



BRINGING THE WORLD TOGETHER

ADIRAN

# Bringing *the* World Together

2014 ANNUAL REPORT



# Bringing *the* World Together

## 2014 ANNUAL REPORT

ADTRAN is an ISO 9001, ISO 14001, and a TL 9000 certified supplier. ADTRAN, Inc. is an Equal Opportunity Employer committed to utilizing Minority Business Enterprises (MBE), Woman-Owned Business Enterprises (WBE) and Disabled Veteran Business Enterprises (DVBE) whenever possible and practical for procurements supporting ADTRAN and our customers.

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*People have always found ways to connect. It's in our nature.  
What is remarkable is that today, we are now able to connect with  
people around the world faster, easier and in more ways than ever before.  
Time and distance no longer preclude real-time connections that are  
full of context, content, collaboration and detail.*

Over 3 billion people are now connected to the Internet and this number will continue to increase at an accelerated pace as people find new and more convenient ways to communicate. The way we communicate has become more personal as we are able to tailor the experience to individual preferences and lifestyle. Being connected has become an essential element of how we live, work, play and learn. It's at the core of what we all want, independent of our location, devices or how we express our thoughts, emotions, and ideas.

What has been amazing for ADTRAN, as we help our customers through this transition, is just how seamless it has been and how quickly we are moving forward in this exciting new era. We are entering the world of smart cars and homes, wearable technology, and the Internet of Things. Connecting people with people, devices with devices and devices with people is quickly transforming the world in which we live, providing an unprecedented level of information, collaboration and efficiency that empowers individuals to have access to the world's resources at their fingertips. We are now sharing more information over a wider variety of venues specifically designed for video, chat, streaming, screen sharing and other innovative means of communication.

This demand is placing an unprecedented burden on today's communications service provider infrastructure.

ADTRAN solutions and services play a key role in building the superhighway for these new technologies, services, and applications and how they are developed, delivered and consumed. Over the past year, hundreds of communities, from the largest to the smallest, began to prioritize Gigabit services as the underlying critical infrastructure for economic development and growth. It is creating a new foundation for how we communicate that will have a profound impact on where and how we live, work, shop, and educate our children.

Combine these carrier infrastructure solutions with ADTRAN's enterprise and business products and services and the entire ecosystem of businesses, schools, universities, municipalities and individuals are positioned now to enable all of the capabilities of an always-on, data-driven economy. That's the real power of ADTRAN... delivering solutions that bridge the gap between our end-customer communities and their ability to efficiently and quickly achieve more, become more and do more.

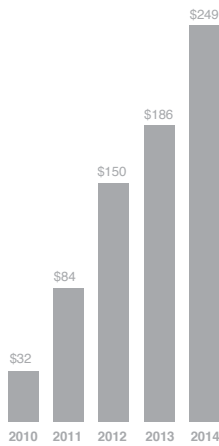
Enabling every person, everywhere, the opportunity to reach their fullest potential.





Empowering  
progress one  
connection  
at a time

International Revenue  
(in millions)



UP **34%**  
over 2013

At ADTRAN, our goal is to provide the means to enable a fully connected world where the power to communicate is available to everyone, everywhere and at any time. Our understanding of the changing world and the impact of a ubiquitous communications network provides us with the vision to develop dynamic solutions that empower change by enabling every person, everywhere, the opportunity to reach their fullest potential. By doing so we are at the forefront of bringing the world together, by advancing human progress through communications technologies.

The network is at a pivotal stage. Technology has given birth to a new generation of “smart” products that are themselves dependent on the network. As the demand for network connectivity continues to grow at exponential rates, the network must continue to evolve. ADTRAN is driving technology innovation and developing solutions that will enable the network to meet the needs of humanity, not only today, but for years to come. We are empowering progress one connection at a time.

2014 was a year of progress, both in terms of network evolution and the evolution of our business. We saw continued growth in key product areas and geographies as we introduced solutions to transform the network and make connections possible. Our core products continued to perform well and now represent 91 percent of sales. Broadband access extended its growth, up eight percent over the previous year. As we continued to focus on customer diversification, we saw growth in international markets, with that segment up nearly 34 percent over 2013.

