ADTRAN INC
Form 10-K
February 27, 2014
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

**FOR ANNUAL AND TRANSITION REPORTS**

**PURSUANT TO SECTION 13 OR 15(d)**

**OF THE SECURITIES EXCHANGE ACT OF 1934**

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

**For the Fiscal Year Ended December 31, 2013**

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

**For the Transition Period from _____ to _____**

**Commission file number 0-24612**

# ADTRAN, Inc.

**(Exact name of registrant as specified in its charter)**

| **Delaware** | **63-0918200** |
|---|---|
| **(State of Incorporation)** | **(I.R.S. Employer Identification Number)** |
| **901 Explorer Boulevard** | |
| **Huntsville, Alabama 35806-2807** | **(256) 963-8000** |
| **(Address of principal executive offices, including zip code)** | **(Registrant s telephone number, including area code)** |

**Securities registered pursuant to Section 12(b) of the Act:**

| **Title of Each Class:** | **Name of Each Exchange on which Registered** |
|---|---|
| **Common Stock, par value $0.01 per share** | **NASDAQ Global Select Market** |

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

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes x No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Securities Exchange Act. Yes ¨ No x

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (232.405 of this chapter) during the preceding 12 months (or for shorter period that the Registrant was required to submit and post such files). Yes x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one)

| | |
|---|---|
| Large Accelerated Filer x | Accelerated Filer ¨ |
| Non-accelerated Filer ¨ | Smaller Reporting Company ¨ |

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

The aggregate market value of the registrant s outstanding common stock held by non-affiliates of the registrant on June 30, 2013 was $1,424,546,508 based on a closing market price of $24.62 as quoted on the NASDAQ Global Select Market. There were 56,643,368 shares of common stock outstanding as of February 10, 2014.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 14, 2014 are incorporated herein by reference in Part III.

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**ADTRAN, Inc.**

**Annual Report on Form 10-K**

**For the Fiscal Year Ended December 31, 2013**

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**PART I**

***ITEM 1. BUSINESS***

***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.

We were incorporated under the laws of Delaware in November 1985, and commenced operations in January 1986. We are headquartered in Cummings Research Park in Huntsville, Alabama. The mailing address at our headquarters is 901 Explorer Boulevard, Huntsville, Alabama, 35806. The telephone number at that location is (256) 963-8000.

***Products and Services***

We maintain two operating divisions based on our product and service offerings: the Carrier Networks Division and the Enterprise Networks Division. These divisions serve two distinct markets and support sales globally, operating as two reportable segments. In 2013, sales of Carrier Networks products accounted for 78.0% of total revenue, while sales of Enterprise Networks products accounted for 22.0%. Sales to countries outside of the United States are included in these aggregate divisional figures, but when accounted for separately, comprised 28.9% of total revenue. For more financial information about these divisions and geographic areas, see Note 12 to the Consolidated Financial Statements included in this report.

Our Carrier Networks Division offers broadband infrastructure products and services used by service providers to deliver voice, data and video services to their customers premises and mobile network cell sites. These products are typically located in central office exchanges or outside plant cabinets, and infrastructure locations for mobile networks. Our Enterprise Networks Division provides Cloud Connectivity solutions, such as IP business gateways and access routers, which provide business access to service provider networks, and Enterprise Communications solutions, which enable businesses to construct voice, data and video networks within the customers site or among distributed sites. These products are sold through service providers in the form of bundled business services and solutions resale, and through value-added resellers (VARs).

Both of our divisions are positioned with product and service offerings that compete in the global communications industry and, specifically, in the areas of Ethernet and Internet Protocol (IP) based networks. As networks continue to migrate to IP-based architectures to deliver and utilize higher-bandwidth services, we have strengthened our technologies in our core product areas: Broadband Access, Optical and Internetworking.

*For a discussion of risks associated with our products see Risk Factors We must continue to update and improve our products and develop new products in order to compete and to keep pace with improvements in communications technology , and Risk Factors If our products do not interoperate with our customers networks, installations may be delayed or cancelled, which could harm our business , in Item 1A of this report.*

***Broadband Access Infrastructure for Advanced Services***

Historically, service providers have deployed independent networks to meet the needs of their residential, enterprise and mobile backhaul customers, with each network developed for their specific needs. As a result, the current state of communications operators networks is comprised of disparate overlay networks. Today, service providers are being challenged to deliver Gigabit-ready residential services, high-bandwidth and widely available cloud connectivity services for enterprise customers, and scalable Ethernet and optical networking for mobile backhaul and data center connectivity, requiring varying service level agreements (SLAs) and simplified service automation requirements. In response to this demand, we are seeing a fundamental shift toward IP network convergence. Communications service providers have four fundamental network priorities: (1) high-capacity residential services, (2) enterprise services, (3) the expansion of 4G/LTE (fourth-generation mobile/Long Term Evolution) and carrier-based Wi-Fi networks and (4) data center connectivity for cloud services.

Communication network operators are working to transition their networks to a single all-fiber, cloud-controlled future state for ubiquitous converged service delivery. Service providers plan to support the full range of residential, enterprise and mobile backhaul services over a common, next-generation network capable of supporting each segment s advanced service management. It is becoming impractical to continue the proliferation of separate overlay networks to address each of these market segment needs. We believe that we are positioned to deliver

flexible network solutions that enable network operators to meet today s service demands, while enabling the transition to the fully converged, scalable, highly automated, cloud-controlled voice, data and video networks of the future.

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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

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.

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***Carrier Networks Division***

Carrier service providers are focused on accelerating the delivery of broadband, business and mobile revenue-generating services while streamlining and automating their network. We deliver flexible next-generation access products that enable service providers to reduce network costs and speed the delivery of services to connect greater numbers of customers at higher speeds and with better quality of experience, allowing for new revenue generation and decreased customer churn. Our Carrier Networks Division supplies the network access products, services and support that these service providers require to connect their customers to core transmission and switching networks. Specifically, we deliver last-mile broadband solutions that enable high-speed digital services. Our customer base includes many of the major service providers around the globe (including Incumbent Local Exchange Carriers (ILECs), Competitive Local Exchange Carriers (CLECs), and Cable Multi-service Operators (MSOs)) and many U.S.-based independent operating companies, utilities, municipalities and wireless service providers. We initially focused on opportunities in North America, but we have significantly increased our customer penetration in the EMEA (Europe, Middle East and Africa) region, Latin America, as well as other regions of the world, aided by the 2012 acquisition of the NSN (formerly Nokia Siemens Networks) Broadband Access business (NSN BBA business).

Carrier services enabled using our Ethernet-based systems, include traditional voice services, VoIP, IPTV, RF Video, high-speed Internet access, mobile broadband and data services based on Ethernet, frame relay, TDM, and ATM technologies. These services connect the network with user components such as switches, routers, gateways, IADs, PBXs and wireless LAN products. Our devices are deployed at business sites and enable carriers to provide Ethernet services to SMEs and distributed enterprises. Our solutions provide a complete end-to-end solution for carriers by supporting both new fiber-based infrastructure and enabling them to reuse their existing copper infrastructure. This lowers their overall cost to deploy advanced Ethernet services to SMEs and distributed enterprises.

Products marketed under the Total Access® and hiX brands are platforms that can accommodate the demand for a variety of high-speed Internet, voice, data and video services from businesses and residential customers. Our Total Access product portfolio is focused on the American National Standards Institute (ANSI) markets for residential and business broadband applications and global markets for Carrier Ethernet and Packet Optical applications. Our hiX product portfolio is focused on the European Telecommunications Standards Institute (ETSI) markets for residential and business broadband applications and is deployed in central exchanges, outside plant cabinets or multi-tenant units. These modular, scalable and geographically distributed products offer advantages such as lower start-up costs, more flexible service deployment, greater network interface options, increased bandwidth, grow-as-you-go modularity and centralized network management. Our products connect to both fiber optic and copper network backbones, making them suitable for installation in many parts of the network and enabling deployment of a wide range of voice, video and data services around the world.

The Total Access products, as well as other ADTRAN products, are accepted by the USDA Rural Utilities Service (RUS) as suitable for use in RUS-financed communications systems. Deployed in central offices, remote terminals, or multi-tenant units, the Total Access® system encompasses carrier-class solutions for fiber and copper broadband multi-service access, DSL access, Carrier Ethernet access and narrowband multi-service access.

***Advanced IP Services***

Our broadband access products provide service providers the ability to increase bandwidth and improve the quality of services to customers. These products are used in high-density central office applications, as well as lower-density applications that include remote terminals and outside plant deployments. These products are available in models that are temperature hardened for use in harsh, outside-plant environments and provide support for Ethernet delivery of advanced IP services over fiber or copper as well as legacy TDM and ATM networks.

***High-speed Residential Services***

Designed with fiber deployment in mind, our Total Access 5000 provides high-capacity switching and bandwidth for FTTP services based on advanced optical standards. It also provides other ultra-broadband services based on advanced copper technologies. FTTP networks are based on the GPON standard. There are two key network components, the Optical Line Terminals (OLTs) and the customer-side ONT. The OLT is typically located in communications exchanges and other network Central Offices within MSANs. For ADTRAN, both the hiX5600 and the Total Access 5000 MSANs house the OLT modules. The OLT provides Gigabit levels of bandwidth shared or dedicated across thousands of subscribers enabling the delivery of advanced solutions like IPTV across an all-Ethernet architecture. On the other end of the FTTP network, every subscriber s home has a provider-owned ONT that terminates the fiber optics from the OLT and converts the optical signals to electric signals, enabling the in-home network to deliver voice, Internet and video services. Customer-owned devices, such as computers, usually expect Ethernet, a standard networking technology, making an all-Ethernet solution preferable. Our portfolio of ONTs, including the Total Access 300, 400 and 500 Series and ADTRAN Certified ONTs, provides carriers with a widely differentiated set of service delivery options for residential, business and mobile backhaul opportunities.

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To accelerate the penetration of 100Mbps and Gigabit services at the lowest cost per bit deployed, both the Total Access and hiX-based platforms allow service providers to realize ultra-broadband speeds over their existing copper infrastructure. This economically secures the broadband connection to the home and enables the delivery of advanced communications and entertainment services. Capabilities like VDSL2 vectoring (a new cross-talk cancellation technology that expands typical 30 50Mbps DSL rates to 100Mbps) are actively being deployed to help service providers overcome the challenge of using existing copper facilities to compete with 100Mbps and higher service offerings without the need to invest in or overcome the obstacles often associated with end-to-end FTTP networks.

The Total Access 1100 Series of environmentally sealed broadband access products provides an innovative approach to the successful deployment of FTTN architectures. Recognizing the technological and economic barriers of traditional cabinet-based DSL deployments, we designed this series of products to eliminate the need for expensive cabinet enclosures, heat exchangers and site construction, which account for a large portion of the total cost of deployment. In many cases, Total Access 1100 Series DSLAMs can deliver FTTN-based services for significantly less than traditional cabinet-based systems. This flexibility, combined with VDSL2 with system level vectoring, allows carriers to economically utilize the capacity of the existing copper network over the last mile.

The hiX series can be positioned as a residential MSAN delivering high density DSL and voice technologies. The hiX MSAN also supports residential point-to-point fiber applications. The product series leverages the latest technology in next generation VDSL2 with vectoring. Additionally, the hiX has a comprehensive voice feature set for ETSI markets.

***Business Ethernet Services***

Business Ethernet is growing with the proliferation of packet-based infrastructure in both enterprise and carrier networks. The implementation of Ethernet throughout the communications network provides benefits in equipment and operational savings. While Gigabit speeds are increasingly becoming available throughout the access network, they are far from being widespread. Ethernet s increasing presence throughout the network is driving costs down, resulting in increasing availability to business customers. We provide Metro Ethernet Forum (MEF) compliant products that enable the delivery of these services.

