

Clearfield, Inc.  
Form 10-Q  
July 31, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

**FORM 10-Q**

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

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2017

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

**Commission File Number 0-16106**

**Clearfield, Inc.**

(Exact name of Registrant as specified in its charter)

**Minnesota**

(State or other jurisdiction of incorporation or organization)

**41-1347235**

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

**7050 Winnetka Avenue North, Suite 100, Brooklyn Park, Minnesota 55428**

(Address of principal executive offices and zip code)

**(763) 476-6866**

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(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES  NO

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Smaller reporting company  Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

YES  NO

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class:	Outstanding at July 27, 2017
Common stock, par value \$.01	13,934,910

**CLEARFIELD, INC.**

**FORM 10-Q**

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## CLEARFIELD, INC.

## CONDENSED BALANCE SHEETS

	(Unaudited) June 30, 2017	(Audited) September 30, 2016
Assets		
Current Assets		
Cash and cash equivalents	\$ 19,748,097	\$ 28,014,321
Short-term investments	5,737,150	5,527,075
Accounts receivables, net	8,052,829	7,999,210
Inventories	9,338,613	8,373,155
Other current assets	869,150	1,198,917
Total current assets	43,745,839	51,112,678
Property, plant and equipment, net	5,511,450	5,780,814
Other Assets		
Long-term investments	17,153,000	10,703,000
Goodwill	2,570,511	2,570,511
Other	484,989	428,310
Total other assets	20,208,500	13,701,821
Total Assets	\$ 69,465,789	\$ 70,595,313
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable	2,196,152	2,573,292
Accrued compensation	2,077,040	4,697,138
Accrued expenses	60,222	75,306
Total current liabilities	4,333,414	7,345,736
Other Liabilities		
Deferred taxes	411,779	411,779
Deferred rent	266,228	243,755
Total other liabilities	678,007	655,534
Total Liabilities	5,011,421	8,001,270
Commitments and Contingencies		

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Shareholders' Equity		
Preferred stock, \$.01 par value; authorized 500 shares; no shares outstanding	-	-
Common stock, authorized 50,000,000, \$.01 par value; 13,961,112 and 14,126,279, shares issued and outstanding at June 30, 2017 and September 30, 2016	139,611	141,263
Additional paid-in capital	56,594,725	57,320,515
Retained earnings	7,720,032	5,132,265
Total Shareholders' Equity	64,454,368	62,594,043
Total Liabilities and Shareholders' Equity	\$69,465,789	\$ 70,595,313

SEE ACCOMPANYING NOTES TO CONDENSED FINANCIAL STATEMENTS

## CLEARFIELD, INC.

## CONDENSED STATEMENTS OF OPERATIONS

## UNAUDITED

	Three Months Ended		Nine Months Ended	
	June 30,	2016	June 30,	2016
	2017		2017	
Net sales	\$19,611,297	\$21,598,720	\$55,529,230	\$54,235,622
Cost of sales	11,674,047	12,258,523	32,940,446	30,938,180
Gross profit	7,937,250	9,340,197	22,588,784	23,297,442
Operating expenses				
Selling, general and administrative	6,614,693	5,878,352	18,794,395	15,712,319
Income from operations	1,322,557	3,461,845	3,794,389	7,585,123
Interest income	73,759	41,608	186,378	114,316
Income before income taxes	1,396,316	3,503,453	3,980,767	7,699,439
Income tax expense	593,000	1,141,392	1,393,000	2,356,945
Net income	\$803,316	\$2,362,061	\$2,587,767	\$5,342,494
Net income per share:				
Basic	\$0.06	\$0.18	\$0.19	\$0.40
Diluted	\$0.06	\$0.17	\$0.19	\$0.39
Weighted average shares outstanding:				
Basic	13,522,755	13,397,509	13,559,704	13,331,632
Diluted	13,598,582	13,806,928	13,730,945	13,654,476

SEE ACCOMPANYING NOTES TO CONDENSED FINANCIAL STATEMENTS

## CLEARFIELD, INC.

## CONDENSED STATEMENTS OF CASH FLOWS

## UNAUDITED

	Nine Months Ended June 30,	
	2017	2016
Cash flows from operating activities		
Net income	\$2,587,767	\$5,342,494
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,205,769	1,068,297
Impairment of long-lived assets	643,604	-
Deferred taxes	-	2,185,534
(Gain) loss on disposal of assets	(5,100 )	1,135
Stock-based compensation	1,774,330	843,658
Changes in operating assets and liabilities:		
Accounts receivable, net	(53,619 )	(2,716,263 )
Inventories	(965,458 )	(923,530 )
Prepaid expenses and other	324,206	(399,662 )
Accounts payable and accrued expenses	(2,989,849 )	1,526,993
Net cash provided by operating activities	2,521,650	6,928,656
Cash flows from investing activities		
Purchases of property, plant and equipment and intangible assets	(1,631,127 )	(982,245 )
Proceeds from sale of property, plant and equipment	5,100	-
Purchases of investments	(13,279,075 )	(5,508,075 )
Proceeds from maturities of investments	6,619,000	5,761,000
Net cash used in investing activities	(8,286,102 )	(729,320 )
Cash flows from financing activities		
Proceeds from issuance of common stock under employee stock purchase plan	334,692	254,426
Proceeds from issuance of common stock upon exercise of stock options	28,718	473,651
Tax withholding related to exercise of stock options and restricted stock vestings	(462,120 )	(77,291 )
Repurchase of common stock	(2,403,062 )	(333,761 )
Net cash (used in) provided by financing activities	(2,501,772 )	317,025
(Decrease) increase in cash and cash equivalents	(8,266,224 )	6,516,361
Cash and cash equivalents, beginning of period	28,014,321	18,071,210
Cash and cash equivalents, end of period	\$19,748,097	\$24,587,571