# Advancing human progress through communications technologies





We continued to push the envelope of innovation

The expansion of higher-speed services was a major focal point for our carrier customers both domestically and internationally. We continued to push the envelope of innovation as we began to pioneer industry breakthroughs in 10 Gigabit PON technologies and the development of multi-terabit platforms. Domestically, we continued to enhance our product portfolio to enable service providers to reap the greatest benefit from their existing infrastructure and to evolve in support of exciting new, innovative services. With the growth in fiber deployments, we enhanced our Gigabit services offering with an expanded Fiber-to-the-Premises (FTTP) solution suite, increased automation to speed service delivery and turn-up and introduced new products which efficiently deliver Gigabit services to high-density housing, allowing service providers to reach a larger customer base. We also expanded our industry-leading vectoring technology across additional platforms, enabling us to reach a broader base of customers and address a broader array of deployment scenarios.

From a global view, we saw growth in excess of 30 percent in both Latin America and Europe. Vectoring took center stage in Europe as we became the majority supplier in the world's largest vectored VDSL2 deployment. We believe our innovations in super vectoring will position the company well for new investment rounds in Fiber-to-the-Curb (FTTC) solutions. We also demonstrated global leadership in G.fast, a breakthrough technology that offers high-bandwidth services over copper facilities (up to 1 Gigabit per second) dependent on loop length. Our success in these areas continued to reaffirm the importance of our Research and Development (R&D) efforts - where we invested more than \$132 million in 2014 alone.



