4%. Despite these actions, if we are unable to meet expected revenue levels in any particular quarter, there may be a material adverse impact

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on our operating results for that period because we may not be able to further reduce our expenses rapidly enough to compensate for reduced revenue levels. Our expense levels are based in part on our expectations of future revenues. Although management has and will continue to take measures to adjust expense levels, if revenue levels in a particular period fluctuate, operating results may be adversely affected. Furthermore, we expect that gross margins may decline due to lower sales volumes, potentially heightened price competition, increasing levels of service revenues as a percentage of total revenues, higher inventory obsolescence and reserve charges, ongoing introduction of new products for new high-growth markets, and changes in channels of distribution or in the mix of products sold. Additional reductions in gross margins may occur if product or related warranty costs are greater than we have experienced in the past.

As part of our restructuring initiative in fiscal 2001, we sold non-strategic product lines in cable/broadcast TV transmission, broadband wireless transmission, enterprise access products, wireless components, phase masks and enhanced services software, and closed down our Cellworx® transport product line. These products accounted for approximately \$368.8 million in net sales in fiscal 2001 but did not meet our growth, profitability and market leadership criteria. As a result of these sales and closures, we recorded non-recurring restructuring charges in fiscal 2001. These charges reflect management's estimate of the overall impact of decisions and actions taken with respect to these product lines. Actual final restructuring charges may differ from management's estimates and may result in additional charges or credits to our future operating results.

Our results of operations normally are subject to seasonal factors. We historically have experienced a stronger demand for our products during the fourth fiscal quarter ending October 31, primarily as a result of customer budget cycles and our fiscal year-end incentives, and have experienced a weaker demand for our products during the first fiscal quarter ending January 31, primarily as a result of the number of holidays in late November, December and early January and a general industry slowdown during that period. There can be no assurance that these historical seasonal trends will continue in the future. For instance, due to the economic downturn in the communications equipment and services market during fiscal 2001, this historical trend was not evident in fiscal 2001. A more detailed description of the risks to our business related to seasonality, along with other risk factors associated with our business, can be found in Exhibit 99-a to this Annual Report on Form 10-K.

As used in this report, fiscal 1999, fiscal 2000, fiscal 2001 and fiscal 2002 refer to our fiscal years ended October 31, 1999, 2000, 2001 and 2002, respectively.

Strategy

Our strategy is to capitalize on opportunities in the global communications market created by the deployment of broadband, multiservice networks. Communications service providers intend to serve their consumer and business customers with broadband, multiservice networks that offer faster, more cost-effective and integrated Internet, data, video and voice services. Our broad range of products and services address key areas of the communications network infrastructure. Our products and services are used to design, build and upgrade networks, connect and access networks, transport Internet, data, video and voice services over communications service networks, and provide operations support system (OSS) software to operate communications networks. Our many product and service offerings address the diverse needs of a customer base that includes local and long-distance telephone companies, cable television operators, wireless service providers, Internet and data service providers, other communications service providers, broadcasters, enterprises, governments, system integrators and communications equipment manufacturers and distributors.

4

During fiscal 2001, we restructured our business. This restructuring was precipitated largely by the general downturn in economic conditions in the communications equipment industry. The goal of our restructuring has been to position us for profitable growth in the most critical market segments for the profitable deployment of broadband networks and services. In connection with this restructuring, we undertook several steps to streamline our operations and more acutely focus our business on strategic products and global customer satisfaction. We completed an extensive review of our existing product and service offerings. Through this review we identified four key future growth areas: optics, IP cable, DSL and software. We also renewed our commitment to two of our historic core businesses: broadband connectivity systems and systems integration services. We then either divested or closed product and service offerings that were not included within the four key future growth areas or the two historic core businesses. In addition to streamlining our operations to focus on strategic products, we also have reorganized our sales, marketing and customer service organizations to serve our customers more effectively with custom-tailored solutions spanning the breadth of our products and services, in contrast to our historical approach of presenting only a narrow set of products or services. We also will provide members of our sales and customer service organizations with primary responsibility for specific customers for all of our product and services offerings. Our intent through this reorganization is to help our customers be successful by understanding and being responsive to their needs, and working collaboratively with them to provide cost-competitive, scalable and custom-tailored solutions that create competitive advantages in broadband communications.

