Reinventing the Network

2013 ANNUAL REPORT

ADTRAN

EVOLVE
CHANGE
GROW

A YEAR OF

2013 EMERGED AS A YEAR OF OPPORTUNITY FOR ADTRAN and I am pleased to report that we capitalized on these opportunities across multiple markets, geographies and technologies. During the year, we launched innovative products that have expanded our opportunities and introduced new services that help set the groundwork for ADTRAN to thrive in the systemic changes that are ongoing in our industry. Innovation, commitment and focus enabled us to substantially grow our core product revenue, deliver world-class customer satisfaction and substantially diversify our customer base. In short, we took the right steps in 2013 to move our company forward at every level. More importantly, we provided the framework that will enable our customers to evolve, change and grow; meeting their needs as they looked to make their networks stronger, faster and able to compete in an always-on, globally connected marketplace.

OPPORTUNITY

EVOLVE

For nearly three decades, ADTRAN's continued evolution has enabled the company to advance in a dynamic and challenging marketplace.

A key evolutionary objective for the company has been to successfully transition our customers from legacy products to the next-generation core solutions of the future. In 2013, that strategy proved effective as core solutions grew to 87 percent of company revenue.

Another evolutionary objective for the company was globalization. While we continued to gain market share with traditional U.S. carrier customers, we also realized significant growth from some of the largest network operators around the world. The U.S. carrier market remained soft throughout the year; however our globalization efforts began to make a meaningful contribution in the second half. This resulted in a 48 percent increase in International sales when compared to the second half of 2012. For the full year, international sales were up 24 percent and company revenue came in at $641.7 million, up three percent over the previous year.

The successful transition of our business has enabled the company to meet the changing needs of our global customer base. As we strengthened our focus on core products, we continued to maintain a strong investment in Research and Development (R&D). This focus on product development enabled us to capitalize in the major product initiatives underway in areas such as Ultra Broadband, IP transition and cloud services. These initiatives represent significant market opportunities for our company and our industry as a whole and we are positioning the company to remain at the technology forefront as these initiatives evolve. Our R&D investment paid dividends in 2013 as we successfully secured several major market wins in the U.S., Europe and Latin America. It also resulted in several significant new product announcements in 2013, including exciting new gigabit services platforms, the industry's first advanced services fiber access gateway for Enterprise and mobile connectivity, packet optical solutions for high-capacity access aggregation, expansion of our market-leading Carrier Ethernet portfolio and ProCloud℠, ADTRAN's first cloud service offering.

EVOLVE

CHANGE

CHANGE

Today, there is a synergistic reaction, a perfect storm of technical capabilities that is accelerating the rate of change in innovation. As a result, we believe the demand for connectivity and capacity will continue to escalate.

We are a few years removed from when governments around the world set aspirational targets of 100 Mbps speeds and 2013 was a milestone year for this initiative as carriers around the world established concrete plans to deliver on those targets.

Today, ADTRAN's hundred megabit equipment is being deployed in the U.S., Europe and Latin America and we expect that this wave of deployment will last several years into the future. However, change requires breakthroughs and breakthroughs require time, as with the recent launch of system-level vectoring in the second half of 2013.

In 2007, ADTRAN presented its research and technical findings to the leading industry standards body. This changed the trajectory of this promising technology, enabling system-level vectoring to become a viable mass-market solution. This technology holds the promise to enable carriers to deliver hundred megabit services to customers around the world via existing infrastructure, overcoming major economic deployment hurdles. This industry breakthrough was pioneered by ADTRAN and implemented by the combined efforts of our U.S. and European engineering teams and marks the most successful product launch in company history.

In terms of bandwidth, hundred megabit service is just the beginning. During the year, we introduced several products that squarely focused on gigabit service delivery. We worked with service providers who are taking a leadership role in moving the industry forward in global innovation. Our innovative gigabit broadband platforms, like the Total Access 5004 introduced in late 2013, have differentiated us in the marketplace as demonstrated by our leading Fiber-to-the-Premises (FTTP) market momentum and recent major customer wins across multiple markets. Our gigabit services delivery architecture boasts industry-leading throughput capacity, advanced traffic management and simplified service automation that will fuel the market penetration of gigabit broadband services within the residential, cloud and backhaul segments.

GROW

GROW

As a global market leader, ADTRAN is committed to our investors, customers, and employees.

We were able to significantly increase our performance in 2013 in a number of key areas. From a market share perspective, we achieved the number two position in global Broadband DSL aggregation revenue and the number two position in broadband revenue for our target markets of North America and EMEA.[1] We continued to diversify our customer mix and increased our global penetration to 68 countries. An expanded customer base and diversified customer mix will be essential to the long-term, sustainable growth of the company. International markets now account for 29 percent of our total revenue, rising from just five percent in 2010.

From a product perspective, we reported growth across all three of our core product segments. Internetworking led the way with 15 percent year-over-year growth, followed by Optical at seven percent and Broadband Access at six percent. Our success in Internetworking was fueled by continued demand for our industry-leading IP Business Gateways by service providers and Cable/MSOs, as well as increased demand for our Ethernet switch products through our Value-Added Reseller (VAR) channel. Growth in our Optical products was helped by the market adoption of our Optical Networking Edge (ONE) solution and we expect to see growing adoption of this solution in 2014 and beyond. Our broadband success continues to be driven by sales of the hi-X and the Total Access 5000 product families.

Strengthening our channels to market remains a priority for the company. We successfully grew our VAR program with the addition of over 300 new resellers in 2013, bringing our total to approximately 3,800 partners. We also provided a range of new products and services, for the VAR Channel, including our first cloud-based managed service offering, that enabled our partners to develop new commercial opportunities, expand addressable markets and win new business for both themselves and ADTRAN.

In our ongoing focus to return value to our shareholders, we continued to reinvest in the company through a stock buyback program. In May 2013, an additional five million shares were added to this program. Throughout the year, the company repurchased 5.6 million shares of ADTRAN stock valued at $124.3 million. As of December 31, 2013, there were 3.5 million shares remaining under this program.

1 Infonetics Research

A BRIGHT FUTURE

A BRIGHT FUTURE

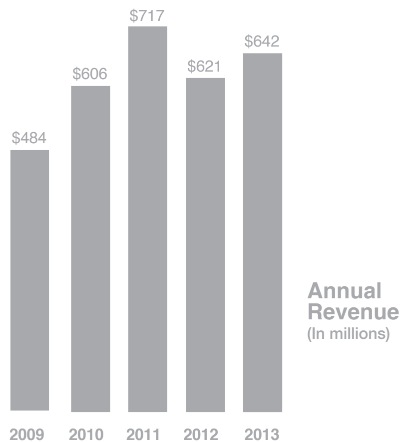
Looking ahead, we believe that 2014 shows great promise. We are confident that the markets will continue to mend, and a progressively better economy will allow companies to accelerate their capital expenditures.

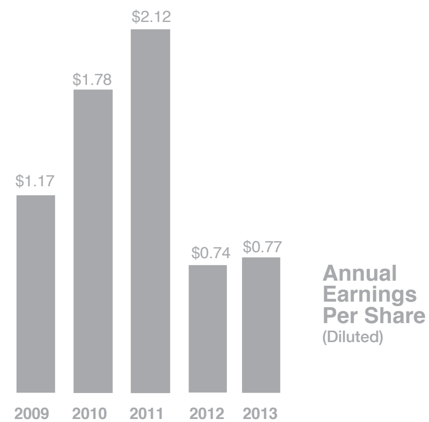
From a technology perspective, we feel we are entering a period of rapid progression and adoption. We believe that technologies like ultra broadband, GPON and vectoring will be deployed in substantial quantities, and ADTRAN is well positioned to benefit from this adoption. We believe that new network architectures, like Software-Defined Networks (SDN) and Network Function Virtualization (NFV), will be explored and adopted by carriers at a pace that we have not seen since the late 90s. All of these technologies and architectures have scores of business opportunities underlying them. Their positive impact will be felt across multiple business lines. Likewise, we believe they will enable significant growth opportunities for agile companies, like ADTRAN, to continue to gain market momentum.

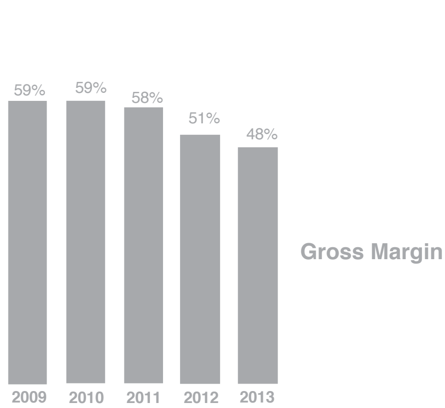
We believe 2014 will be the time that the pent-up demand for ultra broadband technologies will be unlocked, and we are well positioned to be in the driver's seat as carriers look for solutions that can underpin a wave of high-capacity applications and services such as HD streaming video, cloud services and real-time data backup. To meet these needs, carriers will need to reinvent their access networks and evolve to gigabit services and beyond.

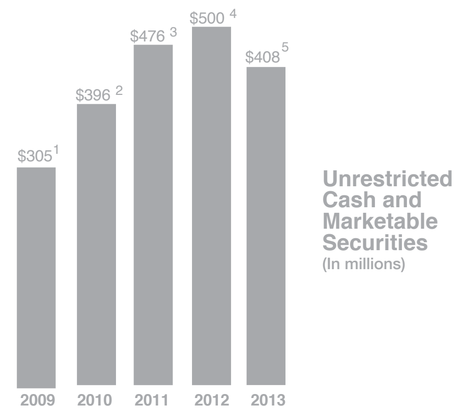
Finally, I would like to extend my appreciation to each of our employees for their commitment to the company, our shareholders and our customers. Their dedication and teamwork enabled us to successfully conquer the challenges placed before us. Our employees remain our company's greatest asset. With their continued support, ADTRAN will remain at the forefront of the industry bringing increased value to our shareholders and enabling our customers to evolve, change and grow.

Chairman & CEO
ADTRAN, Inc.









Consolidated Statements of Income Data

(In thousands, except per share amounts)

Years Ended December 31	2013	2012
Total sales	$641,744	$620,614
Income before provision for income taxes	$60,855	$72,965
Net income	$45,794	$47,263
Earnings per common share (Diluted)	$0.77	$0.74

Consolidated Balance Sheets Data

(In thousands)

Years Ended December 31	2013	2012
Working capital [6]	$277,335	$337,979
Total assets	$789,898	$883,656
Stockholders' equity	$604,606	$692,406

[1] Net of $16 million in stock repurchases and $22 million in dividend payments during 2009

[2] Net of $18 million in stock repurchases and $23 million in dividend payments during 2010

[3] Net of $36 million in stock repurchases and $23 million in dividend payments during 2011

[4] Net of $39 million in stock repurchases and $23 million in dividend payments during 2012

[5] Net of $124 million in stock repurchases and $21 million in dividend payments during 2013

[6] Working capital consists of current assets less current liabilities

Financial Results

14 **Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

15 **Stock Performance Graph**

16 **Selected Financial Data**

17 **Management's Discussion and Analysis of Financial Condition and Results of Operations**

Overview

Critical Accounting Policies and Estimates

Results of Operations

Acquisition Expenses

2013 Compared to 2012

2012 Compared to 2011

Liquidity and Capital Resources

Effect of Recent Accounting Pronouncements

Subsequent Events

Quantitative and Qualitative Disclosures About Market Risk

33 **Management's Report on Internal Control Over Financial Reporting**

34 **Report of Independent Registered Public Accounting Firm**

35 **Financial Statements**

40 **Notes to Consolidated Financial Statements**

Note 1 – Nature of Business and Summary of Significant Accounting Policies

Note 2 – Business Combinations

Note 3 – Stock Incentive Plans

Note 4 – Investments

Note 5 – Derivative Instruments and Hedging Activities

Note 6 – Inventory

Note 7 – Property, Plant and Equipment

Note 8 – Goodwill and Intangible Assets

Note 9 – Alabama State Industrial Development Authority Financing and Economic Incentives

Note 10 – Income Taxes

Note 11 – Employee Benefit Plans

Note 12 – Segment Information and Major Customers

Note 13 – Commitments and Contingencies

Note 14 – Earnings Per Share

Note 15 – Summarized Quarterly Financial Data (Unaudited)

Note 16 – Related Party Transactions

Note 17 – Subsequent Events

This annual report contains forward-looking statements which reflect management's best judgment based on factors currently known. However, these statements involve risks and uncertainties, including the successful development and market acceptance of new products, the degree of competition in the market for such products, the product and channel mix, component costs, manufacturing efficiencies, and other risks detailed in our annual report on Form 10-K for the year ended December 31, 2013. These risks and uncertainties could cause actual results to differ materially from those in the forward-looking statements included in this annual report.

Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

ADTRAN's common stock is traded on the NASDAQ Global Select Market under the symbol ADTN. As of February 6, 2014, ADTRAN had 209 stockholders of record and approximately 5,400 beneficial owners of shares held in street name. The following table shows the high and low closing prices per share for our common stock as reported by NASDAQ for the periods indicated.

Common Stock Prices

2013	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	$23.61	$24.62	$27.46	$27.10
Low	$19.07	$18.55	$23.47	$23.27
2012	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	$38.42	$31.07	$29.55	$20.14
Low	$29.01	$28.02	$17.28	$15.65

The following table shows the shareholder dividends paid in each quarter of 2013 and 2012. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

Dividends per Common Share

2013	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	$0.09	$0.09	$0.09	$0.09
2012	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	$0.09	$0.09	$0.09	$0.09

Stock Repurchases

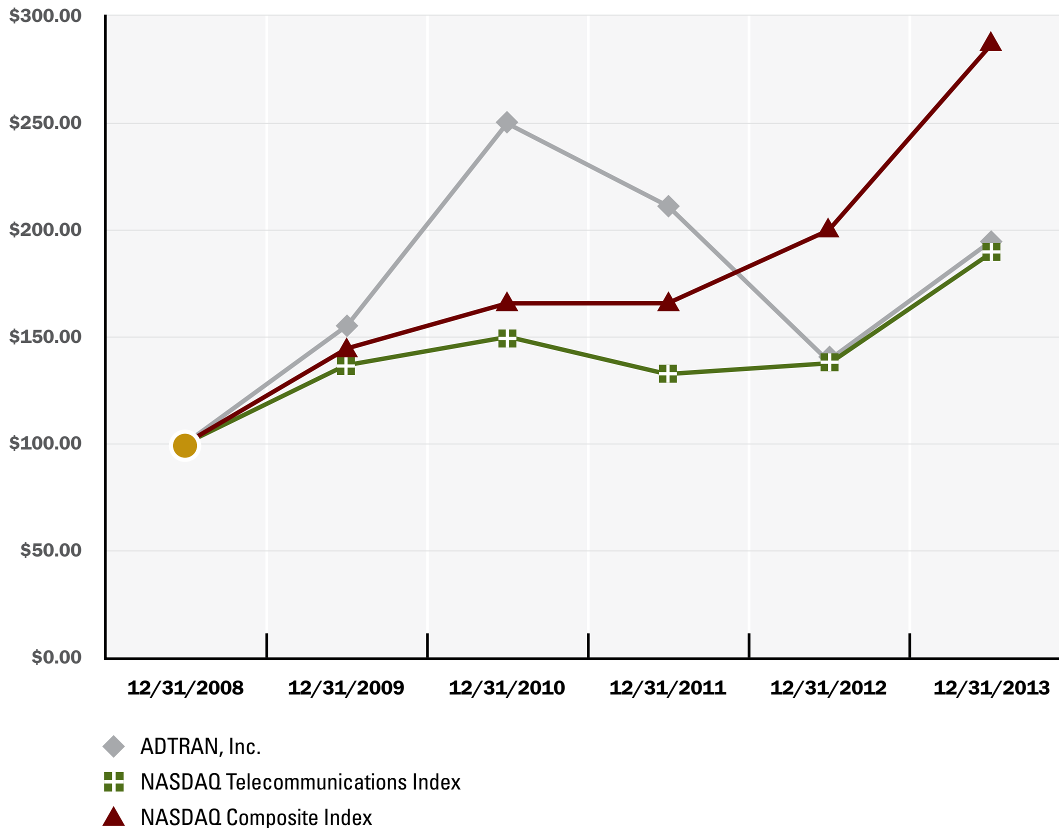
The following table sets forth repurchases of our common stock for the months indicated.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
October 1, 2013 – October 31, 2013	425,620	$23.85	425,620	3,886,848
November 1, 2013 – November 30, 2013	424,717	$23.47	424,717	3,462,131
December 1, 2013 – December 31, 2013	—	—	—	3,462,131
Total	850,337		850,337	

(1) *Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 35 million shares of our common stock. On May 1, 2013, our Board of Directors authorized the repurchase of an additional 5.0 million shares of our common stock (bringing the total shares authorized for repurchase to 40 million), which commenced upon completion of the repurchase plan announced on October 11, 2011. This new authorization is being implemented through open market or private purchases from time to time as conditions warrant.*

Stock Performance Graph

Our common stock began trading on the NASDAQ National Market on August 9, 1994. The price information reflected for our common stock in the following performance graph and accompanying table represents the closing sales prices of the common stock for the period from December 31, 2008 through December 31, 2013, on an annual basis. The graph and the accompanying table compare the cumulative total stockholders' return on our common stock with the NASDAQ Telecommunications Index and the NASDAQ Composite Index. The calculations in the following graph and table assume that $100 was invested on December 31, 2008 in each of our common stock, the NASDAQ Telecommunications Index and the NASDAQ Composite Index and also assume dividend reinvestment.