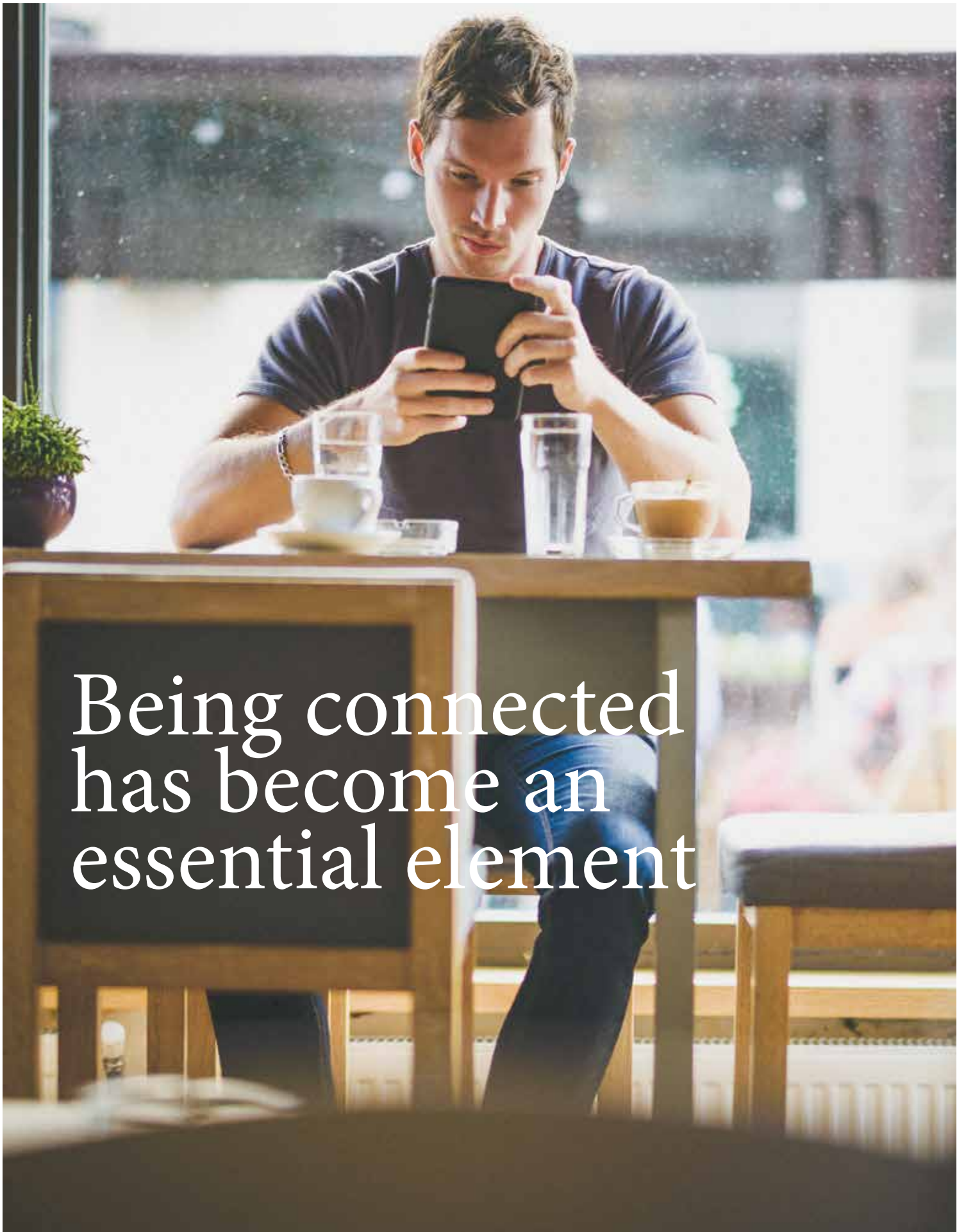
# Pioneering industry breakthroughs



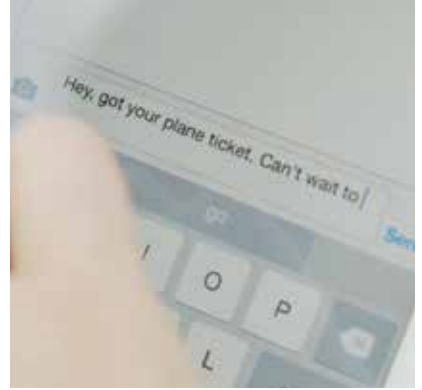
4,100+  
Value Added Resellers

From an enterprise perspective, we introduced a new family of Carrier Ethernet edge solutions that allow service providers to deliver ubiquitous service offerings independent of access, service or media. These Metro Ethernet Forum (MEF)-compliant solutions provide unprecedented performance and offer reduced infrastructure and operating costs for both domestic and international customers. To spur the growth of Hosted Voice over IP (VoIP) services and Session Initiation Protocol (SIP) trunking, we enhanced our product portfolio with the addition of enterprise session border controller capabilities which strengthen security, ease service turn-up and standardize the interface for SIP services. We expanded our Internetworking portfolio with high-performance routers, switches, and gateway solutions. Our service provider customers also benefited as we introduced the next generation of the world's leading and most widely deployed business gateway, delivering higher capacity to enable more demanding services.

Our Value Added Reseller (VAR) channel continues to grow and is now more than 4,100 partners strong. I am pleased to report that our VAR channel has warmly embraced the ProCloud suite of managed services which includes our virtual wireless LAN (vWLAN) service offerings. ProCloud services are enabling our VAR partners to transform their businesses from hardware sales to cloud-based managed services with monthly recurring revenue streams. This enables our VAR partners to diversify their business offering and grow revenue.



Being connected  
has become an  
essential element





# Looking Forward

As we look ahead to 2015, we anticipate continued growth in network demand, resulting in increased necessity for our products and services. On the global front, we anticipate further expansion in the EMEA and LATAM regions. We also expect to see significant growth in our sales of enterprise products outside of the United States.