In our restructured company, key components of our long-term strategy include:

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focusing on opportunities related to broadband, multiservice networks;

leveraging our technological capabilities across our various product groups;

increasing our global market penetration; and

expanding our development through acquisitions, alliances and internal efforts.

Focus on Opportunities Related to Broadband, Multiservice Networks. Global deregulation, the rapid growth of the Internet and increasing consumer and business demands for broadband communications have created significant global opportunities to build and upgrade broadband, multiservice networks. Telephone companies, cable television operators, Internet and data service providers, wireless service providers and other communications service providers are building the broadband communications infrastructure required to offer high-speed Internet access, data, video, voice and other interactive multimedia services to consumers and businesses. Because broader network bandwidths continually are required for these services, we believe that building and upgrading broadband, multiservice networks to serve consumers and businesses presents one of the greatest market growth opportunities in the communications industry today. We are focusing our development and marketing resources on fiber optics, network equipment, software and systems integration services that will enable communications service providers worldwide to serve their consumer and business customers with broadband, multiservice networks that offer faster, more cost-effective and integrated Internet, data, video and voice services.

Leverage Our Technological Capabilities Across Our Various Product Groups. We have developed substantial expertise in fiber-optic, copper, coaxial cable, wireless, Internet Protocol and broadband infrastructure and transport technologies, software products and systems integration services. We have built these core competencies through internal development, acquisitions and technology licensing arrangements. Our strategy is to leverage our core competencies effectively across all of our product and service offerings in order to provide our customers new products with enhanced features, functions, cost effectiveness and network management tools for their evolving Internet, data, video and voice service offerings. This strategy also allows us to offer our customers custom-tailored solutions that

5

enable them to scale network offerings, more fully automate operations and accelerate service and revenue growth.

Increase Our Global Market Penetration. We believe that significant growth for our products and services will occur outside the United States as a result of global deregulation, substantial expansion or enhancement of communications services by many foreign countries, and the global expansion of multinational communications service providers. Our strategy is to grow our international business by increasing our international sales and marketing resources, offering integration services in areas outside North America, leveraging our existing customer relationships, developing additional international distribution channels and seeking strategic alliances and acquisitions. We have established our presence in international markets with manufacturing facilities, distribution centers, sales and technical support offices and systems integration capabilities to serve our customers outside the United States.

Expand Our Development Through Acquisitions, Alliances and Internal Efforts. Due to the dynamic nature of the communications equipment industry, we have sought and intend to continue to seek alliances and acquisitions that will:

add key technologies that we can leverage across our businesses;

broaden our product offerings;

permit us to enter attractive new markets; and

expand or enhance our distribution channels globally.

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Our ability to implement our strategy effectively is subject to numerous uncertainties, many of which are described in Exhibit 99-a to this Form 10-K. We cannot assure you that our efforts will be successful.

Product and Service Offering Groups

Our connectivity solutions, network equipment, software and integration services are divided into two principal segments:

Broadband Infrastructure and Access; and

Integrated Solutions.

Broadband Infrastructure and Access product offerings focus on IP-based offerings for the cable industry, DSL offerings for the communications equipment industry, and optics and broadband connectivity products for a variety of communications network applications. Integrated Solutions product and service offerings focus on software and systems integration services. The primary product and service offerings of each of these segments are described below.

Broadband Infrastructure and Access

Broadband Infrastructure and Access products consist of:

connectivity devices that provide the physical contact points needed to connect different communications network elements and gain access to communications system channels, and

access and transport systems that provide broadband, multiservice delivery capabilities within service provider networks.

Connectivity devices assist in the installation, testing, monitoring, accessing, managing, reconfiguring, splitting and multiplexing of communication systems channels within service providers' serving offices and the last mile/kilometer portion of communications net