	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13
ADTRAN, Inc.	$100.00	$154.27	$250.99	$211.14	$138.91	$195.04
NASDAQ Telecommunications Index	$100.00	$137.81	$148.84	$131.52	$136.58	$189.00
NASDAQ Composite Index	$100.00	$144.88	$170.58	$171.30	$199.99	$283.39

Selected Financial Data

Income Statement Data (1)

(In thousands, except per share amounts)

Year Ended December 31,	2013	2012	2011	2010	2009
Sales					
Carrier Networks Division	$500,733	$492,096	$569,579	$476,030	$371,349
Enterprise Networks Division	141,011	128,518	147,650	129,644	112,836
Total sales	641,744	620,614	717,229	605,674	484,185
Cost of sales	332,858	303,971	302,911	246,811	197,223
Gross profit	308,886	316,643	414,318	358,863	286,962
Selling, general and administrative expenses	129,366	134,523	124,879	114,699	99,446
Research and development expenses	131,055	125,951	100,301	90,300	83,285
Operating income	48,465	56,169	189,138	153,864	104,231
Interest and dividend income	7,012	7,657	7,642	6,557	6,933
Interest expense	(2,325)	(2,347)	(2,398)	(2,436)	(2,430)
Net realized investment gain (loss)	8,614	9,550	12,454	11,008	(1,297)
Other income (expense), net	(911)	183	(694)	(804)	131
Gain on bargain purchase of a business	—	1,753	—	—	—
Income before provision for income taxes	60,855	72,965	206,142	168,189	107,568
Provision for income taxes	(15,061)	(25,702)	(67,565)	(54,200)	(33,347)
Net income	$45,794	$47,263	$138,577	$113,989	$74,221

Year Ended December 31,	2013	2012	2011	2010	2009
Weighted average shares outstanding—basic	59,001	63,259	64,145	62,490	62,459
Weighted average shares outstanding—assuming dilution (2)	59,424	63,774	65,416	63,879	63,356
Earnings per common share—basic	$0.78	$0.75	$2.16	$1.82	$1.19
Earnings per common share—assuming dilution (2)	$0.77	$0.74	$2.12	$1.78	$1.17
Dividends declared and paid per common share	$0.36	$0.36	$0.36	$0.36	$0.36

Balance Sheet Data

(In thousands)

At December 31,	2013	2012	2011	2010	2009
Working capital (3)	$277,335	$337,979	$329,311	$304,952	$278,044
Total assets	$789,898	$883,656	$817,514	$691,974	$564,463
Total debt	$46,500	$46,500	$47,000	$48,000	$48,250
Stockholders' equity	$604,606	$692,406	$692,131	$572,322	$452,515

(1) Net income for 2013, 2012, 2011, 2010 and 2009 includes stock-based compensation expense of $7.8 million, $8.0 million, $7.8 million, $7.1 million and $6.4 million, respectively, net of tax, related to stock option awards. See Note 3 of Notes to the Consolidated Financial Statements.

(2) Assumes exercise of dilutive stock options calculated under the treasury method. See Notes 1 and 14 of Notes to Consolidated Financial Statements.

(3) Working capital consists of current assets less current liabilities.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

ADTRAN, Inc. is a leading global provider of networking and communications equipment. Our solutions enable voice, data, video and Internet communications across a variety of network infrastructures. These solutions are deployed by some of the world's largest service providers, distributed enterprises and small and medium-sized businesses, public and private enterprises, and millions of individual users worldwide.

Our success depends upon our ability to increase unit volume and market share through the introduction of new products and succeeding generations of products having lower selling prices and increased functionality as compared to both the prior generation of a product and to the products of competitors. An important part of our strategy is to reduce the cost of each succeeding product generation and then lower the product's selling price based on the cost savings achieved in order to gain market share and/or improve gross margins. As a part of this strategy, we seek in most instances to be a high-quality, low-cost provider of products in our markets. Our success to date is attributable in large measure to our ability to design our products initially with a view to their subsequent redesign, allowing both increased functionality and reduced manufacturing costs in each succeeding product generation. This strategy enables us to sell succeeding generations of products to existing customers, while increasing our market share by selling these enhanced products to new customers.

Carrier Systems products are used by communications service providers to provide data, voice and video services to consumers and enterprises. This category includes the following product areas and related services:

Broadband Access
- Total Access® 5000 Multi-Service Access Node (MSAN)
- hiX family of MSANs
- Total Access 1100/1200 Series of Fiber to the Node (FTTN) products
- Ultra Broadband Ethernet (UBE)
- Digital Subscriber Line Access Multiplexer (DSLAM) products

Optical
- Optical Networking Edge (ONE)
- NetVanta® 8000 Series of Fiber Ethernet Access Devices (EAD)
- OPTI-6100 and Total Access 3000 optical Multi-Service Provisioning Platforms (MSPP)
- Pluggable Optical Products, including SFP, XFP, and SFP+

TDM Systems

Business Networking products provide access to communication services and facilitate the delivery of cloud connectivity and enterprise communications to the Small and Mid-sized Enterprise (SME) market. This category includes the following product areas and related services:

Internetworking Products
- Total Access IP Business Gateways
- Optical Network Terminals (ONTs)
- Bluesocket® virtual Wireless LAN (vWLAN®)
- NetVanta
  - Multiservice Routers
  - Managed Ethernet Switches
  - IP Business Gateways
  - Unified Communications (UC) solutions
  - Carrier Ethernet Network Terminating Equipment (NTE)
- Network Management Solutions

Integrated Access Devices (IADs)

Loop Access products are used by carrier and enterprise customers for access to copper-based communications networks. The Loop Access category includes the following product areas and related services:

- High bit-rate Digital Subscriber Line (HDSL) products
- Digital Data Service (DDS)
- Integrated Services Digital Network (ISDN) products
- T1/E1/T3 Channel Service Units/Data Service Units (CSUs/DSUs)
- TRACER fixed-wireless products

In addition, we identify subcategories of product revenues, which we divide into core products and legacy products. Our core products consist of Broadband Access and Optical products (included in Carrier Systems) and Internetworking products (included in Business Networking). Our legacy products include HDSL products (included in Loop Access) and other products not included in the aforementioned core products. Many of our customers are migrating their networks to deliver higher bandwidth services by utilizing newer technologies. We believe that products and services offered in our core product areas position us well for this migration. Despite occasional increases, we anticipate that revenues of many of our legacy products, including HDSL, will decline over time; however, revenues from these products may continue for years because of the time required for our customers to transition to newer technologies.

Sales were $641.7 million in 2013 compared to $620.6 million in 2012 and $717.2 million in 2011. Total sales of products in our three core areas, Broadband Access, Optical and Internetworking, increased 8.9% in 2013 compared to 2012 and decreased 1.7% in 2012 compared to 2011. Our gross profit margin decreased in 2013 to 48.1% from 51.0% in 2012 and 57.8% in 2011. Net income was $45.8 million in 2013 compared to $47.3 million in 2012 and $138.6 million in 2011. Earnings per share, assuming dilution, were $0.77 in 2013 compared to $0.74 in 2012 and $2.12 in 2011. Earnings per share in 2013, 2012 and 2011 include the effect of the repurchase of 5.6 million, 1.8 million and 1.1 million shares of our stock in those years, respectively.

Our operating results have fluctuated on a quarterly basis in the past, and may vary significantly in future periods due to a number of factors, including customer order activity and backlog. Backlog levels vary because of seasonal trends, the timing of customer projects and other factors that affect customer order lead times. Many of our customers require prompt delivery of products. This requires us to maintain sufficient inventory levels to satisfy anticipated customer demand. If near-term demand for our products declines, or if potential sales in any quarter do not occur as anticipated, our financial results could be adversely affected. Operating expenses are relatively fixed in the short term; therefore, a shortfall in quarterly revenues could significantly impact our financial results in a given quarter.

Our operating results may also fluctuate as a result of a number of other factors, including a decline in general economic and market conditions, increased competition, customer order patterns, changes in product and services mix, timing differences between price decreases and product cost reductions, product warranty returns, expediting costs and announcements of new products by us or our competitors. Additionally, maintaining sufficient inventory levels to assure prompt delivery of our products increases the amount of inventory that may become obsolete and increases the risk that the obsolescence of this inventory may have an adverse effect on our business and operating results. Also, not maintaining sufficient inventory levels to assure prompt delivery of our products may cause us to incur expediting costs to meet customer delivery requirements, which may negatively impact our operating results in a given quarter.

Accordingly, our historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that our financial results may vary from period to period. See Note 15 of Notes to Consolidated Financial Statements for additional information. For a discussion of risks associated with our operating results, see Item 1A of our Form 10-K for the year ended December 31, 2013.

Critical Accounting Policies and Estimates

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the accounting estimate that are reasonably likely to occur could materially impact the results of financial operations. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. These policies have been consistently applied across our two reportable segments: (1) Carrier Networks Division and (2) Enterprise Networks Division.

- Revenue is generally recognized when persuasive evidence of an arrangement exists, delivery has occurred, the product price is fixed or determinable, collection of the resulting receivable is reasonably assured, and product returns are reasonably estimable. For product sales, revenue is generally recognized upon shipment of the product to our customer in accordance with the title transfer terms of the sales agreement, generally FOB shipping point. In the case of consigned inventory, revenue is recognized when the end customer assumes ownership of the product. Contracts that contain multiple deliverables are evaluated to determine the units of accounting, and the consideration from the arrangement is allocated to each unit of accounting based on the relative selling price and corresponding terms of the contract. We use vendor-specific objective evidence of selling price. When this evidence is not available, we are generally not able to determine third-party evidence of selling price because of the extent of customization among competing products or services from other companies. We record revenue associated with installation services when all contractual obligations are complete. In instances where customer acceptance is required, revenue is deferred until all acceptance criteria have been met. Contracts that include both installation services and product sales are evaluated for revenue recognition in accordance with contract terms. As a result, depending on contract terms, installation services may be considered a separate deliverable or may be considered a combined single unit of accounting with the delivered product. Generally, either the purchaser, ADTRAN, or a third party can perform the installation of our products. Shipping fees are recorded as revenue and the related cost is included in cost of sales. Revenue is recorded net of discounts.
- A significant portion of Enterprise Networks products are sold in the United States through a non-exclusive distribution network of major technology distributors. These organizations then distribute or provide fulfillment services to an extensive network of value-added resellers and system integrators. Value-added resellers and system integrators may be affiliated with us as a channel partner, or they may purchase from the distributor on an unaffiliated basis. Additionally, with certain limitations, our distributors may return unused and unopened product for stock-balancing purposes when these returns are accompanied by offsetting orders for products of equal or greater value.
- We carry our inventory at the lower of cost or market, with cost being determined using the first-in, first-out method. We use standard costs for material, labor, and manufacturing overhead to value our inventory. Our standard costs are updated on at least a quarterly basis and any variances are expensed in the current period; therefore, our inventory costs approximate actual costs at the end of each reporting period. We write down our inventory for estimated obsolescence or unmarketable inventory by an amount equal to the difference between the cost of inventory and the estimated fair value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, we may be required to make additional inventory write-downs. Our reserve for excess and obsolete inventory was $23.0 million and $12.0 million at December 31, 2013 and 2012, respectively. Inventory write-downs charged to the reserve were $0.4 million, $0.5 million and $0.7 million for the years ended December 31, 2013, 2012 and 2011, respectively.
- The objective of our short-term investment policy is to preserve principal and maintain adequate liquidity with appropriate diversification, while achieving market returns. The objective of our long-term investment policy is principal preservation and total return; that is, the aggregate return from capital appreciation, dividend income, and interest income. These objectives are achieved through investments with appropriate diversification in fixed and variable rate income securities, public equity, and private equity portfolios. Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio. We have experienced significant volatility in the market prices of our publicly traded equity investments. These investments are recorded on the consolidated balance sheets at fair value with unrealized gains and losses reported as a component of accumulated other comprehensive income, net of tax. The ultimate realized value on these equity investments is subject to market price volatility.

We have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1 – Values based on unadjusted, quoted prices in active markets for identical assets or liabilities; Level 2 – Values based on inputs other than quoted prices included within Level 1 that are directly or indirectly observable for the asset or liability; Level 3 – Values based on unobservable inputs for the asset or liability. These inputs include information supplied by investees. At December 31, 2013, we categorized $53.6 million and $311.5 million of our available-for-sale investments as Level 1 and Level 2, respectively, and $3.9 million of our cash equivalents as Level 1. At December 31, 2012, we categorized $47.2 million and $395.9 million of our available-for-sale investments as Level 1 and Level 2, respectively, and $28.1 million of our cash equivalents as Level 1.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of $11 thousand during the fourth quarter of 2013. For the years ended December 31, 2013, 2012 and 2011, we recorded charges of $25 thousand, $0.7 million and $68 thousand, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities and our deferred compensation plan assets. Actual losses, if any, could ultimately differ from these estimates. Future adverse changes in market conditions or poor operating results of underlying investments could result in additional losses that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future. See Note 4 of Notes to the Consolidated Financial Statements in this report for more information about our investments.

We also invest in privately held entities and private equity funds and record these investments at cost. We review these investments periodically in order to determine if circumstances (both financial and non-financial) exist that indicate that we will not recover our initial investment. Impairment charges are recorded on investments having a cost basis that is greater than the value that we would reasonably expect to receive in an arm's length sale of the investment. We have not been required to record any impairment losses relating to these investments in 2013, 2012 or 2011.

- For purposes of determining the estimated fair value of our stock option awards on the date of grant, we use the Black-Scholes Model. This model requires the input of certain assumptions that require subjective judgment. These assumptions include, but are not limited to, expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors. Because our stock option awards have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, the existing model may not provide a reliable single measure of the fair value of our stock option awards. For purposes of determining the estimated fair value of our performance-based restricted stock unit awards on the date of grant, we use a Monte Carlo Simulation valuation method. The restricted stock units are subject to a market condition based on the relative total shareholder return of ADTRAN against all of the companies in the NASDAQ Telecommunications Index and vest at the end of a three-year performance period. The fair value of restricted stock issued to our Directors is equal to the closing price of our stock on the date of grant. Management will continue to assess the assumptions and methodologies used to calculate the estimated fair value of stock-based compensation. Circumstances may change and additional data may become available over time, which could result in changes to these assumptions and methodologies and thereby materially impact our fair value determination. If factors change in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period.
- We estimate our income tax provision or benefit in each of the jurisdictions in which we operate, including estimating exposures related to examinations by taxing authorities. We also make judgments regarding the realization of deferred tax assets, and establish valuation allowances where we believe it is more likely than not that future taxable income in certain jurisdictions will be insufficient to realize these deferred tax assets. Our estimates regarding future taxable income and income tax provision or benefit may vary due to changes in market conditions, changes in tax laws, or other factors. If our assumptions, and consequently our estimates, change in the future, the valuation allowances we have established may be increased or decreased, impacting future income tax expense. At December 31, 2013 and 2012 respectively, the valuation allowance was $8.8 million and $10.9 million. As of December 31, 2013, we have state research tax credit carry-forwards of $3.6 million, which will expire between 2015 and 2028. These carry-forwards were caused by tax

credits in excess of our annual tax liabilities to an individual state where we no longer generate sufficient state income. In addition, as of December 31, 2013, we have a deferred tax asset of $11.9 million relating to net operating loss carry-forwards which will expire between 2014 and 2030. These carry-forwards are the result of acquisitions in 2009 and in 2011, plus losses generated in 2012 by a foreign entity. The acquired net operating losses are in excess of the amount of estimated earnings. We believe it is more likely than not that we will not realize the full benefits of our deferred tax asset arising from these credits and net operating losses, and accordingly, have provided a full valuation allowance against them. This valuation allowance is included in non-current deferred tax liabilities in the accompanying balance sheets.

We establish reserves to remove some or all of the tax benefit of any of our tax positions at the time we determine that the positions become uncertain. We adjust these reserves, including any impact on the related interest and penalties, as facts and circumstances change.

- Our products generally include warranties of 90 days to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled $9.0 million and $9.7 million at December 31, 2013 and 2012, respectively. These liabilities are included in accrued expenses in the accompanying Consolidated Balance Sheets.
- Pension benefit plan obligations are based on various assumptions used by our actuaries in calculating these amounts. These assumptions include discount rates, compensation rate increases, expected return on plan assets, retirement rates, and mortality rates. Actual results that differ from the assumptions and changes in assumptions could affect future expenses and obligations. Our net pension liability totaled $2.6 million at December 31, 2013 and 2012. This liability is included in other non-current liabilities in the accompanying Consolidated Balance Sheets.
- We use the acquisition method to account for business combinations. Under the acquisition method of accounting, we recognize the assets acquired and liabilities assumed at their fair value on the acquisition date. Goodwill is measured as the excess of the consideration transferred over the net assets acquired. The acquisition method of accounting requires us to exercise judgment and make significant estimates and assumptions regarding the fair value of the assets acquired and liabilities assumed, including the fair values of inventory, unearned revenue, warranty liabilities, identifiable intangible assets and deferred tax asset valuation allowances. This method also requires us to refine these estimates over a one-year measurement period to reflect information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the asset and liabilities recorded on that date, which could affect our net income.
- We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If we determine that the two-step quantitative test is necessary, then we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. We passed the qualitative assessment in 2013 and 2012; therefore, we did not complete a quantitative assessment. As a result, there were no impairment losses recognized during 2013 or 2012.

Results of Operations

The following table presents selected financial information derived from our consolidated statements of income expressed as a percentage of sales for the years indicated.

Year Ended December 31,	2013	2012	2011
Sales			
Carrier Networks Division	78.0%	79.3%	79.4%
Enterprise Networks Division	22.0	20.7	20.6
Total sales	100.0%	100.0%	100.0%
Cost of sales	51.9	49.0	42.2
Gross profit	48.1	51.0	57.8
Selling, general and administrative expenses	20.2	21.7	17.4
Research and development expenses	20.4	20.3	14.0
Operating income	7.6	9.1	26.4
Interest and dividend income	1.1	1.2	1.1
Interest expense	(0.4)	(0.4)	(0.3)
Net realized investment gain	1.3	1.5	1.7
Other income (expense), net	(0.1)	—	(0.1)
Gain on bargain purchase of a business	—	0.3	—
Income before provision for income taxes	9.5	11.8	28.7
Provision for income taxes	(2.3)	(4.1)	(9.4)
Net income	7.1%	7.6%	19.3%

Acquisition Expenses

On August 4, 2011, we closed on the acquisition of Bluesocket, Inc. and on May 4, 2012, we closed on the acquisition of the NSN BBA business. Acquisition related expenses, amortizations and adjustments for the years ended December 31, 2013, 2012 and 2011 for both transactions are as follows:

(In Thousands)	2013	2012	2011
Bluesocket, Inc. acquisition			
Amortization of acquired intangible assets	$1,069	$1,020	$495
Amortization of other purchase accounting adjustments	73	443	521
Acquisition related professional fees, travel and other expenses	—	—	730
Subtotal	**$1,142**	**$1,463**	**$1,746**
NSN BBA acquisition			
Amortization of acquired intangible assets	$1,174	$762	—
Amortization of other purchase accounting adjustments	1,378	2,305	—
Acquisition related professional fees, travel and other expenses	345	4,860	2,027
Subtotal	**$2,897**	**$7,927**	**$2,027**
Total acquisition related expenses, amortizations and adjustments	**$4,039**	**$9,390**	**$3,773**
Tax effect	**(1,343)**	**(3,148)**	**(1,434)**
Total acquisition related expenses, amortizations and adjustments, net of tax	**$2,696**	**$6,242**	**$2,339**

The acquisition related expenses, amortizations and adjustments above were recorded in the following Consolidated Statements of Income categories for the years ended December 31, 2013, 2012 and 2011:

(In Thousands)	2013	2012	2011
Revenue (adjustments to unearned revenue recognized in the period)	$929	$1,528	$362
Cost of goods sold	196	1,086	165
Subtotal	**$1,125**	**$2,614**	**$527**
Selling, general and administrative expenses	$399	4,510	2,557
Research and development expenses	2,515	2,266	689
Subtotal	**$2,914**	**$6,776**	**$3,246**
Total acquisition related expenses, amortizations and adjustments	**$4,039**	**$9,390**	**$3,773**
Tax effect	**(1,343)**	**(3,148)**	**(1,434)**
Total acquisition related expenses, amortizations and adjustments, net of tax	**$2,696**	**$6,242**	**$2,339**

2013 Compared to 2012

Sales

Our sales increased 3.4% from $620.6 million in 2012 to $641.7 million in 2013. The increase in sales is primarily attributable to a $21.5 million increase in sales of our Internetworking products, a $20.5 million increase in sales of our Broadband Access products, a $3.9 million increase in sales of our Optical products, partially offset by a $24.7 million decrease in sales of our HDSL and other legacy products.