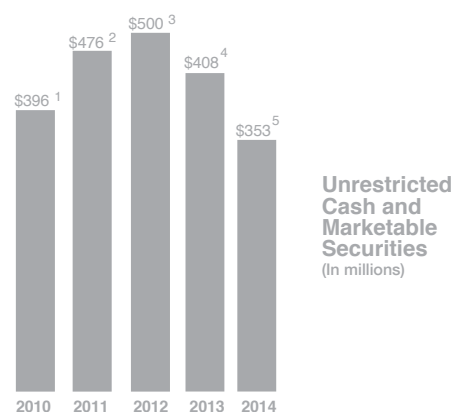
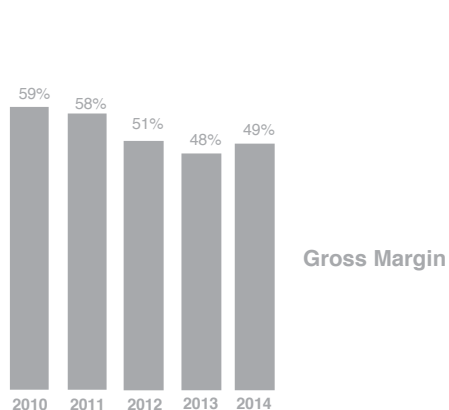
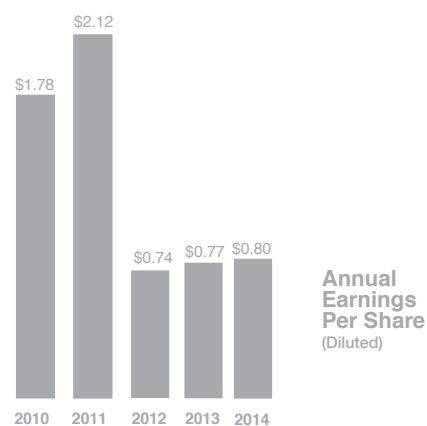
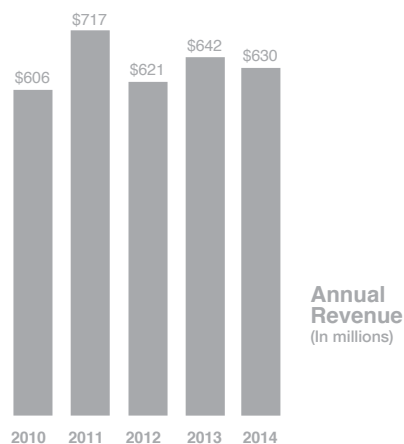
Domestically, we are prepared to begin to capitalize on Tier 1 market expansion as well as accelerated Tier 2 broadband spending from the Connect America Fund (CAF) and meaningful deployments of Gigabit broadband solutions. By year end, hundreds of communities across the U.S. will be using Gigabit networks powered by ADTRAN to transform the lives of their residents by attracting new jobs, better educational opportunities and economic growth. We also anticipate continued

growth in the Tier 3 market as these service providers complete the Universal Service Fund (USF) to CAF transition. From a product perspective, our largest growth area will be broadband access, led by FTTP. We also anticipate continued momentum in vectoring, G.fast and Carrier Ethernet solutions complemented by growth in carrier services.

I must add a word of thanks to our workforce, now over 2,200 strong. These men and women from around the world are the driving strength of our company. They are focused on exceeding customer expectations and delivering the best technology solutions possible. They are the key to the company's continued success.



Chairman & CEO  
ADTRAN, Inc.



## Consolidated Statements of Income Data

(In thousands, except per share amounts)

Years Ended December 31	2014	2013
Total sales	\$630,007	\$641,744
Income before provision for income taxes	\$59,906	\$60,855
Net income	\$44,620	\$45,794
Earnings per common share (Diluted)	\$0.80	\$0.77

## Consolidated Balance Sheets Data

(In thousands)

Years Ended December 31	2014	2013
Working capital <sup>6</sup>	\$232,080	\$277,335
Total assets	\$738,694	\$789,898
Stockholders' equity	\$549,013	\$604,606

<sup>1</sup> Net of \$18 million in stock repurchases and \$23 million in dividend payments during 2010

<sup>2</sup> Net of \$36 million in stock repurchases and \$23 million in dividend payments during 2011

<sup>3</sup> Net of \$39 million in stock repurchases and \$23 million in dividend payments during 2012

<sup>4</sup> Net of \$124 million in stock repurchases and \$21 million in dividend payments during 2013

<sup>5</sup> Net of \$81 million in stock repurchases and \$20 million in dividend payments during 2014

