

ADC TELECOMMUNICATIONS INC
Form 10-K
January 10, 2003

[QuickLinks](#) -- Click here to rapidly navigate through this document

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, 2002.

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

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.

The aggregate market value of voting stock held by non-affiliates of the registrant based on the last sale price of such stock as reported by the NASDAQ Stock Market on April 30, 2002 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$3,089,000,000.

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

The number of shares outstanding of the registrant's common stock, \$0.20 par value, as of January 6, 2003, was 801,720,168.

DOCUMENTS INCORPORATED BY REFERENCE

A portion of the information required by Part III of this Form 10-K is incorporated by reference from portions of our definitive proxy statement for our 2003 Annual Meeting of Shareowners to be filed with the Securities and Exchange Commission on or before January 31, 2003.

As used in this report, fiscal 2000, fiscal 2001, fiscal 2002 and fiscal 2003 refer to our fiscal years ended or ending October 31, 2000, 2001, 2002 and 2003, respectively.

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, 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 broadband 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 telecommunications industry, and broadband connectivity products for wireline, cable and wireless communications network applications. These products consist of:

connectivity systems and components that provide the infrastructure to wireline, cable and wireless service providers to connect Internet, data, video and voice services to the network over copper, coaxial and fiber-optic cables, and

access systems used by wireline, cable and wireless service providers to deliver high-speed Internet, data and voice services to consumers and businesses in the last mile/kilometer of communications networks.

Integrated Solutions focuses on operations support system (OSS) software and system integration services 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 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 help to meet 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, interactive entertainment and gaming, 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 has the potential to transform 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 have the ability to 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 broadband access and network equipment, software and systems integration services to build and upgrade broadband, multiservice networks.

Strategy

Our strategy is to capitalize on selected 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 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.

As explained in more detail in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations of this Form 10-K, we restructured our business in fiscal 2001 and 2002 in response to a significant decline in capital spending by our customers. Through this restructuring, we also sought to better position ourselves for profitable growth in the market segments where we believe we have a sustainable competitive advantage. The six areas of our strategic focus are: broadband connectivity products; IP cable equipment; DSL equipment; OSS software; systems integration services; and products to extend the coverage of existing wireless networks. The most significant strategic change we made in 2002 was our decision to withdraw from the optical components business, an area that was the subject of significant oversupply and intense competition.

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

gaining market share in our areas of strategic focus;

increasing our global market penetration;

leveraging our technological capabilities across our various product groups; and

lowering our cost structure to compete more effectively.

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

Gaining Market Share. In the current environment of reduced capital spending by communication service providers, we believe that we must gain market share in order to grow our business. We intend to increase our market share by offering a compelling value proposition through a combination of product functionality, quality, price-competitiveness and world-class customer service, with particular emphasis on helping our customers lower their overall cost of providing communication services to end user customers.

Increase Our Global Market Penetration. We believe that significant opportunities for communications equipment vendors exist outside the United States as a result of global deregulation, substantial expansion or enhancement of communications services by non-U.S. providers, and the global expansion of multinational communications service providers. Our strategy is to grow our international business by aggressively pursuing and focusing our resources on high potential opportunities, leveraging our existing customer relationships, developing additional international distribution channels and seeking strategic alliances. Where appropriate, we have established our presence in international markets with manufacturing facilities, sales and technical support offices and systems integration capabilities to serve our customers outside the United States.

Leverage Our Technological Capabilities Across Our Various Product Groups. We have developed substantial expertise in copper (twisted pair), coaxial and fiber-optic connectivity, wireless, IP cable data/telephony and DSL 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 enable them to scale network offerings, more fully automate operations and accelerate service and revenue growth.

Lowering Our Cost Structure. We intend to continue our efforts to lower our overall cost structure to become or remain a low-cost industry leader in selected product areas, while also maintaining our reputation for high-quality products and services and world-class customer service.

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 systems integration services are divided into two principal segments:

Broadband Infrastructure and Access; and

Integrated Solutions.

Our Broadband Infrastructure and Access business focuses on IP-based offerings for the cable industry, DSL offerings for the telecommunications industry, and broadband connectivity products for a variety of communications network applications. Broadband Infrastructure and Access products accounted for approximately 68%, 75% and 84% of our net sales in fiscal 2002, 2001 and 2000, respectively. Our Integrated Solutions business focuses on OSS software and systems integration services. Integrated Solutions products and services accounted for approximately 32%, 25% and 16% of

our net sales in fiscal 2002, 2001 and 2000, respectively. The primary products and services offered by each of these segments are described below.

Broadband Infrastructure and Access

Our Broadband Infrastructure and Access products for public network providers are located primarily in service provider serving offices and networks, including telephone company central offices and networks, cable television company headend offices and networks, and wireless company global switching centers, networks and tower sites. All of these facilities contain the equipment used in switching and transmitting incoming and outgoing communications channels. Portions of our broadband transmission systems are located in the public network outside the serving offices and on end-users' premises. Our enterprise private and governmental network customers generally purchase our products for installation in the networks located on their premises. Broadband Infrastructure and Access products consist of the following general product

groupings:

Broadband Connectivity Systems and Components

Our broadband connectivity devices are used in copper (twisted pair), coaxial, fiber-optic, wireless and broadcast communication networks. These products provide the physical interconnections between network components or access points into networks. Principally, these products include:

DSX Products. We manufacture digital signal cross-connect (DSX) modules, panels and bays, which are designed to terminate and cross-connect copper channels and gain access to digital channels for Internet, data, video and voice transmission. Within our DSX product group, we offer solutions to meet global market needs for both twisted-pair and coaxial cable solutions.

Fiber Distribution Panels and Frame Products. Fiber distribution panels and frames, which are functionally similar to copper cross-connect modules and bays, provide interconnection points between fiber-optic cables entering a service provider's serving office and fiber-optic cables connected to fiber-optic equipment within the serving office. Our fiber distribution panels and frames are designed with special consideration of fiber-optic properties.

RF Signal Management Products. Our series of Radio Frequency (RF) products are designed to meet the unique performance requirements of video and data transmission over coaxial cable used in today's cable television networks and emerging cable modem networks. The RF Worx® product family leads the industry by offering the "plug-and-play" flexibility of combiners, splitters, couplers and forward/reverse amplification modules in a single platform designed for optimum cable management. The RF Worx® system provides cable television network design engineers with the full breadth of RF signal management tools that are essential in an evolving cable television headend environment.

Power Distribution and Protection Panels. Our PowerWorx® family of circuit breaker and fuse panels are designed to power and protect network equipment in multi-service broadband networks.

ADSL Splitter Products. We manufacture Asymmetric Digital Subscriber Line (ADSL) products and telephone system splitter platforms designed to separate the low frequency telephone system signal and high frequency data signal that are carried on a single copper pair. This function is critical for carriers offering both data and voice services. Our Broadwire family of splitter products offer a diverse set of platforms meeting all global specifications.

Structured Cabling Connectivity. Our line of patch panels, patch cords, connectors, media converters and cable management products provide telecom service providers and enterprise customers with Ethernet infrastructure solutions for converging Internet, data, video and voice networks.

5

Modular Fiber-Optic Routing Systems. Our FiberGuide® system is a modular routing system that provides a segregated, protected method of storing and routing fiber-optic patch cords and cables within a service provider's serving office.

Fiber-Optic Patch Cords. Fiber-optic patch cords are the basic components used to gain access to fiber communications channels for testing, maintenance, cross-connection and configuration purposes. We incorporate our fiber-optic patch cords and cable assemblies into our own products and also sell them in component form. Our fiber-optic patch cords provide immediate identification of fiber-optic connections. Our LX.5® fiber connector doubles the capacity of fiber termination equipment by allowing two fibers to fit into the standard SC adapter footprint.

Jacks, Plugs, Patch Cords, Jackfields and Patch Bays. Jacks and plugs are the basic components used to gain access to copper communications channels for testing and maintenance. Patch cords are wires or cables with a plug on each end. We incorporate our jacks, plugs and patch cords into our own products and also sell them in component form, primarily to original equipment manufacturers (OEMs). A jackfield is a module containing an assembly of jacks wired to terminal blocks or connectors and used by communications companies to gain access to copper communication channels for testing or patching the channels. When testing a large number of channels, series of jackfields are combined in specialized rack assemblies called patch bays. We manufacture a large range of jackfields and patch bays in various configurations. Some of these jackfields are specialized for use in audio and video transmission networks in the broadcast cable television and post-production industries.

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

PatchSwitch System and PatchMate Module. Our PatchSwitch system is a data network management product that provides access to and monitors, tests and reconfigures digital data channels and permits local or remote switching to alternate channels or backup equipment. This system is modular, permitting the user to select and combine the particular functions desired in a system. The PatchMate module is a manually operated electromechanical device used to gain access to the network in order to monitor, test and reconfigure digital data channels.

Wireless Systems and Components

Our wireless systems and components help amplify and extend the coverage of wireless communications networks. These products include:

Wireless Infrastructure Equipment and Subsystems. We develop, manufacture and market SMARTop® and ClearGain® families of tower-top amplifier products, which are distributed globally for all major air interfaces. These products are sold primarily to wireless original equipment manufacturers (OEMs) and to carriers.

Coverage Products. Our Digivance family of wireless systems products include solutions that address coverage and capacity challenges for wireless operators. Our solutions address a range of applications, from base station hotels that serve significant segments of a metropolitan area to products that provide complete coverage for a single building or campus. The Digivance family is the next-generation replacement of our existing CityCell® product offering.

Access Systems

Our access systems operate between service providers' serving offices and the last mile/kilometer portion of communications networks. These products include:

Soneplex® and HiGain® Products. Soneplex® and HiGain® are carrier-class, intelligent loop access platforms that enable communications service providers to deliver T1/E1-based services over copper or optical facilities in the last mile/kilometer of communications networks. Soneplex® and

6

HiGain® products integrate functions and capabilities that help reduce the capital and operating costs of delivering T1/E1-based services.

PG-Flex®. The PG-Flex® is a micro digital loop carrier that is used by telecommunications service providers to increase the carrying capacity of common voice-grade copper wire in the last mile/kilometer of communications networks. This system is capable of conveying both regular voice service and ADSL.

Homeworx Telephony System. The Homeworx system has been designed for deployment on Hybrid Fiber Coax (HFC) cable television operator networks. The Homeworx system includes headend and customer premises equipment to deliver voice and data service to residential or small business subscribers.

Cuda 12000 Product. The Cuda 12000 is a next-generation IP Access Switch based on a high-performance, carrier class edge IP Router. It is being deployed initially as a Cable Modem Termination System (CMTS) for cable operators who want to offer high-speed Internet access via industry standard cable modem services. The Cuda 12000 is designed to support a high penetration of next generation IP-based cable services, including IP Cable Telephony, gaming, video streaming, video telephony and commercial services that leverage the platform's high reliability, low latency and enhanced quality of service attributes. The Cuda 12000 will also serve as the base platform for other IP-based broadband access systems that we offer, including a voice-over Internet Protocol (VoIP) media gateway for converting between IP and circuit-switched voice traffic.

BroadAccess Platform. Our BroadAccess product is targeted to deliver services to end users over copper wires, ranging from classic telephony to broadband DSL services. BroadAccess is a multiservice access platform designed for and targeted to international markets. It provides multiple services with interfaces to both legacy voice switches as well as to the Internet and asynchronous transfer mode (ATM) networks.

Integrated Solutions

Integrated Solutions products and services consist of systems integration services and 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 billing, customer management, network performance and service-level assurance software used by service providers to operate communications networks.

Systems Integration Services

Our systems integration services are offered in North America and Europe and provide integration solutions for customers that deliver voice, video and data services over wireless and wireline networks. Our systems integration services support both the multi-vendor and multi-service delivery requirements of our customers. These services support customers throughout the technology life-cycle, from network design, build-out, turn-up and testing to ongoing maintenance and training, and are utilized by our customers in creating and maintaining intra-office, inter-office, or coast-to-coast networks.

7

OSS Solutions

We provide a broad range of OSS software and a full range of professional services, including assistance in analyzing a customer's requirements and then designing, developing and implementing a solution. These products include:

Billing and Customer Management Software. We provide real time billing, customer management and enhanced Web solutions for local, Internet, data, long-distance, wireless, cable and content markets. These products and services are designed to enable communications service providers to bring new service offerings to market quickly, and to bill accurately and reliably for multiple services on one convergent invoice. As part of our Singularit.e suite, we introduced Singl.eView, which includes real-time convergent billing, integrated customer management and Web products. Singl.eView is a modular product that features a flexible architecture with a rules-based transaction engine and enhanced Web solutions. We also provide facilities management services, which allow customers to license Singl.eView from us while we manage the operation of the software on customer owned hardware, a complete service bureau billing and customer care service. In addition, we recently introduced our SingleView Commerce Engine , a patent-pending OSS technology that will assist service providers in managing advanced services and complex revenue-share models for 3G wireless and other next-generation networks in real-time. This technology addresses the convergence of mobile and broadband service by allowing service providers to manage complex relationships seamlessly with content providers, supporting varied payment choices and financial transaction options for subscribers. The SingleView Commerce Engine provides the instrument for service providers to develop business models that capitalize on next-generation networks and lifestyle-driven services by providing a three-dimensional view of operations through a single platform from a financial, subscriber and product perspective. We believe that the Singl.eView Commerce Engine also has applications outside of our traditional communication service provider market focus, particularly with media and content companies who have a need for transaction-based billing systems.

Network and Service Management Software. We develop and market network performance management, service quality management and service level agreement software as part of the Singularit.e suite under the Metrica® brand name. These products are designed to enable communications service providers to monitor and to assure quality of service to their customers.

Product Review and Development

As part of our ongoing business, we continually review individual product lines with attention to overlap and profitability. We intend to add or eliminate product lines as appropriate to optimize our financial performance. Elimination of one or more product lines could result in charges associated with the disposition of manufacturing assets and facilities and possible workforce reductions.