Carrier Networks sales increased 1.8% from $492.1 million in 2012 to $500.7 million in 2013. The increase in sales is primarily attributable to increases in sales of Broadband Access products, Internetworking products, and Optical products, partially offset by a decrease in sales of our HDSL products. The increase in sales of our Broadband Access products is primarily attributable to initial VDSL2 vectoring technology shipments to Europe, partially offset by fluctuations in project installation activities at a Latin American carrier. The increase in sales of our Internetworking products is primarily attributable to an improved spending environment and increases in EFM NTE sales and FTTP ONT sales to carriers. The increase in sales of our Optical products is primarily attributable to a technology shift from Time Division Multiplexed (TDM) and SONET/SDH architectures to Ethernet-based packet networks. We offer Ethernet-based solutions within our Optical products that address this technology change, and we expect sales of our Optical products will increase over time due to this transition. The decrease in sales of HDSL and other legacy products has been expected as customers continue to upgrade their networks to deliver higher bandwidth services by migrating to newer technologies, including to our core products from our Broadband Access, Internetworking and Optical product lines. While we expect that revenues from HDSL and our other legacy products will continue to decline over time, these revenues may continue for years because of the time required for our customers to transition to newer technologies.

Enterprise Networks sales increased 9.7% from $128.5 million in 2012 to $141.0 million in 2013. The increase is attributable to an increase in sales of our Internetworking products, partially offset by decreases in sales of our legacy products. The increase in sales of our Internetworking products is primarily attributable to an improved spending environment and reflected an increase in sales of Ethernet switches and IP business gateways to both carriers and value added resellers. The decrease in legacy products was expected and is discussed further above. Internetworking product sales attributable to Enterprise Networks were 93.6% of the division's sales in 2013 compared with 91.5% in 2012. Legacy products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales increased from 20.7% in 2012 to 22.0% in 2013.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 23.6% from $150.2 million in 2012 to $185.7 million in 2013. International sales, as a percentage of total sales, increased from 24.2% in 2012 to 28.9% in 2013. The increase in international sales is primarily attributable to an increase in sales in the EMEA region, partially offset by a decrease in sales in Latin America and the Asia-Pacific region.

Carrier Systems product sales increased $28.2 million in 2013 compared to 2012 primarily due to a $20.5 million increase in Broadband Access product sales, a $3.9 million increase in Optical product sales, and a $3.9 million increase in legacy product sales. The increase in Carrier Systems product sales is primarily attributable to the factors discussed above.

Business Networking product sales increased $19.6 million in 2013 compared to 2012 primarily due to a $21.5 million increase in Internetworking product sales across both divisions, partially offset by a $1.9 million decrease in legacy product sales. The increase in sales of our Internetworking products was primarily attributable to an improved spending environment and reflected an increase in sales to both carriers and value added resellers. The decrease in legacy products was expected and is further discussed above.

Loop Access product sales decreased $26.6 million in 2013 compared to 2012 primarily due to a $25.3 million decrease in HDSL product sales, which is further discussed above.

Cost of Sales

As a percentage of sales, cost of sales increased from 49.0% in 2012 to 51.9% in 2013. The increase was primarily attributable to a higher volume of the lower gross margin products related to the broadband access business we acquired in 2012, customer price movements to achieve market share position and shifts in customer mix.

Carrier Networks cost of sales increased from 49.7% of sales in 2012 to 53.4% of sales in 2013. The increase in Carrier Networks cost of sales as a percentage of sales was primarily attributable to a higher volume of the lower gross margin products related to the acquired broadband access business, customer price movements to achieve market share position and shifts in customer mix.

Enterprise Networks cost of sales increased from 46.1% of sales in 2012 to 46.3% of sales in 2013. The increase in Enterprise Networks cost of sales as a percentage of sales was primarily attributable to customer price movements to achieve market share position and the impact of cost allocations between divisions, partially offset by higher cost absorption due to the higher production volumes.

An important part of our strategy is to reduce the product cost of each succeeding product generation and then to lower the product's price based on the cost savings achieved. This may cause variations in our gross profit percentage due to timing differences between the recognition of cost reductions and the lowering of product selling prices.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased 3.8% from $134.5 million in 2012 to $129.4 million in 2013. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing, and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, trade show expenses, and related travel costs. The decrease in selling, general and administrative expenses is primarily related to decreases in professional services, legal services and travel expenses, which were higher in 2012 due to pre-acquisition activities related to the acquired broadband access business, and decreased independent contractor expense.

Selling, general and administrative expenses as a percentage of sales decreased from 21.7% for the year ended December 31, 2012 to 20.2% for the year ended December 31, 2013. Selling, general and administrative expenses as a percentage of sales will generally fluctuate whenever there is a significant fluctuation in revenues for the periods being compared.

Research and Development Expenses

Research and development expenses increased 4.1% from $126.0 million in 2012 to $131.1 million in 2013. The increase in research and development expenses is primarily attributable to increases in staffing and fringe benefit costs due to increased headcount related to the broadband access business acquired on May 4, 2012, increases in amortization of acquired intangible assets and depreciation of acquired fixed assets, partially offset by a decrease in independent contractor expenses.

Research and development expenses as a percentage of sales increased from 20.3% for the year ended December 31, 2012 to 20.4% for the year ended December 31, 2013. Research and development expenses as a percentage of sales will fluctuate whenever there are incremental product development activities or a significant fluctuation in revenues for the periods being compared.

We expect to continue to incur research and development expenses in connection with our new and existing products and our expansion into international markets. We continually evaluate new product opportunities and engage in intensive research and product development efforts which provide for new product development, enhancement of existing products and product cost reductions. We may incur significant research and development expenses prior to the receipt of revenues from a major new product group.

Interest and Dividend Income

Interest and dividend income decreased from $7.7 million in 2012 to $7.0 million in 2013. The decrease in interest and dividend income is primarily attributable to a reduction in the average rate of return on our investments as well as a decrease in our average investment balances.

Interest Expense

Interest expense remained consistent at $2.3 million in 2012 and 2013, as we had no substantial change in our fixed rate borrowings. See "Liquidity and Capital Resources" below for additional information.

Net Realized Investment Gain

Net realized investment gain decreased from $9.6 million in 2012 to $8.6 million in 2013. The decrease in realized investment gains is primarily attributable to lower gains from the sale of equity securities in 2013. See "Investing Activities" in "Liquidity and Capital Resources" below for additional information.

Other Income (Expense), net

Other income (expense), net, comprised primarily of miscellaneous income, gains and losses on foreign currency transactions, investment account management fees, and gains or losses on the disposal of property, plant and equipment occurring in the normal course of business, changed from $0.2 million of income in 2012 to $0.9 million of expense in 2013.

Income Taxes

Our effective tax rate decreased from 35.2% in 2012 to 24.7% in 2013. The decrease in the effective tax rate between the two periods is primarily attributable to an acquired business that incurred losses in the prior year for which no tax benefit was recognized and the improved profitability of that business in the current year, the net effect of recording the benefit for the research tax credit for the 2012 tax year in January 2013 pursuant to the American Taxpayer Relief Act of 2012, and the inclusion of the benefit of the estimated 2013 research tax credit in the estimated annual effective rate for 2013.

Net Income

As a result of the above factors, net income decreased from $47.3 million in 2012 to $45.8 million in 2013. As a percentage of sales, net income decreased from 7.6% in 2012 to 7.1% in 2013.

2012 Compared to 2011

Sales

ADTRAN's sales decreased 13.5% from $717.2 million in 2011 to $620.6 million in 2012. The decrease in sales is primarily attributable to an $87.6 million decrease in sales of our HDSL and other legacy products, a $30.8 million decrease in sales of our Optical products, an $8.6 million decrease in sales of our Internetworking products, partially offset by a $30.3 million increase in sales of our Broadband Access products.

Carrier Networks sales decreased 13.6% from $569.6 million in 2011 to $492.1 million in 2012. The decrease is primarily attributable to decreases in sales of Optical products, HDSL products and other legacy products. These declines were partially offset by the added sales of the NSN BBA business and an increase in sales of our Internetworking NTE products. Our organic Broadband Access sales in 2012 were negatively impacted by decreased capital expenditures at two substantial Broadband Access customers. The decrease in sales of Optical products in 2012 is primarily attributable to the market transitioning to Ethernet and our transition to new products to address this market. The declining trend in HDSL and other legacy products has been expected as we evolve our products towards packet-based technologies, but was larger than anticipated due to a large carrier customer that initiated a significant acceleration of their installed inventory reuse program.

Enterprise Networks sales decreased 13.0% from $147.7 million in 2011 to $128.5 million in 2012. The decrease is attributable to decreases in sales of Internetworking products and legacy products. The decrease in Internetworking product sales in 2012 is primarily due to a decline in Carrier spending caused by the macroeconomic environment, partially offset by growth in the value-added reseller channel and by the addition of our vWLAN solutions. Internetworking product sales attributable to Enterprise Networks were 91.5% of the division's sales in 2012 compared with 87.4% in 2011. Legacy products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales increased from 20.6% in 2011 to 20.7% in 2012.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 77.9% from $84.4 million in 2011 to $150.2 million in 2012. International sales, as a percentage of total sales, increased from 11.8% in 2011 to 24.2% in 2012. The increase in international sales in 2012 was primarily due to sales attributable to the acquired NSN BBA business and an increase in organic sales in Latin America.

Carrier Systems product sales decreased $20.6 million in 2012 compared to 2011 primarily due to a $30.8 million decrease in Optical product sales and a $20.2 million decrease in legacy product sales, partially offset by an increase of $30.3 million in Broadband Access product sales. The decrease in sales of Optical products in 2012 is primarily attributable to the market transitioning to Ethernet and our transition to new products to address this market. The increase in Broadband Access product sales was due to the added sales of the NSN BBA business, partially offset by a decline in organic Broadband Access product sales. Our organic Broadband Access sales in 2012 were negatively impacted by decreased capital expenditures at two substantial Broadband Access customers.

Business Networking product sales decreased $12.9 million in 2012 compared to 2011 primarily due to an $8.6 million decrease in Internetworking product sales across both divisions and a $4.3 million decrease in legacy product sales. The decrease in Internetworking product sales in 2012 is primarily due to a decline in Carrier spending caused by the macroeconomic environment, partially offset by growth in the value-added reseller channel and by the addition of our vWLAN solutions. The decrease in sales of legacy products is a result of customers shifting to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales decreased $63.1 million in 2012 compared to 2011 primarily due to a $60.0 million decrease in HDSL product sales. The declining trend in HDSL and other legacy products has been expected as we evolve our products

towards packet-based technologies, but was larger than anticipated due to a large carrier customer that initiated a significant acceleration of their installed inventory reuse program.

Cost of Sales

As a percentage of sales, cost of sales increased from 42.2% in 2011 to 49.0% in 2012. The increase was primarily attributable to lower gross margins related to the acquired NSN BBA business, lower cost absorption due to the lower production volumes, customer price movements to achieve market share position and higher warranty costs.

Carrier Networks cost of sales increased from 42.4% of sales in 2011 to 49.7% of sales in 2012. The increase in Carrier Networks cost of sales as a percentage of sales was primarily attributable to lower gross margins related to the acquired NSN BBA business, lower cost absorption due to the lower production volumes, customer price movements to achieve market share position and higher warranty costs.

Enterprise Networks cost of sales increased from 41.4% of sales in 2011 to 46.1% of sales in 2012. The increase in Enterprise Networks cost of sales as a percentage of sales was primarily attributable to lower cost absorption due to the lower production volumes and customer price movements to achieve market share position.

An important part of our strategy is to reduce the product cost of each succeeding product generation and then to lower the product's price based on the cost savings achieved. This may cause variations in our gross profit percentage due to timing differences between the recognition of cost reductions and the lowering of product selling prices.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 7.7% from $124.9 million in 2011 to $134.5 million in 2012. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing, and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, trade show expenses, and related travel costs. The increase in selling, general and administrative expenses is primarily related to increases in staffing and fringe benefit costs due to increased headcount, professional services, legal services and amortization of acquired intangible assets. These increases were primarily related to the NSN BBA business, which was acquired on May 4, 2012, and Bluesocket Inc., which was acquired on August 4, 2011.

Selling, general and administrative expenses as a percentage of sales increased from 17.4% for the year ended December 31, 2011 to 21.7% for the year ended December 31, 2012. Selling, general and administrative expenses as a percentage of sales will generally fluctuate whenever there is a significant fluctuation in revenues for the periods being compared.

Research and Development Expenses

Research and development expenses increased 25.6% from $100.3 million in 2011 to $126.0 million in 2012. The increase in research and development expense is primarily related to increases in staffing and fringe benefit costs due to increased headcount, including expenses and increased headcount related to the NSN BBA business acquired on May 4, 2012 and Bluesocket, Inc., which was acquired on August 4, 2011, amortization of acquired intangible assets related to both acquisitions, and increases in independent contractor expense and office lease expense related to the NSN BBA business.

Research and development expenses as a percentage of sales increased from 14.0% for the year ended December 31, 2011 to 20.3% for the year ended December 31, 2012. Research and development expenses as a percentage of sales will fluctuate whenever there are incremental product development activities or a significant fluctuation in revenues for the periods being compared.

We expect to continue to incur research and development expenses in connection with our new and existing products and our expansion into international markets. We continually evaluate new product opportunities and engage in intensive research and product development efforts which provide for new product development, enhancement of existing products and product cost reductions. We may incur significant research and development expenses prior to the receipt of revenues from a major new product group.

Interest and Dividend Income

Interest and dividend income remained consistent at $7.6 million in 2011 and $7.7 million in 2012, as we had no substantial change in interest-bearing investment balances or interest rates.

Interest Expense

Interest expense remained consistent at $2.4 million in 2011 and $2.3 million in 2012, as we had no substantial change in our fixed rate borrowing. See "Liquidity and Capital Resources" below for additional information.

Net Realized Investment Gain

Net realized investment gain decreased from $12.5 million in 2011 to $9.6 million in 2012. This change is primarily related to a $1.3 million decrease related to sales of marketable equity securities and impaired marketable equity securities, a $0.6 million decrease in distributions from two private equity funds, and a $0.6 million increase in impairment of deferred compensation plan assets. See "Investing Activities" in "Liquidity and Capital Resources" below for additional information.

Other Income (Expense), net

Other income (expense), net, comprised primarily of miscellaneous income, gains and losses on foreign currency transactions, investment account management fees, and gains or losses on the disposal of property, plant and equipment occurring in the normal course of business, changed from $0.7 million of expense in 2011 to $0.2 million of income in 2012.

Income Taxes

Our effective tax rate increased from 32.8% in 2011 to 35.2% in 2012. This increase is primarily attributable to the exclusion of the research tax credit in 2012 and our inability to utilize losses generated by our foreign subsidiaries where a full valuation allowance was provided. These tax rate increases were partially offset by increased state tax incentives in 2012. In 2013, we will recognize a benefit from the research tax credit related to 2012 and 2013, of which we estimate $3.1 million will be attributable to 2012.

Net Income

As a result of the above factors, net income decreased from $138.6 million in 2011 to $47.3 million in 2012. As a percentage of sales, net income decreased from 19.3% in 2011 to 7.6% in 2012.

Liquidity and Capital Resources

Liquidity

We intend to finance our operations with cash flow from operations. We have used, and expect to continue to use, the cash generated from operations for working capital, purchases of treasury stock, shareholder dividends, and other general corporate purposes, including (i) product development activities to enhance our existing products and develop new products and (ii) expansion of sales and marketing activities. We believe our cash and cash equivalents, investments and cash generated from operations to be adequate to meet our operating and capital needs for at least the next 12 months.

At December 31, 2013, cash on hand was $58.3 million and short-term investments were $105.8 million, which placed our short-term liquidity at $164.1 million. At December 31, 2012, our cash on hand of $68.5 million and short-term investments of $160.5 million placed our short-term liquidity at $228.9 million. The decrease in short-term liquidity from 2012 to 2013 primarily reflects funds used for share repurchases, shareholder dividends, and equipment acquisitions, partially offset by funds provided by our operating activities, and proceeds from stock option exercises.

Operating Activities

Our working capital, which consists of current assets less current liabilities, decreased 17.9% from $338.0 million as of December 31, 2012 to $277.3 million as of December 31, 2013. The quick ratio, defined as cash and cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 2.93 as of December 31, 2012 to 2.44 as of December 31, 2013. The current ratio, defined as current assets divided by current liabilities, decreased from 4.20 as of December 31, 2012 to 3.71 as of December 31, 2013. The changes in our working capital, quick ratio and current ratio are primarily attributable to a decrease in short-term investments, which proceeds were primarily used to fund share repurchases during the year.

Net accounts receivable increased 7.7% from $79.7 million at December 31, 2012 to $85.8 million at December 31, 2013. Our allowance for doubtful accounts increased from $6 thousand at December 31, 2012 to $130 thousand at December 31, 2013. Quarterly accounts receivable days sales outstanding (DSO) decreased from 52 days as of December 31, 2012 to 50 days as of December 31, 2013. The change in net accounts receivable and DSO is due to changes in customer mix and the timing of sales and collections during the quarter. Certain international customers can have longer payment terms than U.S. customers. Other receivables increased from $16.3 million at December 31, 2012 to $18.2 million at December 31, 2013. At December 31, 2013 and 2012, other receivables included an estimated receivable due from NSN related to working capital adjustments under negotiation. Other receivables will also fluctuate due to the timing of shipments and collections for materials supplied to our contract manufacturers during the quarter.

Quarterly inventory turnover increased from 2.8 turns as of December 31, 2012 to 3.6 turns as of December 31, 2013. Inventory decreased 11.1% from December 31, 2012 to December 31, 2013. We expect inventory levels to fluctuate as we

attempt to maintain sufficient inventory in response to seasonal cycles of our business ensuring competitive lead times while managing the risk of inventory obsolescence that may occur due to rapidly changing technology and customer demand.

Accounts payable increased 14.5% from $42.2 million at December 31, 2012 to $48.3 million at December 31, 2013. Accounts payable will fluctuate due to variations in the timing of the receipt of supplies, inventory and services and our subsequent payments for these purchases.

Investing Activities

Capital expenditures totaled approximately $8.2 million, $12.3 million and $11.8 million for the years ended December 31, 2013, 2012 and 2011, respectively. These expenditures were primarily used to purchase computer hardware, software and manufacturing and test equipment.