<sup>6</sup> Working capital consists of current assets less current liabilities

# Financial Results

- 14 Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**
- 15 Stock Performance Graph**
- 16 Selected Financial Data**
- 17 Management’s Discussion and Analysis of Financial Condition and Results of Operations**
  - Overview
  - Critical Accounting Policies and Estimates
  - Results of Operations
  - Acquisition Expenses
  - 2014 Compared to 2013
  - 2013 Compared to 2012
  - Liquidity and Capital Resources
  - Effect of Recent Accounting Pronouncements
  - Subsequent Events
- 32 Quantitative and Qualitative Disclosures About Market Risk**
- 33 Management’s Report on Internal Control Over Financial Reporting**
- 34 Report of Independent Registered Public Accounting Firm**
- 35 Financial Statements**
- 40 Notes to Consolidated Financial Statements**
  - Note 1 – Nature of Business and Summary of Significant Accounting Policies
  - Note 2 – Business Combinations
  - Note 3 – Stock Incentive Plans
  - Note 4 – Investments
  - Note 5 – Derivative Instruments and Hedging Activities
  - Note 6 – Inventory
  - Note 7 – Property, Plant and Equipment
  - Note 8 – Goodwill and Intangible Assets
  - Note 9 – Alabama State Industrial Development Authority Financing and Economic Incentives
  - Note 10 – Income Taxes
  - Note 11 – Employee Benefit Plans
  - Note 12 – Segment Information and Major Customers
  - Note 13 – Commitments and Contingencies
  - Note 14 – Earnings Per Share
  - Note 15 – Summarized Quarterly Financial Data (Unaudited)
  - Note 16 – Related Party Transactions
  - Note 17 – Subsequent Events

This annual report contains forward-looking statements which reflect management’s best judgment based on factors currently known. However, these statements involve risks and uncertainties, including the successful development and market acceptance of new products, the degree of competition in the market for such products, the product and channel mix, component costs, manufacturing efficiencies, and other risks detailed in our annual report on Form 10-K for the year ended December 31, 2014. These risks and uncertainties could cause actual results to differ materially from those in the forward-looking statements included in this annual report.



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

ADTRAN's common stock is traded on the NASDAQ Global Select Market under the symbol ADTN. As of February 5, 2015, ADTRAN had 202 stockholders of record and approximately 7,266 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

2014	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	\$27.24	\$26.11	\$23.17	\$22.16
Low	\$24.27	\$21.29	\$20.53	\$18.23
2013	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	\$23.61	\$24.62	\$27.46	\$27.10
Low	\$19.07	\$18.55	\$23.47	\$23.27

The following table shows the shareholder dividends paid in each quarter of 2014 and 2013. 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

2014	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2013	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09

## Stock Repurchases

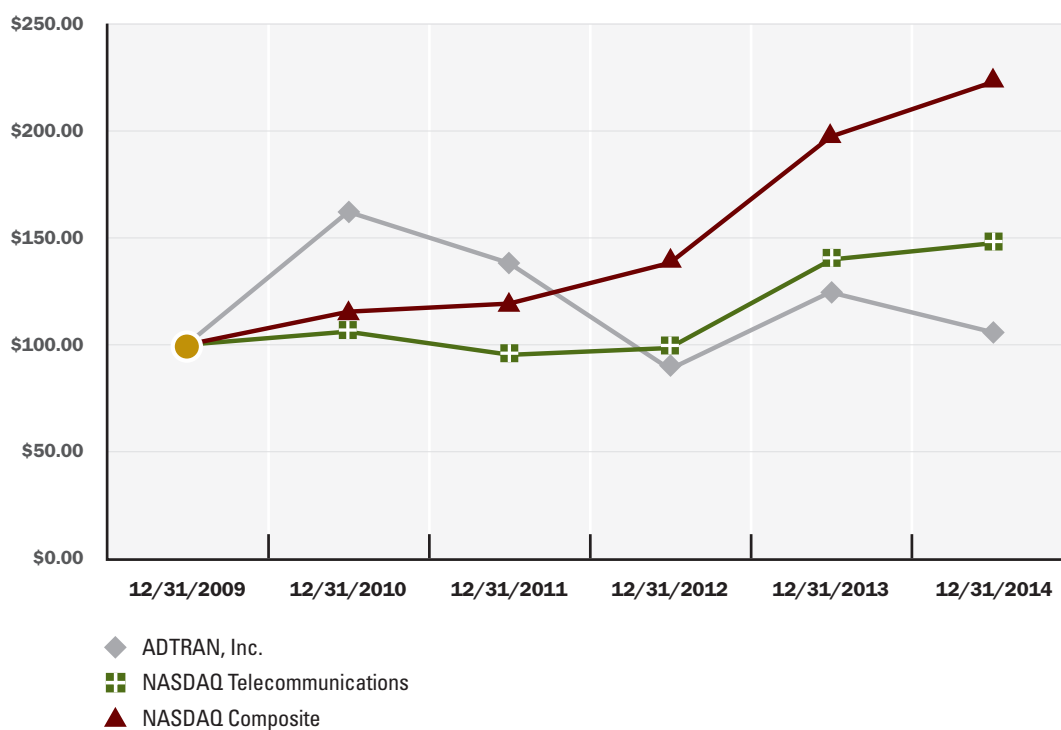
The following table sets forth repurchases of our common stock for the months indicated.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
October 1, 2014 – October 31, 2014	180,422	\$20.47	180,422	5,541,295
November 1, 2014 – November 30, 2014	748,510	\$19.69	748,510	4,792,785
December 1, 2014 – December 31, 2014	—	—	—	4,792,785
<b>Total</b>	<b>928,932</b>		<b>928,932</b>	