Sales and Marketing

We sell our products to customers in three primary markets:

the U.S. public communications network market, which includes the regional bell operating companies (RBOCs), other telephone companies, long-distance carriers, wireless service providers, cable television operators and other domestic public network providers;

the U.S. private and governmental markets, which include business customers and governmental agencies that own and operate their own Internet, data, video and voice networks for internal use; and

the public and private network markets outside of the United States.

8

We also sell products for each of these customer groups to OEMs of communications equipment. The majority of our sales are made to telecommunications service providers, and one customer, Verizon Communications, Inc., accounted for 10.6% of our sales in fiscal 2002. Financial information concerning sales of our products by segment and geographic area is contained in Note 15 to the Consolidated Financial Statements in Item 8 of this Form 10-K. Due to the generally short lead times between receipt of a customer order and the time we ship the product, our committed backlog of orders is not a material portion of our annual revenues, and thus is not a meaningful indicator of future revenues.

We market our products outside the United States, primarily to telephone operating companies, cable television operators and wireless service providers for public communications networks located in Africa, Asia, Australia, Canada, Europe, Latin America, the Middle East and the Pacific. Our non-U.S. net sales accounted for approximately 27%, 29% and 22% of our net sales in fiscal 2002, 2001 and 2000, respectively, and are not concentrated in any one country.

A substantial portion of our sales are made by a direct sales force. We maintain sales offices throughout the United States and in Asia, Australia, Canada, Europe, Latin America, the Middle East and the Pacific. In the United States, our products are sold directly by our sales personnel as well as through value-added resellers and distributors. Outside the United States, our products are sold directly by our field sales personnel and by independent sales representatives and distributors, as well as through other public and private network providers that distribute products outside the United States.

We maintain a customer service group that supports our field sales personnel. The customer service group is responsible for application engineering, customer training, entering orders and supplying delivery status information. We also have a field service engineering group that provides on-site service to customers.

Research and Development

We believe that our future success depends on our ability to adapt to the rapidly changing communications environment, to maintain our significant expertise in core technologies and to continue to meet and anticipate our customers' needs. We continually review and evaluate technological changes affecting the communications market and invest in applications-based research and development. As part of our long-term strategy, we intend to continue an ongoing program of new product development that combines internal development efforts with acquisitions, strategic alliances and licensing or marketing arrangements relating to new products and technologies from sources outside ADC. Our expenses relating to internal research and development activities were \$176.4 million, \$278.6 million and \$338.0 million in fiscal 2002, 2001 and 2000, respectively.

In recent years, increasingly significant portions of new communications equipment purchased by public network providers and private network customers have employed optical transmission, digital, semiconductor, wireless and broadband copper-based technologies. In the future, we believe that these purchasing trends will include IP technology and increasingly sophisticated, software-intensive OSS and network management systems. As a result, our internal and external product development activities are primarily directed at the following areas:

the continued development of our IP-based products, such as Cuda 12000 systems for Internet, data, video and voice services;

the development of network OSS software (including billing, customer management, network performance and service assurance software);

the continued development of our DSL systems for integrated Internet, data, video and voice applications over the existing copper-based telecommunications infrastructure; and

9

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

the incorporation of ATM and IP technologies into other Internet, data, video and voice products for public communications networks.

New product development often requires long-term forecasting of market trends, the development and implementation of new processes and technologies and a substantial capital commitment. Due to the uncertainties inherent in each of these elements, we cannot assure you that we will develop any new products on a timely basis or at all. Moreover, we cannot assure you that any new products we develop will achieve market acceptance.

Competition

Competition in the communications equipment industry is intense, particularly in light of reduced spending levels by our customers. Many of our competitors have more extensive engineering, manufacturing, marketing, financial and personnel resources than we have. In addition, rapid technological developments within the communications industry have resulted in frequent changes among our group of competitors. Currently, our primary competitors include:

For Broadband Infrastructure and Access products: ADTRAN, Allen Telecom, Arris Group, Avaya, Cisco Systems, Corning, ECI Telecom, Lucent Technologies, Motorola and Telect.

For Integrated Solutions products and services: Alcoa Fujikura, Amdocs, Bechtel, Convergys, Greenwoods, Lucent Technologies, Portal Software, SPIE and TTI.

We believe that our success in competing with other communications product manufacturers depends primarily on the following factors:

our engineering, manufacturing, sales and marketing skills;

the price, quality and reliability of our products; and

our delivery and service capabilities.

Although the market for our products historically has not been characterized by significant price competition, we have experienced increasing pricing pressures from competitors in some of the markets for our products, particularly in DSL products and systems integration services, as well as general pricing pressure from our customers as part of their cost reduction efforts.

We believe that technological change, the increasing addition of Internet, data, video and voice services to integrated broadband, multimedia networks, continuing regulatory changes and industry consolidation or new entrants will continue to cause rapid evolution in the competitive environment of the communications equipment market. At this time it is difficult to predict the full scope and nature of this evolution. So long as capital is accessible or our competitors are able to maintain adequate capital resources, we believe that the rapid technological changes that characterize the communications equipment industry will continue to make the markets in which we compete attractive to new entrants or delay the exit of weak competitors, respectively. Increased competition could result in price reductions, reduced margins and the loss of market share. We cannot assure you that we will be able to compete successfully with existing or new competitors. Competitive pressures may materially and adversely affect our business, operating results or financial condition.

Manufacturing and Suppliers

We manufacture a wide variety of products that are fabricated, assembled and tested in our own facilities in the United States. In an effort to reduce costs and improve customer service, we also utilize production facilities outside the United States in addition to sourcing key components and raw materials outside the United States. The manufacturing process for our electronic products consists primarily of assembly and testing of electronic systems built from fabricated parts, printed circuit

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

boards and electronic components. The manufacturing process for our connectivity products is completely vertically integrated and consists primarily of fabrication of jacks, plugs and other basic components from raw materials, assembly of components and testing. Our sheet metal, plastic molding, stamping and machining capabilities permit us to configure components to customer specifications, provide competitive lead times and control production costs. We also utilize several outsource manufacturing companies to manufacture, assemble and test certain of our products, principally within our IP cable, DSL and wireless product lines. We estimate that products obtained from outsourced manufacturers accounted for approximately 33% of our total revenues in fiscal 2002.

We purchase raw materials and component parts from many suppliers. These purchases consist primarily of copper wire, optical fiber, steel, brass, nickel-steel alloys, gold, plastics, printed circuit boards, solid state components, discrete electronic components and similar items. Although many of these items are single-sourced, we have experienced no significant difficulties to date in obtaining adequate quantities. These circumstances could change, however, and we cannot guarantee that sufficient quantities or quality of raw materials and component parts will be as readily available in the future or, if available, that we will be able to obtain them at favorable prices.

Proprietary Rights

We own a portfolio of U.S. and foreign patents relating to our products. These patents, in the aggregate, constitute a valuable asset. We do not believe, however, that our business is dependent upon any single patent or any particular group of related patents.

We have registered the initials "ADC" alone and in conjunction with specific designs as trademarks in the United States and various foreign countries.

Employees

As of October 31, 2002, we employed approximately 7,600 people. During the restructuring of our business in fiscal 2002, we reduced our number of employees by approximately 4,400 through involuntary workforce reductions, unreplaced attrition and as a result of our divestitures. We consider relations with our employees to be good.

11

Executive Officers of the Registrant

Our executive officers are:

<u>Name</u>	<u>Office</u>	<u>Officer Since</u>	<u>Age</u>
Richard R. Roscitt	Chairman of the Board, President and Chief Executive Officer	2001	51
Robert E. Switz	Executive Vice President and Chief Financial Officer	1994	55
Jay T. Hilbert	Senior Vice President, Global Sales, Marketing and Customer Service	2002	43
Michael K. Pratt	Vice President, President, Wireline Business Unit	2002	48
Hilton M. Nicholson	Vice President, President, IP Cable Business Unit	2002	44
Patrick D. O'Brien	Vice President, President, Connectivity Business Unit	2002	39
Jo Anne M. Anderson	Vice President, President, Systems Integration Business Unit	2001	45
Lawrence S. Barker	Vice President, President, Software Systems Business Unit	1999	50
Jeffrey A. Quiram	Vice President, President, Wireless Business Unit	2001	42
William F. O'Brien	Vice President, Chief Marketing Officer	2001	54
Jeffrey D. Pflaum	Vice President, Chief Legal Officer and Secretary	1999	43

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

Name	Office	Officer Since	Age
Laura N. Owen	Vice President, Human Resources	1999	46
Gokul V. Hemmady	Vice President, Controller and Treasurer	1997	42
Mary E. Quay	Vice President, Worldwide Operations	2002	51

Mr. Roscitt has been Chief Executive Officer and Chairman of the Board of ADC since February 2001. He assumed the additional title of President in November 2001. Prior to joining ADC, Mr. Roscitt was a 28-year veteran of AT&T, serving most recently as the President of AT&T Business Services, the operating group within AT&T that serves business customers globally, from December 1999 to February 2001. Mr. Roscitt also served as President and Chief Executive Officer of AT&T Solutions, the integrated services, e-business and outsourcing unit of AT&T, from August 1998 to December 1999, and Vice President, General Manager of AT&T Solutions from February 1995 to August 1998.

Mr. Switz joined ADC in January 1994. From 1988 to 1994, Mr. Switz was employed by Burr-Brown Corporation, a manufacturer of precision micro-electronics, most recently as Vice President, Chief Financial Officer and Director, Ventures and Systems Business.

Mr. Hilbert joined ADC in October 2002, as Senior Vice President of Global Sales, Marketing and Customer Service. Prior to that, Mr. Hilbert was with Alcatel USA, a diversified communications equipment company, since 1985, most recently as Group Vice President of Sales and Marketing.

Mr. Pratt joined ADC in June 2002, as President of ADC's Wireline Business Unit. Prior to joining ADC, Mr. Pratt served in a variety of positions, including Vice President and General Manager of the Access Systems Division of RELTEC Corporation, from 1996 to 1999. In March 1999, RELTEC Corporation was acquired by Marconi, Inc., a subsidiary of Marconi plc, a global telecommunications

12

equipment and solutions company. Mr. Pratt continued to serve as the Vice President and General Manager of this business following this acquisition, until he was promoted to Executive Vice President of Marconi, Inc. in July 2000, a position he held until joining ADC.

Mr. Nicholson joined ADC in July 2002, as President of ADC's IP Cable Business Unit. Prior to that, Mr. Nicholson served in a variety of positions with Lucent Technologies, Inc., a provider of communications networks for the global communications services market, from 1996 to 2002, including most recently as the Vice President and General Manager of Lucent's Core Switching and Routing Division.

Mr. Patrick O'Brien joined ADC in 1993 and was named President of ADC's Connectivity Business Unit in December 2002. Prior to joining ADC, Mr. O'Brien was employed by Contel Telephone for six years in a network planning capacity.

Ms. Anderson joined ADC in 1983 and was named President of ADC's Systems Integration Business Unit in November 2000. Prior to that Ms. Anderson served as Vice President of ADC's Systems Integration Business from May 1998 to November 2000, after having served as ADC's Vice President, Global Customer Service.

Mr. Barker joined ADC in October 1999 following our acquisition of Saville Systems Ltd. Prior to being named President of ADC's Software Systems Business Unit in November 2001, Mr. Barker served as General Manager of ADC's Software Systems Division from October 1999 to November 2001. Prior to joining ADC, Mr. Barker served as President of Saville Systems, Ltd. from June 1999 to October 1999, President of Stanford Associates, Inc., a telecommunications consulting firm, from July 1996 to October 1997, and President and CEO of the Intelicom Division of Computer Sciences Corporation, Inc., a software provider to the telecommunications market, from April 1994 to July 1996.

Mr. Quiram joined ADC in September 1991. Prior to being named the President of ADC's Wireless Business Unit in December 2002, Mr. Quiram served as President of ADC's Connectivity Business Unit from October 2001 to December 2002, President of ADC's Broadband Infrastructure Division from April 2001 to October 2001 and Vice President and General Manager of the Wireless Division of ADC's Broadband Connectivity Group from May 1999 to April 2001. Prior to joining ADC, Mr. Quiram worked for eight years at U S WEST, a communications service provider.

Mr. William O'Brien joined ADC as Vice President and Chief Marketing Officer in May 2001. From January 2000 to May 2001, Mr. O'Brien served as Marketing & Sales Support Vice President of AT&T Business Services, the operating group within AT&T that serves business customers globally. Prior to that Mr. O'Brien served as Marketing Vice President of AT&T Solutions, the integrated services, e-business

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

and outsourcing unit of AT&T, from January 1997 to January 2000.

Mr. Pflaum joined ADC in April 1996. Mr. Pflaum became Vice President, Chief Legal Officer and Secretary of ADC in March 1999 after having served as Associate General Counsel since April 1996. Prior to joining ADC, he was an attorney with the Minneapolis-based law firm of Popham Haik Schnobrich & Kaufman.

Ms. Owen joined ADC as Vice President, Human Resources in December 1997. Prior to joining ADC, Ms. Owen was employed by Texas Instruments and Raytheon (which purchased the Defense Systems and Electronics Group of Texas Instruments in 1997), manufacturers of high-technology systems and components. From 1995 to 1997, she served as Vice President of Human Resources for the Defense Systems and Electronics Group of Texas Instruments.

Mr. Hemmady joined ADC in October 1997. Mr. Hemmady has served as ADC's Vice President and Treasurer since October 1997, and in May 2002, he assumed the additional duties of Controller. Prior to joining ADC, Mr. Hemmady was employed by U S WEST International, a communications

13

service provider, where he served as Director of International Finance from January 1996 to September 1997.

Ms. Quay joined ADC in 1977 and has served in a variety of positions over her 25-year career at ADC. During the last five years, Ms. Quay served as Vice President of Manufacturing/Operations, and during 2002, Ms. Quay was named as Vice President, Worldwide Operations.