We have a complete portfolio of solutions for Business Ethernet services utilizing Fiber (EoF), Copper (EoCu) and TDM (EoTDM). These solutions enable cost-effective business Ethernet service delivery across a variety of network infrastructures. The Total Access 5000 supports standards-based copper pair bonding of xDSL loops for direct Ethernet service delivery. Leveraging a complete end-to-end solution with NetVanta 800 and NetVanta 8000 Series network termination equipment, the Total Access 5000 also offers an innovative approach to delivering Ethernet services by aggregating bonded copper, bonded circuits, and fiber, while supporting multi-megabit rates for MEF certified carrier Ethernet circuits. This combination allows carriers to offer Ethernet services across the entire network, enabling new revenue-generating services for businesses.

***Packet Optical Networking and Optical Access***

Mobile networks that were originally built for voice communications are now being optimized for data applications, putting strain on the mobile backhaul network. With the introduction of carrier-class Ethernet technologies, operators can now take advantage of fiber facilities to achieve the highest traffic carrying capacity utilization of their embedded investment and provide a network migration path toward an all-packet network. With the integration of EoF in the Total Access 5000 and NetVanta 8000 platforms, we offer a scalable solution that supports service migration as providers continue to strive to meet the customer demand for greater bandwidth. As wireless needs continue to grow, EoF is an ideal transport method for mobile backhaul networks and enables long-haul reach to residential and business networks.

ONE has been added to our product portfolio to enable high-performance packet optical services at the network edge and integrated optical transport solutions. ONE solutions combine right-sized core packet optical networking like miniature Reconfigurable Optical Add Drop Multiplexer (mini-ROADM), Wave Division Multiplexing (WDM), Scalable Carrier Ethernet, Optical Transport Network (OTN), and SONET/SDH with high-speed access services in the Total Access 5000 MSAN. ONE modules fit into the installed base or new deployments of the Total Access 5000 to deliver integrated access, aggregation, and transport enabling service providers to simplify service delivery and network operation to improve profitability. ONE enables service providers to deliver, aggregate, and transport carrier-grade services, including multiple 10Gbps interfaces. The ONE portfolio supports agile photonics and tunable pluggable optics. These advancements provide operators with a flexible, efficient and scalable network architecture, improving their market responsiveness and the transition from circuit-based to packet optical services.

Our OPTI® product family includes a multi-service provisioning platform, the OPTI-6100®, delivering high-speed Ethernet connectivity and transport to cellular sites using a variety of fiber optic ring architectures. Our OPTI-3® fiber multiplexer provides OC-3 capacity in terminal mode and DS3 range extension applications. The OPTI-6100 chassis is available in small (SMX), medium (MX) and large (LMX) options

addressing a broad range of applications with a variety of mounting options to meet unique customer requirements.

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All of these products enable wireless and wireline service providers to more efficiently handle network traffic by consolidating multiple circuits into a single facility, upgrading their networks to support next-generation services, and improving backhaul efficiency. These devices provide a migration path from TDM systems to Ethernet/IP networks and also support techniques for bonding multiple physical circuits into a single virtual circuit.

***Business-class Services***

HDSL is a common technology for delivering bandwidth at rates of 1.544 Mbps (known as the DS1 or T1 rate) for infrastructure support, business customer services, and wireless network mobile backhaul services. The T1 interface is universally accepted throughout the United States. Our HDSL products are manufactured in a variety of configurations for use in every major DS1 deployment platform for voice and data services. Outside the United States, our standards-based SHDSL products provide symmetrical solutions for the transport of high-speed, business-class services.

***Service and Support***

In addition to our product portfolio and standard pre-sales and post-sales technical support, the Carrier Networks Division offers a variety of services to provide customers with network implementation, maintenance and management services. Network implementation service offerings include engineering, site preparation, cabinet placement, installation, configuration, turn-up and test, training, project management services, and fully engineered pre-assembled, wired rack and cabinet assemblies. Maintenance services are designed to protect customers networks from unnecessary downtime. We offer services such as managed spares, extended warranty, and remote or on-site technical support beyond our standard warranty coverage. Management services facilitate remote management and monitoring of the service providers networks.

***Network Management***

As communications solutions and networks become more complex, the need for carrier-class management systems becomes vital to ensure operational efficiencies. A system-level view is necessary and service awareness is increasingly important. We develop and support systems to centralize the configuration, provisioning and management of our network access products. These systems are used to configure, monitor and control ADTRAN equipment installed in the network and ensure communication with the service provider s central management system to reduce technician dispatches and operating costs. Our Advanced Operational Environment products provide integrated, end-to-end, service-aware network management tools that enhance network planning, service activation, service assurance and decision support tools for our customers operations.

***Enterprise Networks Division***

Our Enterprise Networks Division delivers a full portfolio of networking and communications solutions tailored for small, medium and distributed enterprises. The portfolio includes Cloud Connectivity solutions, such as IP business gateways and access routers, which provide business access to service provider networks, and Enterprise Communications solutions, which enable businesses to construct voice, data and video networks within the customer s site or among distributed sites. These products are sold through service providers in the form of bundled business services and solutions resale, and through VARs.

With the increased speed, capacity and availability of broadband services to businesses and the proliferation of mobile broadband devices such as smartphones and tablets, both service providers and enterprises are rapidly migrating to cloud-based services and wireless solutions for their communications and networking needs. Businesses of all sizes are increasingly using the cloud for voice, data, video, computing, storage and applications. As business workers adopt mobile devices both inside and outside the physical office, convergence with fixed VoIP and UC solutions are emerging. Voice-capable wireless networks in the enterprise are beginning to converge with wired networks. This wireless-wireline convergence, along with the convergence of voice, data, and messaging from any location or device results in increased employee efficiency and productivity. Our Enterprise Networks Division is addressing these major market shifts by focusing on solutions in two key areas: Cloud Connectivity and Enterprise Communications.

***Cloud Connectivity***

Our Cloud Connectivity solutions allow service providers to deliver hosted and bundled service offerings that enable businesses to connect to the public or private cloud. These bundled service offerings are enabled by our Total Access and NetVanta IP Business Gateway (IPBG) and NetVanta Access Router solutions. Service offerings that are delivered utilizing our Cloud Connectivity solutions include: Hosted Voice and Unified Communications, Hosted Wireless Local Area Networking (WLAN), Business Internet Access, Business Ethernet, Private Network, Session Initiation Protocol (SIP) Trunking, Enterprise Session Border Control (eSBC) functionality, Managed UC, and SIP Trunking with PBX.

Our Enterprise Network Division solutions offered as key elements of these service provider business bundles are our Cloud Connectivity portfolio of IPBGs and Access Routers (used to provide connectivity to the business location), and our Enterprise Communications portfolio of vWLAN, Ethernet Switches, and UC solutions (used to provide the business productivity component of the service provider bundled services).

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Our Total Access and NetVanta IPBGs and NetVanta Access Routers are deployed by service providers at the demarcation point of the customer premises. An IPBG combines the functionality of a voice gateway, multiservice router and firewall into a single device. Our products offer an integrated, cost-effective platform for delivering cloud services to enterprise customers. Our multiservice routers move data between networked computers over public or private IP, Frame Relay, Multi-Protocol Label Switching (MPLS) leased-line infrastructures, or carrier-supplied Ethernet services. These devices provide features to route traffic between multiple destinations, secure the network against cyber-attacks, ensure the privacy of data as it is transported across the Internet, and restore communications in the event of equipment or network failure. Our multiservice routers provide Internet access and interconnect corporate locations. The NetVanta router portfolio, provided in modular and fixed port configurations, offers an assortment of business-class features including: Quality of Service (QoS), Firewall, VPN, Network Performance Monitoring and Voice Quality Monitoring (VQM). These features enable carriers to offer the highest quality service at an advantageous Total Cost of Ownership (TCO).

***Enterprise Communications***

Our Enterprise Communications solutions are premises-based and enable businesses to become more productive and capable through efficient communications. We provide enterprises with solutions from the network edge to the desktop that create business efficiency and capability, while driving employee productivity. Our Enterprise Communications solutions simplify network support and ensure ease of scalability, all while lowering the TCO. These solutions include unified communications and wireless and wireline LAN infrastructure solutions.

Our Bluesocket vWLAN solutions deliver complete endpoint freedom across the enterprise by utilizing virtualized, cloud-based solutions for connectivity, communications and collaboration. With the proliferation of smart phones, tablets and wireless devices, end-users are now dictating which devices should be supported across the enterprise. This Bring Your Own Device (BYOD) trend has forced the proliferation of wireless connectivity campus wide, and is no longer limited to conference rooms and building lobbies. Users now expect to be able to roam seamlessly across the enterprise campus while maintaining a persistent IP session to support voice, video and other wireless applications without interruption. Bluesocket vWLAN solutions allow users to access enterprise resources anytime, anywhere, on any device and deliver a unified service experience. These solutions leverage the scalability, reliability and cost benefits of virtualization and are cloud-ready for easy deployment and management and complement our portfolio of internetworking solutions.

Our NetVanta managed Layer 2 and Layer 3 (L2/L3) Ethernet switches complement our Bluesocket vWLAN solutions, providing integrated wireless/wireline LAN deployments and connectivity from the WAN to the end user s desktop computer and IP Phone. Our managed L2/L3 switches offer speeds up to ten Gigabit and include Power over Ethernet (PoE) options for powering IP phones, wireless network access points, IP cameras and other critical business networking devices.

Our NetVanta UC solutions enable businesses with up to 2,000 employees realize the benefits of UC. These UC products deliver end-to-end Unified Communications that bridge the gap between telephony, desktop communications productivity and business processes. Utilizing CEBP, NetVanta UC solutions enable businesses to increase workforce productivity and improve customer service. Our 7000 Series IP Communications solutions deliver an integrated, single-box solution for small business communications needs and combine the features of an IP PBX with the functionality of an Ethernet switch, a multi-service router, security features and WAN connectivity. Our NetVanta UC Server enables CEBP while providing simplicity and value to businesses that want to make a smooth transition from simple telephony to a UC solution without sacrificing PBX and business systems investments. There are five platforms in the NetVanta UC solutions portfolio: NetVanta 7000 UC Appliances, NetVanta UC Server, NetVanta Business Application Server, NetVanta Enterprise Communications Server and NetVanta Business Communications System.

***Common Internetworking Software***

We view the continued development and evolution of our internetworking software as critical to our success in bringing feature-rich, reliable, solutions to market. As such, our internetworking software is common across many of our products, optimizing our product development resources and minimizing time to market for new products and features. It also ensures common configuration practices, policies, protection schemes, and management interfaces for our carrier customers providing an advantage from a TCO perspective.

***Configuration and Network Management***

We develop and support network productivity tools and systems to centralize the configuration and management of our internetworking products. These tools aid in the management of networks powered by our internetworking products and include the nCommand Managed Service Provider (MSP) management platform. nCommand MSP streamlines service providers product life cycle management efforts including remote monitoring and management of NetVanta or Total Access solutions. A web-based platform, nCommand MSP simplifies new device deployment and enables MSPs, service providers and enterprise IT organizations to deliver on SLAs, improve customer service response time,

reduce network downtime and proactively monitor and report network performance, all while reducing operational costs.

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***Service and Support***

In addition to our product portfolio, we offer technical support services to ensure we are responsive to customers who have deployed our networking and infrastructure solutions. We provide pre-sales and post-sales technical support and a variety of training options. We also offer a complete portfolio of professional services under our ProServices organization. We offer ProStart installation and ProCare maintenance services designed to protect customers networks from unnecessary downtime. ProServices guarantees priority access to technical support engineers and offers five different maintenance programs ranging from five days-a-week, eight hours-a-day and next business day equipment replacement to seven days-a-week, 24 hours-a-day and equipment replacement within four hours of notification. Our service and support offerings are available to all of our customers.

We began offering hosted and managed cloud services in 2013 as an extension of our ProServices organization. ProCloud Wi-Fi offers a fully managed, business-class Wi-Fi service, built on Bluesocket vWLAN. ProCloud Wi-Fi service is flexible and scalable, ensures a secure, reliable wireless network, provides proactive 7x24 network monitoring and management reports, and includes turn-key services to reduce IT support burdens. When coupled with ProStart and ProCare, our ProCloud service offers complete, turn-key wireless LAN installation, maintenance and management.