Supplemental disclosures for cash flow information



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Cash paid during the year for income taxes	\$893,483	\$338,616
Non-cash financing activities		
Cashless exercise of stock options	\$34,268	\$541,016

SEE ACCOMPANYING NOTES TO CONDENSED FINANCIAL STATEMENTS

## NOTES TO CONDENSED FINANCIAL STATEMENTS

### Note 1. Basis of Presentation

The accompanying (a) condensed balance sheet as of September 30, 2016, which has been derived from audited financial statements, and (b) unaudited interim condensed financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial information, pursuant to the rules and regulations of the Securities and Exchange Commission. Pursuant to these rules and regulations, certain financial information and footnote disclosures normally included in the financial statements have been condensed or omitted. However, in the opinion of management, the financial statements include all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the financial position and results of operations and cash flows of the interim periods presented. Operating results for the interim periods presented are not necessarily indicative of results to be expected for the full year or for any other interim period, due to variability in customer purchasing patterns and seasonal, operating and other factors. These condensed financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended September 30, 2016.

In preparation of the Company's financial statements, management is required to make estimates and assumptions that affect reported amounts of assets and liabilities and related revenues and expenses during the reporting periods. As future events and their effects cannot be determined with precision, actual results could differ significantly from these estimates.

In March 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*. The standard is required to be adopted by all companies in their first fiscal year beginning after December 15, 2016 but allows companies to early adopt prior to this date. The standard is intended to simplify various aspects of the accounting and presentation of share-based payments. During the quarter ended September 30, 2016, the Company elected to early adopt this standard as of October 1, 2015. Adoption of this standard impacted the previously filed 10-Q for the period ended June 30, 2016 as follows:

*Statement of earnings* – The standard requires that the tax effects of stock-based compensation be recognized in the income tax provision of the Company's Statements of Earnings. Previously, these amounts were recognized in additional paid-in capital on the Company's Balance Sheets. The new standard requires these amounts to be recasted within these quarters due to the prospective adoption of this standard in the fourth quarter of fiscal 2016. Accordingly, net tax benefits related to stock-based compensation awards of \$79,640 and \$238,087 for the three and nine months ended June 30, 2016, respectively, were recognized as reductions of income tax expense in the statements of earnings. This tax benefit reduced our effective income tax rates 2.3% and 3.1% for the three and nine months ended June 30, 2016, respectively, and resulted in an increase in basic and diluted earnings per share of \$0.01 for both the three and nine months ended June 30, 2016.

*Statement of cash flows* – The standard requires that excess tax benefits from share-based employee awards be reported as operating activities in the consolidated statements of cash flows. Previously, these cash flows were included as hypothetical inflows and outflows in both the operating and financing activities. We elected to apply this change on a prospective basis, resulting in an increase in net cash provided by operating activities and a decrease in net cash used by financing activities of \$1,786,000 for the nine months ended June 30, 2016.

**Note 2. Net Income Per Share**

Basic net income per common share (“EPS”) is computed by dividing net income by the weighted average number of common shares outstanding for the reporting period. Diluted EPS equals net income divided by the sum of the weighted average number of shares of common stock outstanding plus all additional common stock equivalents, such as stock options and restricted stock awards, when dilutive.

The following is a reconciliation of the numerator and denominator of the net income per common share computations for the three and nine months ended June 30, 2017 and 2016:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2017	2016	2017	2016
Net income	\$ 803,316	\$ 2,362,061	\$ 2,587,767	\$ 5,342,494
Weighted average common shares	13,522,755	13,397,509	13,559,704	13,331,632
Dilutive potential common shares	75,827	409,419	171,241	322,844
Weighted average dilutive common shares outstanding	13,598,582	13,806,928	13,730,945	13,654,476
Net income per common share:				
Basic	\$ 0.06	\$ 0.18	\$ 0.19	\$ 0.40
Diluted	\$ 0.06	\$ 0.17	\$ 0.19	\$ 0.39

### Note 3. Cash, Cash Equivalents and Investments

The Company currently invests its excess cash in money market accounts and bank certificates of deposit (CDs) with a term of not more than five years. CDs with original maturities of more than three months are reported as held-to-maturity investments and are carried at amortized cost. Investments maturing in less than one year are classified as short term investments on the balance sheet, and investments maturing in one year or greater are classified as long term investments on the balance sheet. The maturity dates of the Company's CDs at June 30, 2017 and September 30, 2016 are as follows:

	June 30, 2017	September 30, 2016
Less than one year	\$ 5,737,150	\$ 5,527,075
1-5 years	17,153,000	10,703,000
Total	\$ 22,890,150	\$ 16,230,075