Cautionary Statement for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995

The foregoing discussion and the discussion contained in Item 7 of this Form 10-K contain various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements represent our expectations or beliefs concerning future events, including any statements regarding:

future sales, profit percentages, income tax refunds, realization of deferred tax assets, earnings per share or other results of operations;

the continuation of historical trends;

the sufficiency of our cash balances and cash generated from operating and financing activities for our future liquidity and capital resource needs;

the effect of legal and regulatory developments; and

the economy in general or the future of the communications equipment and communications services industries on our business.

We caution that any forward-looking statements made by us in this report or in other announcements made by us are further qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements. These include, without limitation:

overall demand for our products and services;

the demand for particular products or services within the overall mix of products sold, as our products and services have varying profit margins;

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

changing market conditions and growth rates within our industry or generally within the economy;

changes in our customer base due to possible consolidation among our customers;

volatility in the stock market, which may affect the value of our stock or the stock we own in other publicly held companies in the communications industry;

increased competition and new competing technologies;

increased costs associated with protecting our intellectual property rights or responding to the intellectual property rights of others;

availability of materials to make products and reliance on contract manufacturers to make many of our products;

the impact of customer financing activities;

our ability to integrate the operations of acquired companies with our historic operations successfully;

our ability to complete our restructuring initiative and streamline our operations successfully;

14

our ability to retain key employees;

fluctuations in our operating results;

pressures on the pricing of the products and services we offer; and

other risks and uncertainties, including those identified in Exhibit 99-a to this Form 10-K.

We disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Item 2. PROPERTIES

Our corporate headquarters are located in Eden Prairie, Minnesota. We lease our corporate headquarters facility pursuant to an operating lease agreement with a term expiring in 2006. Our corporate headquarters comprise approximately 500,000 square feet.

In addition to our world headquarters facility, our principal facilities as of October 31, 2002 consisted of the following:

Shakopee, Minnesota approximately 360,000 sq. ft. owned facility; general purpose facility used for engineering, manufacturing, and general support of our connectivity products;

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

Tustin, California two facilities totaling approximately 142,000 sq. feet, one owned and one leased; general purpose facilities used for engineering, manufacturing, assembly and testing, and general support of our DSL products;

Westborough, Massachusetts approximately 64,000 sq. ft. leased facility; general purpose facility used for engineering, assembly and testing, and general support of our IP cable products;

Juarez and Delicias, Mexico approximately 228,000 and 139,000 sq. feet, respectively, owned facilities; manufacturing facilities used for our connectivity products;

Glenrothes, Scotland approximately 350,000 sq. ft. owned facility; manufacturing facility used for our connectivity products. During the fourth quarter of fiscal 2002, we decided to dispose of this facility. See Note 11 to the Consolidated Financial Statements in Item 8 of this Form 10-K for further discussion; and

Herzlia, Israel approximately 120,000 sq. ft. leased facility; general purpose facility used for engineering, manufacturing, assembly and testing, and general support of our DSL products.

We also own or lease approximately 74 other facilities in the following locations: Argentina, Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, Hungary, India, Ireland, Italy, Japan, Malaysia, Mexico, Puerto Rico, Russia, Singapore, South Africa, South Korea, Spain, the United Arab Emirates, the United Kingdom, the United States and Venezuela.

We believe that the facilities used in our operations are suitable for their respective uses and adequate to meet our current needs. During fiscal 2002 we took steps to reduce and consolidate our facilities in response to the downturn in the communications equipment industry. At the end of fiscal 2001, we had active space and irrevocable commitments to activate space totaling approximately 4.8 million square feet. Through the sale or subleasing of facilities, the placement of sites on inactive status or the disposition of facilities through the divestiture of product lines, we presently maintain approximately 3.0 million square feet of active space.

Item 3. LEGAL PROCEEDINGS

We are a party in various suits, claims, proceedings and investigations arising in the ordinary course of business. The amount of monetary liability, if any, resulting from an adverse result in any of

15

such lawsuits, proceedings and claims in which we are a defendant cannot be determined at this time. However, in the opinion of management, the aggregate amount of liability under these lawsuits, proceedings and claims will not have a material adverse effect on our consolidated results of operations or financial condition.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

16

PART II

Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED SHAREOWNER MATTERS

Our common stock, \$0.20 par value, is traded on The NASDAQ Stock Market under the symbol "ADCT." The following table sets forth the high and low sales prices of our common stock for each quarter during our fiscal years ended October 31, 2002 and 2001, as reported on that market.

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

	2002		2001	
	High	Low	High	Low
First Quarter	\$ 5.97	\$ 3.52	\$ 27.06	\$ 13.94
Second Quarter	4.90	3.26	14.94	6.22
Third Quarter	4.09	1.66	10.85	4.41
Fourth Quarter	1.83	1.02	5.20	2.63

As of January 6, 2002, there were approximately 8,431 registered holders of record of our common stock. We do not pay cash dividends on our common stock and do not intend to pay cash dividends for the foreseeable future.

17

Item 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following summary information should be read in conjunction with the Consolidated Financial Statements and related notes thereto set forth in Item 8 of this Form 10-K.

FIVE-YEAR FINANCIAL SUMMARY

Years ended October 31

(dollars in millions, except per share data)

	2002	2001	2000	1999	1998
Income statement data					
Net sales	\$ 1,047.7	\$ 2,402.8	\$ 3,287.9	\$ 2,151.8	\$ 1,830.5
International sales	283.6	692.2	708.1	499.3	392.1
Gross profit	246.5	725.0	1,608.9	1,003.4	884.5
Research and development expense	176.4	278.6	338.0	250.7	199.8
Selling and administration expense	370.0	705.3	665.6	445.3	351.9
Goodwill amortization		56.6	34.3	22.2	12.5
Operating income (loss)	(878.2)	(1,031.3)	365.9	135.0	311.1
Income (loss) before income taxes	(882.2)	(1,920.7)	1,460.4	134.9	322.3
Provision (benefit) for income taxes	262.8	(633.0)	592.3	57.0	112.4
Net income (loss)	(1,145.0)	(1,287.7)	868.1	77.9	209.9
Earnings (loss) per diluted share	(1.44)	(1.64)	1.13	0.11	0.31
Non-cash stock compensation expense	10.4	18.7	47.1	1.2	
Impairment and non-recurring charges					
Impairment charges	348.3	501.7			
Non-recurring charges	219.6	195.4	158.0	149.0	9.2
Other restructuring-related charges(1)	13.2	80.8			
Gain (loss) on sale or shutdown of product lines	(6.7)	(81.9)	328.6		
Gain (loss) on investments, net					
Write-down or conversion of investments	(50.9)	(862.5)	722.6		
Sale of investments, net	67.8	76.8	23.8		
Deferred tax valuation charge	640.2	9.4			
Cash flow data					
Total cash provided by operating activities	60.5	95.0	250.9	290.5	170.3
Depreciation and amortization	104.7	197.8	146.2	114.8	80.4
Capital expenditures, net	25.6	241.2	375.3	125.1	112.6
Balance sheet data					
Current assets	686.3	1,305.2	2,650.9	1,376.6	1,310.6
Current liabilities	397.8	599.4	1,041.3	448.5	461.7

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

	2002	2001	2000	1999	1998
Property and equipment, net	206.8	614.0	608.6	341.2	289.5
Total assets	1,144.2	2,499.7	3,970.5	2,057.8	1,796.0
Long-term notes payable	10.8	3.0	16.5	14.0	3.9
Shareowners' investment	732.2	1,893.4	2,912.7	1,595.3	1,330.4

(1) These charges are included in cost of sales and selling and administration expense in our consolidated statements of operations. See Note 11 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

18

Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Marketplace Conditions

Our operating results during fiscal 2002 and 2001 were affected adversely by the downturn in general economic conditions, and a particularly strong downturn in the communications equipment industry. In this economic environment, many of our customers have deferred capital spending, reduced their equipment purchases and announced plans to further reduce capital expenditures in fiscal 2003. A majority of our revenues continue to be derived from telecommunication service providers. These customers in particular have greatly reduced their spending on communications equipment, resulting in significant reductions in our revenues. Moreover, some of our customers have experienced serious financial difficulties, which in some cases resulted in bankruptcy filings or cessation of operations.

When the downturn in communications equipment spending first became evident in fiscal 2001, we implemented a restructuring plan to reduce operating expenses and capital spending and to narrow the focus of our business. As it became evident in fiscal 2002 that our industry was experiencing an even more pronounced and prolonged economic downturn, we took additional measures to realize further cost savings and focus on the following six strategic areas: broadband connectivity products; IP cable equipment; DSL equipment; OSS software; systems integration services; and wireless network coverage products. Our actions to date have included:

- the sale or closure of non-strategic product lines. In fiscal 2002, we sold our broadcast TV video routing and a portion of our optical components product lines. We also closed down our Avidia Multiplexer and optical laser product lines and halted further development of the U.S. version of our iAN product line. In fiscal 2001, we sold our cable/broadcast TV transmission, broadband wireless transmission, enterprise access products, wireless components, and enhanced services software product lines. We also sold a portion of our optical components product line and closed down our Cellworx transport product line.

- significant reductions in discretionary spending.

- the disposition of surplus equipment.

- consolidation of facilities.

- substantial reductions in our workforce.

Despite these restructuring actions, we may be unable to meet expected revenue levels in any particular quarter, in which case our operating results could be materially adversely affected if we are unable to further reduce our expenses in time to counteract such a decline in revenues.

Our ability to grow our business is dependent on our ability to effectively compete with our current products and services, our ability to develop and introduce new products, 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

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

of capital to communications service providers, the amount of capital expenditures by communications service providers, new regulatory and legal requirements and end-user demands for Internet, data, video, voice and other communications services.

Our results of operations have historically been subject to seasonal factors, with stronger demand for our products during our fourth fiscal quarter ending October 31 (primarily as a result of customer budget cycles and our fiscal year-end incentives) and weaker demand for our products during our first fiscal quarter ending January 31 (primarily as a result of the number of holidays in late November, December and early January, the development of annual capital budgets by our customers during that

19

period, 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 2002 and 2001, this historical trend was not evident in either fiscal year. 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 for fiscal 2002.

Impairment and Non-Recurring Charges

Due to the rapid decline in the communications equipment industry and our efforts to streamline our business in response, we recorded significant impairment and non-recurring charges in fiscal 2002 and 2001. Impairment charges represent a write-down of the carrying value of long-lived assets (principally goodwill and facilities) to their estimated fair market value. Non-recurring and other restructuring-related charges represent the direct costs of exiting certain product lines or businesses and the costs of downsizing our business. A brief explanation of these charges follows, and a more thorough summary is contained in Note 11 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Fiscal 2002

During fiscal 2002, we incurred the following charges (in millions):

Impairment Charges	\$	348.3
Non-Recurring Charges		219.6
Other Restructuring-Related Charges		13.2
		<hr/>
	\$	581.1
		<hr/>

Impairment Charges. Our impairment charges were calculated in accordance with our policy for accounting for long-lived assets (see Application of Critical Accounting Policies Long-Lived Assets and Goodwill, below). Of the total impairment charges of \$348.3 million in fiscal 2002, \$136.3 million related to the write-down of goodwill and \$212.0 million related to the write-down of fixed assets. As a result of our decision to exit the optical components product line, we recognized a \$36.6 million goodwill impairment charge. In addition, in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," we tested our remaining goodwill for impairment in the fourth quarter (See Note 12 to the Consolidated Financial Statements in Item 8 of this Form 10-K). This test indicated that a significant impairment of goodwill had occurred. Accordingly, a \$99.7 million goodwill impairment charge was recognized, which consisted of \$85.5 million of the goodwill recognized when our Integrated Solutions segment acquired two European companies during fiscal 2000 and 2001, as well as the \$14.2 million of remaining goodwill associated with our Broadband Infrastructure and Access business. After these write-downs, our remaining goodwill as of October 31, 2002, was \$3.8 million, which relates solely to our Integrated Solutions segment.

Of the total fixed asset impairment charge of \$212.0 million, \$45.7 million relates to our decision to sell our Glenrothes, Scotland manufacturing facility. The remaining charges are primarily related to our decision to exit the optical components, Avidia Multiplexer, and the U.S. version of our iAN product lines.

Non-Recurring Charges. The \$219.6 million of non-recurring charges consist principally of \$153.8 million related to the consolidation of facilities, \$53.1 million for employee severance costs related to our workforce reduction, and \$10.5 million for in-process research and development costs relating to our decision to purchase the interest of our joint venture partner in three technology development partnerships. \$84.3 million of the facilities consolidation costs is related to our decision to extend the lease on our world headquarters facility. This charge represents the reduction in fair market value of the facility below the value we had guaranteed to the lessor. (See Liquidity and Capital

20

Resources Finance Related Transactions below, for a further discussion of our world headquarters lease). The balance of the facilities consolidation costs relate to lease termination costs for excess facilities, as we deactivated approximately 1.8 million square feet, or 38% of our total space, during fiscal 2002. During fiscal 2002, we reduced our workforce by approximately 4,400 employees or 37% of our total workforce, which included approximately 2,900 employees impacted by reductions in force, with the remainder resulting from attrition and our divestitures.

Other Restructuring-Related Charges. We also incurred other restructuring-related charges in fiscal 2002 in the net amount of \$13.2 million for inventory write-downs and the costs of completing certain sales contracts for discontinued product lines. These charges are reported in cost of sales (\$18.9 million) and selling and administration expense (\$5.7 million reversal of previous charges) in our consolidated statements of operations. See Note 11 to the Consolidated Financial Statements in Item 8 of this Form 10-K for further details on these items.