***Customers***

We have a diverse customer base which is segmented based on the markets served, and typically within each of our two divisions.

Customers of our **Carrier Networks Division** include major service providers, independent communications operating companies, competitive service providers, Internet service providers, utilities, municipalities and wireless service providers. Major service providers and many smaller providers require product approval prior to adopting a vendor s products for use in their networks. We are involved in a constant process of submitting new and succeeding generations of products for approval. Our products are widely deployed in many of the service provider networks.

Customers of our **Enterprise Networks Division** in the United States include major service providers, independent communications companies and competitive service providers. Additionally, SME organizations purchase our solutions through a two-tier distribution channel. The two-tier distribution channel is comprised of several large distributor partners and an extensive network of VARs as described in Distribution, Sales and Marketing below. Furthermore, our Enterprise Networks solutions are deployed internationally in various regions. Vertical markets where our solutions are used include retail, food service, healthcare, finance, government, education, manufacturing, military, transportation, hospitality and energy/utility.

Two customers, CenturyLink, Inc. and Deutsche Telekom AG, comprised more than 10 percent of our revenue in 2013. The revenues from these customers are reported in both the Carrier Networks and Enterprise Networks segments.

*For a discussion of risks associated with customers, service providers and approval processes, see Risk Factors The lengthy approval process required by major and other service providers for new products could result in fluctuations in our revenue , Risk Factors We depend heavily on sales to certain customers; the loss of any of these customers would significantly reduce our revenues and net income , and Risk Factors Consolidation and deterioration in the competitive service provider market could result in a significant decrease in our revenue , in Item 1A of this report.*

***Distribution, Sales and Marketing***

We sell our **Carrier Networks** products globally through a combination of a direct sales organization and a distribution network. Our direct sales organization supports major accounts and has offices located in a number of domestic and international locations. Sales to most competitive service providers and independent telephone companies are fulfilled through a combination of direct sales and major technology distribution companies.

Prior to placing any orders, service providers typically require lengthy product qualification and standardization processes that can extend for several months or years. Orders, if any, are typically placed under single or multi-year supply agreements that are generally not subject to minimum volume commitments. Service providers generally prefer having two or more suppliers for most products, so individual orders are usually subject to competition based on some combination of total value, service, price, delivery, and other terms.

Similar to Carrier Networks products, Enterprise Networks products are fulfilled through a combination of direct sales and major technology distribution companies. This is supported by a direct sales organization for major accounts, and a channel-based sales organization to facilitate

sales to our partners. VARs and system integrators may be affiliated with the company as a channel partner, or they may purchase from a distributor in an unaffiliated fashion. Affiliated partners participate with us at various program levels, based on sales volume and other factors, to receive benefits such as product discounts, market development funds, technical support and training. We maintain field offices world-wide to support direct sales, distributors, VARs and system integrators.

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Outside of the United States, most Carrier products are sold through our direct sales organization and Enterprise products are sold through distribution arrangements customized for each region. Each region is supported by a field office that offers sales and support functions, and in some cases, warehousing and manufacturing support.

Our field sales organizations, distributors, and service provider customers receive support from regional-based marketing, sales, and customer support groups. Under certain circumstances, other headquarters personnel may be involved in sales and other activities.

***Research and Development***

Rapidly changing technologies, evolving industry standards, changing customer requirements, and continuing developments in communications service offerings characterize the markets for our products. Our continuing ability to adapt to these changes and to develop new and enhanced products that meet or anticipate market demand is a significant factor influencing our competitive position and our prospects for growth.

During 2013, 2012, and 2011, product development expenditures totaled $131.1 million, $126.0 million, and $100.3 million, respectively. Our product development activities are an important part of our strategy. Because of rapidly changing technology and evolving industry standards, we plan to maintain an emphasis on product development each year.

We strive to deliver innovative network access solutions that lower the total cost of deploying services, increase the level of performance achievable with established infrastructures, reduce operating and capital expense for our customers, increase network bandwidth and functionality, and extend network reach. Our development process is conducted in accordance with ISO 9001, TL 9000, and ISO 14001, which are international standards for quality and environmental management systems.

We develop most of our products internally, although we sometimes license intellectual property for use in certain products. Internal development gives us more control over design and manufacturing issues related to our products and closer control over product costs. Our ability to continually reduce product costs is an important part of our overall business strategy. Our product development efforts are often centered on entering a market with improved technology, allowing us to offer products at competitive prices. We then compete for market share. We continually re-engineer successive generations of the product to improve our product costs.

Product development activities focus on products to support both existing and emerging technologies in the communications industry in segments of our markets that we consider viable revenue opportunities. We are actively engaged in developing and refining technologies to support data, voice, and video transport primarily over IP/Ethernet network architectures. This includes Ethernet aggregation, fiber optic transport and access, DSL access, access routing, Ethernet switching, wireless LANs, integrated access, converged services, VoIP, network management, and professional services.

A centralized research function supports product development efforts throughout the company. This group provides guidance to our various product design and engineering teams in digital signal processing technologies, computer simulation and modeling, CAD/CAM tool sets, custom semiconductor design, industry standards, and technological forecasting.

Many communications issues, processes and technologies are governed by Standards Development Organizations (SDOs). These SDOs consist of representatives from various manufacturers, service providers and testing laboratories working to establish specifications and compliance guidelines for emerging communications technologies. We are an active participant in several SDOs and have assisted with the development of worldwide standards in many technologies.

Our SDO activities are primarily in the area of broadband access. This includes involvement with ITU-Telecommunications sector (ITU-T), ATIS, ETSI, NICC (UK Interoperability Standards), and the Broadband Forum (BBF). We continue to be involved in the evolution of optical access technologies, participating in activities in the ITU-T, ATIS, FSAN, and BBF on next-generation PON. We are also involved in standards development efforts related to maximizing the bandwidth potential of the copper pair to enable new applications. We participate in the ITU-T, where VDSL2, now with enhanced performance from G.Vector, and its short-range successor, G.Fast are being developed. We continue to be involved with the industry-wide interoperability, performance testing, and system-level projects related to those standards in the Broadband Forum. We are also members of MEF, Wi-Fi Alliance (WFA) and the ETSI Network Functions Virtualization Industry Specification Group (NFV-ISG).

*For a discussion of risks associated with our research and development activities, see Risk Factors We must continue to update and improve our products and develop new products in order to compete and to keep pace with improvements in communications technology and Risk Factors We engage in research and development activities to improve the application of developed technologies, and as a consequence may miss certain market opportunities enjoyed by larger companies with substantially greater research and development efforts who may focus on*

*more leading edge development , in Item 1A of this report.*

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***Manufacturing and Operations***

The principal steps in our manufacturing process include the purchase and management of materials, assembly, testing, final inspection, packing and shipping. We purchase parts and components for the assembly of some products from a large number of suppliers through a worldwide sourcing program. In addition, we manage a process that identifies the components that are best purchased directly by contract manufacturers for use in the assembly of our products to achieve manufacturing efficiency, quality and cost objectives. Certain key components used in our products are currently available from a single source, and other key components are available from only a limited number of sources. In the past, we have experienced delays in the receipt of certain key components, which has resulted in delays in related product deliveries. We attempt to manage these risks through developing alternative sources, by staging inventories at strategic locations, through engineering efforts designed to obviate the necessity of certain components, and by maintaining close contact and building long-term relationships with our suppliers.

We rely on subcontractors for assembly and testing of certain printed circuit board assemblies, sub-assemblies, chassis, enclosures and equipment shelves, and to purchase some of the raw materials used in such assemblies. We typically manufacture our lower-volume, higher-mix product assemblies at our manufacturing site in Huntsville, Alabama. We continue to build and test new product prototypes and many of our initial production units for our products in Huntsville, and later transfer the production of high-volume, low-mix assemblies to our subcontractors. Subcontract assembly operations can lengthen fulfillment cycle times, but we believe we can respond more rapidly to uncertainties in incoming order rates by selecting assembly subcontractors having significant reserve capacity and flexibility. Our subcontractors have proven to be flexible and able to meet our quality requirements. We conduct the majority of all transactions with our foreign suppliers in United States currency.

The majority of shipments of products to our U.S. customers occur from our facilities in Huntsville, Alabama, although we do fulfill customer orders from other locations near our customers sites. The majority of our products shipped to EMEA customers occur from locations in that region. We also ship directly from suppliers to a number of customers in the U.S. and international locations. Many of our facilities are certified pursuant to the most current releases of ISO 9001, TL 9000, and ISO 14001. Our Huntsville facilities are U.S. Customs-Trade Partnership Against Terrorism (C-TPAT) certified. Our products are also certified to certain other telephone company standards, including those relating to emission of electromagnetic energy and safety specifications.

*For a discussion of risks associated with manufacturing activities, see Risk Factors Our strategy of outsourcing a portion of our manufacturing requirements to subcontractors located in Asia or other international regions may result in us not meeting our cost, quality or performance standards and Risk Factors Our dependence on a limited number of suppliers may prevent us from delivering our products on a timely basis, which could have a material adverse effect on customer relations and operating results , in Item 1A of this report.*

***Competition***

We compete in markets for networking and communications equipment for service providers, businesses, government agencies and other organizations worldwide. Our products and services support the transfer of data, voice and video across service providers fiber, copper and wireless infrastructures, as well as across wide area networks, local area networks, and the Internet.

The markets for our products are intensely competitive. Numerous competitors exist in each of our product segments. Intensely competitive conditions and recent declines in economic activity have resulted in competitor consolidations, bankruptcies and liquidations. Consumer acceptance of alternative communications technologies such as coaxial cable and cellular-based services that compete with our products has grown in recent years. Competition might further increase if new technologies emerge, new companies enter the market, or existing competitors expand their product lines.

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For our **Carrier Networks Division**, factors influencing the markets in which we currently compete or may compete in the future include the ability to:

- Help the customer solve networking problems within the confines of restrained capital budgets;
- Offer globally competitive solutions against a different set of competitors than in the United States;
- Deliver solutions that fit the distributed networking model being deployed by most service providers;
- Deliver solutions for service provider networks as they increasingly focus on network transformation, convergence, and integration of services;
- Deliver solutions at attractive price points;
- Deliver reliability and redundancy, especially for higher bandwidth products;
- Adapt to new network technologies as they evolve;
- Compete effectively against large companies with greater resources;
- Deliver products when needed by the customer;
- Deliver responsive customer service, technical support and training; and
- Assist customers requiring pre-assembled, turnkey systems and professional services.

Competitors of our Carrier Networks Division include large, established companies such as Alcatel-Lucent, Ciena, ECI Telecom, Fujitsu, Huawei, Tellabs, and ZTE. There are also a number of smaller, specialized companies with which we compete, such as Actelis, Calix Networks, Cyan, Overture Networks, Zhone Technologies, and other privately held firms.

For our **Enterprise Networks Division**, factors influencing the markets in which we currently compete or may compete in the future include the ability to:

- Satisfy the customer s need for a cost-efficient alternative to established internetworking suppliers;
- Satisfy the customer s need to utilize the most cost-effective combination of transmission technologies to connect geographically dispersed locations;

Increase network performance and lower the customer s cost for communications services and equipment;

Add capacity and migrate to new or different technologies without a major system upgrade;

Continue to develop and support established platforms;

Offer products to address new networking technologies in a timely manner;

Deliver reliability and system backup, especially for higher bandwidth products;

Adapt to new network technologies as they evolve;

Deliver responsive customer service, technical support and training; and

Assist customers requiring hands-on installation and maintenance.

Competitors of our Enterprise Networks Division include: Aerohive, Aruba Networks, Avaya, Cisco Systems, Extreme Networks, Hewlett Packard, Juniper Networks, Ruckus, ShoreTel, and other smaller companies. Some of these companies compete in a single product segment, while others compete across multiple product lines.