### Note 4. Stock-Based Compensation

The Company recorded \$590,419 and \$1,774,330 of compensation expense related to current and past option grants, restricted stock grants and the Company's Employee Stock Purchase Plan ("ESPP") for the three and nine months ended June 30, 2017, respectively. For the three months ended June 30, 2017, \$535,719 of this expense is included in selling, general and administrative expense, and \$54,700 is included in cost of sales. For the nine months ended June 30, 2017, \$1,610,229 of this expense is included in selling, general and administrative expense, and \$164,101 is included in cost of sales. The Company recorded \$370,465 and \$843,658 of compensation expense related to current and past equity awards for the three and nine months ended June 30, 2016, respectively. For the three months ended June 30, 2016, \$336,310 of this expense was included in selling, general and administrative expense, and \$34,155 was included in cost of sales. For the nine months ended June 30, 2016, \$765,347 of this expense was included in selling, general

and administrative expense, and \$78,311 was included in cost of sales. As of June 30, 2017, \$5,750,033 of total unrecognized compensation expense related to non-vested restricted stock awards is expected to be recognized over a period of approximately 7.3 years.

There were no stock options granted during the nine month periods ended June 30, 2017 or June 30, 2016. The following is a summary of stock option activity during the nine months ended June 30, 2017:

	Number of options	Weighted average exercise price
Outstanding at September 30, 2016	54,800	\$ 3.13
Granted	-	-
Exercised	(15,850 )	3.97
Cancelled or Forfeited	-	-
Outstanding at June 30, 2017	38,950	\$ 2.79

The intrinsic value of an option is the amount by which the fair value of the underlying stock exceeds its exercise price. As of June 30, 2017, the weighted average remaining contractual term for all outstanding and exercisable stock options was 3.0 years and their aggregate intrinsic value was \$405,657. During the nine months ended June 30, 2017, the Company received proceeds of \$28,718 from the exercise of stock options. During the nine months ended June 30, 2016, exercised stock options totaled 172,450 shares, resulting in \$473,651 of proceeds to the Company.

## Restricted Stock

The Company's 2007 Stock Compensation Plan permits its Compensation Committee to grant stock-based awards, including stock options and restricted stock, to key employees and non-employee directors. The Company has made restricted stock grants that vest over one to ten years.

During the nine month period ended June 30, 2017, the Company granted non-employee directors restricted stock awards totaling 3,795 shares of common stock, with a vesting term of approximately one year and a fair value of \$16.45 per share.

During the nine month period ended June 30, 2016, the Company granted non-employee directors restricted stock awards totaling 2,712 shares of common stock, with a vesting term of approximately one year and a fair value of \$14.73 per share. The Company also granted outgoing non-employee directors fully-vested stock awards totaling 1,356 shares of common stock, with a fair value of \$14.73 per share. Additionally, the Company granted employees restricted stock awards totaling 259,555 shares of common stock, with a vesting term of three to five years and a fair value of \$17.43 per share during the nine month period ended June 30, 2016.

Restricted stock transactions during the nine month period ended June 30, 2017 are summarized as follows:

	Number of shares	Weighted average grant date fair value
Unvested shares at September 30, 2016	563,570	\$ 14.26
Granted	3,795	16.45
Vested	(88,814 )	17.36
Forfeited	(7,952 )	15.05
Unvested at June 30, 2017	470,599	\$ 13.68

## Employee Stock Purchase Plan

Clearfield, Inc.'s ESPP allows participating employees to purchase shares of the Company's common stock at a discount through payroll deductions. The ESPP is available to all employees subject to certain eligibility requirements. Terms of the ESPP provide that participating employees may purchase the Company's common stock on a voluntary after-tax basis. Employees may purchase the Company's common stock at a price that is no less than the lower of 85% of the fair market value of one share of common stock at the beginning or end of each stock purchase period or phase. The ESPP is carried out in six month phases, with phases beginning on January 1 and July 1 of each calendar year. For the phases that ended on June 30, 2017 and December 31, 2016, employees purchased 14,723 and 11,144 shares at a price of \$11.22 and \$15.21 per share, respectively. After the employee purchase on June 30, 2017, 117,255 shares

of common stock were available for future purchase under the ESPP.

**Note 5. Accounts Receivable and Net Sales**

Credit is extended based on the evaluation of a customer's financial condition and collateral is generally not required. Accounts that are outstanding longer than the contractual payment terms are considered past due. The Company writes off accounts receivable when they become uncollectible; payments subsequently received on such receivables are credited to the allowance for doubtful accounts. As of June 30, 2017 and September 30, 2016, the balance in the allowance for doubtful accounts was \$79,085 and \$93,473, respectively.

See Note 7, "Major Customer Concentration" for further information regarding accounts receivable and net sales.

**Note 6. Inventories**

Inventories consist of the following as of:

	June 30, 2017	September 30, 2016
Raw materials	\$ 7,096,105	\$ 5,702,762
Work-in-progress	653,701	471,305
Finished goods	1,588,807	2,199,088
Inventories	\$ 9,338,613	\$ 8,373,155

**Note 7. Major Customer Concentration**

The following table summarizes customers comprising 10% or more of net sales for the three and nine months ended June 30, 2017 and 2016:

	Three Months Ended June 30,				Nine Months Ended June 30,			
	2017		2016		2017		2016	
Customer A	15	%	15	%	20	%	20	%
Customer B	15	%	20	%	15	%	17	%
Customer C	*		11	%	*		*	

\* Less than 10%

As of June 30, 2017, Customer B accounted for 18% accounts receivable. As of September 30, 2016, Customers A and B accounted for 18% and 12% of accounts receivable, respectively. Customers A and B are both distributors. Customer C is an Alternative Carrier.

