AVIAT NETWORKS, INC.
Form 10-Q
February 10, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q
(Mark One)

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

For the quarterly period ended January 1, 2016

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 (State or other jurisdiction of incorporation or organization)	20-5961564 (I.R.S. Employer Identification No.)
5200 Great America Parkway Santa Clara, California	95054
(Address of principal executive offices)	(Zip Code)

(408) 567-7000
(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 (l) 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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 x 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	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o

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

The number of shares outstanding of the registrant's Common Stock as of February 2, 2016 was 63,016,873 shares.

AVIAT NETWORKS, INC.
QUARTERLY REPORT ON FORM 10-Q
For the Quarterly Period Ended January 1, 2016
Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
AVIAT NETWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Quarter Ended		Two Quarters Ended	
(In millions, except per share amounts)	January 1, 2016	December 26, 2014	January 1, 2016	December 26, 2014
Revenues:				
Revenue from product sales	$44.7	$ 56.4	$98.4	$ 112.3
Revenue from services	25.7	34.5	51.6	61.0
Total revenues	70.4	90.9	150.0	173.3
Cost of revenues:				
Cost of product sales	33.3	41.5	70.5	82.9
Cost of services	20.7	25.4	42.1	44.4
Total cost of revenues	54.0	66.9	112.6	127.3
Gross margin	16.4	24.0	37.4	46.0
Operating expenses:				
Research and development expenses	5.2	6.4	10.7	13.0
Selling and administrative expenses	16.2	21.2	33.3	40.4
Amortization of identifiable intangible assets	—	0.1	—	0.2
Restructuring charges	—	—	—	1.5
Total operating expenses	21.4	27.7	44.0	55.1
Operating loss	(5.0)	(3.7)	(6.6)	(9.1)
Interest income	0.1	0.1	0.2	0.2
Interest expense	(0.1)	(0.2)	(0.1)	(0.3)
Loss from continuing operations before income taxes	(5.0)	(3.8)	(6.5)	(9.2)
Provision for income taxes	0.5	0.6	0.5	0.9
Loss from continuing operations	(5.5)	(4.4)	(7.0)	(10.1)
Income (loss) from discontinued operations, net of tax	—	(0.1)	0.3	0.1
Net loss	(5.5)	(4.5)	(6.7)	(10.0)
Less: Net income attributable to noncontrolling interests, net of tax	0.2	—	0.2	—
Net loss attributable to Aviat Networks	$(5.7)	$ (4.5)	$(6.9)	$ (10.0)
Amount attributable to Aviat Networks:				
Loss from continuing operations, net of tax	$(5.7)	$ (4.4)	$(7.2)	$ (10.1)
Income (loss) from discontinued operations, net of tax	$—	$ (0.1)	$0.3	$ 0.1
Loss per share attributable to Aviat Networks' common stockholders, basic and diluted:				
Continuing operations	$(0.09)	$ (0.07)	$(0.12)	$ (0.16)
Discontinued operations	$—	$ (0.00)	$0.00	$ 0.00
Net loss	$(0.09)	$ (0.07)	$(0.11)	$ (0.16)
Weighted average shares outstanding, basic and diluted	62.8	62.1	62.6	62.1

See accompanying Notes to Condensed Consolidated Financial Statements

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

(In millions)	Quarter Ended January 1, 2016	Quarter Ended December 26, 2014	Two Quarters Ended January 1, 2016	Two Quarters Ended December 26, 2014
Net loss	$(5.5)	$(4.5)	$(6.7)	$(10.0)
Other comprehensive loss:				
Change in unrealized gain on cash flow hedges	—	0.1	—	0.2
Net change in unrealized gain on hedging activities	—	0.1	—	0.2
Net change in cumulative translation adjustment	(0.3)	(2.0)	(1.1)	(3.3)
Other comprehensive loss	(0.3)	(1.9)	(1.1)	(3.1)
Comprehensive loss	(5.8)	(6.4)	(7.8)	(13.1)
Comprehensive income attributable to noncontrolling interests, net of tax	0.2	—	0.2	—
Comprehensive loss attributable to Aviat Networks	$(6.0)	$(6.4)	$(8.0)	$(13.1)