*For further discussion of risks associated with our competition, see Risk Factors We must continue to update and improve our products and develop new products in order to compete and to keep pace with improvements in communications technology and Risk Factors We compete in markets that have become increasingly competitive, which may result in reduced gross profit margins and market share , in Item 1A of this report.*

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***Backlog and Inventory***

A substantial portion of our shipments in any fiscal period relate to orders received and shipped in that fiscal period for customers under agreements containing non-binding purchase commitments. Further, a significant percentage of orders require delivery within a few days. These factors normally result in very little order backlog or order flow visibility. Additionally, backlog levels may vary because of seasonal trends, timing of customer projects and other factors that affect customer order lead times. We believe that because we fill a substantial portion of customer orders within the fiscal quarter of receipt, backlog is not a meaningful indicator of actual sales for any succeeding period.

To meet this type of demand, we have implemented supply chain management systems to manage the production process. We also maintain a substantial finished goods inventory. Our practice of maintaining sufficient inventory levels to assure prompt delivery of our products and services increases the amount of inventory that may become obsolete. The obsolescence of this inventory may require us to write down the value of the obsolete inventory, which may have an adverse effect on our operating results.

***Government Regulation***

Our products must comply with various regulations and standards established by communications authorities in various countries, as well as those of certain international bodies. For instance, environmental legislation within the European Union (EU) may increase our cost of doing business as we amend our products to comply with these requirements. The EU issued directives on the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS), Waste Electrical and Electronic Equipment (WEEE), and the Registration, Evaluation, Authorization and Restriction of Chemicals (REACH). We continue to implement measures to comply with the RoHS directive, the WEEE directive and the REACH regulation as individual countries issue their implementation guidance.

*For further discussion of risks associated with government regulation, see Risk Factors Our products may not continue to comply with evolving regulations governing their sale, which may harm our business and Risk Factors Regulatory and potential physical impacts of climate change and other natural events may affect our customers and our production operations, resulting in adverse effects on our operating results , in Item 1A of this report.*

***Employees***

As of December 31, 2013, we had 2,010 full-time employees in the United States and in our international subsidiaries located in Canada, Mexico, the Asia-Pacific region, Europe and the Middle East region. The majority of ADTRAN GmbH employees, our subsidiary in Germany, are subject to collective bargaining agreements of either the Association of Metal and Electrical Industry in Berlin and Brandenburg e.V. or NORDMETALL Association of Metal and Electrical Industry e.V. A small number of our other employees are represented by a collective bargaining agreement. We have never experienced a work stoppage and we believe that our relationship with our employees is good.

We also utilize contractors and temporary employees in various manufacturing, engineering and sales capacities, domestically and internationally, as needed.

***Intellectual Property***

The ADTRAN corporate logo is a registered trademark of ADTRAN. The name ADTRAN is a registered trademark of ADTRAN. A number of our product identifiers and names also are registered. We claim rights to a number of unregistered trademarks as well.

We have ownership of over 500 patents world-wide related to our products and have over 180 additional patent applications pending, of which at least eight have been approved and are in the process of being issued by various patent offices world-wide. Our patents expire at various dates between May 2014 and June 2032. We will continue to seek additional patents from time to time related to our research and development activities. We do not derive any material amount of revenue from the licensing of our patents.

We protect our intellectual property and proprietary rights in accordance with good legal and business practices. We believe, however, that our competitive success will not depend on the ownership of intellectual property, but instead will depend primarily on the innovative skills, technical competence and marketing abilities of our personnel.

The communications industry is characterized by the existence of an ever-increasing volume of patent litigation and licensing activities. From time to time we receive and may continue to receive notices of claims alleging that we are infringing upon patents or other intellectual property. We cannot predict whether we will prevail in any claims or litigation over alleged infringements, or whether we will be able to license any valid and infringed patents, or other intellectual property, on commercially reasonable terms. It is possible that litigation may result in significant legal

costs and judgments. Any intellectual property infringement claims, or related litigation against or by us, could have a material adverse effect on our business and operating results.

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*For a discussion of risks associated with our intellectual property and proprietary rights, see Risk Factors Our failure to maintain rights to intellectual property used in our business could adversely affect the development, functionality, and commercial value of our products , in Item 1A of this report.*

***Available Information***

A copy of this Annual Report on Form 10-K, as well as our Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to these reports, are available free of charge on the Internet at our Web site, www.adtran.com, as soon as reasonably practicable (generally, within one day) after we electronically file these reports with, or furnish these reports to, the Securities and Exchange Commission (SEC). The reference to our Web site address does not constitute incorporation by reference of the information contained on the Web site, which information should not be considered part of this document. You may also read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (www.sec.gov) that contains our reports, proxy and information statements, and other information that we have filed electronically with the SEC.

***ITEM 1A. RISK FACTORS***

*The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by or on behalf of ADTRAN. ADTRAN and its representatives may from time to time make written or oral forward-looking statements, including statements contained in this report and our other filings with the SEC and other communications with our stockholders. Generally, the words, believe, expect, intend, estimate, anticipate, will, may, could and similar expressions identify forward-looking statements. We caution you that any forward-looking statements made by or on our behalf are subject to uncertainties and other factors that could cause these statements to be wrong. Some of these uncertainties and other factors are listed below. Though we have attempted to list comprehensively these important factors, we caution investors that other factors may prove to be important in the future in affecting our operating results. New factors emerge from time to time, and it is not possible for us to predict all of these factors, nor can we assess the impact each factor or combination of factors may have on our business.*

*You are further cautioned not to place undue reliance on those forward-looking statements because they speak only of our views as of the date the statements were made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.*

*The following are some of the risks that could affect our financial performance or could cause actual results to differ materially from those expressed or implied in our forward-looking statements:*

***Our operating results may fluctuate in future periods, which may adversely affect our stock price.***

Our operating results have been and will continue to be subject to quarterly and annual fluctuations as a result of numerous factors. These factors include, but are not limited to:

- Fluctuations in demand for our products and services, especially with respect to significant network expansion projects undertaken by communications service providers;
- Continued growth of communications network traffic and the adoption of communication services and applications by enterprise and consumer end users;
- Changes in sales and implementation cycles for our products and reduced visibility into our customers spending plans and associated revenue;

Reductions in demand for our legacy products as new technologies gain acceptance;

Our ability to maintain appropriate inventory levels and purchase commitments;

Price and product competition in the communications and networking industries, which can change rapidly due to technological innovation;

The overall movement toward industry consolidation among both our competitors and our customers;

Our dependence on sales of our products by channel partners, the timing of their replenishment orders, the potential for conflicts and competition involving our channel partners and large end use customers and the potential for consolidation among our channel partners;

Variations in sales channels, product cost or mix of products and services sold;

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Delays in receiving product acceptance from certain customers as defined under contract, for shipments near the end of a reporting period;

Our ability to maintain high levels of product support and professional services;

Manufacturing and customer order lead times;

Fluctuations in our gross margin, and the factors that contribute to this as described below;

Our ability to achieve cost reductions;

The ability of our customers, channel partners, and suppliers to obtain financing or to fund capital expenditures;

Our ability to execute on our strategy and operating plans;

Benefits anticipated from our investments in engineering, sales and marketing activities;

The effects of climate change and other natural events;

The effect of political or economic conditions, terrorist attacks, acts of war, or other unrest in certain international markets; and

Changes in tax laws and regulations, or accounting pronouncements.

As a result, operating results for a particular future period are difficult to predict, and prior results are not necessarily indicative of results to be expected in future periods. Any of the above mentioned factors, or other factors discussed elsewhere in this document, could have a material adverse effect on our business, results of operations and financial condition that could adversely affect our stock price.

***Our revenue for a particular period can be difficult to predict, and a shortfall in revenue may harm our operating results.***

As a result of the many factors discussed in this report, our revenue for a particular quarter is difficult to predict and will fluctuate from quarter to quarter. Our typical pattern of customer orders requests product delivery within a short period following receipt of an order. Consequently, we do not typically carry a significant order backlog, and are dependent upon obtaining orders and completing delivery in accordance with shipping terms that are predominantly within each quarter to achieve our targeted revenues. Our net sales may grow at a slower rate than in previous quarters or may decline. Our ability to meet financial expectations could also be affected if the variable sales patterns seen in prior quarters recur in future quarters. We have experienced periods of time during which manufacturing issues have delayed shipments, leading to variable shipping patterns. In addition, to the extent that manufacturing issues and any related component shortages result in delayed shipments in the future, and particularly in quarters in which we and our subcontractors are operating at higher levels of capacity, it is possible that revenue for a quarter could be adversely affected, and we may not be able to remediate the conditions within the same quarter.

In the past, under certain market conditions, long manufacturing lead times have caused our customers to place the same order multiple times. When this multiple ordering occurs, along with other factors, it may cause difficulty in predicting our sales and, as a result, could impair our ability to manage parts inventory effectively.

We plan our operating expense levels based primarily on forecasted revenue levels. These expenses and the impact of long-term commitments are relatively fixed in the short term. A shortfall in revenue could lead to operating results being below expectations because we may not be able to quickly reduce these fixed expenses in response to short-term business changes.

***The failure to realize future benefits from the acquisition of the NSN BBA business as significantly as we expect may affect our future results of operations and financial condition, and could affect our stock price.***

On May 4, 2012, we acquired the NSN BBA business. The future revenues of the NSN BBA business may be materially different from those shown in the 8-K, press release and analysts call announcing the planned acquisition transaction, which could reduce the anticipated benefits of the acquisition. Should this occur, we may experience an adverse effect on our business or negative reactions from the financial markets, which may cause a decrease in the market price of our stock.

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***General economic conditions may reduce our revenues and harm our operating results.***

Economic conditions may contribute to a slowdown in communications industry spending, including specific market segments in which we operate. The potential reoccurrence of these trends and their duration and depth are difficult to predict. Capital spending for network infrastructure projects of our largest customers could be delayed or cancelled in response to reduced consumer spending, tight capital markets or declining liquidity trends. Sustained trends of this nature could have a material, adverse effect on our revenues, results of operations and financial condition.

***Our exposure to the credit risks of our customers and distributors may make it difficult to collect accounts receivable and could adversely affect our operating results and financial condition.***

Most of our sales are made on an open credit basis, frequently with payment terms of 30 to 45 days in the United States and typically longer in many geographic markets outside the United States. As a result of our acquisition of the NSN BBA business, our sales to customers outside of the United States as a percentage of our total sales have increased, and our total accounts receivable balance will likely increase. Our days sales outstanding could also increase as a result of greater mix of international sales. Additionally, international laws may not provide the same degree of protection against defaults on accounts receivable as provided under United States laws governing domestic transactions; therefore, as our international business grows, we may be subject to higher bad debt expense compared to historical trends. Overall, we monitor individual customer payment capability in granting such open credit arrangements, seek to limit such open credit to amounts that we believe customers can pay, and maintain reserves we believe are adequate to cover exposure for doubtful accounts. In the course of our sales to customers, we may encounter difficulty collecting accounts receivable and could be exposed to risks associated with uncollectible accounts receivable. We may be exposed to similar credit risks relating to collections from distributors of our products, and we apply similar processes to monitor and reserve for any exposures. Turmoil in the financial markets could impact certain of our customers ability to maintain adequate credit facilities with financial institutions, thereby potentially impacting their ability to pay their debts. While we attempt to monitor these situations carefully and attempt to take appropriate measures to collect accounts receivable balances, there are no assurances we can avoid accounts receivable write-downs or write-off of doubtful accounts. Such write-downs or write-offs could negatively affect our operating results for the period in which they occur, and could potentially have a material adverse effect on our results of operations and financial condition.

***We expect gross margin to vary over time, and our level of product gross margin may not be sustainable.***

Our level of gross margins may not be sustainable and may be adversely affected by numerous factors, including:

- Changes in customer, geographic, or product mix, including the mix of configurations and professional services revenue within each product group;
- Introduction of new products by competitors, including products with price-performance advantages;
- Our ability to reduce product cost;
- Increases in material or labor cost;
- Expediting costs incurred to meet customer delivery requirements;
- Excess inventory and inventory holding charges;
- Obsolescence charges;

Changes in shipment volume;

Our ability to absorb fixed manufacturing costs during short-term fluctuations in customer demand;

Loss of cost savings due to changes in component pricing or charges incurred due to inventory holding periods if parts ordering does not correctly anticipate product demand;

Lower than expected benefits from value engineering;

Increased price competition, including competitors from Asia, especially China;

Changes in distribution channels;

Increased warranty cost;

Liquidated damages costs relating to customer contractual terms; and

Our ability to manage the impact of foreign currency exchange rate fluctuations relating to our accounts receivable and accounts payable.