On May 4, 2012, we acquired the NSN BBA business. This acquisition provides us with an established customer base in key markets and complementary, market-focused products and was accounted for as a business combination. Upon acquisition, we received a cash payment of $7.5 million from NSN and recorded a bargain purchase gain of $1.8 million, net of income taxes, subject to customary working capital adjustments between the parties during the three months ended June 30, 2012. We are currently negotiating the final working capital adjustments in accordance with the provisions of the underlying purchase agreement.

Our combined short-term and long-term investments decreased $78.2 million from $493.2 million at December 31, 2012 to $415.0 million at December 31, 2013. This decrease reflects the impact of our cash needs for share repurchases, shareholder dividends, equipment acquisitions, as well as net realized and unrealized losses and amortization of net premiums on our combined investments, partially offset by additional funds available for investment provided by our operating activities and stock option exercises by our employees.

We invest all available cash not required for immediate use in operations primarily in securities that we believe bear minimal risk of loss. At December 31, 2013 these investments included corporate bonds of $166.9 million, municipal fixed-rate bonds of $136.3 million and municipal variable rate demand notes of $8.3 million. At December 31, 2012, these investments included corporate bonds of $186.4 million, municipal fixed-rate bonds of $175.1 million and municipal variable rate demand notes of $34.4 million. As of December 31, 2013, our corporate bonds, municipal fixed-rate bonds, and municipal variable rate demand notes were classified as available-for-sale and had a combined duration of 0.95 years with an average credit rating of A+. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

Our long-term investments decreased 7.1% from $332.7 million at December 31, 2012 to $309.2 million at December 31, 2013. Long-term investments at December 31, 2013 and December 31, 2012 included an investment in a certificate of deposit of $48.3 million, which serves as collateral for our revenue bonds, as discussed below. We have various equity investments included in long-term investments at a cost of $24.7 million and $21.0 million, and with a fair value of $38.5 million and $35.2 million, at December 31, 2013 and December 31, 2012, respectively.

Long-term investments at December 31, 2013 and 2012 also included $15.1 million and $11.5 million, respectively, related to our deferred compensation plan, and $1.7 million and $1.9 million, respectively, of other investments carried at cost, consisting of interests in two private equity funds and an investment in a privately held telecommunications equipment manufacturer. At December 31, 2012, long-term investments also included $0.5 million of a fixed income bond fund.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of $11 thousand during the fourth quarter of 2013 related to four marketable equity securities. For the years ended December 31, 2013, 2012 and 2011 we recorded charges of $25 thousand, $0.7 million and $68 thousand, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities and our deferred compensation plan assets.

Financing Activities

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the "Authority"). Pursuant to the program, on January 13, 1995, the Authority issued $20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the "Bondholder"), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to $50.0 million. An Amended and Restated Taxable Revenue Bond ("Amended and Restated Bond") was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 5% per annum. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond at December 31, 2013 was approximately $45.4 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A-. We are required to make payments to the Authority in amounts necessary to pay the interest on the Amended and Restated Bond. Included in long-term investments at December 31, 2013 is $48.3 million which is invested in a restricted certificate of deposit. These funds serve as a collateral deposit against the principal of this bond, and we have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness.

In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. For the years ended December 31, 2013, 2012 and 2011, we realized economic incentives related to payroll withholdings totaling $1.3 million, $1.4 million and $1.9 million, respectively.

We did not make a principal payment for the year-ended December 31, 2013. We made a principal payment of $0.5 million for the year ended December 31, 2012. We anticipate making a principal payment in 2014. At December 31, 2013 and 2012, $0.3 million and $0.5 million, respectively, of the bond debt were classified as a current liability in accounts payable in the Consolidated Balance Sheets at December 31, 2013.

The following table shows dividends paid to our shareholders in each quarter of 2013, 2012 and 2011. During 2013, 2012 and 2011, we paid shareholder dividends totaling $21.4 million, $22.8 million and $23.1 million, respectively. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

Dividends per Common Share

2013	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	$0.09	$0.09	$0.09	$0.09
2012	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
	$0.09	$0.09	$0.09	$0.09
2011	**First Quarter**	**Second Quarter**	**Third Quarter**	**Fourth Quarter**
	$0.09	$0.09	$0.09	$0.09

Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 35 million shares of our common stock. On May 1, 2013, our Board of Directors authorized the repurchase of an additional 5.0 million shares of our common stock (bringing the total shares authorized for repurchase to 40 million), which commenced upon completion of the repurchase plan announced on October 11, 2011. This new authorization is being implemented through open market or private purchases from time to time as conditions warrant. For the years 2013, 2012 and 2011, we repurchased 5.6 million shares, 1.8 million shares and 1.1 million shares, respectively, for a cost of $124.3 million, $39.4 million and $35.6 million, respectively, at an average price of $22.16, $22.03 and $31.97 per share, respectively. We currently have the authority to purchase an additional 3.5 million shares of our common stock under the current plan approved by the Board of Directors.

Stock Option Exercises

To accommodate employee stock option exercises, we issued 0.2 million shares of treasury stock for $3.6 million during the year ended December 31, 2013, 0.4 million shares of treasury stock for $6.0 million during the year ended December 31, 2012, and 1.8 million shares of treasury stock for $34.1 million during the year ended December 31, 2011.

Off-Balance Sheet Arrangements and Contractual Obligations

We do not have off-balance sheet financing arrangements and have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of or requirements for capital resources.

We have various contractual obligations and commercial commitments. The following table sets forth, in millions, the annual payments we are required to make under contractual cash obligations and other commercial commitments at December 31, 2013.

Contractual Obligations

(In millions)	Total	2014	2015	2016	2017	After 2017
Long-term debt	$46.5	$0.3	$—	$—	$—	$46.2
Interest on long-term debt	14.0	2.3	2.3	2.3	2.3	4.8
Purchase obligations	75.0	74.9	0.1	—	—	—
Operating lease obligations	13.5	4.5	3.6	2.5	2.2	0.7
Totals	$149.0	$82.0	$6.0	$4.8	$4.5	$51.7

We are required to make payments necessary to pay the interest on the Taxable Revenue Bond, Series 1995, as amended, currently outstanding in the aggregate principal amount of $46.5 million. The bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. Included in long-term investments are $48.3 million of restricted funds, which is a collateral deposit against the principal amount of this bond. We did not make a principal payment for the year-ended December 31, 2013. We made a principal payment of $0.5 million for the year ended December 31, 2012. We anticipate making a principal payment in 2014. At December 31, 2013 and 2012, $0.3 million and $0.5 million, respectively, of the bond debt were classified as a current liability in accounts payable in the Consolidated Balance Sheets at December 31, 2013. See Note 9 of Notes to Consolidated Financial Statements for additional information.

We have committed to invest up to an aggregate of $7.9 million in two private equity funds, and we have contributed $8.4 million as of December 31, 2013, of which $7.7 million has been applied to these commitments. The additional $0.2 million commitment has been excluded from the table above due to uncertainty of when it will be applied.

We also have obligations related to uncertain income tax positions that have been excluded from the table above due to the uncertainty of when the related expense will be recognized. See Note 10 of Notes to Consolidated Financial Statements for additional information.

Effect of Recent Accounting Pronouncements

During 2013, we adopted the following accounting standards, which had no material effect on our consolidated results of operations or financial condition:

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02). ASU 2013-02 requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component either on the face of the financial statements or in the footnotes. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. This update is effective prospectively for reporting periods beginning after December 15, 2012. We adopted this amendment during the first quarter of 2013, and we have provided the disclosures required for the years ended December 31, 2013, 2012 and 2011 in Note 1 of Notes to Consolidated Financial Statements.

Subsequent Events

On January 21, 2014, the Board declared a quarterly cash dividend of $0.09 per common share to be paid to shareholders of record at the close of business on February 6, 2014. The quarterly dividend payment was $5.1 million and was paid on February 20, 2014.

In February 2014, we made a decision to make a $16.5 million principal payment on the Amended and Restated Bond. The restricted certificate of deposit included in our long-term investments will be reduced by the amount of the payment. We anticipate this payment will be made during the first quarter of 2014.

Since January 1, 2014 and as of February 27, 2014, we have repurchased 0.4 million shares of our common stock through open market purchases at an average cost of $25.13 per share. We currently have the authority to purchase an additional 3.1 million shares of our common stock under the current plan approved by the Board of Directors.

Quantitative and Qualitative Disclosures About Market Risk

We are exposed to financial market risks, including changes in interest rates and prices of marketable equity and fixed-income securities. The primary objective of the large majority of our investment activities is to preserve principal while at the same time achieving appropriate yields without significantly increasing risk. To achieve this objective, a majority of our marketable securities are investment grade, municipal, fixed-rate bonds, municipal variable rate demand notes and municipal money market instruments denominated in United States dollars. Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio.

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of December 31, 2013, $53.5 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

As of December 31, 2013, approximately $329.3 million of our cash and investments may be directly affected by changes in interest rates. We have performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps) for an entire year, while all other variables remain constant. At December 31, 2013, we held $144.2 million of cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes where a change in interest rates would impact our interest income. A hypothetical 50 bps decline in interest rates as of December 31, 2013 would reduce annualized interest income on our cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes by approximately $0.7 million. In addition, we held $303.2 million of municipal and corporate bonds whose fair values may be directly affected by a change in interest rates. A hypothetical 50 bps increase in interest rates as of December 31, 2013 would reduce the fair value of our municipal and corporate bonds by approximately $1.4 million.

As of December 31, 2012, interest income on approximately $412.5 million of our cash and investments was subject to being directly affected by changes in interest rates. We performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 bps for an entire year, while all other variables remain constant. A hypothetical 50 bps decline in interest rates as of December 31, 2012 would have reduced annualized interest income on our money market instruments and municipal variable rate demand notes by approximately $0.6 million. In addition, a hypothetical 50 bps increase in interest rates as of December 31, 2012 would have reduced the fair value of our municipal and corporate bonds by approximately $1.7 million.

We are directly exposed to changes in foreign currency exchange rates to the extent that such changes affect our revenue derived from international customers, expenses related to our foreign sales offices, and our foreign assets and liabilities. We attempt to manage these risks by primarily denominating contractual and other foreign arrangements in U.S. dollars. Our primary exposure in regard to our foreign assets and liabilities is with our German subsidiary whose functional currency is the Euro and our Australian subsidiary whose functional currency is the Australian dollar. We are indirectly exposed to changes in foreign currency exchange rates to the extent of our use of foreign contract manufacturers and foreign raw material suppliers whom we pay in U.S. dollars. As a result, changes in the local currency rates of these vendors in relation to the U.S. dollar could cause an increase in the price of products that we purchase.

We have certain international customers who are invoiced in their local currency. Changes in the monetary exchange rates used to invoice such customers versus the functional currency of the entity billing such customers may adversely affect our results of operations and financial condition. To manage the volatility relating to these typical business exposures, we may enter into various derivative transactions, when appropriate. We do not hold or issue derivative instruments for trading or other speculative purposes. The Yen and Riyal are the predominant currencies of the customers who are billed in their local currency. Taking into account the effects of foreign currency fluctuations of the Yen and Riyal versus the Euro, a hypothetical 10% weakening of the Euro as of December 31, 2013 would provide a gain on foreign currency of approximately $0.4 million. Conversely, a hypothetical 10% strengthening of the Euro as of December 31, 2013 would provide a loss on foreign currency of approximately $0.4 million. Any gain or loss would be significantly mitigated by the hedges discussed in the following paragraph.

As of December 31, 2013, we had no material contracts, other than accounts receivable, accounts payable, and loans to a subsidiary, denominated in foreign currencies. As of December 31, 2013, we had forward contracts outstanding with notional amounts totaling €18.5 million ($25.5 million), which mature at various times throughout 2014. The fair value of these forward contracts was a net asset of approximately $3 thousand as of December 31, 2013.

Management's Report on Internal Control over Financial Reporting

Management of ADTRAN, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. ADTRAN's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. ADTRAN's internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of ADTRAN;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of ADTRAN are being made only in accordance with authorizations of management and directors of ADTRAN; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of ADTRAN's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of ADTRAN's internal control over financial reporting as of December 31, 2013. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework (1992)*.

Based on our assessment and those criteria, management has concluded that ADTRAN maintained effective internal control over financial reporting as of December 31, 2013.

The effectiveness of our internal control over financial reporting has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Report of Independent Registered Public Accounting Firm

To Board of Directors and Stockholders of ADTRAN, Inc.:

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of ADTRAN, Inc. and its subsidiaries at December 31, 2013 and December 31, 2012 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in *Internal Control—Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report On Internal Control Over Financial Reporting*. Our responsibility is to express opinions on these financial statements, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
Birmingham, Alabama
February 27, 2014

Financial Statements

ADTRAN, INC.

Consolidated Balance Sheets

December 31, 2013 and 2012

(In thousands, except per share amounts)

Assets	2013	2012
Current Assets		
Cash and cash equivalents	$58,298	$68,457
Short-term investments	105,760	160,481
Accounts receivable, less allowance for doubtful accounts of $130 and $6 at December 31, 2013 and 2012, respectively	85,814	79,675
Other receivables	18,249	16,253
Inventory, net	90,111	101,377
Prepaid expenses	4,325	4,148
Deferred tax assets, net	17,083	13,055
Total Current Assets	379,640	443,446
Property, plant and equipment, net	76,739	80,246
Deferred tax assets, net	9,622	10,261
Goodwill	3,492	3,492
Other assets	11,180	13,482
Long-term investments	309,225	332,729
Total Assets	$789,898	$883,656
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	$48,282	$42,173
Unearned revenue	22,205	35,326
Accrued expenses	12,776	11,735
Accrued wages and benefits	14,040	15,022
Income tax payable, net	5,002	1,211
Total Current Liabilities	102,305	105,467
Non-current unearned revenue	14,643	22,377
Other non-current liabilities	22,144	17,406
Bonds payable	46,200	46,000
Total Liabilities	185,292	191,250
Commitments and contingencies (see Note 13)		
Stockholders' Equity		
Common stock, par value $0.01 per share; 200,000 shares authorized; 79,652 shares issued and 56,918 shares outstanding at December 31, 2013 and 79,652 shares issued and 62,310 shares outstanding at December 31, 2012	797	797
Additional paid-in capital	233,511	224,517
Accumulated other comprehensive income	10,753	11,268
Retained earnings	884,451	861,465
Less treasury stock at cost: 22,734 and 17,342 shares at December 31, 2013 and 2012, respectively	(524,906)	(405,641)
Total Stockholders' Equity	604,606	692,406
Total Liabilities and Stockholders' Equity	$789,898	$883,656

See notes to consolidated financial statements.

ADTRAN, INC.

Consolidated Statements of Income

Years ended December 31, 2013, 2012 and 2011

(In thousands, except per share amounts)	2013	2012	2011
Sales	$641,744	$620,614	$717,229
Cost of sales	332,858	303,971	302,911
Gross Profit	308,886	316,643	414,318
Selling, general and administrative expenses	129,366	134,523	124,879
Research and development expenses	131,055	125,951	100,301
Operating Income	48,465	56,169	189,138
Interest and dividend income	7,012	7,657	7,642
Interest expense	(2,325)	(2,347)	(2,398)
Net realized investment gain	8,614	9,550	12,454
Other income (expense), net	(911)	183	(694)
Gain on bargain purchase of a business	—	1,753	—
Income before provision for income taxes	60,855	72,965	206,142
Provision for income taxes	(15,061)	(25,702)	(67,565)
Net Income	$45,794	$47,263	$138,577
Weighted average shares outstanding—basic	59,001	63,259	64,145
Weighted average shares outstanding—diluted	59,424	63,774	65,416
Earnings per common share—basic	$0.78	$0.75	$2.16
Earnings per common share—diluted	$0.77	$0.74	$2.12

See notes to consolidated financial statements.

ADTRAN, INC.

Consolidated Statements of Comprehensive Income

Years ended December 31, 2013, 2012 and 2011

(In thousands)	2013	2012	2011
Net Income	**$45,794**	**$47,263**	**$138,577**
Other Comprehensive Loss, net of tax:			
Net unrealized gains (losses) on available-for-sale securities	629	(52)	(13,692)
Defined benefit plan adjustments	1,061	(1,952)	—
Foreign currency translation	(2,205)	170	(154)
Other Comprehensive Loss, net of tax	**(515)**	**(1,834)**	**(13,846)**
Comprehensive Income, net of tax	**$45,279**	**$45,429**	**$124,731**

See notes to consolidated financial statements.

ADTRAN, INC.

Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2013, 2012 and 2011

(In thousands)	Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance, December 31, 2010	79,652	$797	$193,866	$731,962	$(381,251)	$26,948	$572,322
Net income				138,577			138,577
Other comprehensive loss, net of tax						(13,846)	(13,846)
Dividend payments				(23,124)			(23,124)
Dividends accrued for unvested restricted stock units				(52)			(52)
Stock options exercised				(6,345)	40,470		34,125
Restricted stock units vested				(812)	812		—
Purchase of treasury stock: 1,112 shares					(35,565)		(35,565)
Income tax benefit from exercise of stock options			10,525				10,525
Stock-based compensation expense			9,169				9,169
Balance, December 31, 2011	79,652	$797	$213,560	$840,206	$(375,534)	$13,102	$692,131
Net income				47,263			47,263
Other comprehensive loss, net of tax						(1,834)	(1,834)
Dividend payments				(22,813)			(22,813)
Dividends accrued for unvested restricted stock units				15			15
Stock options exercised				(2,659)	8,708		6,049
Restricted stock units vested			(212)	(547)	547		(212)
Purchase of treasury stock: 1,786 shares					(39,362)		(39,362)
Income tax benefit from exercise of stock options			1,905				1,905
Stock-based compensation expense			9,264				9,264
Balance, December 31, 2012	79,652	$797	$224,517	$861,465	$(405,641)	$11,268	$692,406
Net income				45,794			45,794
Other comprehensive loss, net of tax						(515)	(515)
Dividend payments				(21,412)			(21,412)
Dividends accrued for unvested restricted stock units				(23)			(23)
Stock options exercised				(762)	4,391		3,629
Restricted stock units vested			(248)	(611)	611		(248)
Purchase of treasury stock: 5,608 shares					(124,267)		(124,267)
Income tax benefit from exercise of stock options			169				169
Stock-based compensation expense			9,073				9,073
Balance, December 31, 2013	79,652	$797	$233,511	$884,451	$(524,906)	$10,753	$604,606

We issued 217 shares, 393 shares and 1,813 shares of treasury stock to accommodate employee stock option exercises, vesting of restricted stock, and vesting of restricted stock units during 2013, 2012 and 2011, respectively. During 2011, we received 7 shares, previously held by employees for at least six months as payment of the exercise price for employee stock options. None of the transactions with respect to these shares were made in the open market. The average price paid per share with respect to these transactions was based on the closing price of the common stock on the NASDAQ Global Select Market on the date of the transaction. There were no such transactions during 2012 and 2013.