**Note 8. Goodwill and Patents**

The Company analyzes its goodwill for impairment annually or at an interim period when events occur or changes in circumstances indicate potential impairment. The result of the analysis performed in the fourth quarter ended September 30, 2016 did not indicate an impairment of goodwill. During the nine months ended June 30, 2017, there



were no triggering events that indicate potential impairment exists.

The Company capitalizes legal costs incurred to obtain patents. Once accepted by either the U.S. Patent Office or the equivalent office of a foreign country, these legal costs are amortized using the straight-line method over the remaining estimated lives, not exceeding 20 years. As of June 30, 2017, the Company has ten patents granted and ten pending applications inside the United States.

#### **Note 9. Impairment of Long-Lived Assets**

The Company assesses potential impairments to its long-lived assets or asset groups when there is evidence that events occur or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recovered. An impairment loss is recognized when the carrying amount of the long-lived asset or asset group is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset or asset group is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group.

Any required impairment loss is measured as the amount by which the carrying amount of a long-lived asset or asset group exceeds its fair value and is recorded as a reduction in the carrying value of the related asset or asset group and a charge to operating results. During the three and nine months ended June 30, 2017, the Company incurred an impairment charge on long-lived assets of \$643,604. This impairment was related to the cancellation of an enterprise resource planning software implementation. No impairment of long-lived assets occurred during the three and nine months ended June 30, 2016.

#### **Note 10. Income Taxes**

For the three and nine months ended June 30, 2017, the Company recorded a provision for income taxes of \$593,000 and \$1,393,000, respectively, reflecting an effective tax rate of 42.5% and 35.0%, respectively. The primary difference between the effective tax rate and the statutory tax rate is related to nondeductible meals and entertainment, favorable domestic manufacturing deduction and research and development credits, expenses related to equity award compensation and unfavorable discrete items for the three and nine months ended June 30, 2017 from tax shortfalls related to stock-based compensation awards.

As of both June 30, 2017 and September 30, 2016, the Company had a remaining valuation allowance of approximately \$322,000 related to state net operating loss carry forwards the Company does not expect to utilize. Based on the Company's analysis and review of long-term forecasts and all available evidence, the Company has determined that there should be no change in this existing valuation allowance in the quarter ended June 30, 2017.

For the three and nine months ended June 30, 2016, the Company recorded a provision for income taxes of \$1,141,392 and \$2,356,945, respectively, reflecting an effective tax rate of 32.6% and 30.6%, respectively. The primary difference between the effective tax rate and the statutory tax rate is related to nondeductible meals and entertainment, expenses related to equity award compensation and favorable discrete items for the three and nine months ended June 30, 2016 from tax benefits related to stock-based compensation awards and research and development credits which were permanently extended in December 2015 by the federal government.

Deferred taxes recognize the impact of temporary differences between the amounts of the assets and liabilities recorded for financial statement purposes and these amounts measured in accordance with tax laws. The Company's realization of deferred tax temporary differences is contingent upon future taxable earnings. The Company reviewed its deferred tax assets for expected utilization using a "more likely than not" criteria by assessing the available positive and negative factors surrounding its recoverability.

As of June 30, 2017, we do not have any unrecognized tax benefits. It is the Company's practice to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. The Company does not expect any material changes in its unrecognized tax positions over the next 12 months.

#### Note 11. Accounting Pronouncements

##### Recent Accounting Pronouncements

In May 2014, the FASB issued guidance creating Accounting Standards Codification ("ASC") Section 606, *Revenue from Contracts with Customers*. The new section will replace Section 605, "Revenue Recognition" and creates modifications to various other revenue accounting standards for specialized transactions and industries. The section is intended to conform revenue accounting principles with a concurrently issued International Financial Reporting Standards with previously differing treatment between United States practice and those of much of the rest of the world, as well as, to enhance disclosures related to disaggregated revenue information. The updated guidance is effective for annual reporting periods beginning after December 15, 2017, and interim periods within that reporting period. Early application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Although the Company has not completed a full impact assessment of this guidance, we do not believe it will have a material impact on the reported net sales amounts.

In July 2015, the FASB issued ASU 2015-11, *Inventory (Topic 330) Related to Simplifying the Measurement of Inventory* which applies to all inventory except inventory that is measured using last-in, first-out (“LIFO”) or the retail inventory method. Inventory measured using first-in, first-out (“FIFO”) or average cost is covered by the new amendments. Inventory within the scope of the new guidance should be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. The amendments will take effect for public business entities for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The new guidance should be applied prospectively, and earlier application is permitted as of the beginning of an interim or annual reporting period. Although the Company has not completed a full impact assessment of this guidance, we do not believe it will have a material impact on reported inventory amounts.