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***We must continue to update and improve our products and develop new products in order to compete and to keep pace with improvements in communications technology.***

The markets for our products are characterized by rapidly changing technology, evolving industry standards, and continuing improvements in the communications service offerings of common service providers. If technologies or standards applicable to our products, or common service provider offerings based on our products, become obsolete or fail to gain widespread commercial acceptance, our existing products or products under development may become obsolete or unmarketable. Moreover, the introduction of products embodying new technologies, the emergence of new industry standards, or changes in common service provider offerings could adversely affect our ability to sell our products. For instance, we offer a large number of products that apply primarily to the delivery of high-speed digital communications over the local loop utilizing copper wire. We compete favorably with our competitors by developing a high-performance line of these products. We market products that apply to fiber optic transport in the local loop. We expect, however, that use of coaxial cable and mobile wireless access in place of local loop access will increase. Also, MSOs are increasing their presence in the local loop. To meet the requirements of these new delivery systems and to maintain our market position, we may have to develop new products or modify existing products.

Our sales and profitability in the past have, to a significant extent, resulted from our ability to anticipate changes in technology, industry standards and common service provider offerings, and to develop and introduce new and enhanced products. Our continued ability to adapt will be a significant factor in maintaining or improving our competitive position and our prospects for growth. We cannot assure that we will be able to respond effectively to changes in technology, industry standards, common service provider offerings or new product announcements by our competitors. We also cannot assure that we will be able to successfully develop and market new products or product enhancements, or that these products or enhancements will achieve market acceptance. Should the rate of decline in sales of certain traditional TDM based products exceed the rate of market acceptance and growth in sales of our newer IP-based products, our revenues may be adversely affected. Any failure by us to continue to anticipate or respond in a cost-effective and timely manner to changes in technology, industry standards, common service provider offerings, or new product announcements by our competitors, or any significant delays in product development or introduction, could have a material adverse effect on our ability to competitively market our products and on our revenues, results of operations and financial condition.

***Our products may not continue to comply with evolving regulations governing their sale, which may harm our business.***

Our products must comply with various regulations, regional standards established by communications authorities, import/export control authorities or other authorities who control the execution of trade agreements in various countries, as well as those of certain international bodies. Although we believe our products are currently in compliance with domestic and international standards and regulations in countries in which we currently sell, there can be no assurance that we will be able to design our products to comply with evolving standards and regulations in the future. Changes in domestic or international communications regulations, tariffs, application requirements, import/export controls or expansion of regulation to new areas, including access, communications or commerce over the Internet, may affect customer demand for our products or slow the adoption of new technologies which may affect our sales. Further, the cost of complying with the evolving standards and regulations, or the failure to obtain timely domestic or foreign regulatory approvals or certification such that we may not be able to sell our products where these standards or regulations apply, may adversely affect our results of operations and financial condition.

***Our failure or the failure of our contract manufacturers to comply with applicable environmental regulations could adversely impact our results of operations.***

The manufacture, assembly and testing of our products may require the use of hazardous materials that are subject to environmental, health and safety regulations. Our failure or the failure of our contract manufacturers to comply with any of these applicable requirements could result in regulatory penalties, legal claims or disruption of production. In addition, our failure or the failure of our contract manufacturers to properly manage the use, transportation, emission, discharge, storage, recycling or disposal of hazardous materials could subject us to increased costs or liabilities. Existing and future environmental regulations may restrict our use of certain materials to manufacture, assemble and test products. Any of these consequences could adversely impact our results of operations by increasing our expenses and/or requiring us to alter our manufacturing processes.

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***If our products do not interoperate with our customers networks, installations may be delayed or cancelled, which could harm our business.***

Our products must interface with existing networks, each of which may have different specifications, utilize multiple protocol standards and incorporate products from other vendors. Many of our customers networks contain multiple generations of products that have been added over time as these networks have grown and evolved. Our products may be required to interoperate with many or all of the products within these networks as well as future products in order to meet our customers requirements. If we find errors in the existing software or defects in the hardware used in our customers networks, we may have to modify our software or hardware to fix or overcome these errors so that our products will interoperate with the existing software and hardware. Such issues may affect our ability to obtain product acceptance from other customers. Implementation of product corrections involving interoperability issues could increase our costs and adversely affect our results of operations.

***The lengthy approval process required by major and other service providers for new products could result in fluctuations in our revenue.***

In the industry in which we compete, a supplier must first obtain product approval from a major or other service provider to sell its products to them. This process can last from six to 18 months, or longer, depending on the technology, the service provider, and the demand for the product from the service provider s subscribers. Consequently, we are involved in a constant process of submitting for approval succeeding generations of products, as well as products that deploy new technology or respond to new technology demands from a major or other service provider. We have been successful in the past in obtaining these approvals. However, we cannot be certain that we will obtain these approvals in the future or that sales of these products will continue to occur. Any attempt by a major or other service provider to seek out additional or alternative suppliers, or to undertake, as permitted under applicable regulations, the production of these products internally, could have a material adverse effect on our operating results. Furthermore, the delay in sales until the completion of the approval process, the length of which is difficult to predict, could result in fluctuations of revenue and uneven operating results from quarter to quarter or year to year.

***We engage in research and development activities to improve the application of developed technologies, and as a consequence may miss certain market opportunities enjoyed by larger companies with substantially greater research and development efforts who may focus on more leading edge development.***

A portion of our research and development activities are focused on the refinement and redefinition of access technologies that are currently accepted and commonly practiced, which may include emerging technologies not yet widely distributed across all networks. These research and development efforts result in improved applications of technologies for which demand already exists or is latent. We rarely engage in research projects that represent a vast departure from the current business practices of our key customers. This includes pioneering new services and participating in leading edge field trials or demonstration projects for new technologies. While we believe our strategy provides a higher likelihood of producing nearer term revenue streams, this strategy could reduce our ability to influence industry standards and share in the establishment of intellectual property rights associated with new technologies, and could result in lost revenue opportunities should a new technology achieve rapid and widespread market acceptance.

***We depend heavily on sales to certain customers; the loss of any of these customers would significantly reduce our revenues and net income.***

Historically, a large percentage of our sales have been made to major service providers and larger independent communications companies. In 2013, these customers continued to comprise over half of our revenue. As long as the major and larger independent communications companies represent such a substantial percentage of our total sales, our future success will significantly depend upon certain factors which are not within our control, including:

- the timing and size of future purchase orders, if any, from these customers;
- the product requirements of these customers;
- the financial and operational success of these customers;
- the impact of legislative and regulatory changes on these customers;

the success of these customers services deployed using our products; and

the impact of work stoppages at these customers.

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Sales to our large customers have, in the past, fluctuated and may fluctuate significantly from quarter to quarter and year to year. The loss of, or a significant reduction or delay in, sales to any such customer or the occurrence of sales fluctuations could have a material adverse effect on our business and results of operations. Further, any attempt by a major or other service provider to seek out additional or alternative suppliers or to undertake, as permitted under applicable regulations, the production of these products internally, could have a material adverse effect on our operating results.

There has been a trend toward industry consolidation in our markets for several years. We expect this trend to continue as companies attempt to strengthen or hold their market positions and as companies are acquired or are unable to continue operations. This could lead to variability in our operating results and could have a material adverse effect on our business, operating results, and financial condition. In addition, particularly in the service provider market, rapid consolidation will lead to fewer customers, with the effect that a loss of a major customer could have a material impact on our results that we would not have anticipated in a marketplace composed of more numerous participants.

***Our strategy of outsourcing a portion of our manufacturing requirements to subcontractors located in Asia or other international regions may result in us not meeting our cost, quality or performance standards.***

We are heavily dependent on subcontractors for the assembly and testing of certain printed circuit board assemblies, subassemblies, chassis, enclosures and equipment shelves, and the purchase of some raw materials used in such assemblies. This reliance involves several risks, including the unavailability of, or interruptions in, access to certain process technologies and reduced control over product quality, delivery schedules, transportation, manufacturing yields and costs. We may not be able to provide product order volumes to our subcontractors that are high enough to achieve sufficient cost savings. If shipments fall below forecasted levels, we may incur increased costs or be required to take ownership of excess inventory. Changes in international tariff structures could adversely impact our product costs. In addition, a significant component of maintaining cost competitiveness is the ability of our subcontractors to adjust their own costs to compensate for possible adverse exchange rate movements. To the extent that the subcontractors are unable to do so, and we are unable to procure alternative product supplies, then our own competitiveness and results of operations could be adversely impaired. These risks may be exacerbated by economic or political uncertainties, terrorist actions, the effects of climate change, natural disasters or pandemics in the foreign countries in which our subcontractors are located.

To date, we believe that we have successfully managed the risks of our dependence on these subcontractors through a variety of efforts, which include seeking and developing alternative subcontractors while maintaining existing relationships; however, we cannot be assured that delays in product deliveries will not occur in the future because of shortages resulting from this limited number of subcontractors or from the financial or other difficulties of these parties. Our inability to develop alternative subcontractors if and as required in the future, or the need to undertake required retraining and other activities related to establishing and developing a new subcontractor relationship, could result in delays or reductions in product shipments which, in turn, could have a negative effect on our customer relationships and operating results.

***Our dependence on a limited number of suppliers may prevent us from delivering our products on a timely basis, which could have a material adverse effect on customer relations and operating results.***

Certain raw materials and key components used in our products are currently available from only one source, and others are available from only a limited number of sources. The availability of these raw materials and supplies may be subject to market forces beyond our control. From time to time, there may not be sufficient quantities of raw materials and supplies in the marketplace to meet customer demand. Many companies utilize the same raw materials and supplies that we do in the production of their products. Companies with more resources than our own may have a competitive advantage in obtaining raw materials and supplies due to greater buying power. These factors can result in reduced supply, higher prices of raw materials, and delays in the receipt of certain of our key components, which in turn may generate increased costs, lower margins, and delays in product delivery, with a corresponding adverse effect on sales, customer relationships, and revenue. Furthermore, due to general economic conditions in the United States and globally, our suppliers may experience financial difficulties, which could result in increased delays, additional costs, or loss of a supplier. We attempt to manage these risks through developing alternative sources, by staging inventories at strategic locations, through engineering efforts designed to obviate the necessity of certain components, and by building long-term relationships and close contact with each of our key suppliers; however, we cannot assure you that delays in or failures of deliveries of key components, either to us or to our contract manufacturers, and consequent delays in product deliveries, will not occur in the future.

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The SEC has adopted disclosure requirements regarding the use of conflict minerals mined from the Democratic Republic of Congo and adjoining countries and procedures to identify the source of such minerals included in manufactured products. The required disclosures begin in 2014, and will require us to incur additional costs to verify the origins of the identified minerals used and comply with disclosure requirements. The implementation of these requirements could affect the availability of minerals used in the manufacture of a limited number of parts contained in our products. This may reduce the number of suppliers who provide conflict-free minerals, and may affect our ability to obtain products in sufficient quantities or at competitive prices. Our material sourcing is broad based and multi-tiered. While we are taking steps to identify sourcing based on recommended standards for our industry, we may not be able to conclusively verify the origins for all minerals used in our products. An inability to make a sourcing determination of minerals in our products could impact our revenues and harm our financial condition should our customers require that we certify that all components used in our products are free of minerals from this region.