See notes to consolidated financial statements.

ADTRAN, INC.

Consolidated Statements of Cash Flows

Years ended December 31, 2013, 2012 and 2011

(In thousands)	2013	2012	2011
Cash flows from operating activities			
Net income	$45,794	$47,263	$138,577
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	14,628	14,079	11,499
Amortization of net premium on available-for-sale investments	5,956	8,257	6,617
Net realized gain on long-term investments	(8,614)	(9,550)	(12,454)
Net (gain) loss on disposal of property, plant, and equipment	3	(214)	6
Gain on bargain purchase of a business	—	(1,753)	—
Stock-based compensation expense	9,073	9,264	9,169
Deferred income taxes	(4,058)	(3,785)	575
Tax benefit from stock option exercises	169	1,905	10,525
Excess tax benefits from stock-based compensation arrangements	(158)	(1,456)	(9,373)
Change in operating assets and liabilities:			
Accounts receivable, net	(5,541)	(2,847)	(4,939)
Other receivables	(1,549)	2,977	(5,781)
Income tax receivable, net	—	—	2,741
Inventory	10,265	8,333	(12,734)
Prepaid expenses and other assets	(11)	(1,045)	522
Accounts payable	5,206	7,510	6,044
Accrued expenses and other liabilities	(15,146)	8,895	6,309
Income taxes payable, net	3,747	(1,960)	3,169
Net cash provided by operating activities	59,764	85,873	150,472
Cash flows from investing activities			
Purchases of property, plant, and equipment	(8,173)	(12,320)	(11,778)
Proceeds from disposals of property, plant and equipment	—	266	—
Proceeds from sales and maturities of available-for-sale investments	343,567	282,039	466,243
Purchases of available-for-sale investments	(261,625)	(282,740)	(554,629)
Acquisition of business, net of cash acquired	—	7,496	(22,661)
Net cash provided by (used in) investing activities	73,769	(5,259)	(122,825)
Cash flows from financing activities			
Proceeds from stock option exercises	3,629	6,049	34,125
Purchases of treasury stock	(124,267)	(39,362)	(35,565)
Dividend payments	(21,412)	(22,813)	(23,124)
Payments on long-term debt	—	(500)	(1,000)
Excess tax benefits from stock-based compensation arrangements	158	1,456	9,373
Net cash used in financing activities	(141,892)	(55,170)	(16,191)
Net increase (decrease) in cash and cash equivalents	(8,359)	25,444	11,456
Effect of exchange rate changes	(1,800)	34	(154)
Cash and cash equivalents, beginning of year	68,457	42,979	31,677
Cash and cash equivalents, end of year	$58,298	$68,457	$42,979
Supplemental disclosure of cash flow information			
Cash paid during the year for interest	$2,325	$2,348	$2,396
Cash paid during the year for income taxes	$15,431	$31,021	$51,402
Supplemental disclosure of non-cash investing activities			
Purchases of property, plant and equipment included in accounts payable	$444	$108	$353

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1 Nature of Business and Summary of Significant Accounting Policies

ADTRAN, Inc. is a leading global provider of networking and communications equipment. Our solutions enable voice, data, video and Internet communications across a variety of network infrastructures. These solutions are deployed by some of the world's largest service providers, distributed enterprises and small and medium-sized businesses, public and private enterprises, and millions of individual users worldwide.

Principles of Consolidation

Our consolidated financial statements include ADTRAN and its wholly owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation.

Changes in Classifications

Certain balance sheet amounts (including inventory, accounts receivable, unearned revenue and accrued expenses) and related disclosures have been revised to correct immaterial misclassifications in 2012 that were corrected in 2013. The revisions decreased both total assets and total liabilities each by $2.7 million at December 31, 2012. The revisions had no impact on our previously reported stockholders' equity, income statement, comprehensive income, or earnings per share. Additionally, we corrected immaterial misclassifications between the operating and investing sections of our consolidated statements of cash flows and adjusted our 2012 and 2011 cash flows in these categories by $0.2 million and $0.1 million, respectively, in order to be consistent with the 2013 presentation.

Additionally, changes in classifications have been made to the prior period balances in other comprehensive income to conform to the current period's presentation as a result of our adoption of Accounting Standards Update No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Comprehensive Income.

Out of Period Adjustment

During the year ended December 31, 2013, we identified two adjustments in the acquired NSN (formerly Nokia Siemens Networks) Broadband Access business (NSN BBA business) relating to customer payment discounts for one customer, and recoverable VAT taxes on certain vendor freight invoices that should have been recorded in prior periods. These adjustments resulted from a $0.4 million understatement of net income in 2012. We evaluated the impact of the adjustments on the results of our previously issued financial statements for the prior period affected and concluded that the impact was not material. We also evaluated the impact of the cumulative effect of the adjustments in the current year and concluded that the impact was not material to our results for the year 2013. Accordingly, during the year ended December 31, 2013 we recorded an out of period adjustment to correct these issues.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expense during the reporting period. Our more significant estimates include the obsolete and excess inventory reserves, warranty reserves, customer rebates, determination of the deferred revenue components of multiple element sales agreements, estimated costs to complete obligations associated with deferred revenues, estimated income tax provision and income tax contingencies, the fair value of stock-based compensation, impairment of goodwill, valuation and estimated lives of intangible assets, estimated working capital adjustments under negotiation related to the NSN BBA business acquisition, estimated pension liability, fair value of investments, and the evaluation of other-than-temporary declines in the value of investments. Actual amounts could differ significantly from these estimates.

Cash and Cash Equivalents

Cash and cash equivalents represent demand deposits, money market funds, and short-term investments classified as available-for-sale with original maturities of three months or less. We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these applicable financial institutions, and determined the risk of material financial loss due to the exposure of such credit risk to be minimal. As of December 31, 2013, $53.5 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the immediate or short-term maturity of these financial instruments. The carrying amount reported for bonds payable was $46.5 million, compared to an estimated fair value of $45.4 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A-.

Investments with contractual maturities beyond one year, such as our municipal variable rate demand notes, may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. Despite the long-term nature of their stated contractual maturities, we routinely buy and sell these securities and we believe we have the ability to quickly sell them to the remarketing agent, tender agent, or issuer at par value plus accrued interest in the event we decide to liquidate our investment in a particular variable rate demand note. All income generated from these investments was recorded as interest income. We have not been required to record any losses relating to municipal variable rate demand notes.

Long-term investments represent a restricted certificate of deposit held at cost, municipal fixed-rate bonds, corporate bonds, a fixed income bond fund, marketable equity securities, and other equity investments. Marketable equity securities are reported at fair value as determined by the most recently traded price of the securities at the balance sheet date, although the securities may not be readily marketable due to the size of the available market. Unrealized gains and losses, net of tax, are reported as a separate component of stockholders' equity. Realized gains and losses on sales of securities are computed under the specific identification method and are included in current income. We periodically review our investment portfolio for investments considered to have sustained an other-than-temporary decline in value. Impairment charges for other-than-temporary declines in value are recorded as realized losses in the accompanying consolidated statements of income. All of our investments at December 31, 2013 and 2012 are classified as available-for-sale securities. See Note 4 of Notes to Consolidated Financial Statements for additional information.

Accounts Receivable

We record accounts receivable at net realizable value. Prior to issuing payment terms to a new customer, we perform a detailed credit review of the customer. Credit limits are established for each new customer based on the results of this credit review. Payment terms are established for each new customer, and collection experience is reviewed periodically in order to determine if the customer's payment terms and credit limits need to be revised. At December 31, 2013, one customer accounted for 13.1% of our total accounts receivable. At December 31, 2012, one customer accounted for 10.4% of our total accounts receivable.

We maintain an allowance for doubtful accounts for losses resulting from the inability of our customers to make required payments. We regularly review the allowance for doubtful accounts and consider factors such as the age of accounts receivable balances, the current economic conditions that may affect a customer's ability to pay, significant one-time events and our historical experience. If the financial condition of a customer deteriorates, resulting in an impairment of their ability to make payments, we may be required to record an allowance for doubtful accounts. If circumstances change with regard to individual receivable balances that have previously been determined to be uncollectible (and for which a specific reserve has been established), a reduction in our allowance for doubtful accounts may be required. Our allowance for doubtful accounts was $130 thousand at December 31, 2013 and $6 thousand at December 31, 2012.

Other Receivables

Other receivables are comprised primarily of amounts due from subcontract manufacturers for product component transfers, accrued interest on investments and on a restricted certificate of deposit, and amounts due from employee stock option exercises. At December 31, 2013 and 2012, other receivables also included an estimated receivable due from NSN related to working capital adjustments that are currently under negotiation.

Inventory

Inventory is carried at the lower of cost or market, with cost being determined using the first-in, first-out method. Standard costs for material, labor and manufacturing overhead are used to value inventory. Standard costs are updated at least quarterly; therefore, inventory costs approximate actual costs at the end of each reporting period. We establish reserves for estimated excess, obsolete or unmarketable inventory equal to the difference between the cost of the inventory and the estimated fair value of the inventory based upon assumptions about future demand and market conditions. When we dispose of excess and obsolete inventories, the related write-downs are charged against the inventory reserve. See Note 6 of Notes to Consolidated Financial Statements for additional information.

Property, Plant and Equipment

Property, plant and equipment, which is stated at cost, is depreciated using the straight-line method over the estimated useful lives of the assets. We depreciate building and land improvements from five to 39 years, office machinery and equipment from three to seven years, engineering machinery and equipment from three to seven years, and computer software from three to five years. Expenditures for repairs and maintenance are charged to expense as incurred. Betterments that materially prolong the lives of the assets are capitalized. The cost of assets retired or otherwise disposed of and the related accumulated depreciation are removed from the accounts, and the gain or loss on such disposition is included in other income (expense), net in the accompanying consolidated statements of income. See Note 7 of Notes to Consolidated Financial Statements for additional information.

Liability for Warranty

Our products generally include warranties of 90 days to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled $9.0 million and $9.7 million at December 31, 2013 and 2012, respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets.

A summary of warranty expense and write-off activity for the years ended December 31, 2013 and 2012 is as follows:

(In thousands)

Year Ended December 31,	2013	2012
Balance at beginning of period	$9,653	$4,118
Plus: Amounts charged to cost and expenses	4,051	5,363
Amounts assumed on acquisition	—	3,781
Less: Deductions	(4,727)	(3,609)
Balance at end of period	$8,977	$9,653

Pension Benefit Plan Obligations

As a result of our acquisition of the NSN BBA business, we assumed a defined benefit pension plan covering employees in certain foreign countries. Pension benefit plan obligations are based on various assumptions used by our actuaries in calculating these amounts. These assumptions include discount rates, compensation rate increases, expected return on plan assets, retirement rates and mortality rates. Actual results that differ from the assumptions and changes in assumptions could affect future expenses and obligations.

Stock-Based Compensation

We have two Board and stockholder approved stock option plans from which stock options and other awards are available for grant to employees and directors. All employee and director stock options granted under our stock option plans have an exercise price equal to the fair market value of the award, as defined in the plan, of the underlying common stock on the grant date. There are currently no vesting provisions tied to performance or market conditions for any option awards; vesting for all outstanding option grants is based only on continued service as an employee or director of ADTRAN. All of our outstanding stock option awards are classified as equity awards.

Under the provisions of our approved plans, we made grants of performance-based restricted stock units to five of our executive officers in 2013, 2012 and 2011. The restricted stock units are subject to a market condition based on the relative total shareholder return of ADTRAN against all the companies in the NASDAQ Telecommunications Index and vest at the end of a three-year performance period. The restricted stock units are converted into shares of common stock upon vesting. Depending on the relative total shareholder return over the performance period, the executive officers may earn from 0% to 150% of the number of restricted stock units granted. The fair value of the award is based on the market price of our common stock on the date of grant, adjusted for the expected outcome of the impact of market conditions using a Monte Carlo Simulation valuation method. The recipients of the restricted stock units also earn dividend credits during the performance period, which will be paid in cash upon the issuance of common stock for the restricted stock units.

Stock-based compensation expense recognized in 2013, 2012 and 2011 was approximately $9.1 million, $9.3 million and $9.2 million, respectively. As of December 31, 2013, total compensation cost related to non-vested stock options, restricted stock units and restricted stock not yet recognized was approximately $18.8 million, which is expected to be recognized over an average remaining recognition period of 2.7 years. See Note 3 of Notes to Consolidated Financial Statements for additional information.

Impairment of Long-Lived Assets

We review long-lived assets used in operations for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and the undiscounted cash flows estimated to be generated by the asset are less than the asset's carrying value. An impairment loss would be recognized in the amount by which the recorded value of the asset exceeds the fair value of the asset, measured by the quoted market price of an asset or an estimate based on the best information available in the circumstances. There were no impairment losses recognized during 2013, 2012 or 2011.

Goodwill and Purchased Intangible Assets

We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If we determine that the two-step quantitative test is necessary, then we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. There were no impairment losses recognized during 2013, 2012 or 2011. Purchased intangible assets with finite lives are carried at cost, less accumulated amortization. Amortization is recorded over the estimated useful lives of the respective assets, which is 2.5 to 14 years.

Research and Development Costs

Research and development costs include compensation for engineers and support personnel, outside contracted services, depreciation and material costs associated with new product development, the enhancement of current products, and product cost reductions. We continually evaluate new product opportunities and engage in intensive research and product development efforts. Research and development costs totaled $131.1 million, $126.0 million and $100.3 million for the years ended December 31, 2013, 2012 and 2011, respectively.

Other Comprehensive Income

Other comprehensive income consists of unrealized gains (losses) on available-for-sale securities, reclassification adjustments for amounts included in net income related to impairments of available-for-sale securities and realized gains (losses) on available-for-sale securities, defined benefit plan adjustments and foreign currency translation adjustments.

The following tables present changes in accumulated other comprehensive income, net of tax, by component for the years ended December 31, 2011, 2012 and 2013:

(In thousands)	Unrealized Gains (Losses) on Available-for-Sale Securities	Defined Benefit Plan Adjustments	Foreign Currency Adjustments	Total
Balance at December 31, 2010	**$23,852**	**—**	**$3,096**	**$26,948**
Other comprehensive loss before reclassifications	(6,784)	—	(154)	(6,938)
Amounts reclassified from accumulated other comprehensive income	(6,908)	—	—	(6,908)
Balance at December 31, 2011	**$10,160**	**—**	**$2,942**	**$13,102**
Other comprehensive income (loss) before reclassifications	5,426	(1,952)	170	3,644
Amounts reclassified from accumulated other comprehensive income	(5,478)	—	—	(5,478)
Balance at December 31, 2012	**$10,108**	**$(1,952)**	**$3,112**	**$11,268**
Other comprehensive income (loss) before reclassifications	5,508	1,061	(2,205)	4,364
Amounts reclassified from accumulated other comprehensive income	(4,879)	—	—	(4,879)
Balance at December 31, 2013	**$10,737**	**$(891)**	**$907**	**$10,753**

The following tables present the details of reclassifications out of accumulated other comprehensive income for the years ended December 31, 2013, 2012 and 2011:

(In thousands)	2013	
Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income Is Presented
Unrealized gains (losses) on available-for-sale securities:		
Net realized gain on sales of securities	$8,023	Net realized investment gain
Impairment expense	(25)	Net realized investment gain
Total reclassifications for the period, before tax	7,998	
Tax (expense) benefit	(3,119)	
Total reclassifications for the period, net of tax	**$4,879**	

(In thousands)	2012	
Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income Is Presented
Unrealized gains (losses) on available-for-sale securities:		
Net realized gain on sales of securities	$9,662	Net realized investment gain
Impairment expense	(682)	Net realized investment gain
Total reclassifications for the period, before tax	8,980	
Tax (expense) benefit	(3,502)	
Total reclassifications for the period, net of tax	**$5,478**	

(In thousands)	2011	
Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement Where Net Income Is Presented
Unrealized gains (losses) on available-for-sale securities:		
Net realized gain on sales of securities	$11,393	Net realized investment gain
Impairment expense	(68)	Net realized investment gain
Total reclassifications for the period, before tax	11,325	
Tax (expense) benefit	(4,417)	
Total reclassifications for the period, net of tax	**$6,908**	

The following tables present the tax effects related to the change in each component of other comprehensive income for the years ended December 31, 2013, 2012 and 2011:

		2013	
(In thousands)	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized gains (losses) on available-for-sale securities	$9,030	$(3,522)	$5,508
Reclassification adjustment for amounts included in net income	(7,998)	3,119	(4,879)
Defined benefit plan adjustments	1,061	—	1,061
Foreign currency translation adjustment	(2,205)	—	(2,205)
Total Other Comprehensive Income (Loss)	**$(112)**	**$(403)**	**$(515)**

(In thousands)	2012 Before-Tax Amount	 Tax (Expense) Benefit	 Net-of-Tax Amount
Unrealized gains (losses) on available-for-sale securities	$8,895	$(3,469)	$5,426
Reclassification adjustment for amounts included in net income	(8,980)	3,502	(5,478)
Defined benefit plan adjustments	(1,952)	—	(1,952)
Foreign currency translation adjustment	170	—	170
Total Other Comprehensive Income (Loss)	$(1,867)	$33	$(1,834)

(In thousands)	2011 Before-Tax Amount	 Tax (Expense) Benefit	 Net-of-Tax Amount
Unrealized gains (losses) on available-for-sale securities	$(11,121)	$4,337	$(6,784)
Reclassification adjustment for amounts included in net income	(11,325)	4,417	(6,908)
Foreign currency translation adjustment	(154)	—	(154)
Total Other Comprehensive Income (Loss)	$(22,600)	$8,754	$(13,846)

Income Taxes

The provision for income taxes has been determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from the difference between financial and tax bases of our assets and liabilities and are adjusted for changes in tax rates and tax laws when such changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

We establish reserves to remove some or all of the tax benefit of any of our tax positions at the time we determine that the positions become uncertain. We adjust these reserves, including any impact on the related interest and penalties, as facts and circumstances change.

Foreign Currency

We record transactions denominated in foreign currencies on a monthly basis using exchange rates from throughout the year. Assets and liabilities denominated in foreign currencies are translated at the balance sheet dates using the closing rates of exchange between those foreign currencies and the U.S. dollar with any transaction gains or losses reported in other income (expense). Adjustments resulting from translating financial statements of international subsidiaries are recorded as a component of accumulated other comprehensive income (loss).