(1) Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 40.0 million shares of our common stock. On May 14, 2014, 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 45.0 million), which commenced upon completion of the repurchase plan announced on May 1, 2013. This new authorization is being implemented through open market or private purchases from time to time as conditions warrant.

## Stock Performance Graph

Our common stock began trading on the NASDAQ National Market on August 9, 1994. The price information reflected for our common stock in the following performance graph and accompanying table represents the closing sales prices of the common stock for the period from December 31, 2009 through December 31, 2014, on an annual basis. The graph and the accompanying table compare the cumulative total stockholders' return on our common stock with the NASDAQ Telecommunications Index and the NASDAQ Composite Index. The calculations in the following graph and table assume that \$100 was invested on December 31, 2009 in each of our common stock, the NASDAQ Telecommunications Index and the NASDAQ Composite Index and also assume dividend reinvestment.



	12/31/09	12/31/10	12/31/11	12/31/12	12/31/13	12/31/14
ADTRAN, Inc.	\$100.00	\$162.69	\$136.86	\$90.04	\$126.43	\$103.69
NASDAQ Telecommunications	\$100.00	\$107.95	\$96.16	\$100.40	\$139.11	\$148.69
NASDAQ Composite	\$100.00	\$117.61	\$118.70	\$139.00	\$196.83	\$223.74

# Selected Financial Data

## Income Statement Data (1)

(In thousands, except per share amounts)

Year Ended December 31,	2014	2013	2012	2011	2010
<b>Sales</b>					
Carrier Networks Division	\$510,373	\$500,733	\$492,096	\$569,579	\$476,030
Enterprise Networks Division	119,634	141,011	128,518	147,650	129,644
<b>Total sales</b>	<b>630,007</b>	<b>641,744</b>	<b>620,614</b>	<b>717,229</b>	<b>605,674</b>
Cost of sales	318,680	332,858	303,971	302,911	246,811
<b>Gross profit</b>	<b>311,327</b>	<b>308,886</b>	<b>316,643</b>	<b>414,318</b>	<b>358,863</b>
Selling, general and administrative expenses	131,958	129,366	134,523	124,879	114,699
Research and development expenses	132,258	131,055	125,951	100,301	90,300
<b>Operating income</b>	<b>47,111</b>	<b>48,465</b>	<b>56,169</b>	<b>189,138</b>	<b>153,864</b>
Interest and dividend income	5,019	7,012	7,657	7,642	6,557
Interest expense	(677)	(2,325)	(2,347)	(2,398)	(2,436)
Net realized investment gain	7,278	8,614	9,550	12,454	11,008
Other income (expense), net	1,175	(911)	183	(694)	(804)
Gain on bargain purchase of a business	—	—	1,753	—	—
<b>Income before provision for income taxes</b>	<b>59,906</b>	<b>60,855</b>	<b>72,965</b>	<b>206,142</b>	<b>168,189</b>
Provision for income taxes	(15,286)	(15,061)	(25,702)	(67,565)	(54,200)
<b>Net income</b>	<b>\$44,620</b>	<b>\$45,794</b>	<b>\$47,263</b>	<b>\$138,577</b>	<b>\$113,989</b>
<b>Year Ended December 31,</b>					
	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>	<b>2010</b>
Weighted average shares outstanding—basic	55,120	59,001	63,259	64,145	62,490
Weighted average shares outstanding— assuming dilution (2)	55,482	59,424	63,774	65,416	63,879
Earnings per common share—basic	\$0.81	\$0.78	\$0.75	\$2.16	\$1.82
Earnings per common share— assuming dilution (2)	\$0.80	\$0.77	\$0.74	\$2.12	\$1.78
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,	2014	2013	2012	2011	2010
Working capital (3)	\$232,080	\$277,335	\$337,979	\$329,311	\$304,952
Total assets	\$738,694	\$789,898	\$883,656	\$817,514	\$691,974
Total debt	\$30,000	\$46,500	\$46,500	\$47,000	\$48,000
Stockholders' equity	\$549,013	\$604,606	\$692,406	\$692,131	\$572,322