***We compete in markets that have become increasingly competitive, which may result in reduced gross profit margins and market share.***

The markets for our products are intensely competitive. Additional manufacturers have entered the markets in recent years to offer products in competition with us. Additionally, certain companies have, in recent years, developed the ability to deliver competing products using coaxial cable and cellular transmission, especially in high-density metropolitan areas. Competition would further increase if new companies enter the market or existing competitors expand their product lines. Some of these potential competitors may have greater financial, technological, manufacturing, sales and marketing, and personnel resources than we have. As a result, these competitors may be able to respond more rapidly or effectively to new or emerging technologies and changes in customer requirements, withstand significant price decreases, or devote greater resources to the development, promotion, and sale of their products than we can.

In addition, our present and future competitors may be able to enter our existing or future markets with products or technologies comparable or superior to those that we offer. An increase in competition could cause us to reduce prices, decrease our market share, require increased spending by us on product development and sales and marketing, or cause delays or cancellations in customer orders, any one of which could reduce our gross profit margins and adversely affect our business and results of operations.

***Our estimates regarding future warranty obligations may change due to product failure rates, shipment volumes, field service obligations and other rework costs incurred in correcting product failures. If our estimates change, the liability for warranty obligations may be increased or decreased, impacting future cost of goods sold.***

Our products are highly complex, and we cannot assure you that our extensive product development, manufacturing and integration testing will be adequate to detect all defects, errors, failures and quality issues. Quality or performance problems for products covered under warranty could adversely impact our reputation and negatively affect our operating results and financial position. The development and production of new products with high complexity often involves problems with software, components and manufacturing methods. If significant warranty obligations arise due to reliability or quality issues arising from defects in software, faulty components, or manufacturing methods, our operating results and financial position could be negatively impacted by:

- costs associated with fixing software or hardware defects;
- high service and warranty expenses;
- high inventory obsolescence expense;
- delays in collecting accounts receivable;
- payment of liquidated damages for performance failures; and
- a decline in sales to existing customers.

***Managing our inventory is complex and may include write-downs of excess or obsolete inventory.***

Managing our inventory of components and finished products is complicated by a number of factors, including the need to maintain a significant inventory of certain components that are in short supply, have been discontinued by the component manufacturer, that must be purchased in bulk to obtain favorable pricing or that require long lead times. These issues may result in our purchasing and maintaining significant amounts of inventory, which if not used or expected to be used based on anticipated production requirements, may become excess or obsolete. Any excess or obsolete inventory could also result in sales price reductions and/or inventory write-downs, which could adversely affect our business and results of operations.

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***The continuing growth of our international operations could expose us to additional risks, increase our costs and adversely affect our operating results and financial condition.***

We are expanding our presence in international markets, which represented 28.9% of our net sales for 2013, and as a result, we anticipate increased sales and operating costs in these markets. This international expansion may increase our operational risks and impact our results of operations, including:

- Exposure to unfavorable commercial terms in certain countries;
- The time and cost to staff and manage foreign operations;
- The time and cost to maintain good relationships with employer associations and works councils;
- The time and cost to ensure adequate business interruption controls, processes and facilities;
- The time and cost to manage and evolve financial reporting systems, maintain effective financial disclosure controls and procedures, and comply with corporate governance requirements in multiple jurisdictions;
- The cost to collect accounts receivable and extension of collection periods;
- The cost and potential disruption of facilities transitions required in some business acquisitions;
- Less regulation of patents or other safeguards of intellectual property in certain countries;
- Potential impact of adverse tax, customs regulations and transfer-pricing issues;
- Exposure to global social, political and economic instability, and changes in economic conditions;
- Potential exposure to liability or damage of reputation resulting from a higher incidence of corruption or unethical business practices in some countries;
- Potential trade protection measures, export compliance issues, domestic preference procurement requirements, qualification to transact business and additional regulatory requirements;
- Potential exposure to natural disasters, epidemics and acts of war or terrorism.

The NSN BBA acquisition may result in future impairment charges and other cost amortizations and we cannot assure that revenues from the acquired business will offset any additional costs incurred. If we are unable to successfully address the potential risks associated with our overall international expansion, our operating results and financial condition may be negatively impacted.

***We may be adversely affected by fluctuations in currency exchange rates.***

As our international sales increase or as utilization of international suppliers expands, we may transact additional business in currencies other than United States currency. As a result, we will be subject to the possibility of greater effects of foreign currency exchange translation on our financial statements. Sales contract commitments and accounts receivable balances based on foreign currency expose us to potential risk of loss as the value of the United States dollar fluctuates over time. In addition, for those countries outside the United States where we have significant sales or significant purchases of supplies, devaluation in the local currency could make our products more expensive for customers to purchase or increase our operating costs, thereby adversely affecting our competitiveness. When appropriate, we may enter into various derivative transactions to enhance our ability to manage the volatility relating to these typical business exposures. If used, the derivative transactions will be intended to reduce, but not eliminate, the impact of foreign currency exchange rate movements; therefore, we generally would not anticipate hedging all outstanding foreign currency risk. There can be no assurance that exchange rate fluctuations in the future will not have a material adverse effect on our revenue from international sales, manufacturing costs, results of operations and financial condition.

***Our success depends on our ability to reduce the selling prices of succeeding generations of our products.***

Our strategy is to attempt to increase unit sales volumes and market share each year by introducing succeeding generations of products having lower selling prices and increased functionality as compared to prior generations of products. To maintain or increase our revenues and margins while continuing this strategy, we must continue, in some combination, to increase sales volumes of existing products, introduce and sell new products, or reduce our per unit costs at rates sufficient to compensate for the reduced revenue effect of continuing reductions in the average sales prices of our products. We cannot assure you that we will be able to maintain or increase revenues or margins by increasing unit sales volumes of our products, introducing and selling new products, or reducing unit costs of our products.

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***Breaches in our information systems could cause significant damage to our business and reputation.***

We maintain sensitive data on our information systems, including intellectual property, financial data and proprietary or confidential business information relating to our business, customers and business partners. The secure maintenance of this information is critical to our business and reputation. We rely upon a number of internal business processes and information systems to support key operations and financial functions, and the efficient operation of these processes and systems is critical. Companies are increasingly subjected to cyber-attacks and other attempts to gain unauthorized access. We have multiple layers of access control, and devote significant resources to data encryption and other security measures to protect our information technology and communications systems. We test our vulnerability periodically and take action to further secure our networks, yet our network and storage applications may be subject to unauthorized access by cyber-attack or breached due to operator error, fraudulent activity or other system disruptions. In some cases, it is difficult to anticipate or immediately detect damage caused by such incidents. Unauthorized access or disclosure of our information could compromise our intellectual property and expose sensitive business information. Our information systems are designed to appropriate industry standards to reduce downtime in the event of power outages, weather or climate events and cyber-security issues. A significant failure of our systems due to these issues could result in significant remediation costs, disrupt business operations, and divert management attention, which could result in harm to our business reputation, financial condition and operating results.

***Our failure to maintain rights to intellectual property used in our business could adversely affect the development, functionality, and commercial value of our products.***

Our future success depends in part upon our proprietary technology. Although we attempt to protect our proprietary technology by contract, trademark, copyright and patent registration, and internal security, these protections may not be adequate. Furthermore, our competitors can develop similar technology independently without violating our proprietary rights. From time to time we receive and may continue to receive notices of claims alleging that we are infringing upon patents or other intellectual property. Any of these claims, whether with or without merit, could result in significant legal fees; divert our management s time, attention and resources; delay our product shipments; or require us to enter into royalty or licensing agreements. We cannot predict whether we will prevail in any claims or litigation over alleged infringements, or whether we will be able to license any valid and infringed patents, or other intellectual property, on commercially reasonable terms. If a claim of intellectual property infringement against us is successful and we fail to obtain a license or develop or license non-infringing technology, our business, financial condition, and operating results could be affected adversely.

***Software under license from third parties for use in certain of our products may not continue to be available to us on commercially reasonable terms.***

We integrate third-party software into certain of our products. Licenses for this technology may not be available or continue to be available to us on commercially reasonable terms. Difficulties with third party technology licensors could result in termination of such licenses, which may result in increased costs or require us to purchase or develop a substitute technology. Difficulty obtaining and maintaining third-party technology licenses may disrupt development of our products and increase our costs, which could harm our business.

***We may incur liabilities or become subject to litigation that would have a material effect on our business.***

In the ordinary course of business, we accept purchase orders, and enter into sales and other related contracts, for the marketing, sale, manufacture, distribution, or use of our products and services. We may incur liabilities relating to our performance under such agreements, or which result from damage claims arising from certain events as outlined within the particular contract. While we attempt to structure all agreements to include normal protection clauses, such agreements may not always contain, or be subject to, maximum loss clauses, and liabilities arising from them may result in significant adverse changes to our results of operations and financial condition.

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. Any such disputes may be resolved before trial, or if litigated, may be resolved in our favor; however, the cost of claims sustained in litigation, and costs associated with the litigation process, may not be covered by our insurance. Such costs, and the demands on management time during such an event, could harm our business and have a material adverse effect on our liquidity, results of operations and financial condition.

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***Consolidation and deterioration in the competitive service provider market could result in a significant decrease in our revenue.***

We sell a moderate volume of products directly or indirectly to competitive service providers who compete with the established ILECs. The competitive service provider market is experiencing a process of consolidation. Many of our competitive service provider customers do not have a strong financial position and have limited ability to access the public financial markets for additional funding for growth and operations. If one or more of these competitive service providers fail, we could face a loss in revenue and an increased bad debt expense, due to their inability to pay outstanding invoices, as well as the corresponding decrease in customer base and future revenue. Furthermore, significant portions of our sales to competitive service providers are made through independent distributors. The failure of one or more competitive service providers could also negatively affect the financial position of a distributor to the point that the distributor could also experience business failure and/or default on payments to us.

***We depend on distributors who maintain inventories of our products. If the distributors reduce their inventories of these products, our sales could be adversely affected.***

We work closely with our distributors to monitor channel inventory levels and ensure that appropriate levels of product are available to resellers and end users. If our distributors reduce their levels of inventory of our products, our sales would be negatively impacted during the period of change.

***If we are unable to successfully develop relationships with system integrators, service providers, and enterprise value added resellers, our sales may be negatively affected.***

As part of our sales strategy, we are targeting system integrators (SIs), service providers (SPs), and enterprise VARs. In addition to specialized technical expertise, SIs, SPs and VARs typically offer sophisticated service capabilities that are frequently desired by enterprise customers. In order to expand our distribution channel to include resellers with such capabilities, we must be able to provide effective support to these resellers. If our sales, marketing or service capabilities are not sufficient to provide effective support to such SIs, SPs and VARs, our sales may be negatively affected, and current SI, SP and VAR partners may terminate their relationships with us, which would adversely impact our sales and overall results of operations.

***If we fail to manage our exposure to worldwide financial and securities markets successfully, our operating results and financial statements could be materially impacted.***

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 corporate and 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 have significant investments in corporate and municipal fixed-rate bonds and municipal variable rate demand notes. Through December 31, 2013, we have not been required to impair any of these investments; however, we may experience a reduction in value or loss of liquidity in these investments, which may have an adverse effect on our results of operations, liquidity and financial condition. Fixed rate interest securities may have their fair value adversely impacted due to a rise in interest rates, while variable rate securities may produce less income than expected if interest rates fall. Our investments are subject to general credit, liquidity, market, and interest rate risks, which may increase because of conditions in the financial markets and related credit liquidity issues. Consequently, our future investment income may fall short of expectations due to changes in interest rates, or we may suffer losses in principal if we are forced to sell securities that decline in fair value due to changes in interest rates.

Our long-term investments include $38.5 million of marketable equity securities. At December 31, 2013, our total marketable equity securities, which included 440 individual securities, had unrealized gains of $14.0 million, which includes an unrealized gain of $7.6 million related to a single security. If market conditions deteriorate in 2014, we may be required to record impairment charges related to our marketable equity securities.

See Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources in Item 7, Part II of this report and Quantitative and Qualitative Disclosures about Market Risk in Item 7A, Part II of this report for more information about our investments.