Revenue Recognition

Revenue is generally recognized when persuasive evidence of an arrangement exists, delivery has occurred, the product price is fixed or determinable, collection of the resulting receivable is reasonably assured, and product returns are reasonably estimable. For product sales, revenue is generally recognized upon shipment of the product to our customer in accordance with the title transfer terms of the sales agreement, generally FOB shipping point. In the case of consigned inventory, revenue is recognized when the end customer assumes ownership of the product. Contracts that contain multiple deliverables are evaluated to determine the units of accounting, and the consideration from the arrangement is allocated to each unit of accounting based on the relative selling price and corresponding terms of the contract. We use vendor-specific objective evidence of selling price. When this evidence is not available, we are generally not able to determine third-party evidence of selling price because of the extent of customization among competing products or services from other companies. We record revenue associated with installation services when all contractual obligations are complete. In instances where customer acceptance is required, revenue is deferred until all acceptance criteria have been met. Contracts that include both installation services and product sales are evaluated for revenue recognition in accordance with contract terms. As a result, depending on contract terms, installation services may be considered a separate deliverable or may be considered a combined single unit of accounting with the delivered product. Generally, either the purchaser, ADTRAN, or a third party can perform the installation of our products. Shipping fees are recorded as revenue and the related cost is included in cost of sales. Sales taxes invoiced to

customers are included in revenues, and represent less than one percent of total revenues. The corresponding sales taxes paid are included in cost of goods sold. Value added taxes collected from customers in international jurisdictions are recorded in accrued expenses as a liability. Revenue is recorded net of discounts. Sales returns are accrued based on historical sales return experience, which we believe provides a reasonable estimate of future returns.

A portion of Enterprise Networks products are sold to a non-exclusive distribution network of major technology distributors in the United States. These large organizations then distribute or provide fulfillment services to an extensive network of value-added resellers and system integrators. Value-added resellers and system integrators may be affiliated with us as a channel partner, or they may purchase from the distributor in an unaffiliated fashion. Additionally, with certain limitations our distributors may return unused and unopened product for stock-balancing purposes when such returns are accompanied by offsetting orders for products of equal or greater value.

We participate in cooperative advertising and market development programs with certain customers. We use these programs to reimburse customers for certain forms of advertising, and in general, to allow our customers credits up to a specified percentage of their net purchases. Our costs associated with these programs are estimated and included in marketing expenses in our consolidated statements of income. We also participate in rebate programs to provide sales incentives for certain products. Our costs associated with these programs are estimated and accrued at the time of sale, and are recorded as a reduction of sales in our consolidated statements of income.

Unearned Revenue

Unearned revenue primarily represents customer billings on our maintenance service programs and unearned revenues relating to multiple element contracts where we still have contractual obligations to our customers. We currently offer maintenance contracts ranging from one to five years, primarily on Enterprise Networks Division products sold through distribution channels. Revenue attributable to maintenance contracts is recognized on a straight-line basis over the related contract term. In addition, we provide software maintenance and a variety of hardware maintenance services to Carrier Networks Division customers, which include customers of the acquired NSN BBA business, under contracts with terms up to ten years. At December 31, 2013 and 2012, unearned revenue was as follows:

(In thousands)	2013	2012
Current unearned revenue	$22,205	$35,326
Non-current unearned revenue	14,643	22,377
Total	$36,848	$57,703

Other Income (Expense), Net

Other income (expense), net, is comprised primarily of miscellaneous income and expense, gains and losses on foreign currency transactions, investment account management fees, and gains or losses on the disposal of property, plant and equipment occurring in the normal course of business.

Earnings per Share

Earnings per common share, and earnings per common share assuming dilution, are based on the weighted average number of common shares and, when dilutive, common equivalent shares outstanding during the year. See Note 14 of Notes to Consolidated Financial Statements for additional information.

Dividends

The Board of Directors presently anticipates that it will declare a regular quarterly dividend as long as the current tax treatment of dividends exists and adequate levels of liquidity are maintained. During the years ended December 31, 2013, 2012 and 2011, we paid $21.4 million, $22.8 million and $23.1 million, respectively, in shareholder dividends. On January 21, 2014, the Board of Directors declared a quarterly cash dividend of $0.09 per common share to be paid to shareholders of record at the close of business on February 6, 2014. The ex-dividend date was February 4, 2014 and the payment date was February 20, 2014. The quarterly dividend payment was $5.1 million.

Business Combinations

We use the acquisition method to account for business combinations. Under the acquisition method of accounting, we recognize the assets acquired and liabilities assumed at their fair value on the acquisition date. Goodwill is measured as the excess of the consideration transferred over the net assets acquired. Costs incurred to complete the business combination, such as legal, accounting or other professional fees, are charged to general and administrative expenses as they are incurred.

Recently Issued Accounting Standards

During 2013, we adopted the following accounting standards, which had no material effect on our consolidated results of operations or financial condition:

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02). ASU 2013-02 requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component either on the face of the financial statements or in the footnotes. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. This update is effective prospectively for reporting periods beginning after December 15, 2012. We adopted this amendment during the first quarter of 2013, and we have provided the disclosures required for the years ended December 31, 2013, 2012 and 2011 in Note 1 of Notes to Consolidated Financial Statements.

2 Business Combinations

On May 4, 2012, we acquired the NSN BBA business. This acquisition provides us with an established customer base in key markets and complementary, market-focused products and was accounted for as a business combination. We have included the financial results of the NSN BBA business in our consolidated financial statements since the date of acquisition. These revenues are included in the Carrier Networks division in the Broadband Access subcategory.

Upon acquisition, we received a cash payment of $7.5 million from NSN and recorded a bargain purchase gain of $1.8 million, net of income taxes, subject to customary working capital adjustments between the parties as defined in the purchase agreement. As of December 31, 2013, the parties were in the process of negotiating final working capital adjustments. We have adjusted the purchase price allocation to record additional estimated liabilities and an estimated receivable from NSN related to working capital adjustments under negotiation. The bargain purchase gain of $1.8 million represents the excess of the consideration exchanged over the fair value of the assets acquired and liabilities assumed. We have assessed the recognition and measurements of the assets acquired and liabilities assumed based on historical and pro forma data for future periods and have concluded that our valuation procedures and resulting measures were appropriate. The gain is included in the line item "Gain on bargain purchase of a business" in the 2012 Consolidated Statements of Income.

The allocation of the purchase price to the estimated fair value of the assets acquired and liabilities assumed at the acquisition date is as follows:

(In thousands)	
Other receivables	$9,486
Inventory	21,068
Property, plant and equipment	5,035
Accounts payable	(5,194)
Unearned revenue	(18,203)
Accrued expenses	(3,361)
Accrued wages and benefits	(2,251)
Deferred tax liability	(788)
Non-current unearned revenue	(19,886)
Net liabilities assumed	**(14,094)**
Customer relationships	5,162
Developed technology	3,176
Other	13
Gain on bargain purchase of a business, net of tax	(1,753)
Net consideration received by seller	**$(7,496)**

The fair value of the customer relationships acquired was calculated using a discounted cash flow method (excess earnings) and is being amortized using a declining balance method derived from projected customer revenue over an average estimated useful life of 13 years. The fair value of the developed technology acquired was calculated using a discounted cash flow method (relief from royalty) and is being amortized using the straight-line method over an estimated useful life of five years.

For the years ended December 31, 2013 and 2012, we incurred acquisition and integration related expenses and amortization of acquired intangibles of $2.9 million and $7.9 million, respectively, related to this acquisition.

The following supplemental pro forma information presents the financial results of the acquired NSN BBA business for the years ended December 31, 2012 and 2011. The pro forma results for the period January 1, 2012 to May 4, 2012 and January 1, 2011 to December 31, 2011 are not included in our consolidated financial results.

This supplemental pro forma information does not purport to be indicative of what would have occurred had the acquisition of the NSN BBA business been completed on January 1, 2011, nor are they indicative of any future results.

(In thousands) (Unaudited)	2012	2011
Pro forma revenue	$119,600	$196,256
Pro forma pre-tax loss	$(23,621)	$(36,980)
Weighted average exchange rate during the period (EURO/USD)	€1.00/$1.29	€1.00/$1.38

On August 4, 2011, we acquired all of the outstanding stock of Bluesocket, Inc., a provider of wireless network solutions with virtual control, for $23.7 million in cash. The acquisition provides us with IEEE802.11N enterprise class wireless LAN expertise, technology, and products to address the growing transition within small-medium enterprises and large enterprises to wireless networks and mobile devices. We have included the financial results of Bluesocket in our consolidated financial statements since the date of acquisition. Pro forma results of operations prior to the closing date for the acquisition have not been presented because the effect of the acquisition was not material to our financial results. The allocation of the purchase price to the estimated fair value of the assets acquired and liabilities assumed at the acquisition date is as follows:

(In thousands)	
Cash	$1,027
Accounts receivable	298
Inventory	792
Prepaid expenses	357
Property, plant and equipment	173
Deferred tax assets, net	12,962
Accounts payable	(441)
Unearned revenue	(600)
Accrued expenses	(332)
Net assets acquired	**14,236**
Customer relationships	1,530
Developed technology	3,230
Intellectual property	930
Trade names	270
Goodwill	3,492
Total purchase price	**$23,688**

During the fourth quarter of 2011, the purchase price and purchase price allocation were adjusted for our final valuations. The adjustments resulted in a decrease to the goodwill recognized in the transaction.

The net deferred tax assets acquired are primarily related to net operating losses and previously capitalized and unamortized research and development expense for tax deduction purposes.

The fair value of the customer relationships, developed technology and intellectual property acquired was calculated using an income approach (excess earnings method) and is being amortized using the straight-line method. The customer relationships and intellectual property are being amortized over an estimated useful life of 7 years and the developed technology is being amortized over an average estimated useful life of 4.5 years.

The fair value of the trade names acquired was calculated using an income approach (relief from royalty method) and is being amortized using the straight-line method over the estimated useful life of 4.5 years.

The goodwill of $3.5 million generated from this acquisition is primarily related to expected synergies and was assigned to our Enterprise Networks division. The goodwill will not be deductible for U.S. federal income tax purposes.

For the years ended December 31, 2013, 2012 and 2011, we incurred integration related expenses and amortization of acquired intangibles of $1.1 million, $1.5 million and $1.7 million, respectively, related to this acquisition.

3 Stock Incentive Plans

Stock Incentive Program Descriptions

Our Board of Directors adopted the 1996 Employee Incentive Stock Option Plan (1996 Plan) effective February 14, 1996, as amended, under which 17.0 million shares of common stock were authorized for issuance to certain employees and officers through incentive stock options and non-qualified stock options. Options granted under the 1996 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four or five-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. The 1996 Plan expired February 14, 2006, and expiration dates of options outstanding at December 31, 2013 under the 1996 Plan range from 2014 to 2015.

On January 23, 2006, the Board of Directors adopted the 2006 Employee Stock Incentive Plan (2006 Plan), which authorizes 13.0 million shares of common stock for issuance to certain employees and officers through incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. The 2006 Plan was adopted by stockholder approval at our annual meeting of stockholders held on May 9, 2006. Options granted under the 2006 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. Expiration dates of options outstanding at December 31, 2013 under the 2006 Plan range from 2016 to 2023.

Our stockholders approved the 2010 Directors Stock Plan (2010 Directors Plan) on May 5, 2010, under which 0.5 million shares of common stock have been reserved. This plan replaces the 2005 Directors Stock Option Plan. The 2010 Directors Plan provides that the Company may issue stock options, restricted stock and restricted stock units to our non-employee directors. Stock awards issued under the 2010 Directors Plan normally become vested in full on the first anniversary of the grant date. Options issued under the 2010 Directors Plan have a ten-year contractual term. We currently also have options outstanding under the 1995 Directors Plan, as amended, and the 2005 Directors Stock Option Plan. Expiration dates of options outstanding under both plans at December 31, 2013 range from 2014 to 2019.

The following table is a summary of our stock options outstanding as of December 31, 2012 and 2013 and the changes that occurred during 2013:

(In thousands, except per share amounts)	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Options outstanding, December 31, 2012	6,035	$24.81	6.69	$5,154
Options granted	1,005	$23.64		
Options cancelled/forfeited	(491)	$29.60		
Options exercised	(191)	$19.07		
Options outstanding, December 31, 2013	6,358	$24.43	6.60	$25,878
Options exercisable, December 31, 2013	3,911	$24.75	5.19	$15,336

All of the options above were issued at exercise prices that approximate fair market value at the date of grant. At December 31, 2013, 6.0 million options were available for grant under the shareholder approved plans.

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic value (the difference between ADTRAN's closing stock price on the last trading day of 2013 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2013. The amount of aggregate intrinsic value will change based on the fair market value of ADTRAN's stock.

The total pre-tax intrinsic value of options exercised during 2013, 2012 and 2011 was $1.1 million, $4.5 million and $39.8 million, respectively. The fair value of options fully vesting during 2013, 2012 and 2011 was $7.7 million, $7.7 million and $7.3 million, respectively.

The following table further describes our stock options outstanding as of December 31, 2013:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Options Outstanding at 12/31/13 *(in thousands)*	Weighted Avg. Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable at 12/31/13 *(in thousands)*	Weighted Average Exercise Price
$14.88 – 18.07	1,456	7.42	$16.37	742	$15.79
$18.08 – 23.36	1,002	3.04	$22.59	1,001	$22.59
$23.37 – 26.06	1,745	8.10	$23.60	745	$23.54
$26.07 – 30.04	466	3.59	$29.39	383	$29.71
$30.05 – 30.36	905	7.67	$30.36	454	$30.36
$30.37 – 41.92	784	6.84	$33.78	586	$33.76
	6,358			3,911	

Restricted Stock Program Description

On November 6, 2008, the Compensation Committee of the Board of Directors approved the Performance Shares Agreement under the 2006 Plan which sets forth the terms and conditions of awards of performance-based restricted stock units (RSUs). Of the 13.0 million shares of common stock authorized for issuance under the 2006 Plan, we may grant up to 5.0 million shares of common stock for issuance to certain employees and officers for awards other than stock options, which would include RSUs. Under a proposal that was approved by the Board of Directors and shareholders at the 2010 annual meeting, the number of shares available for awards other than stock options under all stock plans was reduced to 3.3 million. The number of shares of common stock earned by a recipient pursuant to the RSUs is subject to a market condition based on ADTRAN's relative total shareholder return against all companies in the NASDAQ Telecommunications Index at the end of a three-year performance period. Depending on the relative total shareholder return over the performance period, the recipient may earn from 0% to 150% of the shares underlying the RSUs, with the shares earned distributed upon the vesting of the RSUs at the end of the three-year performance period. The fair value of the award is based on the market price of our common stock on the date of grant, adjusted for the expected outcome of the impact of market conditions using a Monte Carlo Simulation valuation method. A portion of the granted RSUs also vest and the underlying shares become deliverable upon the death or disability of the recipient or upon a change of control of ADTRAN, as defined by the 2006 Plan. The recipients of the RSUs receive dividend credits based on the shares of common stock underlying the RSUs. The dividend credits are vested and earned in the same manner as the RSUs and will be paid in cash upon the issuance of common stock for the RSUs.

The following table is a summary of our RSUs and restricted stock outstanding as of December 31, 2012 and 2013 and the changes that occurred during 2013:

(In thousands except per share amounts)	Number of Shares	Weighted Average Grant Date Fair Value
Unvested RSUs and restricted stock outstanding, December 31, 2012	**103**	**$29.25**
RSUs and restricted stock granted	41	$27.47
RSUs and restricted stock vested	(39)	$29.42
Adjustments to shares granted due to shares earned at vesting	(10)	$39.21
Unvested RSUs and restricted stock outstanding, December 31, 2013	**95**	**$28.38**

At December 31, 2013, total compensation cost related to the non-vested portion of RSUs and restricted stock not yet recognized was approximately $1.7 million, which is expected to be recognized over an average remaining recognition period of 1.9 years.

Valuation and Expense Information

We use the Black-Scholes option pricing model (Black-Scholes Model) for the purpose of determining the estimated fair value of stock option awards on the date of grant. The Black-Scholes Model requires the input of certain assumptions that involve judgment. Because our stock options have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, existing models may not provide reliable measures of fair value of our stock options. We use a Monte Carlo Simulation valuation method to value our

performance-based RSUs. The fair value of restricted stock issued is equal to the closing price of our stock on the date of grant. We will continue to assess the assumptions and methodologies used to calculate the estimated fair value of stock-based compensation. If circumstances change, and additional data becomes available over time, we may change our assumptions and methodologies, which may materially impact our fair value determination.

The following table summarizes stock-based compensation expense related to stock options, RSUs and restricted stock for the years ended December 31, 2013, 2012 and 2011, which was recognized as follows:

(In thousands)	2013	2012	2011
Stock-based compensation expense included in cost of sales	$465	$422	$412
Selling, general and administrative expense	4,443	4,351	4,316
Research and development expense	4,165	4,491	4,441
Stock-based compensation expense included in operating expenses	8,608	8,842	8,757
Total stock-based compensation expense	9,073	9,264	9,169
Tax benefit for expense associated with non-qualified options	(1,298)	(1,234)	(1,321)
Total stock-based compensation expense, net of tax	$7,775	$8,030	$7,848

At December 31, 2013, total compensation cost related to non-vested stock options not yet recognized was approximately $17.1 million, which is expected to be recognized over an average remaining recognition period of 2.8 years.

The stock option pricing model requires the use of several assumptions that impact the fair value estimate. These variables include, but are not limited to, the volatility of our stock price and employee exercise behaviors. There were no material changes made during 2013 to the methodology used to determine our assumptions.

The weighted-average estimated fair value of stock options granted to employees and directors during the years ended December 31, 2013, 2012 and 2011 was $8.35 per share, $5.60 per share and $9.53 per share, respectively, with the following weighted-average assumptions:

	2013	2012	2011
Expected volatility	39.92%	39.46%	38.32%
Risk-free interest rate	1.71%	0.96%	1.01%
Expected dividend yield	1.52%	2.05%	1.19%
Expected life (in years)	6.36	6.18	5.15

We based our estimate of expected volatility for the years ended December 31, 2013, 2012 and 2011 on the sequential historical daily trading data of our common stock for a period equal to the expected life of the options granted. The selection of the historical volatility method was based on available data indicating our historical volatility is as equally representative of our future stock price trends as is our implied volatility. We have no reason to believe the future volatility of our stock price is likely to differ from its past volatility.

The risk-free interest rate assumption is based upon implied yields of U.S. Treasury zero-coupon bonds on the date of grant having a remaining term equal to the expected life of the options granted. The dividend yield is based on our historical and expected dividend payouts.

The expected life of our stock options is based upon historical exercise and cancellation activity of our previous stock-based grants with a ten-year contractual term.

The RSU pricing model also requires the use of several significant assumptions that impact the fair value estimate. The estimated fair value of the RSUs granted to employees during the years ended December 31, 2013, 2012 and 2011 was $27.72 per share, $19.46 per share and $38.73 per share, respectively, with the following assumptions:

	2013	2012	2011
Expected volatility	38.83%	37.75%	39.32%
Risk-free interest rate	0.61%	0.38%	0.37%
Expected dividend yield	1.52%	2.12%	1.08%

Stock-based compensation expense recognized in our Consolidated Statements of Income for the years ended December 31, 2013, 2012 and 2011 is based on RSUs and options ultimately expected to vest, and has been reduced for estimated forfeitures. Estimates for forfeiture rates are based upon historical experience and are evaluated quarterly. We expect our forfeiture rate for stock option awards to be approximately 2.5% annually. We estimated a 0% forfeiture rate for our RSUs and restricted stock due to the limited number of recipients and historical experience for these awards.