In February 2016, the FASB issued ASU 2016-02, *Leases*, which requires lessees to present right-of-use assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. The guidance is to be applied using a modified retrospective approach at the beginning of the earliest comparative period in the financial statements and is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is evaluating the impact the adoption of this ASU will have on our financial statements.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

*The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements relate to future events and typically address the Company’s expected future business and financial performance. Words such as “plan,” “expect,” “aim,” “believe,” “project,” “target,” “anticipate,” “intend,” “estimate,” “will,” “should,” “could” and other words and terms of similar meaning, typically identify these forward-looking statements. Forward-looking statements are based on certain assumptions and expectations of future events and trends that are subject to risks and uncertainties. Actual results could differ from those projected in any forward-looking statements because of the factors identified in and incorporated by reference from Part I, Item 1A, “Risk Factors,” of our Annual Report on Form 10-K for the year ended September 30, 2016, as well as in other filings we make with the Securities and Exchange Commission, which should be considered an integral part of Part I, Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” All forward-looking statements included herein are made as the date of this Quarterly Report on Form 10-Q and we assume no obligation to update the forward-looking statements or to update the reasons why actual results could differ from those projected in the forward-looking statements.*

The following discussion and analysis of our financial condition and results of operations as of and for the three and nine months ended June 30, 2017 and 2016 should be read in conjunction with the financial statements and related notes in Item 1 of this report and our Annual Report on Form 10-K for the year ended September 30, 2016.

### **OVERVIEW**

#### **General**

Clearfield, Inc. designs, manufactures and distributes fiber optic management, protection and delivery products for communications networks. Our “fiber to the anywhere” platform serves the unique requirements of leading incumbent local exchange carriers (Traditional Carriers, within the Tier 2 and Tier 3 broadband markets), including large national and global telecom providers (Tier 1), wireless operators, MSO/cable TV companies, utility/municipality, enterprise, data center and military markets, while also serving the broadband needs of the competitive local exchange carriers (Alternative Carriers). The Company also provides contract manufacturing services for original equipment manufacturers (OEM) requiring copper and fiber cable assemblies built to their specifications.

The Company has historically focused on the un-served or under-served rural communities who receive their voice, video and data services from independent telephone companies. By aligning its in-house engineering and technical knowledge alongside its customers, the Company has been able to develop, customize and enhance products from design through production. Final build and assembly of the Company's products is completed at Clearfield's plants in Brooklyn Park, Minnesota, and Mexico, with manufacturing support from a network of domestic and global manufacturing partners. Clearfield specializes in producing these products on both a quick-turn and scheduled delivery basis. The Company deploys a hybrid sales model with some sales made directly to the customer, some made through two-tier distribution (channel) partners, and some sales through original equipment suppliers who private label their products.

## **RESULTS OF OPERATIONS**

### **Three months ended June 30, 2017 vs. three months ended June 30, 2016**

Net sales for the third quarter of fiscal 2017 ended June 30, 2017 were \$19,611,000, a decrease of approximately 9%, or \$1,988,000, from net sales of \$21,599,000 for the third quarter of fiscal 2016. Net sales to broadband service providers and commercial data networks customers were \$18,857,000 in the third quarter of fiscal 2017, versus \$20,018,000 in the same period of fiscal 2016. Among this group, the Company recorded \$1,174,000 in international sales for the third quarter of fiscal 2017, versus \$1,147,000 in the same period of fiscal 2016. Net sales to build-to-print and OEM customers were \$754,000 in the third quarter of fiscal 2017 versus \$1,581,000 in the same period of fiscal 2016. The Company allocates sales from external customers to geographic areas based on the location to which the product is transported. Accordingly, international sales represented 6% and 5% of total net sales for the third quarters of fiscal 2017 and 2016, respectively.

The decrease in net sales for the quarter ended June 30, 2017 of \$1,988,000 compared to the quarter ended June 30, 2016 is primarily attributable to a decrease in the ongoing builds of an Alternative Carrier customer of \$2,088,000 in the quarter ended June 30, 2017. The Company had an increase of \$73,000 in net sales to our customer base of commercial data network providers, build-to-print and OEM manufacturers, and broadband service providers, outside of the Alternative Carrier group and international sales noted below, when compared to the same period of fiscal 2016. The improvement was due to increased deployments by the Company's Traditional Carrier and Tier 1 customers. International sales increased \$27,000 during the same period due to an increase in demand. Revenue from all customers is obtained from purchase orders submitted from time to time. Accordingly, the Company's ability to predict orders in future periods or trends affecting orders in future periods is limited.

Cost of sales for the third quarter of fiscal 2017 was \$11,674,000, a decrease of \$585,000, or 5%, from \$12,259,000 in the comparable period of fiscal 2016. Gross profit was 40.5% of net sales in the fiscal 2017 third quarter, a decrease from 43.2% of net sales for the fiscal 2016 third quarter. Gross profit decreased \$1,403,000, or 15%, to \$7,937,000 for the three months ended June 30, 2017 from \$9,340,000 in the comparable period in fiscal 2016. The decrease in gross profit in the third quarter of fiscal 2017 was due to decreased volume while the decrease in gross profit percent for the quarter was due to a higher percentage of sales to the Tier 1 customer group, which typically have lower margins, along with a lower percentage of sales associated with the integration of optical components within our product line, which typically have higher margins.

Selling, general and administrative expenses increased \$737,000, or 13%, to \$6,615,000 in the fiscal 2017 third quarter from \$5,878,000 for the fiscal 2016 third quarter. The increase in the third quarter of fiscal 2017 consists primarily of an increase of \$396,000 in compensation costs due primarily to additional sales and marketing personnel, an increase of \$199,000 in stock compensation expense, an increase \$179,000 in product development costs, an increase of \$261,000 in legal expenses, and an impairment of long-lived assets of \$644,000 somewhat offset by a decrease of \$1,114,000 in performance compensation accruals when compared to the fiscal 2016 third quarter.