Fiscal 2001

During fiscal 2001, we incurred the following charges (in millions):

Impairment Charges	\$ 501.7
Non-Recurring Charges	195.4
Other Restructuring-Related Charges	80.8
	<u>777.9</u>

Impairment Charges. Of the total \$501.7 million of impairment charges in fiscal 2001, \$294.5 million related to the write-down of goodwill and \$207.2 million related to the write-down of fixed assets. The goodwill impairment charge was recognized as a result of our decision to exit non-strategic product lines. The fixed asset impairment charge of \$207.2 resulted from the consolidation of unproductive and duplicative facilities as well as the exit from non-strategic product lines. Both the goodwill and fixed asset impairment charges were recognized in accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The amount of these impairment charges was based on our estimates of the fair value of the assets.

Non-Recurring Charges. The \$195.4 million of non-recurring charges related to our actions to downsize our business in response to declining sales. These charges consisted principally of \$89.0 million for employee severance costs related to our workforce reduction, and \$96.0 million in facilities consolidation costs, which consist principally of lease termination costs. During fiscal 2001, we reduced our workforce by approximately 10,400 employees, or 46% of the total workforce, which included approximately 7,400 employees impacted by reductions in force. We also deactivated approximately 1.1 million square feet of excess facilities, or 19% of our total active space during fiscal 2001. In addition, we incurred \$10.4 million of acquisition and integration costs and other restructuring charges in fiscal 2001, principally related to our acquisitions of CommTech Corporation and France Electronique in early fiscal 2001.

Other Restructuring-Related Charges. We incurred additional restructuring-related charges in fiscal 2001 in the amount of \$80.8 million relating to inventory write-downs and the costs of completing certain sales contracts for discontinued product lines. These charges were reported in cost of sales (\$52.4 million) and selling and administration expense (\$28.4 million) in our consolidated statements of operations. See Note 11 to the Consolidated Financial Statements in Item 8 of this Form 10-K for further details on these items.

Effect of Restructuring Charges on Future Cash Flow:

The following table provides detail on the remaining restructuring accrual by category as of October 31, 2002 and 2001 (in millions):

Type of Charge	2002	2001
Employee severance costs	\$ 17.0	\$ 22.3
Facilities consolidation	105.6	83.6
Inventory and committed sales contracts		3.8
Committed sales contracts-administrative	1.6	11.1

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

Type of Charge	2002	2001
Total	\$ 124.2	\$ 120.8

We believe that our entire restructuring accrual of \$124.2 million as of October 31, 2002 will have to be paid in cash. Of this amount, \$57.5 million will be paid from our unrestricted cash (shown as cash and cash equivalents on our balance sheet) and \$66.7 million will be paid from our restricted cash (shown as restricted cash on our balance sheet) as follows:

The \$17.0 million of employee severance will be paid in fiscal 2003 from unrestricted cash;

The \$1.6 million of committed sales contracts-administrative will be paid in fiscal 2003 from unrestricted cash;

\$38.9 million of the facilities consolidation costs relates principally to excess leased facilities. Of the \$38.9 million, we estimate \$27.1 million will be paid in fiscal 2003 with the remainder being paid over the respective lease terms ending through 2008, from unrestricted cash; and

The balance of \$66.7 million of facilities consolidation costs will be paid from our restricted cash balance. This amount represents the cash pledged to secure our lease obligations on three long-term operating leases, and will be used to pay down the lease obligation in exchange for a reduced purchase option price, or to purchase the leased property at the end of the lease term (or sooner if we dispose of the property prior to the end of the lease term). See "Liquidity and Capital Resources Finance Related Transactions" below for a further discussion of these leases.

Establishment of the restructuring accrual was based on our assumptions of the relevant costs at the time the restructuring decisions were made. The accrual is periodically adjusted based on new information and actual costs incurred. The ultimate resolution of the accrual may result in further adjustments, which may have a material effect on our operating results.

Results of Operations

Our financial statements for fiscal 2000 have been restated to include the operations of PairGain Technologies, Inc. and Broadband Access Systems, Inc., both of which were acquired in fiscal 2000 in transactions accounted for using the pooling-of-interests method of accounting. Both of these acquisitions were made by our Broadband Infrastructure and Access segment. See Note 5 to the Consolidated Financial Statements in Item 8 of this Form 10-K for additional information on these acquisitions.

22

The following table contains information regarding the percentage of net sales of certain income and expense items for the three fiscal years ended October 31, 2002, 2001, and 2000 and the percentage changes in these income and expense items from year to year:

	Percentage of Net Sales			Percentage Increase (Decrease) Between Periods	
	2002	2001	2000	2002 vs. 2001	2001 vs. 2000
Net sales	100.0%	100.0%	100.0%	(56.4)	(26.9)%
Cost of sales	(76.5)	(69.8)	(51.1)	(52.2)	(0.1)
Gross profit	23.5	30.2	48.9	(66.0)	(54.9)
Operating expenses:					
Research and development	(16.8)	(11.6)	(10.3)	(36.7)	(17.6)
Selling and administration	(35.3)	(29.3)	(20.2)	(47.5)	6.0
Goodwill amortization		(2.4)	(1.1)	(100.0)	65.0
Impairment charges	(33.2)	(18.7)		(30.6)	N/A

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

	Percentage of Net Sales			Percentage Increase (Decrease) Between Periods	
	2002	2001	2000	2002 vs 2001	2001 vs 2000
Non-recurring charges	(21.0)	(10.3)	(4.8)	(12.4)	57.5
Non-cash stock compensation	(1.0)	(0.8)	(1.4)	(44.4)	(60.3)
Operating income (loss)	(83.8)	(42.9)	11.1	14.8	(381.9)
Other income (expense), net:					
Interest income (expense), net	0.8	(0.1)	0.6	481.8	N/A
Other, net	(1.2)	(36.9)	32.7	(98.6)	(182.5)
Income (loss) before income taxes	(84.2)	(79.9)	44.4	54.1	(231.5)
Provision (benefit) for income taxes	25.1	(26.3)	18.0	(141.5)	(206.9)
Net income (loss)	(109.3)%	(53.6)%	26.4%	11.1%	(248.3)%

The table below sets forth our net sales for the three fiscal years ended October 31, 2002 for each of our reportable segments described in Item 1 of this Form 10-K (in millions).

Operating Segment	2002		2001		2000	
	Net Sales	%	Net Sales	%	Net Sales	%
Broadband Infrastructure and Access	\$ 715.1	68.3	1,810.8	75.4	\$ 2,774.0	84.4
Integrated Solutions	332.6	31.7	592.0	24.6	513.9	15.6
Total	\$ 1,047.7	100.0%	2,402.8	100.0%	\$ 3,287.9	100.0%

Net Sales

Fiscal 2002 vs. Fiscal 2001

Net sales were \$1.05 billion and \$2.40 billion for fiscal 2002 and 2001, respectively, reflecting a 56.4% decrease. International net sales comprised 27.1% and 28.8% of our net sales in fiscal 2002 and 2001, respectively.

The 56.4% decrease in net sales was largely attributable to lower volumes of products sold due to significant reductions in communication service provider capital budgets, as well as the lack of new network build-outs or significant expansions of existing networks. The decline was most pronounced for our broadband connectivity products, but occurred across all product lines with the exception of our IP Cable products, which had increased sales over the prior year. Sales of our software products also declined, which we believe was in part due to the fact that these products had been targeted for the competitive local exchange carrier market, a segment which has been severely affected by a lack of capital resources, causing many of these companies to cease operations. In response, during fiscal 2002, we repositioned our software products to add applications for next-generation wireless providers, enterprises and media and content providers, which we believe will present broader and higher growth

opportunities. We believe this target market transition contributed to the year-over-year decline in sales.

The sales decline was also due to the absence of sales from product lines we divested in fiscal 2002 and 2001. Sales from divested product lines were \$14.9 million, \$404.9 million, and \$626.0 million in fiscal 2002, 2001 and 2000, respectively. See Note 6 to the Consolidated Financial Statements in Item 8 of this Form 10-K for a further breakdown of divested product lines net sales by segment.

Fiscal 2001 vs. Fiscal 2000

Net sales were \$2.40 billion and \$3.29 billion for fiscal 2001 and 2000, respectively, reflecting a 26.9% decrease. International net sales comprised of 28.8% and 21.5% of our net sales in fiscal 2001 and 2000, respectively.

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

During fiscal 2001, net sales of Broadband Infrastructure and Access products declined by 34.7% over fiscal 2000. The decrease in fiscal 2001 primarily resulted from lower sales for broadband connectivity systems due to a weakened communications equipment industry and lower carrier spending budgets. Sales of most other products declined by smaller dollar amounts and percentages. Broadband Infrastructure and Access sales represented approximately 75.4% of our net sales in fiscal 2001.

During fiscal 2001, net sales of Integrated Solutions products increased by 15.2% over fiscal 2000. Both software systems and systems integration services contributed to sales growth. Sales of systems integration services grew as a result of broadening our U.S. and European carrier and OEM customer base, which resulted in market share gains. We also benefited from the expansion of our presence into Europe due to the acquisitions of systems integration businesses in the United Kingdom and France during September 2000 and November 2000, respectively. Our sales growth in software systems resulted from our acquisitions of Centigram Communications Corporation, which was completed in July 2000, and CommTech Corporation, which was completed in February 2001. The operations of Centigram were divested on October 31, 2001, in connection with the sale of our enhanced services software product line. We also divested a substantial portion of CommTech in November of fiscal 2003 as part of our restructuring initiatives.

International sales increased as a percentage of total sales from fiscal 2000 to fiscal 2001, primarily due to the fact that the U.S. communications equipment market declined prior to the European and Asian markets. Also, our acquisitions of systems integration businesses in the United Kingdom and France in September 2000 and November 2000, respectively, increased our European sales in fiscal 2001.

Gross Profit

Fiscal 2002 vs. Fiscal 2001

During fiscal 2002 and 2001, gross profit percentages were 23.5% and 30.2%, respectively. The decrease in gross profit percentage is primarily due to a decrease in sales volume without a corresponding reduction in fixed factory expenses, and a shift in sales mix to lower margin products and services. Also, in fiscal 2002 and 2001, \$18.9 million and \$52.4 million of other restructuring-related charges for inventory write-offs and other costs to exit certain sales contracts were included in cost of product sold, respectively. We anticipate that our future gross profit percentage will continue to be affected by many factors, including sales mix, competitive pricing, timing of new product introductions and manufacturing volume.

Fiscal 2001 vs. Fiscal 2000

During fiscal 2001 and 2000, gross profit percentages were 30.2% and 48.9%, respectively. This decrease was primarily the result of approximately \$52.4 million of inventory write-offs and other costs to exit certain sales contracts in connection with our restructuring efforts in fiscal 2001 that were

24

included in cost of product sold. In addition, gross profit for ongoing product lines for fiscal 2001 was affected negatively by increased charges of approximately \$92.0 million for additional inventory and warranty reserves, which were taken in response to current market conditions. The decrease in gross profits also is due in part to a decrease in sales volume and a shift in sales mix to lower margin products.

Operating Expenses

Fiscal 2002 vs. Fiscal 2001

Total operating expenses for fiscal 2002 and 2001 were \$1.12 billion and \$1.76 billion, representing 107.3% and 73.1% of net sales, respectively. Included in these operating expenses were non-recurring charges of \$219.6 million and \$195.4 million, other restructuring-related charges (reversals) of \$(5.7) million and \$28.4 million and impairment charges of \$348.3 million and \$501.7 million in fiscal 2002 and 2001, respectively, which are discussed above. In addition, operating expenses for fiscal 2002 and 2001 included non-cash stock compensation expenses of \$10.4 million and \$18.7 million, respectively. Fiscal 2002 non-cash stock compensation expenses are associated with our acquisition of Broadband Access Systems (BAS). Fiscal 2001 operating expenses include non-cash stock compensation expenses related to our acquisition of BAS as well as our acquisition of Centigram Communications Corporation. Non-cash stock compensation expenses related to Centigram Communications Corporation are not included in operating expenses for fiscal 2002 because we divested the Centigram operations through the sale of our enhanced services software product line in fiscal 2001. Due to the significance of our restructuring activities and the fact that the non-cash stock compensation expenses relate to business acquisitions, we believe that a more meaningful presentation of our year-over-year operating expense performance would exclude these impairment charges, non-recurring charges, other restructuring-related charges and non-cash stock compensation expenses.

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

Operating expenses, excluding the impairment charges, non-recurring charges, other restructuring-related charges and the non-cash stock compensation expenses, were \$552.1 million for fiscal 2002, a 45.5% reduction from \$1.01 billion for fiscal 2001, representing 52.7% and 42.1% of net sales, respectively. The decrease in absolute dollars of operating expenses, before impairment charges, non-recurring charges, other restructuring-related charges and non-cash stock compensation expenses, was primarily due to the ongoing cost savings from our restructuring efforts as well as the divestiture of certain business units and product lines. The increase in operating expenses excluding impairment charges, non-recurring charges, other restructuring-related charges and the non-cash stock compensation expenses as a percentage of net sales was primarily due to fixed and variable costs incurred by us that could not be reduced as quickly as the rate of decline in net sales.

Research and development expenses were \$176.4 million for fiscal 2002, representing a 36.7% decrease from \$278.6 million for fiscal 2001. We believe that given the rapidly changing technology and competitive environment in the communications equipment industry, continued commitment to product development efforts will be required for us to remain competitive. Accordingly, we intend to continue to allocate substantial resources, as a percentage of our net sales, to product development for each of our operating segments.

Selling and administration expenses were \$370.0 million for fiscal 2002, representing a decrease of 47.5% from \$705.3 million for fiscal 2001. This decrease reflects a beneficial realization of our restructuring efforts. In addition, selling and administration expenses decreased \$138.7 million from 2001 due to the divestiture or discontinuance of certain business units and product lines in fiscal 2001. Also included in the fiscal 2002 and 2001 amounts were \$(5.7) million and \$28.4 million, respectively, in selling and administration expenses (reversals) incurred to complete certain non-cancelable sales contracts and contract cancellation payments to customers as a result of our decision to exit certain product lines.

25

In accordance with SFAS No. 142 we did not record goodwill amortization in fiscal 2002 compared to \$56.6 million of goodwill amortization expense in fiscal 2001.