4 Investments

At December 31, 2013, we held the following securities and investments, recorded at either fair value or cost:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value/ Carrying Value
Deferred compensation plan assets	$12,300	$2,847	$(24)	$15,123
Corporate bonds	166,370	534	(45)	166,859
Municipal fixed-rate bonds	135,773	583	(54)	136,302
Municipal variable rate demand notes	8,310	—	—	8,310
Marketable equity securities	24,654	13,975	(177)	38,452
Available-for-sale securities held at fair value	$347,407	$17,939	$(300)	$365,046
Restricted investment held at cost				48,250
Other investments held at cost				1,689
Total carrying value of available-for-sale investments				$414,985

At December 31, 2012, we held the following securities and investments, recorded at either fair value or cost:

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value/ Carrying Value
Deferred compensation plan assets	$10,688	$846	$(7)	$11,527
Corporate bonds	185,464	966	(18)	186,412
Municipal fixed-rate bonds	174,530	627	(73)	175,084
Municipal variable rate demand notes	34,375	—	—	34,375
Fixed income bond fund	444	12	—	456
Marketable equity securities	20,966	14,630	(392)	35,204
Available-for-sale securities held at fair value	$426,467	$17,081	$(490)	$443,058
Restricted investment held at cost				48,250
Other investments held at cost				1,902
Total carrying value of available-for-sale investments				$493,210

As of December 31, 2013, corporate and municipal fixed-rate bonds had the following contractual maturities:

(In thousands)	Corporate bonds	Municipal fixed-rate bonds
Less than one year	$55,396	$46,606
One to two years	37,838	25,284
Two to three years	70,447	55,358
Three to five years	3,178	9,054
Total	$166,859	$136,302

Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of $11 thousand during the fourth quarter of 2013. For each of the years ended December 31, 2013, 2012 and 2011 we recorded a charge of $25 thousand, $0.7 million and $68 thousand, respectively, related to the other-than-temporary impairment of certain marketable equity securities and our deferred compensation plan assets.

Realized gains and losses on sales of securities are computed under the specific identification method. The following table presents gross realized gains and losses related to our investments for the years ended December 31, 2013, 2012 and 2011:

(In thousands)

Year Ended December 31,	2013	2012	2011
Gross realized gains	$8,932	$11,006	$13,641
Gross realized losses	$(318)	$(1,456)	$(1,187)

The following table presents the breakdown of investments with unrealized losses at December 31, 2013:

(In thousands)	Continuous Unrealized Loss Position for Less than 12 Months		Continuous Unrealized Loss Position for 12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Deferred compensation plan assets	$48	$(6)	$409	$(18)	$457	$(24)
Corporate bonds	20,697	(45)	—	—	20,697	(45)
Municipal fixed-rate bonds	13,733	(54)	—	—	13,733	(54)
Marketable equity securities	2,758	(173)	31	(4)	2,789	(177)
Total	$37,236	$(278)	$440	$(22)	$37,676	$(300)

The following table presents the breakdown of investments with unrealized losses at December 31, 2012.

(In thousands)	Continuous Unrealized Loss Position for Less than 12 Months		Continuous Unrealized Loss Position for 12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Deferred compensation plan assets	915	$(7)	$—	$—	$915	$(7)
Corporate bonds	20,204	(17)	1,600	(1)	21,804	(18)
Municipal fixed-rate bonds	34,297	(73)	—	—	34,297	(73)
Marketable equity securities	6,171	(355)	230	(37)	6,401	(392)
Total	$61,587	$(452)	$1,830	$(38)	$63,417	$(490)

The decrease in unrealized losses during 2013, as reflected in the table above, is primarily due to the restructuring of our investment portfolio relating to marketable equity securities in December 2013 resulting in the sale of several securities in an unrealized loss position. At December 31, 2013, a total of 168 of our marketable equity securities were in an unrealized loss position.

We have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1 - Values based on unadjusted quoted prices for identical assets or liabilities in an active market; Level 2 - Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly; Level 3 - Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs include information supplied by investees.

Fair Value Measurements at December 31, 2013 Using

(In thousands)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents				
Money market funds	$3,949	$3,949	$—	$—
Available-for-sale securities				
Deferred compensation plan assets	15,123	15,123	—	—
Available-for-sale debt securities				
Corporate bonds	166,859	—	166,859	—
Municipal fixed-rate bonds	136,302	—	136,302	—
Municipal variable rate demand notes	8,310	—	8,310	—
Available-for-sale marketable equity securities				
Marketable equity securities—technology industry	11,398	11,398	—	—
Marketable equity securities—other	27,054	27,054	—	—
Available-for-sale securities	365,046	53,575	311,471	—
Total	$368,995	$57,524	$311,471	$—

Fair Value Measurements at December 31, 2012 Using

(In thousands)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents				
Money market funds	$28,071	$28,071	$—	$—
Available-for-sale securities				
Deferred compensation plan assets	11,527	11,527	—	—
Available-for-sale debt securities				
Corporate bonds	186,412	—	186,412	—
Municipal fixed-rate bonds	175,084	—	175,084	—
Municipal variable rate demand notes	34,375	—	34,375	—
Fixed income bond fund	456	456	—	—
Available-for-sale marketable equity securities				
Marketable equity securities—technology industry	14,099	14,099	—	—
Marketable equity securities—other	21,105	21,105	—	—
Available-for-sale securities	443,058	47,187	395,871	—
Total	$471,129	$75,258	$395,871	$—

The fair value of our Level 2 securities is calculated using a weighted average market price for each security. Market prices are obtained from a variety of industry standard data providers, security master files from large financial institutions, and other third-party sources. These multiple market prices are used as inputs into a distribution-curve-based algorithm to determine the daily market value of each security.

Our municipal variable rate demand notes have a structure that implies a standard expected market price. The frequent interest rate resets make it reasonable to expect the price to stay at par. These securities are priced at the expected market price.

5 Derivative Instruments and Hedging Activities

We have certain international customers who are billed in their local currency. Changes in the monetary exchange rates may adversely affect our results of operations and financial condition. When appropriate, we enter into various derivative transactions to enhance our ability to manage the volatility relating to these typical business exposures. We do not hold or issue derivative instruments for trading or other speculative purposes. Our derivative instruments are recorded in the Consolidated Balance Sheets at their fair values. Our derivative instruments do not qualify for hedge accounting, and accordingly, all changes in the fair value of the instruments are recognized as other income (expense) in the Consolidated Statements of Income. The maximum contractual period for our derivatives is currently less than twelve months. Our derivative instruments are not subject to master netting arrangements and are not offset in the Consolidated Balance Sheets.

As of December 31, 2013, we had forward contracts outstanding with notional amounts totaling €18.5 million ($25.5 million), which mature through 2014.

The fair values of our derivative instruments recorded in the Consolidated Balance Sheet as of December 31, 2013 were as follows:

(In thousands)

Balance, December 31, 2013	Balance Sheet Location	Fair Value
Derivatives Not Designated as Hedging Instruments (Level 2):		
Foreign exchange contracts – asset derivatives	Other receivables	$18
Foreign exchange contracts – liability derivatives	Accounts payable	$(15)

The change in the fair values of our derivative instruments recorded in the Consolidated Statements of Income during the year ended December 31, 2013 were as follows:

(In thousands)	Income Statement Location	2013
Derivatives Not Designated as Hedging Instruments:		
Foreign exchange contracts	Other income (expense)	$750

6 Inventory

At December 31, 2013 and 2012, inventory was comprised of the following:

(In thousands)	2013	2012
Raw materials	$44,093	$47,054
Work in process	3,484	3,262
Finished goods	42,534	51,061
Total Inventory, net	$90,111	$101,377

We establish reserves for estimated excess, obsolete, or unmarketable inventory equal to the difference between the cost of the inventory and the estimated fair value of the inventory based upon assumptions about future demand and market conditions. At December 31, 2013 and 2012, raw materials reserves totaled $16.9 million and $9.9 million, respectively, and finished goods inventory reserves totaled $6.1 million and $2.1 million, respectively.

7 Property, Plant and Equipment

At December 31, 2013 and 2012, property, plant and equipment were comprised of the following:

(In thousands)	2013	2012
Land	$4,263	$4,263
Building and land improvements	21,776	20,915
Building	68,479	68,479
Furniture and fixtures	16,465	16,631
Computer hardware and software	70,468	68,596
Engineering and other equipment	104,584	99,081
Total Property, Plant and Equipment	**286,035**	**277,965**
Less accumulated depreciation	(209,296)	(197,719)
Total Property, Plant and Equipment, net	**$76,739**	**$80,246**

Depreciation expense was $12.2 million, $12.1 million and $10.8 million in 2013, 2012 and 2011, respectively.

8 Goodwill and Intangible Assets

The changes in the carrying value of goodwill, all of which is included in our Enterprise Networks division, for the year ended December 31, 2013 are as follows:

(In thousands)	
Balance, December 31, 2012	**$3,492**
Acquisitions	—
Impairment losses	—
Balance, December 31, 2013	**$3,492**
Balance as of December 31, 2013	
Goodwill	$3,492
Accumulated impairment losses	—
Total goodwill	**$3,492**

We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. There were no impairment losses recognized during 2013 or 2012.

Intangible assets are included in other assets in the accompanying Consolidated Balance Sheets and include intangible assets acquired in conjunction with our acquisition of Objectworld Communications Corporation on September 15, 2009, Bluesocket, Inc. on August 4, 2011, and the NSN BBA business on May 4, 2012.

The following table presents our intangible assets as of December 31, 2013 and 2012:

(In thousands)	December 31, 2013			December 31, 2012		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Customer relationships	$6,996	$(1,555)	$5,441	$6,769	$(766)	$6,003
Developed technology	6,537	(2,692)	3,845	6,397	(1,354)	5,043
Intellectual property	2,340	(1,185)	1,155	2,340	(851)	1,489
Trade names	270	(145)	125	270	(85)	185
Other	14	(8)	6	13	(3)	10
Total	**$16,157**	**$(5,585)**	**$10,572**	**$15,789**	**$(3,059)**	**$12,730**

Amortization expense was $2.4 million, $2.0 million and $0.7 million in 2013, 2012 and 2011, respectively.

As of December 31, 2013, the estimated future amortization expense of intangible assets is as follows:

(In thousands)	Amount
2014	$2,335
2015	2,199
2016	1,925
2017	1,302
2018	784
Thereafter	2,027
Total	$10,572

9 Alabama State Industrial Development Authority Financing and Economic Incentives

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the "Authority"). Pursuant to the program, on January 13, 1995, the Authority issued $20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the "Bondholder"), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to $50.0 million. An Amended and Restated Taxable Revenue Bond ("Amended and Restated Bond") was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 5% per annum. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond using a level 2 valuation technique at December 31, 2013 was approximately $45.4 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A-. We are required to make payments to the Authority in amounts necessary to pay the interest on the Amended and Restated Bond. Included in long-term investments at December 31, 2013 is $48.3 million which is invested in a restricted certificate of deposit. These funds serve as a collateral deposit against the principal of this bond, and we have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness.

In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. For the years ended December 31, 2013, 2012 and 2011, we realized economic incentives related to payroll withholdings totaling $1.3 million, $1.4 million and $1.9 million, respectively.

We did not make a principal payment for the year-ended December 31, 2013. We made a principal payment of $0.5 million for the year ended December 31, 2012. We anticipate making a principal payment in 2014. At December 31, 2013 and 2012, $0.3 million and $0.5 million, respectively, of the bond debt were classified as a current liability in accounts payable in the Consolidated Balance Sheets at December 31, 2013.

10 Income Taxes

A summary of the components of the provision for income taxes for the years ended December 31, 2013, 2012 and 2011 is as follows:

(In thousands)	2013	2012	2011
Current			
Federal	$15,641	$26,225	$59,382
State	2,041	3,766	7,177
International	1,437	(504)	431
Total Current	19,119	29,487	66,990
Deferred			
Federal	(3,606)	(3,395)	527
State	(412)	(388)	60
International	(40)	(2)	(12)
Total Deferred	(4,058)	(3,785)	575
Total Provision for Income Taxes	$15,061	$25,702	$67,565

Our effective income tax rate differs from the federal statutory rate due to the following:

	2013	2012	2011
Tax provision computed at the federal statutory rate	35.00%	35.00%	35.00%
State income tax provision, net of federal benefit	3.98	3.78	3.19
Federal research credits	(9.24)	—	(2.50)
International	(2.93)	3.80	—
Tax-exempt income	(1.11)	(1.01)	(0.27)
State tax incentives	(2.19)	(4.46)	(0.90)
Stock-based compensation	2.97	2.36	0.03
Domestic production activity deduction	(1.80)	(3.21)	(1.84)
Other, net	0.07	(1.03)	0.07
Effective Tax Rate	24.75%	35.23%	32.78%

Income before provision for income taxes for the years ended December 31, 2013, 2012 and 2011 is as follows:

(In thousands)	2013	2012	2011
U.S. entities	$51,752	$80,926	$204,652
International	9,103	(7,961)	1,490
Total	$60,855	$72,965	$206,142

Income before provision for income taxes for international entities reflects income based on statutory transfer pricing agreements. This amount does not correlate to consolidated international revenues, many of which occur from our U.S. entity.

Deferred income taxes on the balance sheet result from temporary differences between the amount of assets and liabilities recognized for financial reporting and tax purposes. The principal components of our current and non-current deferred taxes are as follows:

(In thousands)	2013	2012
Current deferred tax assets		
Accounts receivable	$51	$2
Inventory	9,877	7,507
Accrued expenses	7,155	5,546
Total Current Deferred Tax Assets	17,083	13,055
Non-current deferred tax assets		
Accrued expenses	140	116
Deferred compensation	5,972	4,456
Stock-based compensation	5,331	4,569
Uncertain tax positions related to state taxes and related interest	1,107	1,005
Pensions	301	605
Foreign losses	5,702	6,978
State losses and credit carry-forwards	3,737	4,349
Federal loss and research carry-forwards	8,322	12,210
Valuation allowance	(8,842)	(10,939)
Total Non-current Deferred Tax Assets	21,770	23,349
Total Deferred Tax Assets	$38,853	$36,404
Non-current Deferred Tax Liabilities		
Property, plant and equipment	$(5,499)	$(6,405)
Intellectual property	(1,006)	(1,839)
Investments	(5,643)	(4,844)
Total Non-current Deferred Tax Liabilities	$(12,148)	$(13,088)
Net Deferred Tax Assets	$26,705	$23,316

At December 31, 2013 and 2012, non-current deferred tax liabilities and non-current deferred tax assets, respectively, related to our investments, reflect deferred taxes on unrealized gains and losses on available-for-sale investments. The net change in non-current deferred taxes associated with these investments, a deferred tax expense of $0.4 million in 2013 and a deferred tax benefit of $33 thousand in 2012, is recorded as an adjustment to other comprehensive income, presented in the Consolidated Statements of Comprehensive Income.

We have deferred tax assets for foreign and domestic loss carry-forwards, unamortized research and development costs and state credit carry-forwards of $19.0 million which will expire between 2014 and 2030. The foreign loss carry-forwards were generated through the acquisition of a foreign entity in 2009 and through current losses at a foreign subsidiary. The unamortized research and development costs are related to our acquisition of Bluesocket in 2011. The state credit carry-forwards result from tax credits in excess of our annual tax liability to an individual state where we do not generate sufficient state income to offset the credit. We believe it is more likely than not that we will not realize the full benefits of the deferred tax asset arising from these losses and credits in various states and foreign countries, and accordingly, we have provided a valuation allowance against these deferred tax assets. We do not provide for U.S. income tax on undistributed earnings of our foreign operations, whose earnings are intended to be permanently reinvested. These earnings are not required to service debt or fund our U.S. operations.

During 2013, 2012 and 2011, we recorded an income tax benefit of $0.2 million, $1.9 million and $10.5 million, respectively, as an adjustment to equity. This deduction is calculated on the difference between the exercise price of stock option exercises and the market price of the underlying common stock upon exercise.

The change in the unrecognized income tax benefits for 2013, 2012 and 2011 is reconciled below:

(In thousands)	2013	2012	2011
Balance at beginning of period	$2,926	$2,970	$2,593
Increases for tax position related to:			
Prior years	89	965	—
Current year	549	302	840
Decreases for tax positions related to:			
Prior years	—	(49)	(92)
Settlements with taxing authorities	(141)	(507)	(354)
Expiration of applicable statute of limitations	(183)	(755)	(17)
Balance at end of period	$3,240	$2,926	$2,970

As of December 31, 2013, 2012, and 2011, our total liability for unrecognized tax benefits was $3.2 million, $2.9 million, and $3.0 million, respectively, of which $2.5 million, $2.2 million, and $2.4 million, respectively, would reduce our effective tax rate if we were successful in upholding all of the uncertain positions and recognized the amounts recorded. We classify interest and penalties recognized on the liability for unrecognized tax benefits as income tax expense. As of December 31, 2013, 2012 and 2011, the balances of accrued interest and penalties were $1.0 million, $0.8 million and $1.2 million, respectively.

We do not anticipate a single tax position generating a significant increase or decrease in our liability for unrecognized tax benefits within 12 months of this reporting date. We file income tax returns in the U.S. federal and various state jurisdictions and several foreign jurisdictions. We have been audited by the Internal Revenue Service and the state of Alabama through the 2009 tax year. Generally, we are not subject to changes in income taxes by any taxing jurisdiction for the years prior to 2010.

11 Employee Benefit Plans

Pension Benefit Plan

As a result of our acquisition of the NSN BBA business, we assumed a defined benefit pension plan covering employees in certain foreign countries. We established a Contribution Trust Arrangement (CTA) to hold the pension assets, and NSN transferred assets to us equal to the defined benefit obligation as of the May 4, 2012 acquisition date.

The pension benefit plan obligations and funded status at December 31, 2013 and 2012, are as follows:

(In thousands)	2013	2012
Change in projected benefit obligation:		
Projected benefit obligation at beginning of period	$(21,181)	$—
Business combination	—	(18,063)
Service cost	(1,198)	(766)
Interest cost	(745)	(494)
Actuarial gain (loss)	779	(1,862)
Benefit payments	(1)	—
Foreign currency exchange rate changes	(1,008)	4
Projected benefit obligation at end of period	$(23,354)	$(21,181)
Change in plan assets:		
Fair value of plan assets at beginning of period	$18,620	$—
Business combination	—	18,063
Actual return on plan assets	1,281	592
Foreign currency exchange rate changes	872	(35)
Fair value of plan assets at end of period	$20,773	$18,620
Funded status at end of period	$(2,581)	$(2,561)

The accumulated benefit obligation was $22.9 million and $20.8 million at December 31, 2013 and 2012, respectively.