Income from operations for the quarter ended June 30, 2017 was \$1,323,000 compared to income from operations of \$3,462,000 for the comparable quarter of fiscal 2016, a decrease of approximately 62%. This decrease is attributable to decreased gross profit and increased selling, general and administrative expenses.

Interest income for the quarter ended June 30, 2017 was \$74,000 compared to \$42,000 for the comparable quarter for fiscal 2016. The increase is due mainly to higher interest rates earned on its investments in fiscal 2017 as well as higher cash invested balances. The Company invests its excess cash primarily in FDIC-backed bank certificates of deposit and money market accounts.

We recorded a provision for income taxes of \$593,000 and \$1,141,000 for the three months ended June 30, 2017 and 2016, respectively. We record our quarterly provision for income taxes based on our estimated annual effective tax rate for the year. The decrease in tax expense of \$548,000 from the third quarter of fiscal 2016 is primarily due to

lower profitability in the third quarter of fiscal 2017. The increase in the income tax expense rate to 42.5% for the third quarter of fiscal 2017 from 32.6% for the third quarter of fiscal 2016 is primarily the result of the Company having unfavorable discrete items during the third quarter of fiscal 2017 related to tax shortfalls for stock-based compensation awards.

The Company's net income for the three months ended June 30, 2017 was \$803,000, or \$0.06 per basic and diluted share. The Company's net income for the three months ended June 30, 2016 was \$2,362,000, or \$0.18 per basic and \$0.17 per diluted share.

**NINE months ended JUNE 30, 2017 vS. NINE months ended JUNE 30, 2016**

Net sales for the nine months ended June 30, 2017 were \$55,529,000, an increase of 2%, or approximately \$1,293,000, from net sales of \$54,236,000 for the first nine months of fiscal 2016. Net sales to broadband service providers and commercial data networks customers were \$52,508,000 for the first nine months of fiscal 2017, versus \$50,340,000 in the same period of fiscal 2016. Among this group, the Company recorded \$4,547,000 in international sales versus \$2,606,000 in the same period of fiscal 2016. Net sales to build-to-print and OEM customers were \$3,021,000 in the first nine months of fiscal 2017 versus \$3,896,000 in the same period of fiscal 2016. The Company allocates sales from external customers to geographic areas based on the location to which the product is transported. Accordingly, international sales represented 8% and 5% of total net sales for the first nine months of fiscal 2017 and 2016, respectively.

The increase in net sales for the nine months ended June 30, 2017 of \$1,293,000 compared to the nine months ended June 30, 2016 is primarily attributable to an increase of \$2,659,000 in net sales to our customer base of commercial data network providers, build-to-print and OEM manufacturers, and broadband service providers, outside of the Alternative Carrier group and international sales noted below, when compared to the same period of fiscal 2016. The improvement was due to increased deployments by the Company's Traditional Carrier and Tier 1 customers. Also, international sales increased \$1,941,000 during the same period due to an increase in demand. Net sales were negatively affected by a decrease in the ongoing builds of an Alternative Carrier customer of \$3,307,000 for the nine months ended June 30, 2017. Revenue from all customers is obtained from purchase orders submitted from time to time. Accordingly, the Company's ability to predict orders in future periods or trends affecting orders in future periods is limited.

Cost of sales for the nine months ended June 30, 2017 was \$32,940,000, an increase of \$2,002,000, or 6%, from \$30,938,000 in the comparable period of fiscal 2016. Gross profit was 40.7% of net sales in the fiscal 2017 first nine months, down from 43.0% for the comparable nine months in fiscal 2016. Gross profit decreased \$708,000, or 3%, to \$22,589,000 for the nine months ended June 30, 2017 from \$23,297,000 in the comparable period in fiscal 2016. The increase in cost of sales in the first nine months of fiscal 2017 was due to increased volume while the decrease in gross profit percent was due to a higher percentage of sales to the Tier 1 customer group, which typically have lower margins, along with a lower percentage of sales associated with the integration of optical components within our product line, which typically have higher margins.

Selling, general and administrative expenses increased 20%, or \$3,082,000, from \$15,712,000 for the first nine months of fiscal 2016 to \$18,794,000 for the first nine months of fiscal 2017. The increase in the first nine months of fiscal 2017 consists primarily of an increase of \$1,618,000 in compensation expense mainly due to additional sales and marketing personnel and wage increases. Also contributing to the increase were increased stock compensation expense of \$845,000, increased product development costs of \$605,000, increased legal expenses of \$439,000, and impairment of long-lived assets of \$644,000 when compared to the same period of fiscal 2016. These were somewhat offset by lower performance compensation accruals of \$1,359,000.

Income from operations for the nine months ended June 30, 2017 was \$3,794,000 compared to income from operations of \$7,585,000 for the first nine months of fiscal 2016, a decrease of \$3,791,000, or 50%. This decrease is primarily attributable to increased selling, general and administrative expenses.

Interest income for the nine months ended June 30, 2017 was \$186,000 compared to \$114,000 for the comparable period for fiscal 2016. The increase is due mainly to higher interest rates earned on its investments in fiscal 2017 as well as higher cash invested balances. The Company invests its excess cash primarily in FDIC-backed bank certificates of deposit and money market accounts.