Fiscal 2001 vs. Fiscal 2000

Total operating expenses for fiscal 2001 and 2000 were \$1.76 billion and \$1.24 billion, respectively, representing 73.1% and 37.8% of net sales, respectively. Included in operating expenses were non-recurring charges of \$195.4 million and \$158.0 million, other restructuring-related charges of \$28.4 million and \$0 and impairment charges of \$501.7 million and \$0 for fiscal 2001 and 2000, respectively. The fiscal 2001 non-recurring charges, other restructuring-related charges and impairment charges are discussed above. The non-recurring charges in fiscal 2000 represent costs associated with our acquisition of PairGain, Broadband Access Systems and Centigram. These operating expenses also include non-cash stock compensation expenses of \$18.7 million and \$47.1 million in fiscal 2001 and 2000, respectively, associated with our acquisitions of Broadband Access Systems and Centigram, which were completed during fiscal 2000.

Operating expenses, excluding the impairment charges, non-recurring charges, other restructuring-related charges, and non-cash stock compensation expenses were \$1.01 billion and \$1.04 billion for fiscal 2001 and fiscal 2000, respectively, representing 42.1% and 31.6% of net sales, respectively. The increase in operating expenses as a percentage of net sales before impairment charges, non-recurring charges, other restructuring-related charges and non-cash compensation expenses was due primarily to charges for increased operating reserves that were recorded in response to market conditions in fiscal 2001. These increased operating reserves for ongoing product lines related primarily to additional bad debt reserves of \$73.8 million. The decrease in absolute dollars of operating expenses, excluding the impairment charges, non-recurring charges, other restructuring-related charges, and non-cash stock compensation expenses from the prior year reflects our effort to reduce costs and streamline our operations in response to the weakened market conditions in fiscal 2001.

Research and development expenses were \$278.6 million for fiscal 2001, representing a 17.6% decrease from \$338.0 million for fiscal 2000. This decrease reflected our efforts to control expenses.

Selling and administration expenses were \$705.3 million for fiscal 2001, representing an increase of 6.0% over expenses of \$665.6 million for fiscal 2000. This increase reflects approximately \$28.4 million in selling and administration expenses for payroll and other non-production costs incurred to complete non-cancelable sales contracts and to make contract cancellation payments to customers as a result of our decision to exit certain product lines. In addition, we incurred approximately \$74.0 million of additional bad debt provision in fiscal 2001 due to declining market conditions. These increases were partially offset by reduced employee costs resulting from reductions in our overall workforce that occurred in fiscal 2001.

Several of our acquisitions have been accounted for as purchase transactions in which the initial purchase price exceeded the fair value of the acquired assets. As a result of our acquisition activity, goodwill amortization increased to \$56.6 million in fiscal 2001, compared to \$34.3 million in fiscal 2000.

Other Income (Expense), Net

Other income (expense), net includes net interest income (expense), gain or loss on the write-down, sale or conversion of our investments, gain or loss on the sale or shutdown of certain product lines and other items. Each of these items is discussed below.

Interest

The net interest income (expense) category represents net interest on cash and cash equivalents as well as debt. Interest income was \$12.4 million in fiscal 2002, \$6.6 million in fiscal 2001 and \$23.6 million in fiscal 2000. Our interest income increased over fiscal 2001 due to higher average cash balances maintained during fiscal 2002, partially offset by lower yields on our short-term investments.

26

Interest income decreased from fiscal 2000 to fiscal 2001 primarily due to lower average cash balances. Interest expense was \$4.0 million, \$8.8 million and \$4.1 million in fiscal 2002, 2001 and 2000, respectively. See "Liquidity and Capital Resources" below for a discussion of cash and debt levels.

Write-down, Sale or Conversion of Investments

Fiscal 2002: During fiscal 2002, we sold common stock of certain companies in our investment portfolio and settled related hedging arrangements for a gain of \$67.8 million. These gains were offset by non-cash write-downs in the amount of \$5.7 million for our marketable securities investments, and \$45.2 million for our non-marketable securities. See Note 3 to the Consolidated Financial Statements in Item 8 of this Form 10-K for further discussion of our investment activity.

Fiscal 2001: During fiscal 2001, we sold common stock of certain companies in our portfolio and settled related hedging arrangements for a net gain of \$76.8 million. This gain was more than offset by a non-cash loss of \$862.5 million we recognized for the decline in the market value of our marketable and non-marketable securities. Of this non-cash loss, \$657.0 million was attributable to the write-down in the value of our marketable securities of Redback Networks, Inc., which we acquired in fiscal 2000 pursuant to Redback Network's acquisition of Siara Systems, Inc., in which we were an early investor.

Fiscal 2000: In the second quarter of fiscal 2000, Siara Systems, Inc., in which we held a 7.3% ownership interest, was acquired by Redback Networks in a stock-for-stock transaction valued at approximately \$4.3 billion. Our initial investment in Siara Systems was \$3.5 million. Upon consummation of the acquisition of Siara Systems by Redback Networks, our investment was marked-to-market through earnings and was reflected on the balance sheet at the market value of the Redback Networks shares. The non-cash gain recognized on the conversion of these shares was \$722.6 million.

Sale or Shutdown of Product Lines

Fiscal 2002: During fiscal 2002, we sold non-strategic product lines in broadcast TV video routing and optical components. We also closed down our Avidia Multiplexer and our optical laser product lines and halted further development of the U.S. version of our iAN product line. These products did not meet our growth, profitability and market leadership criteria. The sales of these assets generated approximately \$2.3 million in cash, net of cash disposed, in fiscal 2002. Included in these sales and closures were domestic operations in California, Minnesota and Texas, as well as international operations in Australia and Sweden. These product lines generated annual net sales of approximately \$14.9 million, \$36.1 million and \$46.8 million and operating losses of \$96.8 million, \$170.5 million and \$10.3 million in fiscal 2002, 2001 and 2000, respectively. As a result of these actions, we recorded total losses on sales or shutdowns of approximately \$6.7 million in fiscal 2002.

Fiscal 2001: During fiscal 2001, we sold non-strategic product lines in cable/broadcast TV transmission, broadband wireless transmission, enterprise access products, wireless components, optical components and enhanced services software. We also closed down our Cellworx transport product line in fiscal 2001. The sales of these assets generated approximately \$117.5 million in cash, net of cash disposed, in fiscal 2001. Included in these sales were domestic operations in California, Connecticut, Minnesota, Oregon and Pennsylvania, as well as international operations in Argentina, Austria, Denmark and Finland. These product lines generated annual net sales of approximately \$368.8 million and \$579.2 million and operating losses of \$79.8 million and \$48.6 million in fiscal 2001 and 2000, respectively. As a result of these actions, we recorded total losses on sales or shutdowns of approximately \$81.9 million in fiscal 2001.

Fiscal 2000: In fiscal 2000, we recognized a \$328.6 million gain on the divestiture of the microelectronics group by PairGain Technologies, Inc.

27

Patent Infringement Settlement

During fiscal 2002, we recognized a \$26.2 million gain from the settlement of a patent infringement lawsuit we brought against a competitor.

Fixed Assets

In connection with our efforts to streamline and focus our operations to reduce costs, we sold excess equipment in fiscal 2002 and 2001. As a result of these sales, we recognized a \$11.5 million and \$1.3 million loss in fiscal 2002 and 2001, respectively. There were no gains or losses associated with fixed assets in fiscal 2000.

Other, Net

Other, net primarily represents the gain or loss on foreign exchange transactions, loss on sale-leaseback transactions and our share of losses in equity method investments. Other net expense was approximately \$37.3 million, \$18.3 million and \$0 in fiscal 2002, 2001 and 2000, respectively.

Income Taxes

Fiscal 2002 vs. Fiscal 2001

The effective income tax rate for fiscal 2002 and 2001 was affected by certain non-deductible impairment charges, as well as no benefit recognized for losses incurred in the fourth quarter of fiscal 2002. In addition as a result of our cumulative losses over the past two years and the full utilization of our loss carryback potential, we concluded during the third quarter of fiscal 2002 that a full valuation allowance against our net deferred tax assets was appropriate. Accordingly, we recorded a valuation allowance of \$640.2 million during fiscal 2002.

Fiscal 2001 vs. Fiscal 2000

The effective income tax rate for fiscal 2001 was affected by certain non-deductible impairment charges, whereas, the effective income tax rate for fiscal 2000 was affected by non-deductible charges for certain acquisition fees. During fiscal 2001, we made an election for U.S. tax purposes that gave rise to a \$240.0 million non-current deferred tax asset. This election related to a business combination that was accounted for as pooling-of-interests. Therefore, the recognition of this tax asset was recorded as an increase to paid-in capital.

Net Loss

Fiscal 2002 vs. Fiscal 2001

Net loss was \$1.15 billion (or \$1.44 per diluted share) for fiscal 2002, compared to net loss of \$1.29 billion (or \$1.64 per diluted share) for fiscal 2001.

Fiscal 2001 vs. Fiscal 2000

Net loss was \$1.29 billion (or \$1.64 per diluted share) for fiscal 2001, compared to net income of \$868.1 million (or \$1.13 per diluted share) for fiscal 2000.

Segment Disclosures

Broadband Infrastructure and Access Segment

Detailed information regarding our Broadband Infrastructure and Access segment is provided in the following table (dollars in millions):

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

	For the years ended October 31,		
	2002	2001	2000
External sales	\$ 715.1	\$ 1,810.8	\$ 2,774.0
Operating income (loss)(1)	(208.7)	(99.2)	626.1
Depreciation and amortization	25.1	101.3	91.5
Capital expenditures	8.2	186.4	320.0

	At October 31,		
	2002	2001	2000
Assets	\$ 354.7	\$ 1,517.3	\$ 1,759.6

(1) Operating income (loss) excludes certain charges and expenses as described in Note 15 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Broadband Infrastructure and Access sales decreased \$1.1 billion, or 60.5%, in fiscal 2002 compared to fiscal 2001, primarily due to decreased demand for broadband connectivity systems, components, an overall weakness in the telecommunications equipment industry and product lines sold or shutdown in fiscal 2002 and 2001. In fiscal 2001, economic and industry weakness also led to a sales decrease of \$963.2 million, or 34.7%, compared to fiscal 2000.

During fiscal 2002, operating loss for the Broadband Infrastructure and Access segment increased by \$109.5 million compared to fiscal 2001. This increase resulted primarily from a decrease in sales volume and a shift in product sales mix to lower margin products. During fiscal 2001, we incurred losses of \$99.2 million compared to operating income of \$626.1 million in fiscal 2000. Fiscal 2001 operating income decreased primarily for the same reasons as it decreased in fiscal 2002. As a result of the restructuring initiative undertaken in fiscal 2002 and 2001, we expect to realize future cost savings through improvements in our cost structure and operating processes.

During fiscal 2002, depreciation and amortization decreased \$76.2 million compared to fiscal 2001. This decrease is the result of our restructuring efforts in fiscal 2002 and fiscal 2001, which led to a reduction in our global production capacity. Implementation of SFAS No. 142 did not have a significant impact on amortization because goodwill amortization is not allocated to segments.

Capital expenditures decreased \$178.2 million (95.6%) and \$133.6 million (41.8%), in fiscal 2002 and 2001, respectively. The decrease in fiscal 2002 and 2001 was a result of our company-wide efforts to limit capital expenditures in light of the industry downturn.

Integrated Solutions Segment

Detailed information regarding our Integrated Solutions segment is provided in the following table (dollars in millions):

	For the years ended October 31,		
	2002	2001	2000
External sales	\$ 332.6	\$ 592.0	\$ 513.9
Operating income (loss)(1)	(32.0)	(45.3)	20.6
Depreciation and amortization	10.4	20.6	16.9

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

	For the years ended October 31,		
Capital expenditures	4.4	13.0	22.7
	At October 31,		
	2002	2001	2000
Assets	\$ 269.5	\$ 403.7	\$ 386.2

- (1) Operating income (loss) excludes certain charges and expenses as described in Note 15 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Integrated Solutions sales decreased \$259.4 million, or 43.8%, in fiscal 2002 compared to fiscal 2001. During fiscal 2002, many of our customers reduced their spending budgets as well as focused on improving their existing infrastructure rather than building new capacity. In addition, we shifted the market focus for our software products away from competitive local exchange carriers and into next-generation service providers, enterprises and media and content providers. This transition led to a decline in software sales in fiscal 2002. Fiscal 2001 amounts also include \$104.6 million of sales from product lines sold prior to fiscal 2002, which represented 17.7% of net sales. The 15.2% increase in fiscal 2001 sales over fiscal 2000 sales primarily was attributable to an expansion of our U.S. and European carrier and OEM customer base, which resulted in market share gains. In the fourth quarter of fiscal 2000 and the first quarter of fiscal 2001, we expanded our systems integration service capabilities into Europe with the acquisitions of Computer Telecom Installations Ltd. in September 2000 and France Electronique's telecom systems integration business in November 2000. Fiscal 2000 net sales also include \$59.7 million of sales from product lines sold during fiscal 2001.

During fiscal 2002, operating loss for the Integrated Solutions segment decreased \$13.3 million compared to fiscal 2001. The decrease in operating loss was primarily due to cost savings achieved as a result of our restructuring initiatives in fiscal 2002 and 2001. Fiscal 2001 operating income decreased by \$65.9 million compared to fiscal 2000. The decrease was due primarily to an increase in bad debt reserves in light of the sharp decline in the telecommunications industry and the restructuring of our workforce to correspond to the decrease in telecommunications equipment and software integration projects throughout the year.

Depreciation and amortization decreased by \$10.2 million in fiscal 2002 and increased by \$3.7 million in fiscal 2001. The fiscal 2002 decrease is the result of the fiscal 2002 and 2001 restructuring efforts, which reduced the size of our global operations. Implementation of SFAS No. 142 did not have a significant impact on amortization because goodwill amortization is not allocated to segments.