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***Changes in our effective tax rate or assessments arising from tax audits may have an adverse impact on our results.***

We are subject to taxation in various jurisdictions, both domestically and internationally, in which we conduct business. Significant judgment is required in the determination of our provision for income taxes and this determination requires the interpretation and application of complex and sometimes uncertain tax laws and regulations. Our effective tax rate may be adversely impacted by changes in the mix of earnings between jurisdictions with different statutory tax rates, in the valuation of our deferred tax assets, and by changes in tax rules and regulations. For instance, the availability and timing of lapses in the United States research tax credit, the accounting of uncertain tax positions and the amount of our estimated tax deduction for manufacturer s domestic production activities under Internal Revenue Code Section 199 may add more variability to our future effective tax rates. We currently receive corporate income tax credits under a program administered by the Alabama State Industrial Development Authority in connection with revenue bonds issued to provide funding for expansion of our corporate facilities. We cannot be certain that the state of Alabama will continue to make these corporate income tax credits available; therefore, we may not realize the full benefit of these incentives, which would increase our effective tax rate. Also, employment related tax benefits are currently accounted for in our effective tax rate. In addition, we are subject to examination of our income tax returns by the Internal Revenue Service and various other jurisdictions in which we conduct business. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse effect on our results of operations and financial condition.

***We are required to periodically evaluate the value of our long-lived assets, including the value of intangibles acquired and goodwill resulting from business acquisitions. Any future impairment charges required may adversely affect our operating results.***

Valuation of our long-lived assets requires us to make assumptions about future sales prices and sales volumes for our products. These assumptions are used to forecast future, undiscounted cash flows. Forecasting future business trends is difficult and subject to modification. Should actual market conditions differ or our forecasts change, we may be required to reassess long-lived assets and could record an impairment charge. Any impairment charge relating to long-lived assets would have the effect of decreasing our earnings or increasing our losses in such period.

***Our success depends on attracting and retaining key personnel.***

Our business has grown significantly since its inception. Our success is dependent in large part on the continued employment of our executive officers, including Thomas R. Stanton, our Chief Executive Officer, and other key management personnel. The unplanned departure of one or more of these individuals could adversely affect our business. In addition, for ADTRAN to continue as a successful entity we must also be able to attract and retain key engineers and technicians whose expertise helps us maintain competitive advantages. We believe that our future success will depend, in large part, upon our ability to continue to attract, retain, train, and motivate highly-skilled employees who are in great demand. Stock option grants are designed to reward employees for their long-term contributions and to provide incentives for them to remain with us. Changes to our overall compensation program, including our stock option incentive program, may adversely affect our ability to retain key employees. Properly managing our continued growth, avoiding the problems often resulting from such growth and expansion, and continuing to operate in the manner which has proven successful to us to date will be critical to the future success of our business.

***Regulatory and potential physical impacts of climate change and other natural events may affect our customers and our production operations, resulting in adverse effects on our operating results.***

There is a growing political and scientific consensus that emissions of greenhouse gases continue to alter the composition of the atmosphere, affecting large-scale weather patterns and the global climate. It appears that some form of U.S. federal regulation related to greenhouse gas emissions may occur, and any such regulation could result in the creation of additional costs in the form of taxes or emission allowances. The impact of any future legislation, regulations or product specification requirements on our products and business operations is dependent on the design of the final mandate or standard, so we are unable to predict its significance at this time.

The potential physical impacts of climate change and other natural events on our customers, suppliers, and on our operations are highly uncertain, and will be particular to the circumstances developing in various geographical regions. These events may include changes in weather patterns (including drought and rainfall levels), water availability, storm patterns and intensities, ocean levels, temperature levels, earthquakes and tsunamis. These potential physical effects may adversely affect our revenues, costs, production and delivery schedules, and cause harm to our results of operations and financial condition.

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***While we believe our internal control over financial reporting is adequate, a failure to maintain effective internal control over financial reporting as our business expands could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.***

Section 404 of the Sarbanes-Oxley Act of 2002 requires that we assess the effectiveness of our internal control over financial reporting as of the end of our fiscal year, and issue a report that states whether or not such internal control is effective. Compliance with these requirements requires significant cost and the commitment of time and staff resources. Expansion of our business, particularly in international geographies, will necessitate ongoing changes to our internal control systems, processes and information systems. We cannot be certain that as this expansion occurs, our current design for internal control over financial reporting will be sufficient to enable management or our independent registered public accounting firm to determine that our internal control is effective for any period, or on an ongoing basis. If we or our independent registered public accounting firm are unable to assert that our internal control over financial reporting is effective, we could lose investor confidence in the accuracy and completeness of our financial statements, which could have an adverse effect on our stock price.

***The price of our common stock has been volatile and may continue to fluctuate significantly.***

Our common stock is traded on the NASDAQ Global Select Market under the symbol ADTN. Since our initial public offering in August 1994, there has been, and may continue to be, significant volatility in the market for our common stock, based on a variety of factors, including factors listed in this section, some of which are beyond our control.

## *ITEM 1B. UNRESOLVED STAFF COMMENTS*

None.

## *ITEM 2. PROPERTIES*

Our headquarters and principal administrative, engineering and manufacturing facilities are located on an 82-acre campus in Cummings Research Park in Huntsville, Alabama. Two office buildings serve both our Carrier Networks and Enterprise Networks Divisions. These facilities can accommodate up to 3,000 employees. We lease engineering facilities in the U.S., Europe and India that are used to develop products sold by our Carrier Networks Division. We lease engineering facilities in the U.S., Canada and India that are used to develop products sold by our Enterprise Networks division.

In addition, we lease office space in North America, Latin America, EMEA, and the Asia-Pacific region, providing sales and service support for both of our divisions.

These cancelable and non-cancelable leases expire at various times through 2018. For more information, see Note 13 of the Notes to Consolidated Financial Statements included in this report.

We also have numerous sales and support staff operating from home-based offices serving both our Carrier Networks and Enterprise Networks Divisions, which are located within the United States and abroad.

## *ITEM 3. LEGAL PROCEEDINGS*

We have been involved from time to time in litigation in the normal course of our business. We are not aware of any pending or threatened litigation matters that could have a material adverse effect on us.

## *ITEM 4. MINE SAFETY DISCLOSURES*

Not applicable.

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***ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT***

Set forth below, in accordance with General Instruction G(3) of Form 10-K and Instruction 3 of Item 401(b) of Regulation S-K, is certain information regarding the executive officers of ADTRAN. Unless otherwise indicated, the information set forth is as of December 31, 2013.

| | |
|---|---|
| **Thomas R. Stanton** | Age 49 |
| 2007 to present | Chief Executive Officer and Chairman of the Board |
| 2005 2007 | Chief Executive Officer and Director |
| 2001 2005 | Senior Vice President and General Manager, Carrier Networks |
| 1999 2001 | Vice President and General Manager, Carrier Networks |
| 1995 1999 | Vice President, Carrier Networks Marketing |
| 1995 | Vice President, Marketing & Engineering Transcrypt International, Inc. |
| 1994 1995 | Senior Director, Marketing E.F. Johnson Company |
| 1993 1994 | Director, Marketing E.F. Johnson Company |
| **James E. Matthews** | Age 57 |
| 2007 to present | Senior Vice President Finance, Chief Financial Officer, Treasurer, Secretary and Director |
| 2001 2007 | Senior Vice President Finance, Chief Financial Officer and Treasurer |
| 1999 2001 | Chief Financial Officer Home Wireless Networks, Inc. |
| 1998 1999 | Chief Executive Officer Miltope Group, Inc. |
| 1995 1998 | Vice President, Finance and Chief Financial Officer Miltope Group, Inc. |
| 1992 1995 | Controller Hughes Training, Inc. |
| **Michael K. Foliano** | Age 53 |
| 2006 to present | Senior Vice President, Global Operations |
| 2005 2006 | Senior Vice President, Sales, Services and Supply Chain Somera Communications Inc. |
| 2004 2005 | Senior Vice President, Global Operations Somera Communications Inc. |
| 2002 2004 | Senior Director, Global Logistics and Customer Operations Lucent Technologies |
| 2001 2002 | Executive General Manager, Mobility Supply Chain Lucent Technologies |
| 2000 2001 | Stanford University Sloan Fellow Lucent Technologies |
| 1997 2000 | Vice President, Global Provisioning Center Lucent Technologies |
| 1995 1997 | Manufacturing Operations Plant Manager Lucent Technologies/AT&T Network Systems |
| **Kevin P. Heering** | Age 42 |
| 2014 to present | Senior Vice President, Quality and Administration |
| 2010 2014 | Vice President, Quality |
| 2007 2010 | Engineering Director, Enterprise Network Systems |
| 1999 2007 | Engineering Manager, Enterprise Network Systems |
| 1994 1999 | Design Engineer, Enterprise Network Systems |
| **Raymond R. Schansman** | Age 57 |
| 2006 to present | Senior Vice President and General Manager, Enterprise Networks |
| 2001 2006 | Vice President, Carrier Networks Engineering |
| 1998 2001 | Engineering Director, Carrier Networks Systems |
| 1996 1998 | Engineering Manager, Enterprise Networks Systems |
| 1989 1996 | Program Manager SCI Systems, Inc. |
| 1986 1989 | Vice President, System and Product Engineering General Digital Industries |
| 1983 1986 | Senior Design Engineer General Digital Industries |
| **James D. Wilson, Jr.** | Age 43 |
| 2006 to present | Senior Vice President and General Manager, Carrier Networks |
| 2005 2006 | Vice President, Product Marketing, Carrier Networks |
| 2002 2005 | Director, Product Management, Carrier Networks |
| 1998 2002 | Director, Product Management, Loop Technologies, Carrier Networks |
| 1996 1998 | Manager, Engineering Operations Wyle Laboratories, Inc. |
| 1992 1996 | Manager, Program Development Wyle Laboratories, Inc. |

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| | |
|---|---|
| **Robert A. Fredrickson** | Age 63 |
| 1996 to present | Vice President Carrier Networks Sales |
| 1996 | Vice President, Broadband Business Development DSC Communications Corporation |
| 1991 1996 | Senior Director, Access Products DSC Communications Corporation |
| **Kevin W. Schneider** | Age 50 |
| 2003 to present | Vice President Chief Technology Officer |
| 1999 2003 | Vice President Technology |
| 1996 1999 | Chief Scientist |
| 1992 1996 | Staff Scientist |

There are no family relationships among our directors or executive officers. All officers are elected annually by, and serve at the discretion of, the Board of Directors of ADTRAN.

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## PART II

### *ITEM 5. 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**

| | High | Low |
|---|---|---|
| **2013** | | |
| First Quarter | $ 23.61 | $ 19.07 |
| Second Quarter | $ 24.62 | $ 18.55 |
| Third Quarter | $ 27.46 | $ 23.47 |
| Fourth Quarter | $ 27.10 | $ 23.27 |
| **2012** | | |
| First Quarter | $ 38.42 | $ 29.01 |
| Second Quarter | $ 31.07 | $ 28.02 |
| Third Quarter | $ 29.55 | $ 17.28 |
| Fourth Quarter | $ 20.14 | $ 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 | 2012 |
|---|---|---|
| First Quarter | $ 0.09 | $ 0.09 |
| Second Quarter | $ 0.09 | $ 0.09 |
| Third Quarter | $ 0.09 | $ 0.09 |
| Fourth Quarter | $ 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.

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***ITEM 6. 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.*

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***ITEM 7. 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)

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**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 this report.*

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**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.

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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.

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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.

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**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%** |

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**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** |

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**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.

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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.

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**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.

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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.

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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.

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*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.

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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 | 2012 | 2011 |
|---|---|---|---|
| First Quarter | $ 0.09 | $ 0.09 | $ 0.09 |
| Second Quarter | $ 0.09 | $ 0.09 | $ 0.09 |
| Third Quarter | $ 0.09 | $ 0.09 | $ 0.09 |
| Fourth Quarter | $ 0.09 | $ 0.09 | $ 0.09 |

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*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.

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**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.

***ITEM 7A. 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.

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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.

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***ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

The following consolidated financial statements are contained in this report.