See accompanying Notes to Condensed Consolidated Financial Statements

AVIAT NETWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In millions)	January 1, 2016	July 3, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	$39.5	$34.7
Accounts receivable, net	76.4	83.5
Unbilled costs	13.2	17.3
Inventories	32.6	32.9
Customer service inventories	4.2	6.2
Deferred income taxes	1.4	1.5
Other current assets	12.1	15.0
Total current assets	179.4	191.1
Property, plant and equipment, net	21.2	24.3
Deferred income taxes	7.2	7.6
Other assets	1.5	1.7
TOTAL ASSETS	$209.3	$224.7
LIABILITIES AND EQUITY		
Current Liabilities:		
Short-term debt	$9.0	$9.0
Accounts payable	40.4	46.6
Accrued compensation and benefits	6.9	7.5
Other accrued expenses	18.0	19.7
Advance payments and unearned income	36.3	35.8
Deferred income taxes	0.2	0.2
Restructuring liabilities	2.5	3.9
Total current liabilities	113.3	122.7
Unearned income	10.9	9.8
Other long-term liabilities	2.0	2.2
Reserve for uncertain tax positions	1.4	1.4
Deferred income taxes	4.7	4.7
Total liabilities	132.3	140.8
Commitments and contingencies (Note 11)		
Equity:		
Aviat Networks stockholders’ equity:		
Preferred stock	—	—
Common stock	0.6	0.6
Additional paid-in-capital	810.1	809.2
Accumulated deficit	(724.4)	(717.5)
Accumulated other comprehensive loss	(9.6)	(8.5)
Total Aviat Networks stockholders’ equity	76.7	83.8
Noncontrolling interests	0.3	0.1
Total equity	77.0	83.9
TOTAL LIABILITIES AND EQUITY	$209.3	$224.7

See accompanying Notes to Condensed Consolidated Financial Statements

5

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

(In millions)	Two Quarters Ended January 1, 2016	December 26, 2014
Operating Activities		
Net loss	$(6.7)	$(10.0)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Amortization of identifiable intangible assets	—	0.2
Depreciation and amortization of property, plant and equipment	3.4	3.5
Provision for receivables	0.2	0.4
Share-based compensation	0.9	1.0
Deferred income tax benefit (expense)	0.5	(0.1)
Charges for inventory and customer service inventory write-downs	2.6	2.8
Gain on disposition of WiMAX business	—	(0.1)
Loss on disposition of property, plant and equipment, net	0.2	—
Changes in operating assets and liabilities:		
Accounts receivables	6.4	(5.7)
Unbilled costs	4.0	(2.6)
Inventories	(3.1)	(0.5)
Customer service inventories	1.3	1.6
Accounts payable	(6.0)	0.6
Accrued expenses	(0.5)	4.6
Advance payments and unearned income	2.8	(1.7)
Income taxes payable or receivable	(0.7)	(0.5)
Other assets and liabilities	1.1	(2.6)
Net cash provided by (used in) operating activities	6.4	(9.1)
Investing Activities		
Payments for acquisition of property, plant and equipment	(0.8)	(2.4)
Net cash used in investing activities	(0.8)	(2.4)
Financing Activities		
Proceeds from borrowings	18.0	18.0
Repayments of borrowings	(18.0)	(15.0)
Payments on capital lease obligations	—	(0.1)
Net cash provided by financing activities	—	2.9
Effect of exchange rate changes on cash and cash equivalents	(0.8)	(1.5)
Net Increase (Decrease) in Cash and Cash Equivalents	4.8	(10.1)
Cash and Cash Equivalents, Beginning of Period	34.7	48.8
Cash and Cash Equivalents, End of Period	$39.5	$38.7