Capital expenditures decreased \$8.6 million, or 66.2%, and \$9.7 million, or 42.7%, in fiscal 2002 and 2001, respectively. The decrease in fiscal 2002 and 2001 was a result of our company-wide efforts to limit capital expenditures in light of the industry downturn.

Application of Critical Accounting Policies and Estimates

Investments: We hold equity interests in both publicly traded and privately held companies. When the carrying value of an investment exceeds its fair value and the decline in value is deemed to be other than temporary, we write down the value of the investment and establish a new cost basis. Fair values for investments in public companies are determined using quoted market prices. Fair values for investments in privately held companies are estimated based upon one or more of the following factors: the values of the most recent round of financing, quoted market prices of comparable public companies, or analyses of historical and forecasted financial information. We regularly evaluate our investments based on criteria that include, but are not limited to, the duration and extent to which the fair value has been less than the carrying value, the current economic environment and the duration of any market decline, and the financial health and business outlooks of the portfolio's companies. We generally believe that an other-than temporary decline occurs when the fair value of a publicly traded investment is below the carrying value for nine consecutive months. Future adverse changes in these or other factors could result in an other-than-temporary decline in the value of our investments, thereby requiring us to write down such investments. Our ability to liquidate our positions in the investments in

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

privately held companies will be affected to a significant degree by the lack of an actively traded market, and we may not be able to dispose of these investments in a timely manner. As of October 31, 2002, our investments in publicly and privately held companies had a current cost basis (after giving effect to other than temporary impairment charges) and estimated fair value of \$4.4 million.

Inventories: We state our inventories at the lower of first-in, first-out cost or market. In assessing the ultimate realization of inventories, we are required to make judgments as to future demand requirements compared with current or committed inventory levels. Our reserve requirements generally increase as our projected demand requirements decrease due to market conditions, technological and product life cycle changes as well as longer than previously expected usage periods. We have experienced significant changes in required reserves in recent periods due primarily to declining market conditions. It is possible that significant increases in inventory reserves may be required in the future if there is a further decline in market conditions. Alternatively, if market conditions improve significantly, we may find it necessary to reverse a portion of the reserves. As of October 31, 2002, we had \$93.9 million reserved against our inventories.

Long-Lived Assets & Goodwill: We evaluate the carrying value of our long-lived assets, consisting primarily of property and equipment, whenever certain events or changes in circumstances indicate that the carrying amount of these assets may not be recoverable, in accordance with Statement of Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets." Such events or circumstances include, but are not limited to, a prolonged industry downturn, a significant decline in our market value, or significant reductions in projected future cash flows. In assessing the recoverability of our long-lived assets, we compare the carrying value to the undiscounted future cash flows the assets are expected to generate. If the total of the undiscounted future cash flows is less than the carrying amount of the assets, we write down such assets based on the excess of the carrying amount over the fair value of the assets. Fair value is generally determined by calculating the discounted future cash flows, including long-term forecasts of the amounts and timing of overall market growth and our percentage of that market, grouping of assets, discount rate and terminal growth rates. Changes in these estimates could have a material adverse effect on the assessment of our long-lived assets, thereby requiring us to write down the assets. See Note 11 to the Consolidated Financial Statements in Item 8 of this Form 10-K for details on our impairment charges.

We adopted SFAS No. 142, "Goodwill and Other Intangible Assets" during 2002. We are required to test goodwill for impairment annually or at other times if events have occurred or circumstances exist that indicate the carrying value of goodwill may no longer be recoverable. The impairment test for goodwill involves a two-step process: step one consists of a comparison of the fair value of a reporting unit with its carrying amount, including the goodwill allocated to each reporting unit. If the carrying amount is in excess of the fair value, step two requires the comparison of the implied fair value of the

31

reporting unit goodwill with the carrying amount of the reporting unit goodwill. Any excess of the carrying value of the reporting unit goodwill over the implied fair value of the reporting unit goodwill will be recorded as an impairment loss. Fair value of the business units was determined using the income approach. Under the income approach, value is dependent on the present value of future economic benefits to be derived from ownership. The income approach requires significant estimates about future cash flows and the discount rates. See Note 12 to the Consolidated Financial Statements in Item 8 of this Form 10-K for information about the results of the goodwill impairment tests. At October 31, 2002, \$3.8 million of goodwill remained on our books, related solely to our Integrated Solutions segment.

Restructuring Accrual: During fiscal 2002 and 2001, we recorded significant restructuring charges representing the direct costs of exiting certain product lines or businesses and the costs of downsizing our business. Such charges were established in accordance with EITF 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (Including Certain Costs Incurred in a Restructuring)" and represent our best estimate at the date the charges were taken. Adjustments for changes in assumptions are recorded in the period they become known. Changes in assumptions could have a material effect on our restructuring accrual as well as our consolidated results of operations.

Revenue Recognition: We recognize revenue when persuasive evidence of a final agreement exists, delivery has occurred, the selling price is fixed or determinable and collectibility is reasonably assured. Revenue from product sales is primarily recognized at the time of delivery and acceptance, and after consideration of all the terms and conditions of the customer contract. Revenue from services consists of fees for systems requirements, system design and analysis, customization and installation services, ongoing system management, system enhancements, service bureau processing, facilities management and maintenance. Services revenue is recognized as the services are performed, primarily on a time and materials basis and to a lesser extent on a fixed fee basis over the term of the services provided. Revenue from maintenance contracts is recognized ratably over the term of the agreement, generally one year. Revenue from the licensing of software rights is recognized at the time of delivery of the software to the customer, provided that we have no remaining service obligations, collectibility is reasonably assured and the fees are fixed and determinable. Where there are service obligations that are essential to the functionality of the software installed, license fees are recorded over the term of the initial customization period.

The assessment of collectibility is particularly critical in determining whether or not revenue should be recognized in the current market environment. As part of the revenue recognition process, we determine whether trade and notes receivable are reasonably assured of collection based on various factors, including an evaluation of whether there has been deterioration in the credit quality of our customers, which could result in us being unable to collect or sell the receivables. In situations where it is unclear as to whether we will be able to sell or collect the receivable, revenue and related costs are deferred. Costs are recognized when it has been determined that the collection of the receivable is unlikely.

We record provisions against our gross revenue for estimated product returns and allowances in the period when the related revenue is recorded. These estimates are based on factors that include, but are not limited to, historical sales returns, analyses of credit memo activities, current economic trends and changes in our customers' demand. Should our actual product returns and allowances exceed our estimates, additional reductions to our revenue would result.

Allowance for Uncollectible Accounts: We are required to estimate the collectibility of our trade receivables and notes receivable. A considerable amount of judgment is required in assessing the realization of these receivables including the current creditworthiness of each customer and related aging of the past due balances. In order to assess the collectibility of these receivables, we perform ongoing credit evaluations of our customers' financial condition. Through these evaluations we may

become aware of a situation where a customer may not be able to meet its financial obligations due to deterioration of its financial viability, credit ratings or bankruptcy. The reserve requirements are based on the best facts available to us and are reevaluated and adjusted as additional information is received. Our reserves are also based on amounts determined by using percentages applied to certain aged receivable categories. These percentages are determined by a variety of factors including, but are not limited to, current economic trends, historical payment and bad debt write-off experience. Significant increases in reserves have been recorded in recent periods and may occur in the future due to deteriorating market conditions. We are not able to predict changes in the financial condition of our customers and if circumstances related to our customers deteriorate, our estimates of the recoverability of our receivables could be materially affected and we may be required to record additional allowances. Alternatively, if we provided more allowances than are ultimately required, we may reverse a portion of such provisions in future periods based on our actual collection experience. As of October 31, 2002, we had \$33.9 million reserved against our account receivables.

Warranty: We provide reserves for the estimated cost of warranties at the time revenue is recognized. We estimate the costs of our warranty obligations based on our warranty policy or applicable contractual warranty, our historical experience of known product failure rates, and use of materials and service delivery costs incurred in correcting product failures. In addition, from time to time, specific warranty accruals may be made if unforeseen technical problems arise. Should our actual experience relative to these factors differ from our estimates, we may be required to record additional warranty reserves. Alternatively, if we provide more reserves than we need, we may reverse a portion of such provisions in future periods. As of October 31, 2002, we reserved \$13.1 million related to future estimated warranty costs.

Income Taxes and Deferred Taxes: We utilize the liability method of accounting for income taxes. Deferred tax liabilities or assets are recognized for the expected future tax consequences of temporary differences between the book and tax bases of assets and liabilities. We regularly assess the likelihood that our deferred tax assets will be recovered from future taxable income, and we record a valuation allowance to reduce our deferred tax assets to the amounts we believe to be realizable. We consider projected future taxable income and ongoing tax planning strategies in assessing the amount of the valuation allowance. If we determine we will not realize all or part of our deferred tax assets, an adjustment to the deferred tax asset will be charged to earnings in the period such determination is made. As a result of the cumulative losses over the past two years, and the full utilization of our loss carryback potential, we concluded during the third quarter of fiscal 2002 that a full valuation allowance against our net deferred tax assets was appropriate. The valuation allowance at October 31, 2002 was \$711.3 million. In addition, we expect to provide a full valuation allowance on any future tax benefits until we can sustain a level of profitability that demonstrates our ability to utilize these assets.

Recently Issued Accounting Pronouncements: In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 supersedes SFAS 121. SFAS 144 primarily addresses significant issues relating to the implementation of SFAS 121 and develops a single accounting model for long-lived assets to be disposed of, whether primarily held, used or newly acquired. The provisions of SFAS 144 will be effective for fiscal years beginning after December 15, 2001. We will apply this standard beginning in fiscal 2003. Prior to adopting this standard, we wrote down long-lived assets, excluding goodwill, by \$212.0 million and \$207.2 million in fiscal 2002 and 2001, respectively, by applying SFAS No. 121.

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 supersedes EITF No. 94-3. The principle difference between SFAS No. 146 and EITF No. 94-3 relates to when an entity can recognize a liability related to exit or disposal activities. SFAS No. 146 requires a liability be recognized for a cost associated with an exit or disposal activity when the liability is incurred. EITF No. 94-3 allowed a liability, related to an exit or disposal activity, to be recognized

at the date an entity commits to an exit plan. The provisions of SFAS No. 146 are effective on January 1, 2003. Accordingly, we will apply this standard to all exit or disposal activities initiated after January 1, 2003.

Liquidity and Capital Resources

Cash

Cash and cash equivalents, primarily short-term investments in commercial paper with maturities of less than 90 days and other short-term investments had a balance of \$278.9 million at October 31, 2002, which is a decrease of \$69.7 million compared to October 31, 2001. The major uses of cash during fiscal 2002 were a \$177.0 million net increase in restricted cash (which reduced the balance in cash and cash equivalents), \$25.6 million in property, plant, and equipment additions, and \$208.9 million used to pay down current liabilities as well as net cash losses from operations. These cash outflows were partially offset by \$259.4 million provided from income tax refunds, and \$79.6 million from more effective working capital management such as account receivable collections, lower inventory requirements, and lower prepaid assets. In addition, we received \$68.6 million on the sale of available-for-sale securities.

As of October 31, 2002, we had restricted cash of \$177.0 million. Restricted cash represents cash pledged to various financial institutions to secure certain of our obligations, and thus is not available to us for working capital. The majority of this restricted cash relates to four long-term operating lease obligations, with the remainder representing cash collateral for letters of credit, guarantees relating to vendor financing transactions, and foreign currency hedging activities. We expect that \$149 million of our restricted cash will be used to settle the four long-term lease obligations it secures, and accordingly will never become available to us for general working capital purposes. The remainder of the restricted cash is expected to become available to us upon satisfaction of the obligations pursuant to which the letters of credit, guarantees or currency hedging arrangement was issued. We are entitled to the interest earnings on our restricted cash balances.

During fiscal 2001, cash increased by \$131.3 million compared to fiscal 2000. In addition, as of October 31, 2001, we held approximately \$73.2 million in marketable securities. Our primary source of cash in fiscal 2001 was \$428.8 million from the collection of accounts receivable combined with lower inventory requirements compared to fiscal 2000. In addition, in fiscal 2001 we generated \$117.5 million from the divestiture of certain product lines and businesses and \$208.7 million from investment sale proceeds. These cash sources were partially offset by decreased earnings, \$115.0 million from paying down current liabilities, \$185.5 million from higher prepaid and other assets, and \$241.2 million of capital expenditures.

Finance-Related Transactions

We are a party to four operating lease agreements related to certain of our facilities, including our Eden Prairie, Minnesota headquarters facility. These leases have expiration dates ranging from 2004 to 2009, depending on whether we exercise our renewal options. These operating leases, which are sometimes referred to as "synthetic leases," contain minimum residual value guarantees by us at the end of the lease term and also give us a purchase option at the end of the lease term. If we choose to retain the property at the end of the lease term, or if the lease is terminated prematurely, we must pay the purchase option price. If we dispose of the property at the end of the lease term, we must pay any shortfall of the sales proceeds as compared to the purchase option price, not to exceed the amount of the residual value guarantee to the lessor. The aggregate purchase option price and minimum residual value guarantees from all of these leases are approximately \$149.0 million and \$116.0 million, respectively. Our obligations under these leases are secured by \$149.0 million in cash collateral, which is classified as restricted cash on our balance sheet.

During the fourth quarter of fiscal 2002, we concluded that the fair market value of our headquarters facility was significantly less than the minimum value we had guaranteed the lessor. As we intend to occupy this facility in the long-term, we amended this lease to extend the lease term by an additional two years. In connection with this amendment, we paid the lessor \$85.5 million from our

restricted cash, which was the difference between the existing purchase option price and the current fair market value of the facility, and obtained reductions in the purchase option price and minimum residual value guarantee.