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| Report of Independent Registered Public Accounting Firm | 47 |
| Financial Statements | |
| Consolidated Balance Sheets, As of December 31, 2013 and 2012 | 48 |
| Consolidated Statements of Income, Years Ended December 31, 2013, 2012 and 2011 | 49 |
| Consolidated Statements of Comprehensive Income, Years Ended December 31, 2013, 2012 and 2011 | 50 |
| Consolidated Statements of Changes in Stockholders Equity, Years Ended December 31, 2013, 2012 and 2011 | 51 |
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| Schedule II - Valuation and Qualifying Accounts | 88 |

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**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.

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**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. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. 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 and financial statement schedule, 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, on the financial statement schedule, 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.

/s/ PricewaterhouseCoopers LLP

Birmingham, Alabama

February 27, 2014

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**Financial Statements**

***ADTRAN, INC.***

***Consolidated Balance Sheets (In thousands, except per share amounts)***

***December 31, 2013 and 2012***

| | *2013* | *2012* |
|---|---|---|
| ***ASSETS*** | | |
| **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.*

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***ADTRAN, INC.***

***Consolidated Statements of Income (In thousands, except per share amounts)***

***Years ended December 31, 2013, 2012 and 2011***

| | *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.*

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***ADTRAN, INC.***

***Consolidated Statements of Comprehensive Income (In thousands)***

***Years ended December 31, 2013, 2012 and 2011***

| | *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.*

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***ADTRAN, INC.***

***Consolidated Statements of Changes in Stockholders Equity (In thousands)***

***Years ended December 31, 2013, 2012 and 2011***

| | 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.*

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***ADTRAN, INC.***

***Consolidated Statements of Cash Flows (In thousands)***

***Years ended December 31, 2013, 2012 and 2011***

| | *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.*

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*Notes to Consolidated Financial Statements*

**Note 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.

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**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.

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**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:

| **Year Ended December 31,** *(In thousands)* | **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.

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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.

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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 | |

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| *(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:

| *(In thousands)* | Before-Tax Amount | 2013 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)* | Before-Tax Amount | 2012 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)* | Before-Tax Amount | 2011 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)** |

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**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.

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**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.

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**Note 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 from 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 |

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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.

**Note 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.

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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 Avg. 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** | |

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*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** |

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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.

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**Note 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.

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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:

| | Year Ended December 31, | | |
|---|---|---|---|
| *(In thousands)* | **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.

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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.

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**Note 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:

| | | December 31, 2013 | |
|---|---|---|---|
| *(In thousands)* | | 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 |

**Note 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.

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**Note 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.

**Note 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)* | 2013 | | | 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.

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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** |

**Note 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.

**Note 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** |

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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 entities | 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.

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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.

**Note 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.

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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** |

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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:

| | 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** |

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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.

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*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.

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**Note 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.

**Sales and Gross Profit by Market Segment**

| *(In thousands)* | 2013 | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|
| | **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)

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**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® & 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.

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**Note 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.

**Note 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.

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**Note 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.

**Note 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.

**Note 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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***ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE***

None.

***ITEM 9A. CONTROLS AND PROCEDURES***

(a) *Internal control over financial reporting.* Section 404 of the Sarbanes-Oxley Act of 2002 requires management to include in this Annual Report on Form 10-K a report on management s assessment of the effectiveness of our internal control over financial reporting, as well as a report from our independent registered public accounting firm on the effectiveness of internal control over financial reporting. Management s report on internal control over financial reporting and the related report from our independent registered public accounting firm are located in Item 8 Financial Statements and Supplementary Data of this report.

(b) *Evaluation of disclosure controls and procedures*. Our Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) for the company. Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this annual report, have concluded that our disclosure controls and procedures are effective.

(c) *Changes in internal control over financial reporting*. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

***ITEM 9B. OTHER INFORMATION***

None.

**PART III**

***ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE***

Information relating to nominees for director of ADTRAN and compliance with Section 16(a) of the Securities Exchange Act of 1934 is set forth under the captions Proposal 1 Election of Directors, Section 16(a) Beneficial Ownership Reporting Compliance and Corporate Governance, respectively, in the Proxy Statement for the Annual Meeting of Stockholders to be held on May 14, 2014. Such information is incorporated herein by reference. The definitive Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after December 31, 2013. Information relating to the executive officers of ADTRAN, pursuant to Instruction 3 of Item 401(b) of Regulation S-K and General Instruction G(3) of Form 10-K, is set forth at Part I, Item 4A of this report under the caption Executive Officers of the Registrant. This information is incorporated herein by reference.

**Code of Ethics**

We have adopted the ADTRAN, Inc. Code of Conduct, which applies to all employees, officers and directors of ADTRAN. The Code of Conduct meets the requirements of a code of ethics as defined by Item 406 of Regulation S-K, and applies to our Chief Executive Officer, Chief Financial Officer (who is both our principal financial and principal accounting officer), as well as all other employees, as indicated above. The Code of Conduct also meets the requirements of a code of conduct under NASDAQ listing standards. The Code of Conduct is posted on our website at www.adtran.com under the links Investor Relations Corporate Governance Code of Conduct. We intend to disclose any amendments to the Code of Conduct, as well as any waivers for executive officers or directors, on our website at www.adtran.com.

***ITEM 11. EXECUTIVE COMPENSATION***

Information required by this Item 11 relating to executive compensation and other matters is set forth under the captions Executive Compensation, Director Compensation and Corporate Governance in the Proxy Statement referred to in Item 10. This information is incorporated herein by reference.

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***ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS***

Information relating to ownership of common stock of ADTRAN by certain persons is set forth under the caption Share Ownership of Principal Stockholders and Management in the Proxy Statement referred to in Item 10 above. Such information is incorporated herein by reference. Information regarding securities authorized for issuance under equity compensation plans of ADTRAN is set forth under the caption Equity Compensation Plan Information in the Proxy Statement referred to in Item 10. This information is incorporated herein by reference.

***ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE***

Information relating to existing or proposed relationships or transactions between ADTRAN and any affiliate of ADTRAN is set forth under the captions Certain Relationships and Related Transactions and Corporate Governance in the Proxy Statement referred to in Item 10. This information is incorporated herein by reference.

***ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES***

Information relating to ADTRAN s principal accountant s fees and services is set forth under the caption Principal Accountant Fees and Services in the Proxy Statement referred to in Item 10. This information is incorporated herein by reference.

**PART IV**

***ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES***

Documents Filed as Part of This Report.

1. Consolidated Financial Statements

The consolidated financial statements of ADTRAN and the report of independent registered public accounting firm thereon are set forth under Part II, Item 8 of this report.

Consolidated Balance Sheets as of December 31, 2013 and 2012

Consolidated Statements of Income for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Comprehensive Income for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Changes in Stockholders Equity for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011

Notes to Consolidated Financial Statements

2. Consolidated Financial Statement Schedule

Schedule II - Valuation and Qualifying Accounts

3. Exhibits

The following exhibits are filed with or incorporated by reference in this report. Where such filing is made by incorporation by reference to a previously filed registration statement or report, such registration statement or report is identified in parentheses. We will furnish any exhibit upon request to: ADTRAN, Inc., Attn: Investor Relations, 901 Explorer Boulevard, Huntsville, Alabama 35806. There is a charge of $0.50 per page to cover expenses for copying and mailing.

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| Exhibit Number | Description |
|---|---|
| 2.1 | Asset Sale and Purchase Agreement dated 11 December 2011 Regarding the Sale and Purchase of the NSN DSLAM, GPON and ACI Products and the Related Services Businesses. |
| 3.1 | Certificate of Incorporation, as amended (Exhibit 3.1 to ADTRAN s Registration Statement on Form S-1, No. 33-81062 (the Form S-1 Registration Statement )). |
| 3.2 | Bylaws, as amended (Exhibit 3.1 to ADTRAN s Current Report on Form 8-K filed October 16, 2007). |
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| | (a) First Amended and Restated Financing Agreement dated April 25, 1997, among the State Industrial Development Authority, a public corporation organized under the laws of the State of Alabama (the Authority ), ADTRAN and First Union National Bank of Tennessee, a national banking corporation (the Bondholder ) (Exhibit 10.1(a) to ADTRAN s Quarterly Report on Form 10-Q for the quarter ended March 31, 1997 (the 1997 Form 10-Q )). |
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(h) Amendment to First Amended and Restated Financing Agreement and First Amended and Restated Loan Agreement dated January 3, 2002 between ADTRAN and the Successor Bondholder (Exhibit 10.1(h) to the 2002 Form 10-K).

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| 10.3 | Management Contracts and Compensation Plans: |
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(k) First Amendment to the ADTRAN, Inc. 2005 Directors Stock Option Plan (Exhibit 10.3(l) to the 2007 Form 10-K).

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21* Subsidiaries of ADTRAN.

23* Consent of PricewaterhouseCoopers LLP.

24* Powers of Attorney.

31* Rule 13a-14(a)/15d-14(a) Certifications.

32* Section 1350 Certifications.

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| Exhibit Number | Description |
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| 101.INS** | XBRL Instance Document |
| 101.SCH** | XBRL Taxonomy Extension Schema Document |
| 101.CAL** | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB** | XBRL Taxonomy Extension Labels Linkbase Document |
| 101.PRE** | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF** | XBRL Taxonomy Extension Definition Linkbase Document |

* Filed herewith

** Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on February 27, 2014.

**ADTRAN, Inc.**

**(Registrant)**

By: /s/ James E. Matthews
James E. Matthews

Senior Vice President Finance,

Chief Financial Officer, Treasurer, Secretary and Director

(Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on February 27, 2014.

| **Signature** | **Title** |
|---|---|
| /s/ Thomas R. Stanton<br>Thomas R. Stanton | Chief Executive Officer and Chairman of the Board |
| /s/ James E. Matthews<br>James E. Matthews | Senior Vice President Finance,<br>Chief Financial Officer, Treasurer, Secretary and Director |
| /s/ Balan Nair*<br>Balan Nair | Director |
| /s/ William L. Marks*<br>William L. Marks | Director |
| /s/ Roy J. Nichols*<br>Roy J. Nichols | Director |
| /s/ H. Fenwick Huss *<br>H. Fenwick Huss | Director |

*By: /s/ James E. Matthews
James E. Matthews as Attorney in Fact

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**ADTRAN, INC.**

**SCHEDULE II**

**VALUATION AND QUALIFYING ACCOUNTS**

| Column A<br>*(In thousands)* | Column B<br>Balance at Beginning of Period | Column C<br>Assumed on Acquisition | Column D<br>Charged to Costs & Expenses | Column E<br>Deductions | Column F<br>Balance at End of Period |
|---|---|---|---|---|---|
| ***Year ended December 31, 2013*** | | | | | |
| Allowance for Doubtful Accounts | $ 6 | | 136 | 12 | $ 130 |
| Inventory Reserve | $ 11,957 | | 11,457 | 421 | $ 22,993 |
| Warranty Liability | $ 9,653 | | 4,051 | 4,727 | $ 8,977 |
| Deferred Tax Asset Valuation Allowance | $ 10,939 | | (1,056) | 1,041 | $ 8,842 |
| ***Year ended December 31, 2012*** | | | | | |
| Allowance for Doubtful Accounts | $ 8 | | 38 | 40 | $ 6 |
| Inventory Reserve | $ 9,419 | | 3,042 | 504 | $ 11,957 |
| Warranty Liability | $ 4,118 | 3,781 | 5,363 | 3,609 | $ 9,653 |
| Deferred Tax Asset Valuation Allowance | $ 7,585 | | 3,594 | 240 | $ 10,939 |
| ***Year ended December 31, 2011*** | | | | | |
| Allowance for Doubtful Accounts | $ 162 | | 117 | 271 | $ 8 |
| Inventory Reserve | $ 8,932 | | 1,137 | 650 | $ 9,419 |
| Warranty Liability | $ 3,304 | 33 | 2,860 | 2,079 | $ 4,118 |
| Deferred Tax Asset Valuation Allowance | $ 5,627 | 1,462 | 496 | | $ 7,585 |

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**ADTRAN, INC.**

**INDEX OF EXHIBITS**

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