The net amounts recognized in the balance sheet for the unfunded pension liability as of December 31, 2013 and 2012 are as follows:

(In thousands)	2013	2012
Current liability	—	$(609)
Non-current liability	(2,581)	(1,952)
Total	$(2,581)	$(2,561)

The components of net periodic pension cost and amounts recognized in other comprehensive income for the year ended December 31, 2013 and the period May 4, 2012 to December 31, 2012 are as follows:

(In thousands)	Year Ended December 31, 2013	May 4, 2012 to December 31, 2012
Net periodic benefit cost:		
Service cost	$1,198	$766
Interest cost	745	494
Expected return on plan assets	(1,010)	(674)
Net periodic benefit cost	933	586
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Net actuarial (gain) loss	(779)	1,862
Net unrealized (gain) loss on plan assets	(282)	90
Other comprehensive (income) loss	(1,061)	1,952
Total recognized in net periodic benefit cost and other comprehensive income	$(128)	$2,538

The amounts recognized in accumulated other comprehensive income as of December 31, 2013 and 2012 are as follows:

(In thousands)	2013	2012
Net actuarial (gain) loss	$1,083	$1,862
Net unrealized (gain) loss on plan assets	(192)	90
Total	$891	$1,952

The defined benefit pension plan is accounted for on an actuarial basis, which requires the selection of various assumptions, including an expected rate of return on plan assets and a discount rate. The expected return on our German plan assets that is utilized in determining the benefit obligation and net periodic benefit cost is derived from periodic studies, which include a review of asset allocation strategies, anticipated future long-term performance of individual asset classes, risks using standard deviations and correlations of returns among the asset classes that comprise the plans' asset mix. While the studies give appropriate consideration to recent plan performance and historical returns, the assumptions are primarily long-term, prospective rates of return.

Another key assumption in determining net pension expense is the assumed discount rate to be used to discount plan obligations. The discount rate has been derived from the returns of high-quality, corporate bonds denominated in Euro currency with durations close to the duration of our pension obligations.

The weighted-average assumptions that were used to determine the net periodic benefit cost for the year ended December 31, 2013 and the period May 4, 2012 to December 31, 2012 are as follows:

(In thousands)	Year Ended December 31, 2013	May 4, 2012 to December 31, 2012
Discount rates	3.50%	3.96%
Rate of compensation increase	2.25%	2.25%
Expected long-term rates of return	5.40%	5.40%

The weighted-average assumptions that were used to determine the benefit obligation at December 31, 2013 and 2012:

	2013	2012
Discount rates	3.70%	3.50%
Rate of compensation increase	2.25%	2.25%

No amounts will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2014.

We do not anticipate making a contribution to our pension plan in 2014. The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid to participants:

(In thousands)	
2014	$357
2015	312
2016	223
2017	390
2018	650
2019-2023	4,427
Total	$6,359

We have categorized our cash equivalents and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1 - Values based on unadjusted quoted prices for identical assets or liabilities in an active market; Level 2 - Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly; Level 3 - Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs include information supplied by investees.

Fair Value Measurements at December 31, 2013 Using

(In thousands)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	$4	$4	$—	$—
Available-for-sale securities				
Bond funds				
Corporate bonds	12,976	12,976	—	—
Government bonds	1,915	1,915	—	—
Equity funds				
Large cap blend	4,720	4,720	—	—
Large cap value	287	287	—	—
Balanced fund	871	871	—	—
Available-for-sale securities	**20,769**	**20,769**	**—**	**—**
Total	**$20,773**	**$20,773**	**$—**	**$—**

Fair Value Measurements at December 31, 2012 Using

(In thousands)	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	$6	$6	$—	$—
Available-for-sale securities				
Bond funds				
Corporate bonds	12,041	12,041	—	—
Government bonds	1,839	1,839	—	—
Equity funds				
Large cap blend	3,740	3,740	—	—
Large cap value	235	235	—	—
Balanced fund	759	759	—	—
Available-for-sale securities	**18,614**	**18,614**	**—**	**—**
Total	**$18,620**	**$18,620**	**$—**	**$—**

Our investment policy includes various guidelines and procedures designed to ensure assets are invested in a manner necessary to meet expected future benefits earned by participants. The investments guidelines consider a broad range of economic conditions. Central to the policy are target allocation ranges by asset class, which is currently 75% for bond funds and 25% for equity funds.

The objectives of the target allocations are to maintain investment portfolios that diversify risk through prudent asset allocation parameters, achieve asset returns that meet or exceed the plans' actuarial assumptions, and achieve asset returns that are competitive with like institutions employing similar investment strategies.

The investment policy is periodically reviewed by us and a designated third-party fiduciary for investment matters. The policy is established and administered in a manner that is compliant at all times with applicable government regulations.

401(k) Savings Plan

We maintain the ADTRAN, Inc. 401(k) Retirement Plan (Savings Plan) for the benefit of our eligible employees. The Savings Plan is intended to qualify under Sections 401(a) and 401(k) of the Internal Revenue Code of 1986, as amended (Code), and is intended to be a "safe harbor" 401(k) plan under Code Section 401(k)(12). The Savings Plan allows employees to save for retirement by contributing part of their compensation to the plan on a tax-deferred basis. The Savings Plan also requires us to contribute a "safe harbor" amount each year. We match up to 4% of employee contributions (100% of an employee's first 3% of contributions and 50% of their next 2% of contributions), beginning on the employee's one year anniversary date. In calculating our matching contribution, we only use compensation up to the statutory maximum under the Code ($255 thousand for 2013). All contributions under the Savings Plan are 100% vested. Expenses recorded for employer contributions and plan administration costs for the Savings Plan amounted to approximately $4.5 million, $4.6 million and $4.3 million in 2013, 2012 and 2011, respectively.

Deferred Compensation Plans

We maintain the ADTRAN, Inc. Deferred Compensation Plan (Deferred Compensation Plan). This plan is offered as a supplement to our tax-qualified 401(k) plan and is available to certain executive management employees who have been designated by our Board of Directors. The deferred compensation plan allows participants to defer all or a portion of certain specified bonuses and up to 25% of remaining cash compensation, and permits us to make matching contributions on a discretionary basis, without the limitations that apply to the 401(k) plan. To date, we have not made any matching contributions under this plan.

We also maintain the ADTRAN, Inc. Equity Deferral Program for Employees for the purpose of providing deferred compensation for certain executive management employees. Participants may elect to defer all or a portion of their vested Performance Share awards to the Plan. Such deferrals shall continue to be held and deemed to be invested in shares of ADTRAN stock unless and until the amounts are distributed or such deferrals are moved to another deemed investment pursuant to an election made by the Participant.

We have set aside the plan assets for both plans in a rabbi trust (Trust) and all contributions are credited to bookkeeping accounts for the participants. The Trust assets are subject to the claims of our creditors in the event of bankruptcy or insolvency. The assets of the Trust are deemed to be invested in pre-approved mutual funds as directed by each participant, and the participant's bookkeeping account is credited with the earnings and losses attributable to those investments. Benefits are scheduled to be distributed six months after termination of employment in a single lump sum payment or annual installments paid over a three or ten year term. Distributions will be made on a pro rata basis from each of the hypothetical investments of the Participant's account in cash. Any whole shares of ADTRAN, Inc. common stock that are distributed will be distributed in-kind.

Assets of the Trust are deemed invested in mutual funds that cover an investment spectrum ranging from equities to money market instruments. These mutual funds are publicly quoted and reported at fair value. The fair value of the assets held by the Trust and the amounts payable to the plan participants are as follows:

(In thousands)	2013	2012
Fair Value of Plan Assets		
Long-term Investments	$15,123	$11,527
Total Fair Value of Plan Assets	**$15,123**	**$11,527**
Amounts Payable to Plan Participants		
Non-current Liabilities	$15,123	$11,527
Total Amounts Payable to Plan Participants	**$15,123**	**$11,527**

Interest and dividend income of the Trust have been included in interest and dividend income in the accompanying 2013, 2012 and 2011 Consolidated Statements of Income. Changes in the fair value of the plan assets held by the Trust have been included in accumulated other comprehensive income in the accompanying 2013 and 2012 Consolidated Balance Sheets. Changes in the fair value of the deferred compensation liability are included as selling, general and administrative expense in the accompanying 2013, 2012 and 2011 Consolidated Statements of Income. Based on the changes in the total fair value of the Trust's assets, we recorded deferred compensation adjustments in 2013, 2012 and 2011 of $2.8 million, $0.9 million and $(0.2) million, respectively.

Retiree Medical Coverage

We provide medical, dental and prescription drug coverage to one retired former officer and his spouse, for his life, on the same terms as provided to our active officers, and to the spouse of a former deceased officer for up to 30 years. At December 31, 2013 and 2012, this liability totaled $0.2 million.

12 Segment Information and Major Customers

We operate in two reportable segments: (1) the Carrier Networks Division and (2) the Enterprise Networks Division. The accounting policies of the segments are the same as those described in the "Nature of Business and Summary of Significant Accounting Policies" (see Note 1) to the extent that such policies affect the reported segment information. We evaluate the performance of our segments based on gross profit; therefore, selling, general and administrative expense, research and development expenses, interest income and dividend income, interest expense, net realized investment gain/loss, other income/expense and provision for taxes are reported on an entity-wide basis only. There are no inter-segment revenues.

The following table presents information about the reported sales and gross profit of our reportable segments for each of the years ended December 31, 2013, 2012 and 2011. Asset information by reportable segment is not reported, since we do not produce such information internally.

(In thousands)	2013		2012		2011	
Sales and Gross Profit by Market Segment	Sales	Gross Profit	Sales	Gross Profit	Sales	Gross Profit
Carrier Networks	$500,733	$233,206	$492,096	$247,380	$569,579	$327,813
Enterprise Networks	141,011	75,680	128,518	69,263	147,650	86,505
Total	**$641,744**	**$308,886**	**$620,614**	**$316,643**	**$717,229**	**$414,318**

Sales by Product

Our three major product categories are Carrier Systems, Business Networking and Loop Access.

Carrier Systems products are used by communications service providers to provide data, voice and video services to consumers and enterprises. This category includes the following product areas and related services:

Broadband Access

- Total Access® 5000 Multi-Service Access Node (MSAN)
- hiX family of MSANs
- Total Access 1100/1200 Series of Fiber to the Node (FTTN) products
- Ultra Broadband Ethernet (UBE)
- Digital Subscriber Line Access Multiplexer (DSLAM) products

Optical

- Optical Networking Edge (ONE)
- NetVanta® 8000 Series of Fiber Ethernet Access Devices (EAD)
- OPTI-6100 and Total Access 3000 optical Multi-Service Provisioning Platforms (MSPP)
- Pluggable Optical Products, including SFP, XFP, and SFP+

TDM Systems

Business Networking products provide access to communication services and facilitate the delivery of cloud connectivity and enterprise communications to the Small and Mid-sized Enterprise (SME) market. This category includes the following product areas and related services:

Internetworking Products

- Total Access IP Business Gateways
- Optical Network Terminals (ONTs)
- Bluesocket® virtual Wireless LAN (vWLAN®)
- NetVanta
  - – Multiservice Routers
  - – Managed Ethernet Switches
  - – IP Business Gateways
  - – Unified Communications (UC) solutions
  - – Carrier Ethernet Network Terminating Equipment (NTE)
- Network Management Solutions

Integrated Access Devices (IADs)

Loop Access products are used by carrier and enterprise customers for access to copper-based communications networks. The Loop Access category includes the following product areas and related services:

- High bit-rate Digital Subscriber Line (HDSL) products
- Digital Data Service (DDS)
- Integrated Services Digital Network (ISDN) products
- T1/E1/T3 Channel Service Units/Data Service Units (CSUs/DSUs)
- TRACER fixed-wireless products

The table below presents sales information by product category for the years ended December 31, 2013, 2012 and 2011:

(In thousands)	2013	2012	2011
Carrier Systems	$427,850	$399,646	$420,289
Business Networking	168,871	149,304	162,186
Loop Access	45,023	71,664	134,754
Total	$641,744	$620,614	$717,229

In addition, we identify subcategories of product revenues, which we divide into core products and legacy products. Our core products consist of Broadband Access and Optical products (included in Carrier Systems), and Internetworking products (included in Business Networking). Our legacy products include HDSL products (included in Loop Access) and other products not included in the aforementioned core products.

The table below presents subcategory revenues for the years ended December 31, 2013, 2012 and 2011:

(In thousands)	2013	2012	2011
Core Products			
Broadband Access (included in Carrier Systems)	$340,560	$320,076	$289,776
Optical (included in Carrier Systems)	55,615	51,755	82,535
Internetworking (NetVanta and Multi-service Access Gateways) (included in Business Networking)	164,422	142,958	151,536
Subtotal	$560,597	$514,789	$523,847
Legacy Products			
HDSL (does not include T1) (included in Loop Access)	41,666	66,974	126,976
Other products (excluding HDSL)	39,481	38,851	66,406
Subtotal	$81,147	$105,825	$193,382
Total	$641,744	$620,614	$717,229

The following table presents sales information by geographic area for the years ended December 31, 2013, 2012 and 2011. International sales correlate to shipments with a non-U.S. destination.

(In thousands)	2013	2012	2011
United States	$455,996	$470,369	$632,795
Germany	97,151	26,918	554
Other International	88,597	123,327	83,880
Total	$641,744	$620,614	$717,229

Customers comprising more than 10% of revenue can change from year to year. Single customers comprising more than 10% of our revenue in 2013 included two customers at 17% and 14%, respectively. Only a single customer comprised more than 10% of our revenue in 2012 at 23%. Single customers comprising more than 10% of our revenue in 2011 included two customers at 25% and 10%, respectively. No other customer accounted for 10% or more of our sales in 2013, 2012 or 2011. Our five largest customers, other than those with more than 10 percent of revenues disclosed above, can change from year to year. These customers represented 22%, 34% and 29% of total revenue in 2013, 2012 and 2011, respectively. Revenues in this disclosure do not include distributor agents who predominately provide fulfillment services to end users. In such cases where known, that revenue is associated with the end user.

As of December 31, 2013, long-lived assets, net totaled $76.7 million, which includes $71.2 million held in the United States and $5.5 million held outside the United States. As of December 31, 2012, long-lived assets, net totaled $80.2 million, which includes $73.9 million held in the United States and $6.3 million held outside the United States.

13 Commitments and Contingencies

In the ordinary course of business, we may be subject to various legal proceedings and claims, including employment disputes, patent claims, disputes over contract agreements and other commercial disputes. In some cases, claimants seek damages or other relief, such as royalty payments related to patents, which, if granted, could require significant expenditures. Although the outcome of any claim or litigation can never be certain, it is our opinion that the outcome of all contingencies of which we are currently aware will not materially affect our business, operations, financial condition or cash flows.

We lease office space and equipment under operating leases which expire at various dates through 2018. As of December 31, 2013, future minimum rental payments under non-cancelable operating leases with original maturities of greater than 12 months are approximately as follows:

(In thousands)	
2014	$4,523
2015	3,556
2016	2,506
2017	2,156
Thereafter	686
Total	$13,427

Rental expense was approximately $4.8 million, $3.9 million and $2.4 million for the years ended December 31, 2013, 2012 and 2011, respectively.

14 Earnings per Share

A summary of the calculation of basic and diluted earnings per share (EPS) for the years ended December 31, 2013, 2012 and 2011 is as follows:

(In thousands, except for per share amounts)	2013	2012	2011
Numerator			
Net Income	$45,794	$47,263	$138,577
Denominator			
Weighted average number of shares—basic	59,001	63,259	64,145
Effect of dilutive securities:			
Stock options	390	488	1,236
Restricted stock and restricted stock units	33	27	35
Weighted average number of shares—diluted	59,424	63,774	65,416
Net income per share—basic	$0.78	$0.75	$2.16
Net income per share—diluted	$0.77	$0.74	$2.12

For each of the years ended December 31, 2013, 2012 and 2011, 3.2 million, 3.2 million and 1.2 million stock options were outstanding but were not included in the computation of that year's diluted EPS because the options' exercise prices were greater than the average market price of the common shares, therefore making them anti-dilutive under the treasury stock method.

15 Summarized Quarterly Financial Data (Unaudited)

The following table presents unaudited quarterly operating results for each of our last eight fiscal quarters. This information has been prepared on a basis consistent with our audited financial statements and includes all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation of the data.

Unaudited Quarterly Operating Results

(In thousands, except for per share amounts)

Three Months Ended	March 31, 2013	June 30, 2013	September 30, 2013	December 31, 2013
Net sales	$143,013	$162,233	$177,404	$159,094
Gross profit	$69,677	$79,798	$82,547	$76,864
Operating income	$6,563	$14,053	$17,210	$10,639
Net income	$7,890	$9,859	$16,205	$11,840
Earnings per common share	$0.13	$0.17	$0.28	$0.21
Earnings per common share assuming dilution (1)	$0.13	$0.17	$0.28	$0.20
Three Months Ended	**March 31, 2012**	**June 30, 2012**	**September 30, 2012**	**December 31, 2012**
Net sales	$134,735	$183,998	$162,125	$139,756
Gross profit	$74,087	$95,201	$79,972	$67,383
Operating income	$16,181	$26,838	$10,276	$2,874
Net income	$12,960	$21,070	$9,272	$3,961
Earnings per common share	$0.20	$0.33	$0.15	$0.06
Earnings per common share assuming dilution (1)	$0.20	$0.33	$0.15	$0.06

(1) Assumes exercise of dilutive stock options calculated under the treasury stock method.

16 Related Party Transactions

We employ the law firm of our director emeritus for legal services. All bills for services rendered by this firm are reviewed and approved by our Chief Financial Officer. We believe that the fees for such services are comparable to those charged by other firms for services rendered to us. For the years ended 2013, 2012 and 2011, we incurred fees of $10 thousand per month for these legal services.

17 Subsequent Events

On January 21, 2014, the Board declared a quarterly cash dividend of $0.09 per common share to be paid to shareholders of record at the close of business on February 6, 2014. The quarterly dividend payment was $5.1 million and was paid on February 20, 2014. In July 2003, our Board of Directors elected to begin declaring quarterly dividends on our common stock considering the tax treatment of dividends and adequate levels of Company liquidity.

In February 2014, we made a decision to make a $16.5 million principal payment on the Amended and Restated Bond. The restricted certificate of deposit included in our long-term investments will be reduced by the amount of the payment. We anticipate this payment will be made during the first quarter of 2014.

As of February 27, 2014, we have repurchased 0.4 million shares of our common stock through open market purchases at an average cost of $25.13 per share. We currently have the authority to purchase an additional 3.1 million shares of our common stock under the current plan approved by the Board of Directors.

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