See accompanying Notes to 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. 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 by us 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 quarter ended January 1, 2016 (the “second quarter and first two quarters of fiscal 2016”) 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 July 3, 2015.
The condensed consolidated financial statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. Significant intercompany transactions and accounts have been eliminated.
We operate on a 52-week or 53-week year ending on the Friday nearest June 30. The first two quarters of fiscal 2016 and fiscal 2015 included 13 weeks in each quarter.
Use of Estimates
The preparation of 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 doubtful accounts, inventory valuation, valuation allowances for deferred tax assets, uncertainties in income taxes, restructuring obligations, product warranty obligations, share-based awards, contingencies and useful lives of property, plant and equipment.
Reclassification
During the first quarter of fiscal 2016, we recorded a $1.2 million reclassification to increase long term unearned income and decrease current advance payments and unearned income as of July 3, 2015. This reclassification had no impact on our total assets, total liabilities, results of operations or cash flows and has been included in the previously reported amounts in the table below.
During the second quarter of fiscal 2016, we recorded a $4.7 million reclassification to decrease both accounts receivable and current unearned income in our consolidated balance sheet as of July 3, 2015. This reclassification had no impact on our results of operations. In our consolidated statements of cash flow, the reclassification increased changes in accounts receivables and decreased changes in advance payments and unearned income by $4.7 million; however, the net

cash used in operating activities was not impacted by this reclassification. This reclassification was immaterial to the previously issued financial statements; therefore, we revised our consolidated balance sheet for comparative purpose. The following table summarizes the effect of this reclassification on the previously filed consolidated balance sheet as of July 3, 2015:

	Previously Reported (In millions)	Reclassification Adjustment	Revised
As of July 3, 2015:			
Accounts receivables, net	$88.2	$(4.7)	$83.5
Total current assets	$195.8	$(4.7)	$191.1
Total assets	$229.4	$(4.7)	$224.7
Advance payments and unearned income	$40.5	$(4.7)	$35.8
Total current liabilities	$127.4	$(4.7)	$122.7
Total liabilities	$145.5	$(4.7)	$140.8

Summary of Significant Accounting Policies

There have been no material changes in our significant accounting policies as of and for the first two quarters of fiscal 2016, as compared to the significant accounting policies described in our Annual Report on Form 10-K for the fiscal year ended July 3, 2015.

Recently Issued Accounting Standards

In January 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-01, 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 that 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 are currently evaluating the impact this guidance will have on our consolidated financial statements and it will become effective for us at the beginning of our first quarter of fiscal 2019.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes, which amends the existing guidance on income taxes to require the classification of all deferred tax assets and liabilities as non-current on the balance sheet. The amendments are effective for financial statements issued for the annual periods beginning after December 15, 2016 and interim periods within those annual periods, and may be applied either prospectively or retrospectively. Early adoption is permitted. We are currently evaluating the effect of the adoption of the standard will have on our consolidated financial statements and related disclosures.

In July 2015, the FASB issued ASU No. 2015-11 (Subtopic 330), Simplifying the Measurement of Inventory, which provides guidance to companies who account for inventory using either the first-in, first-out (“FIFO”) or average cost methods. The guidance states that companies should measure inventory at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. This ASU is effective for fiscal years beginning after December 15, 2016. Early adoption is permitted. We are currently evaluating the effect of the adoption of the standard will have on our consolidated financial statements and related disclosures.

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30), Simplifying the Presentation of Debt Issuance Costs, which provides guidance on the balance sheet presentation for debt issuance costs and debt discounts and debt premiums. To simplify the presentation of debt issuance costs, the standard requires

that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The standard is effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. We are currently evaluating the effect of the adoption of the standard will have on our consolidated financial statements and related disclosures.

In August 2014, FASB issued ASU No. 2014-15, Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern, which provides guidance on determining when and how to disclose going concern uncertainties in the financial statements. The guidance requires management to perform interim and annual assessments of an entity's ability to continue as a going concern. This standard is effective for annual reporting periods beginning after December 15, 2016, including interim periods during the annual period. Early application is permitted. We are currently evaluating the effect of the adoption of the standard will have on our consolidated financial statements and related disclosures.