With the exception of our world headquarters facility, we do not intend to continue to occupy the other three leased facilities for the full lease term. Accordingly, we are attempting to sell these facilities. In order for us to sell these leased facilities we must first purchase the facilities from the lessor for the purchase option price (which we will fund through the use of restricted cash). As the fair market value of these facilities is

likely to be less than the amount payable to the lessor for the purchase option price, we may incur additional non-recurring charges related to the disposal of these leased facilities. The net sales proceeds obtained from a buyer of these facilities would be available to us as unrestricted cash. In November of fiscal 2003, we purchased one of these leased facilities from the lessor for \$21.0 million, using the restricted cash pledged for this lease to pay the purchase price, and immediately sold the facility for \$5.8 million. The \$5.8 million sales proceeds became available to us as unrestricted cash.

In December 2001, we entered into an accounts receivable securitization arrangement with a financial institution. The purpose of this securitization arrangement was to allow us to accelerate the cash realized from our receivables, and to provide an additional liquidity resource. During the fiscal year ended October 31, 2002, the amount available under this arrangement ranged from \$3 million to \$54 million, and the amount available as of October 31, 2002 was approximately \$23 million. As of October 31, 2002, there have been no sales of receivables under this arrangement. We do not expect to utilize this facility and do not consider it a significant source of liquidity.

Capital Expenditure and Investment Commitments

As of October 31, 2002, we had commitments (both cancelable and non-cancelable) for capital expenditures related to the ongoing operation of our business of approximately \$12.4 million. These commitments primarily reflect future equipment purchases as well as improvements to existing buildings and facilities. The commitments are estimated to be paid by the end of fiscal 2003. We intend to fund these expenditures from cash on hand.

In connection with our investment activity, we invested in two independent venture capital funds in fiscal 2000. Our investment in these funds are recorded as long-term assets on our balance sheet. We committed to invest an aggregate of \$15 million in these funds as capital calls were made by the fund managers. As of October 31, 2002, our outstanding unfunded commitment was \$9.4 million. We expect that our remaining commitment will be funded through the use of cash on hand over the course of the next three years.

Vendor Financing

We have worked with customers and third-party financiers to find a means of financing projects by negotiating financing arrangements. As of October 31, 2002, 2001 and 2000, we had commitments to extend credit of \$58.0 million, \$166.9 million and \$380.0 million for such arrangements, respectively. The total amount drawn and outstanding under the commitments was approximately \$20.9 million, \$80.2 million and \$35.0 million, respectively, as of October 31, 2002, 2001 and 2000. The commitments to extend credit are conditional agreements generally having fixed expiration or termination dates and specific interest rates, conditions and purposes. These commitments may expire without being drawn. Some of these commitments enable the customer to draw on the commitment after the customer has made payment to us for the products we sold, up to the amount the customer previously paid to us. Accordingly, amounts committed may affect future cash flows. We regularly review all outstanding commitments, and the results of these reviews are considered in assessing the overall risk for possible

credit losses. At October 31, 2002, we had approximately \$12.7 million in loss reserves in the event of non-performance related to these financing arrangements.

During fiscal 2002 we sold a participation interest in one of our vendor financing notes receivable for cash equal to \$10.5 million. This sale was without any discount to the face amount of the receivable, was with full recourse to us, and our recourse obligation is secured by a letter of credit. We accounted for this sale of a participation interest as a loan, and thus recorded a \$10.5 million long-term note payable. See Note 4 to the Consolidated Financial Statements in Item 8 of this Form 10-K.

Working Capital Outlook

Our main source of liquidity continues to be our unrestricted cash on hand. In addition, based on our recent operating losses, we expect to receive a federal income tax refund in the range of \$100.0 to \$135.0 million during the first calendar quarter of 2003.

Although we expect to continue to use our unrestricted cash to fund operating losses in the near term and to pay \$57.5 million of our restructuring accrual, we believe that our current unrestricted cash on hand and cash from the expected federal income tax refunds should be adequate to fund our working capital requirements, planned capital expenditures and restructuring costs through fiscal 2003 and beyond. However, if our operating losses are more severe than expected or continue longer than expected, we may find it necessary or desirable to seek other sources of financing to support our capital needs and provide available funds for working capital. In addition, should we determine to make any significant acquisitions, additional sources of capital may be required. Given the current state of the communications equipment industry, there are few alternatives available as sources of financing. Commercial bank financing is not available at this time to us or to many companies in our industry. Accordingly, any plan to raise additional capital would likely involve an equity-based or equity-linked financing, such as the

issuance of convertible debt, common stock or preferred stock, which would be dilutive to existing shareowners.

Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk from changes in security prices, foreign exchange rates and interest rates. Market fluctuations could affect our results of operations and financial condition adversely. We, at times, reduce this risk through the use of derivative financial instruments. We do not enter into derivative financial instruments for the purpose of speculation. Changes in interest rates are not expected to have a material adverse effect on our consolidated financial condition or results of operations because we have only \$15.7 million of interest-bearing notes payable as of October 31, 2002.

As described in Note 3 to the Consolidated Financial Statements in Item 8 of this Form 10-K, we maintain an investment portfolio of common stock in three publicly traded companies in the telecommunications or technology industries. This portfolio was developed primarily through investments in privately held companies, which later became publicly traded. The investments in two of these companies, Vyyo, Inc. and Interwave Communications International, Ltd., have been written down to a nominal value. The investment in the third company, Redback Networks, is classified as an available-for-sale security and, consequently, is recorded on the balance sheet at its written-down fair value. The values recorded for these investments are subject to market price volatility. Assuming an immediate 100% decrease in our publicly traded investments, the hypothetical reduction in shareowners' investment related to these holdings is estimated to be \$0.5 million as of October 31, 2002. We also hold minority investments in a number of companies that are not publicly traded. These investments are included in long-term assets and are carried at their written-down cost of \$3.9 million. We monitor these investments for impairment and make appropriate reductions in carrying value when necessary.

36

We also are exposed to market risk from changes in foreign exchange rates. To mitigate the risk from these exposures, we have instituted a balance sheet hedging program. The objective of this program is to protect our net monetary assets and liabilities in non-functional currencies from fluctuations due to movements in foreign exchange rates. The program operates in markets where hedging costs are beneficial. We attempt to minimize exposure to currencies in which hedging instruments are unavailable or prohibitively expensive by managing our operating activities and net asset positions. The majority of hedging instruments utilized are forward contracts with maturities of less than one year. Foreign exchange contracts reduce our overall exposure to exchange rate movements, since gains and losses on these contracts offset losses and gains on the underlying exposure. See Note 13 to the Consolidated Financial Statements in Item 8 of this Form 10-K for information about our foreign exchange hedging program and the notional and fair values of our hedge instruments.

37

Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Auditors

**Board of Directors and Shareowners
ADC Telecommunications, Inc.**

We have audited the accompanying consolidated balance sheet of ADC Telecommunications, Inc. and subsidiaries as of October 31, 2002 and the related consolidated statements of operations, shareowners' investment, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of ADC Telecommunications, Inc. and subsidiaries as of October 31, 2001 and 2000, and for the two years then ended, were audited by other auditors who have ceased operations and whose reports dated November 21, 2001 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

In our opinion, the 2002 financial statements referred to above present fairly, in all material respects, the consolidated financial position of ADC Telecommunications, Inc. and subsidiaries as of October 31, 2002 and the consolidated results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

As discussed above, the consolidated financial statements of ADC Telecommunications, Inc. and subsidiaries as of October 31, 2001 and 2000, and for the two years then ended, were audited by other auditors who have ceased operations. As described in Note 12, these consolidated financial statements have been revised to include the transitional disclosures required by Financial Accounting Standard No. 142, "Goodwill and other Intangible Assets", which was adopted by the Company as of November 1, 2001. We have audited the disclosures in Note 12 and, in our opinion, the disclosures for fiscal 2001 and 2000 in Note 12 are appropriate. However, we were not engaged to audit, review, or apply any procedures to the fiscal 2001 and 2000 consolidated financial statements of the Company other than with respect to such disclosures and, accordingly, we do not express an opinion or any other form of assurance on the fiscal 2001 and 2000 consolidated financial statements taken as a whole.

/s/ Ernst & Young LLP

Minneapolis, Minnesota
December 2, 2002

38

The following report is a copy of a report previously issued by Arthur Andersen LLP ("Andersen"), which report has not been reissued by Andersen. Certain financial information for each of the two years in the period ended October 31, 2001 was not reviewed by Andersen and includes: (i) reclassifications to conform to our fiscal 2002 financial statement presentation and (ii) additional disclosures to conform with new accounting pronouncements and SEC rules and regulations issued during such fiscal year.

Report of Independent Public Accountants

To ADC Telecommunications, Inc.:

We have audited the accompanying consolidated balance sheets of ADC Telecommunications, Inc. (a Minnesota corporation) and subsidiaries as of October 31, 2001 and 2000, and the related consolidated statements of operations, shareowners' investment and cash flows for each of the three years in the period ended October 31, 2001. These financial statements are the responsibility of ADC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to the above present fairly, in all material respects, the financial position of ADC Telecommunications, Inc., and subsidiaries as of October 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 2001 in conformity with accounting principles generally accepted in the United States.

/s/ Arthur Andersen LLP
Minneapolis, Minnesota

November 21, 2001

39

Consolidated Statements of Operations (in millions, except earnings per share)

For the years ended October 31,

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

	2002	2001	2000
Net Sales:			
Products	\$ 809.3	\$ 2,044.5	\$ 2,977.8
Services	238.4	358.3	310.1
Total net sales	1,047.7	2,402.8	3,287.9
Cost of Sales:			
Products	593.7	1,358.2	1,426.5
Services	207.5	319.6	252.5
Total cost of sales	801.2	1,677.8	1,679.0
Gross Profit	246.5	725.0	1,608.9
Operating Expenses:			
Research and development	176.4	278.6	338.0
Selling and administration	370.0	705.3	665.6
Goodwill amortization		56.6	34.3
Impairment charges	348.3	501.7	
Non-recurring charges	219.6	195.4	158.0
Non-cash stock compensation(1)	10.4	18.7	47.1
Total expenses	1,124.7	1,756.3	1,243.0
Operating Income (Loss)	(878.2)	(1,031.3)	365.9
Other Income (Expense), Net:			
Interest income (expense), net	8.4	(2.2)	19.5
Gain (loss) on sale or shutdown of product lines	(6.7)	(81.9)	328.6
Gain (loss) on write-down or sale of investments, net	16.9	(785.7)	23.8
Gain on conversion of investment			722.6
Loss on sale of fixed assets	(11.5)	(1.3)	
Gain on patent infringement settlement	26.2		
Other, net	(37.3)	(18.3)	
Income (Loss) Before Income Taxes	(882.2)	(1,920.7)	1,460.4
Provision (Benefit) for Income Taxes	262.8	(633.0)	592.3
Net Income (Loss)	\$ (1,145.0)	\$ (1,287.7)	\$ 868.1
Average Common Shares Outstanding (Basic)	795.6	787.0	721.6
Earnings (Loss) Per Share (Basic)	\$ (1.44)	\$ (1.64)	\$ 1.20
Average Common Shares Outstanding (Diluted)	795.6	787.0	770.3
Earnings (Loss) Per Share (Diluted)	\$ (1.44)	\$ (1.64)	\$ 1.13

(1)

Non-cash stock compensation expense resulted from stock options and restricted stock converted in connection with the Centigram and Broadband Access Systems acquisitions. If we had reported this non-cash stock compensation in existing operating expense categories, research and development expense and selling and administration expense would have increased by \$6.4 million and \$4.0 million, respectively, in fiscal 2002, by \$8.7 million and \$10.0 million, respectively, in fiscal 2001, and by \$24.1 million and \$23.0 million, respectively, in fiscal 2000.

The accompanying notes are an integral part of these Consolidated Financial Statements.

40

Consolidated Balance Sheets
(in millions)

	October 31, 2002	October 31, 2001
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 278.9	\$ 348.6
Available-for-sale securities	0.5	73.2
Accounts receivable, net of reserves of \$33.9 and \$50.1	115.1	280.7
Unbilled revenues	25.8	36.4
Inventories, net of reserves of \$93.9 and \$89.5	94.9	253.6
Prepaid income taxes	126.6	142.0
Deferred tax assets		107.0
Prepaid and other current assets	44.5	63.7
Total current assets	686.3	1,305.2
Property and Equipment, Net	206.8	614.0
Assets Held for Sale	20.0	8.3
Restricted Cash	177.0	
Other Assets:		
Deferred tax assets		367.1
Goodwill	3.8	140.1
Other	50.3	65.0
Total assets	\$ 1,144.2	\$ 2,499.7
LIABILITIES AND SHAREOWNERS' INVESTMENT		
Current Liabilities:		
Accounts payable	\$ 73.0	\$ 162.0
Accrued compensation and benefits	74.1	109.1
Other accrued liabilities	110.8	205.8
Restructuring accrual	124.2	120.8
Notes payable	15.7	1.7
Total current liabilities	397.8	599.4
Long-Term Notes Payable	10.8	3.0
Other Long-Term Liabilities	3.4	3.9
Total liabilities	412.0	606.3

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

	October 31, 2002	October 31, 2001
Commitments and Contingencies		
Shareowners' Investment:		
Common stock, \$0.20 par value; authorized 1,200.0 shares; issued and outstanding 799.6 and 792.0 shares	159.9	158.4
Paid-in capital	1,272.6	1,256.1
Retained earnings (deficit)	(673.3)	471.7
Deferred compensation	(12.3)	(16.7)
Accumulated other comprehensive income (loss)	(14.7)	23.9
Total shareowners' investment	732.2	1,893.4
Total liabilities and shareowners' investment	\$ 1,144.2	\$ 2,499.7

The accompanying notes are an integral part of these Consolidated Financial Statements

41

Consolidated Statements of Shareowners' Investment
(in millions)