We recorded a provision for income taxes of \$1,393,000 and \$2,357,000 for the nine months ended June 30, 2017 and 2016, respectively. We record our quarterly provision for income taxes based on our estimated annual effective tax rate for the year. The decrease in tax expense of \$964,000 from the nine months ended June 30, 2016 is primarily due to lower profitability in the first nine months fiscal 2017. The increase in the income tax expense rate to 35.0% for the first nine months of fiscal 2017 from 30.6% for the first nine months of fiscal 2016 is primarily the result of the Company having unfavorable discrete items during the third quarter of fiscal 2017 related to tax shortfalls for stock-based compensation awards.

The Company's net income for the first nine months of fiscal 2017 ended June 30, 2017 was \$2,588,000, or \$0.19 per basic and diluted share. The Company's net income for the first nine months of fiscal 2016 ended June 30, 2016 was \$5,342,000, or \$0.40 per basic and \$0.39 per diluted share.

### **LIQUIDITY AND CAPITAL RESOURCES**

As of June 30, 2017, our principal source of liquidity was our cash, cash equivalents and short-term investments. Those sources total \$25,485,000 at June 30, 2017 compared to \$33,541,000 at September 30, 2016. Our excess cash is invested mainly in certificates of deposit backed by the FDIC and money market accounts. Substantially all of our funds are insured by the FDIC. Investments considered long-term were \$17,153,000 as of June 30, 2017, compared to \$10,703,000 as of September 30, 2016. We believe the combined balances of short-term cash and investments along with long-term investments provide a more accurate indication of our available liquidity. We had no long-term debt obligations at June 30, 2017 or September 30, 2016.

We believe our existing cash equivalents and short-term investments, along with cash flow from operations, will be sufficient to meet our working capital and investment requirements for beyond the next 12 months. The Company intends on utilizing its available cash and assets primarily for its continued organic growth and potential future strategic transactions, as well as execution of the share repurchase program adopted by our Board of Directors. The share repurchase program was originally adopted on November 13, 2014 with \$8,000,000 authorized for common stock repurchases. On April 25, 2017, our Board of Directors increased the authorization to \$12,000,000 of common stock.

### Operating Activities

Net cash provided by operating activities totaled \$2,522,000 for the nine months ended June 30, 2017. This was primarily due to net income of \$2,588,000, non-cash expenses for depreciation and amortization of \$1,206,000, stock based compensation of \$1,774,000 and impairment of long-lived assets of \$644,000 offset by changes in operating assets and liabilities using cash. Changes in operating assets and liabilities providing cash include a decrease in other assets of \$324,000. The decrease in other assets primarily represents a decrease in the current income tax receivable. Changes in working capital items using cash include an increase in accounts receivable of \$54,000, an increase in inventory of \$965,000, and a decrease in accounts payable and accrued expenses of \$2,990,000. Accounts receivable balances can be influenced by the timing of shipments for customer projects and payment terms. Days sales outstanding, which measures how quickly receivables are collected, increased two days to 37 days from September 30, 2016 to June 30, 2017. The increase in inventory represents an adjustment for seasonal demand along with new product introductions while the decrease in accounts payable and accrued expenses primarily reflects fiscal 2016 accrued bonus compensation accruals paid in the first quarter of fiscal 2017.

Net cash provided by operating activities totaled \$6,929,000 for the nine months ended June 30, 2016. This was primarily due to net income of \$5,342,000, non-cash expenses for depreciation and amortization of \$1,068,000, deferred taxes of \$2,186,000, and stock-based compensation of \$844,000 offset by changes in operating assets and liabilities using cash. Changes in operating assets and liabilities using cash include increases for the nine months ending June 30, 2016 in accounts receivable and inventory of \$2,716,000 and \$924,000, respectively. Accounts receivable balances can be influenced by the timing of shipments for customer projects and payment terms. Days sales outstanding, which measures how quickly receivables are collected, increased two days to 37 days from September 30, 2015 to June 30, 2016. The increase in inventory represents an adjustment for seasonal demand along with changes in stocking levels. Changes in working capital items providing cash include an increase in accounts payable and accrued expenses in the amount of \$1,527,000, primarily reflecting inventory purchases and increased compensation accruals.

### Investing Activities

We invest our excess cash in money market accounts and bank CDs in denominations across numerous banks. We believe we obtain a competitive rate of return given the economic climate along with the security provided by the FDIC on these investments. During the nine months ended June 30, 2017, we used cash to purchase \$13,279,000 of FDIC-backed securities and received \$6,619,000 on CDs that matured. Purchases of patents and capital equipment, mainly related to information technology and manufacturing equipment, consumed \$1,631,000 of cash in the nine months ended June 30, 2017.

During the nine months ended June 30, 2016, we used cash to purchase \$5,508,000 of FDIC-backed securities and received \$5,761,000 on CDs that matured. Purchases of patents and capital equipment, mainly related to information technology and manufacturing equipment, consumed \$982,000 of cash in the nine months ended June 30, 2016.

### Financing Activities

For the nine months ended June 30, 2017, we received \$335,000 from employees' participation and purchase of stock through our ESPP. We also received \$29,000 from stock option exercises. The Company used \$462,000 to pay for taxes as a result of employees' vesting of restricted shares using share withholding. Additionally, we used \$2,403,000 to repurchase our common stock in the nine months ended June 30, 2017. As of June 30, 2017, we had authority to purchase approximately \$8,414,000 in additional shares under the repurchase program announced on November 13, 2014 that was subsequently increased on April 25, 2017.