On May 28, 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This ASU is based on the principle that revenue is recognized to depict the transfer of 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. This ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In July 2015, the FASB deferred the effective date of this ASU from December 15, 2016 to December 15, 2017, with early adoption permitted before annual periods beginning after December 15, 2016. Accordingly, the new standard is effective for us beginning in our fiscal year 2019. The principles may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. We are currently evaluating the transition methods and the effect that this ASU will have on our consolidated financial statements and related disclosures.

Note 2. Net Loss Per Share of Common Stock

We compute net loss per share attributable to our common stockholders using the two-class method. Basic net loss per share is computed using the weighted average number of common shares and participating securities outstanding during the period. Our unvested restricted shares contain rights to receive non-forfeitable dividends and therefore are considered to be participating securities and would be included in the calculations of net income per basic and diluted common share. However, we incurred a net loss in all periods presented. Undistributed losses are not allocated to unvested restricted shares due to the fact that the unvested restricted shares are not contractually obligated to share the losses of the company.

As we incurred a net loss for all periods presented, the effect of outstanding stock options, restricted stocks and units and performance shares and units were anti-dilutive and therefore were excluded from the diluted net loss per share calculations. The following table summarizes the potential shares of common stock that were excluded from the diluted net loss per share calculations:

	January 1, 2016	December 26, 2014
	(In millions)	
Stock options	6.9	7.0
Restricted stocks and units and performance shares and units	3.9	0.2
Total potential shares of common stock excluded	10.8	7.2

Note 3. Balance Sheet Components

Accounts Receivable, net

Our net accounts receivable as of January 1, 2016 and July 3, 2015 was as follows:

	January 1, 2016	July 3, 2015
	(In millions)	
Accounts receivable	$82.9	$90.2
Less allowances for collection losses	(6.5)	(6.7)
	$76.4	$83.5

We regularly require letters of credit from some customers and, from time to time, we discount these letters of credit issued by customers through various financial institutions. The discounting of letters of credit depends on many factors, including the willingness of financial institutions to discount the letters of credit and the cost of such arrangements. Under these arrangements, collection risk is fully transferred to the financial institutions. We record the financing charges on discounting these letters of credit as interest expense. Total customer letters of credit discounted and related interest expense were as follows:

	Quarter Ended		Two Quarters Ended	
	January 1, 2016	December 26, 2014	January 1, 2016	December 26, 2014
	(In millions)			
Customer letters of credit being discounted	$15.8	$7.8	$18.5	$7.8
Interest expense	$0.1	$0.1	$0.1	$0.1

Inventories

Our inventories as of January 1, 2016 and July 3, 2015 were as follows:

	January 1, 2016	July 3, 2015
	(In millions)	
Finished products	$21.5	$21.1
Work in process	3.3	3.8
Raw materials and supplies	7.8	8.0
	$32.6	$32.9
Deferred cost of revenue included within finished goods	$3.0	$2.2
Consigned inventories included within raw materials	$7.3	$6.8

We recorded charges to adjust our inventory and customer service inventory to the lower of cost or market. These charges were primarily due to excess and obsolete inventory resulting from product transitioning and discontinuance. During the first two quarters of fiscal 2016 and 2015, such charges incurred were classified in cost of product sales as follows:

	Quarter Ended		Two Quarters Ended	
	January 1, 2016	December 26, 2014	January 1, 2016	December 26, 2014
	(In millions, except percentages)			
Excess and obsolete inventory charges	$1.0	$0.9	$1.9	$1.9
Customer service inventory write-downs	0.4	0.3	0.7	0.9
	$1.4	$1.2	$2.6	$2.8
As % of revenue	2.0 %	1.3 %	1.7 %	1.6 %

Property, Plant and Equipment, net

Our property, plant and equipment, net as of January 1, 2016 and July 3, 2015 were as follows:

	January 1, 2016	July 3, 2015
	(In millions)	
Land	$0.7	$0.7
Buildings and leasehold improvements	9.7	9.7
Software	13.6	13.6
Machinery and equipment	45.3	45.2
	69.3	69.2
Less accumulated depreciation and amortization	(48.1)	(44.9)
	$21.2	$24.3

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