	<u>Common Stock</u>		<u>Paid-in Capital</u>	<u>Retained Earnings (Deficit)</u>	<u>Deferred Compensation</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Comprehensive Income (Loss)</u>
	<u>Shares</u>	<u>Amount</u>					
Balance, October 31, 1999	678.6	\$ 135.7	\$ 519.6	\$ 899.2	\$ (1.1)	\$ 41.9	
Net income				868.1			\$ 868.1
Exercise of common stock options	10.4	2.1	169.5				
Stock issued for business acquisitions	81.0	16.2	177.3		(85.2)		
Adjustment to conform year-end of acquired companies				(7.9)			
Stock issued for employee benefit plans	0.3	0.1	7.9				
Reduction of deferred compensation					47.1		
Tax benefits from exercise of common stock options			79.7				
Translation loss						(16.5)	(16.5)
Unrealized gain on securities, net of taxes of \$40.5						59.0	59.0
Balance, October 31, 2000	770.3	\$ 154.1	\$ 954.0	\$ 1,759.4	\$ (39.2)	\$ 84.4	\$ 910.6
Net income				(1,287.7)			\$ (1,287.7)
Exercise of common stock options	6.9	1.4	27.6				
Stock issued for business acquisitions	11.6	2.3	3.0				
	3.2	0.6	12.8				

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

Common Stock

Stock issued for employee benefit plans														
Reduction of deferred compensation			(3.8)		22.5									
Tax benefits from exercise of common stock options			22.5											
Tax benefits related to acquisition			240.0											
Translation gain						12.4	12.4							
Unrealized loss on securities, net of taxes of \$(338.0)						(575.5)	(575.5)							
Adjustment for write-down of securities, net of taxes of \$302.1						514.4	514.4							
Adjustment for sale of securities, net of taxes of \$(6.9)						(11.8)	(11.8)							
Balance, October 31, 2001	792.0	\$	158.4	\$	1,256.1	\$	471.7	\$	(16.7)	\$	23.9	\$	(1,348.2)	
Net loss							(1,145.0)						\$	(1,145.0)
Exercise of common stock options	1.2		0.2		3.2									
Stock issued for employee benefit plans	6.4		1.3		13.3				(9.9)					
Reduction of deferred compensation									14.3					
Translation gain											2.3	2.3		
Unrealized loss on securities, net of taxes of \$(1.4)											(2.3)	(2.3)		
Adjustment for write-down of securities, net of taxes of \$1.9											3.2	3.2		
Adjustment for sale of securities, net of taxes of \$(24.5)											(41.8)	(41.8)		
Balance, October 31, 2002	799.6	\$	159.9	\$	1,272.6	\$	(673.3)	\$	(12.3)	\$	(14.7)	\$	(1,183.6)	

The accompanying notes are an integral part of these Consolidated Financial Statements.

42

Consolidated Statements of Cash Flows
(in millions)

	For the years ended October 31,					
	2002	2001	2000			
Operating Activities:						
Net income (loss)	\$	(1,145.0)	\$	(1,287.7)	\$	868.1
Adjustments to reconcile net income (loss) to net cash provided by operating activities						
Depreciation and amortization		104.7		197.8		146.2
Provision for losses on receivables		26.4		73.8		9.6
Inventory reserves		49.7		47.7		19.6
Acquisition-related charges						29.1
Purchased in-process research and development		10.5				22.8
Write-down of inventory, property and equipment and goodwill		367.2		477.8		

Edgar Filing: ADC TELECOMMUNICATIONS INC - Form 10-K

	For the years ended October 31,		
Non-cash stock compensation	14.3	18.7	47.1
Deferred income taxes	498.1	(438.9)	332.0
Gain on ownership of investments		(0.6)	(8.1)
Loss on write-down of investments	50.9	862.5	
Gain on sale of investments	(67.8)	(76.8)	(23.8)
Gain on conversion of investment			(722.6)
Loss on sale of fixed assets and sale leasebacks	14.8	6.5	
(Gain) loss on sale or shutdown of product lines	6.7	81.9	(328.6)
Other, net	(0.1)	4.0	4.5
Changes in operating assets and liabilities, net of acquisitions and divestitures:			
Accounts and unbilled receivables	160.8	339.3	(158.7)
Inventories	104.3	89.5	(207.8)
Prepaid and other assets	73.9	(185.5)	(84.8)
Accounts payable	(88.1)	(61.7)	83.6
Accrued liabilities	(120.8)	(53.3)	222.7
Total cash provided by operating activities	60.5	95.0	250.9
Investing Activities:			
Acquisitions, net of cash acquired	(4.2)	(48.7)	(345.3)
Divestitures, net of cash disposed	2.3	117.5	
Property and equipment additions, net	(25.6)	(241.2)	(375.3)
Change in restricted cash	(177.0)		
Proceeds from sale of building		10.4	
Sale of available-for-sale securities, net	68.6	208.7	246.1
Sale (purchase) of long-term investments, net	2.3	(15.7)	(49.6)
Total cash provided by (used for) investing activities	(133.6)	31.0	(524.1)
Financing Activities:			
Repayments of debt	(5.9)	(35.8)	(32.5)
Common stock issued	9.1	40.4	277.2
Total cash provided by financing activities	3.2	4.6	244.7
Effect of Exchange Rate Changes on Cash	0.2	0.7	(3.7)
Effect of Conforming Year-Ends of Acquired Companies			(29.5)
Increase (Decrease) in Cash and Cash Equivalents	(69.7)	131.3	(61.7)
Cash and Cash Equivalents, Beginning of Year	348.6	217.3	279.0
Cash and Cash Equivalents, End of Year	\$ 278.9	\$ 348.6	\$ 217.3

The accompanying notes are an integral part of these Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Note 1: Summary of Significant Accounting Policies

Principles of Consolidation: The consolidated financial statements include the accounts of ADC Telecommunications, Inc., a Minnesota corporation, and all significant subsidiaries in which ADC Telecommunications, Inc. has more than a 50% equity ownership. In these Notes to Consolidated Financial Statements, these companies are collectively referred to as "ADC," "we," "us" or "our." All significant intercompany transactions and balances have been eliminated in consolidation.

Cash and Cash Equivalents: Cash equivalents represent short-term investments in commercial paper with original maturities of three months or less. The carrying amounts of these investments approximate their fair value due to their short maturities. At October 31, 2002, our cash and cash equivalents were spread among three major financial institutions to avoid any significant concentration risk.

Investments: Short-term investments in publicly held companies in our investment portfolio are classified as available-for-sale securities under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Investments classified as available-for-sale securities are carried at market value with any unrealized holding gains and losses, net of any related tax effect, presented within shareowners' investment as a component of accumulated other comprehensive income (loss). We also have minority investments in companies not publicly traded. These investments are included in long-term other assets and are carried at their cost.

When the carrying value of an investment exceeds its fair value and the decline in value is deemed to be other than temporary, we write down the value of the investment and establish a new cost basis. Fair value for investments in public companies are determined using quoted market prices. Fair values for investments in privately held companies are estimated based upon one or more of the following factors: the values of the most recent round of financing, quoted market prices of comparable public companies, or analyses of historical and forecasted financial information. We regularly evaluate our investments based on criteria that include, but are not limited to, the duration and extent to which the fair value has been less than the carrying value, the current economic environment and the duration of any market decline, and the financial health and business outlooks of the portfolio's companies. We generally believe that an other-than temporary decline occurs when the fair value of a publicly traded investment is below the carrying value for nine consecutive months.

Inventories: Inventories include material, labor and overhead and are stated at the lower of first-in, first-out cost or market. In assessing the ultimate realization of inventories, we are required to make judgments as to future demand requirements compared to current or committed inventory levels. Our reserve requirements generally increase as our projected demand requirements decrease due to market conditions, technological and product life cycle changes as well as longer than previously expected usage periods.

Property and Equipment: Property and equipment are recorded at cost and depreciated using the straight-line method over estimated useful lives of three to thirty years or, in the case of leasehold improvements, over the term of the lease, if shorter. Both straight-line and accelerated methods of depreciation are used for income tax purposes.

Impairment of Long-Lived Assets: We evaluate property and equipment and identifiable intangibles for potential impairment in compliance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." We record impairment losses on long-lived assets used in operations when events and circumstances indicate the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the

carrying amounts of those assets. The impairment loss is measured by comparing the fair value of the asset to its carrying amount. See Note 11 for details of our impairment charges.

Goodwill and Other Intangible Assets: In June 2001, the Financial Accounting Standards Board issued SFAS No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." We adopted these standards on November 1, 2001. Under the new rules, goodwill is no longer amortized but will be reviewed annually for impairment. Our other intangible assets (consisting primarily of patents and developed technology) will continue to be amortized over their useful lives, typically seven years. Refer to Note 12 for details about the adoption of this standard and the results of our initial and annual impairment tests.

Research and Development Costs: Our policy is to expense all research and development costs in the period incurred.

Revenue Recognition: We recognize revenue when persuasive evidence of a final agreement exists, delivery has occurred, the selling price is fixed or determinable and collectibility is reasonably assured. Revenue from product sales is primarily recognized at the time of delivery and acceptance, and after consideration of all the terms and conditions of the customer contract. Revenue from services consists of fees for systems requirements, system design and analysis, customization and installation services, ongoing system management, system enhancements, service bureau processing, facilities management and maintenance. Services revenue is recognized as the services are performed, primarily on a time and materials basis and to a lesser extent on a fixed fee basis over the term of the services provided. Revenue from maintenance contracts is recognized ratably over the term of the agreement, generally one year. Revenue from the licensing of software rights is recognized at the time of delivery of the software to the customer, provided that we have no remaining service obligations, collectibility is reasonably assured and the fees are fixed and determinable. Where there are service obligations that are essential to the functionality of the software installed, license fees are recorded over the term of the initial customization period.

The assessment of collectibility is particularly critical in determining whether or not revenue should be recognized in the current market environment. As part of the revenue recognition process, we determine whether trade and notes receivable are reasonably assured of collection based on various factors, including an evaluation of whether there has been deterioration in the credit quality of our customers, which could result in us being unable to collect or sell the receivables. In situations where it is unclear as to whether we will be able to sell or collect the receivable, revenue and related costs are deferred. Costs are recognized when it has been determined that the collection of the receivable is unlikely.

We record provisions against our gross revenue for estimated product returns and allowances in the period when the related revenue is recorded. These estimates are based on factors that include, but are not limited to, historical sales returns, analyses of credit memo activities, current economic trends and changes in our customers' demand. Should our actual product returns and allowances exceed our estimates, additional reductions to our revenue would result.

Allowance for Uncollectible Accounts: We are required to estimate the collectibility of our trade and notes receivable. A considerable amount of judgment is required in assessing the realization of these receivables including the current creditworthiness of each customer and related aging of the past due balances. In order to assess the collectibility of these receivables, we perform ongoing credit evaluations of our customers' financial condition. Through these evaluations we may become aware of a

situation where a customer may not be able to meet its financial obligations due to deterioration of its financial viability, credit ratings or bankruptcy. The reserve requirements are based on the best facts available to us and are reevaluated and adjusted as additional information is received.

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

Income Taxes and Deferred Taxes: We utilize the liability method of accounting for income taxes. Deferred tax liabilities or assets are recognized for the expected future tax consequences of temporary differences between the book and tax bases of assets and liabilities. We regularly assess the likelihood that our deferred tax assets will be recovered from future taxable income, and we record a valuation allowance to reduce our deferred tax assets to the amounts we believe to be realizable. We consider projected future taxable income and ongoing tax planning strategies in assessing the amount of the valuation allowance. If we determine we will not realize all or part of our deferred tax assets, an adjustment to the deferred tax asset will be charged to earnings in the period such determination is made. As a result of our cumulative losses over the past two years, and the full utilization of our loss carryback potential, we concluded during the third quarter of fiscal 2002 that a full valuation allowance against our net deferred tax assets was appropriate. In addition, we expect to provide a full valuation allowance on any future tax benefits until we can sustain a level of profitability that demonstrates our ability to utilize these assets.

Foreign Currency Translation: We convert assets and liabilities of foreign operations to their U.S. dollar equivalents at rates in effect at the balance sheet dates, and we record translation adjustments in shareowners' investment. Income statements of foreign operations are translated from the operations' functional currency to U.S. dollar equivalents at the exchange rate on the transaction dates. Foreign exchange transaction gains and losses are reported in other income (expense), net.

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Although these estimates are based on our knowledge of current events and actions we may undertake in the future, these estimates ultimately

may differ from actual results.

Comprehensive Income (Loss): Components of comprehensive income (loss) include net income, foreign currency translation adjustments and unrealized gains (losses) on available-for-sale securities, net of tax. Comprehensive income is presented in the consolidated statements of shareowners' investment.

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

Recently Issued Accounting Pronouncements: In October 2001, the Financial Accounting Standards Board issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS 144 supersedes SFAS 121. SFAS 144 primarily addresses significant issues relating to the implementation of SFAS 121 and develops a single accounting model for long-lived assets to be disposed of, whether primarily held, used or newly acquired. The provisions of SFAS 144 will be

46

effective for fiscal years beginning after December 15, 2001. We will apply this standard beginning in fiscal 2003 and believe that the effect of adoption will not be significant. Prior to adopting this standard, we wrote down long-lived assets, excluding goodwill, by \$212.0 and \$207.2 million in fiscal 2002 and 2001, respectively, by applying SFAS No. 121.

In June 2002, the Financial Accounting Standards Board issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 supersedes EITF No. 94-3. The principal difference between SFAS No. 146 and EITF No. 94-3 relates to when an entity can recognize a liability related to exit or disposal activities. SFAS No. 146 requires that a liability be recognized for a cost associated with an exit or disposal activity when the liability is incurred. EITF No. 94-3 allowed a liability related to an exit or disposal activity to be recognized at the date an entity commits to an exit plan. The provisions of SFAS No. 146 are effective for all exit or disposal activities initiated after January 1, 2003.

Note 2: Other Financial Statement Data (in millions)

Other Income (Expense), Net:

	2002	2001	2000
	<u> </u>	<u> </u>	<u> </u>
Interest income	\$ 12.4	\$ 6.6	\$ 23.6
Interest expense	(4.0)	(8.8)	(4.1)
	<u> </u>	<u> </u>	