For the nine months ended June 30, 2016, we received \$254,000 from employees' participation and purchase of stock through our ESPP. We also received \$474,000 from stock option exercises. Additionally, we used \$334,000 to repurchase our common stock and used \$77,000 to pay for taxes as a result of employees' exercises of stock options and vesting of restricted shares using share withholding in the nine months ended June 30, 2016.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Management utilizes its technical knowledge, cumulative business experience, judgment and other factors in the selection and application of the Company's accounting policies. The accounting policies considered by management to be the most critical to the presentation of the financial statements because they require the most difficult, subjective and complex judgments include revenue recognition, stock based compensation, deferred tax asset valuation allowances, accruals for uncertain tax positions, and impairment of goodwill and long-lived assets.

These accounting policies are described in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" of the Company's Annual Report on Form 10-K for the year ended September 30, 2016. Management made no changes to the Company's critical accounting policies during the quarter ended June 30, 2017.

In applying its critical accounting policies, management reassesses its estimates each reporting period based on available information. Changes in these estimates did not have a significant impact on earnings for the quarter ended June 30, 2017.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

The Company's management carried out an evaluation, under the supervision and with the participation of the Company's Chief Executive Officer and the Company's Chief Financial Officer of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of June 30, 2017. Based upon that evaluation, the Company's Chief Executive Officer and the Company's Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

### **Changes in Internal Control over Financial Reporting**

There were no changes to the Company's internal control over financial reporting, as defined in Rule 13a-15(f) of the Securities Exchange Act of 1934, that occurred during the quarter ended June 30, 2017 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

On January 31, 2017, CommScope Technologies LLC ("CommScope") filed a Complaint against Clearfield, Inc. in the United States District Court for the District of Minnesota. The Complaint asserts infringement of thirteen CommScope patents by certain Clearfield products, including our FieldSmart® PON Cabinets, WaveSmart® Ruggedized Splitters, Clearview® Blue and Clearview® Classic Cassettes, FieldShield® Deployment Reel System, SmartRoute® Panel, FieldShield® Multiport SmarTerminal and FieldShield® Hardened Connectors. The asserted CommScope patents are U.S. Patent Nos. 7,233,731; 8,811,791; 7,198,409; 7,809,233; 9,201,206; 7,809,234; 7,816,602; 8,263,861; 8,705,929; 8,938,147; RE42,258; 7,397,997 and 9,122,021. CommScope's Complaint seeks an injunction against further infringement and an award of unspecified compensatory and enhanced damages, interest, costs and attorneys' fees.

On April 24, 2017, we filed an Answer to CommScope’s Complaint denying all claims of infringement and asserting affirmative defenses on the grounds of non-infringement, invalidity and unenforceability, among others. We intend to vigorously defend this lawsuit and believe that none of our products violate any valid intellectual property of CommScope. However, litigation is inherently uncertain, and any judgment or injunctive relief entered against us or any adverse settlement could negatively affect our business, results of operations and financial condition. In addition, this litigation may negatively affect our business, results of operations and financial condition due to the likely substantial cost of defense and potential diversion of the attention of company management away from operational activities.

In addition to the matter described above, we are exposed to a number of asserted and unasserted legal claims encountered in the ordinary course of business. Although the outcome of any such legal action cannot be predicted, we do not believe that any of these other claims or potential claims will be material to our business, results of operations or financial condition.

## ITEM 1A. RISK FACTORS

The most significant risk factors applicable to the Company are described in Part I, Item 1A “Risk Factors” of our Annual Report on Form 10-K for the year ended September 30, 2016. There have been no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K.

## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In the three months ended June 30, 2017, the Company repurchased shares of stock as follows:

### ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program <sup>(1)</sup>
April 1-30, 2017	53,100	\$ 15.50	53,100	\$ 9,944,816
May 1-31, 2017	97,983	14.01	65,800	9,018,809
June 1-30, 2017	46,314	13.17	45,942	8,414,020
Total	197,397	\$ 14.21	164,842	\$ 8,414,020

- (1) Amount remaining from the \$8,000,000 repurchase authorization approved by the Company's Board of Directors in November 2014. On April 25, 2017, the Board of Directors increased the repurchase authorization by \$4,000,000 to \$12,000,000 of common stock. The program does not obligate Clearfield to repurchase any particular amount of common stock during any period. The repurchase will be funded by cash on hand. The repurchase program is expected to continue indefinitely until the maximum dollar amount of shares has been repurchased or until the repurchase program is earlier modified, suspended or terminated by the Board of Directors.

In the three months ending June 30, 2017, the Company repurchased a total of 32,555 shares in connection with payment of taxes upon vesting of restricted stock previously issued to employees

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

### ITEM 5. OTHER INFORMATION

None.

ITEM 6. Exhibits

Exhibit 31.1 – Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act

Exhibit 31.2 – Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Exchange Act

Exhibit 32.1 – Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. §1350



**SIGNATURES**

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

**CLEARFIELD, INC.**

July 31, 2017 /s/ Cheryl Beranek  
By: Cheryl Beranek

Its: President and Chief  
Executive Officer  
(Principal Executive Officer)

July 31, 2017 /s/ Daniel Herzog  
By: Daniel Herzog

Its: Chief Financial Officer  
(Principal Financial and  
Accounting Officer)