(1) Net income for 2014, 2013, 2012, 2011 and 2010 includes stock-based compensation expense of \$7.4 million, \$7.8 million, \$8.0 million, \$7.8 million and \$7.1 million, respectively, net of tax, related to stock option awards. See Note 3 of Notes to the Consolidated Financial Statements.

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

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



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

## Overview

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

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

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 Series of Multi-Service Access Nodes (MSANs)
- hiX 5600 Series of MSANs
- Total Access 1100/1200 Series of Fiber to the Node (FTTN) products
- hiX 1100 Series of FTTN products
- VDSL2 Vectoring based Digital Subscriber Line Access Multiplexer (DSLAM) products
- ADTRAN 500 Series of FTThp G.fast Distribution Point Units (DPU)

### Optical

- Optical Networking Edge (ONE)
- NetVanta® 8000 Series of Fiber Ethernet Access Devices (EAD)
- NetVanta 8400 Series of 10 Gig Multi-service Edge Switches
- OPTI-6100 and Total Access 3000 optical Multi-Service Provisioning Platforms (MSPP)
- Pluggable Optical Products, including SFP, XFP, and SFP+

### Time Division Multiplexed (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
  - Access Routers
  - Enterprise Session Border Controllers (eSBC)
  - Managed Ethernet Switches
  - IP Business Gateways
  - Unified Communications (UC) solutions
  - Carrier Ethernet Network Terminating Equipment (NTE)
  - Carrier Ethernet Routers and Gateways
- Network Management Solutions

**Loop Access** products are used by carrier and enterprise customers for access to copper-based communications networks. This 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 \$630.0 million in 2014 compared to \$641.7 million in 2013 and \$620.6 million in 2012. Total sales of products in our three core areas, Broadband Access, Optical and Internetworking, increased 2.8% in 2014 compared to 2013 and increased 8.9% in 2013 compared to 2012. Our gross profit margin was 49.4% in 2014 compared to 48.1% in 2013 and 51.0% in 2012. Net income was \$44.6 million in 2014 compared to \$45.8 million in 2013 and \$47.3 million in 2012. Earnings per share, assuming dilution, were \$0.80 in 2014 compared to \$0.77 in 2013 and \$0.74 in 2012. Earnings per share in 2014, 2013 and 2012 include the effect of the repurchase of 3.7 million, 5.6 million and 1.8 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, foreign currency exchange rate movements, timing differences between price decreases and product cost reductions, product warranty returns, expediting costs, and announcements of new products by us or our competitors. Additionally, maintaining sufficient inventory levels to assure prompt delivery of our products increases the amount of inventory that may become obsolete and increases the risk that the obsolescence of this inventory may have an adverse effect on our business and operating results. Also, not maintaining sufficient inventory levels to assure prompt delivery of our products may cause us to incur expediting costs to meet customer delivery requirements, which may negatively impact our operating results in a given quarter.

Accordingly, our historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that our financial results may vary from period to period. See Note 15 of Notes to Consolidated Financial Statements for additional information. For a discussion of risks associated with our operating results, see Item 1A of our Form 10-K for the year ended December 31, 2014.

### **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. In these instances, we use best estimates to allocate consideration to each respective unit of accounting. These estimates include analysis of respective bills of material and review and analysis of similar product and service offerings. We record revenue associated with installation services when respective contractual obligations are complete. In instances where customer acceptance is required, revenue is deferred until respective 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, 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 VARs and system integrators. VARs 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 \$24.7 million and \$23.0 million at December 31, 2014 and 2013, respectively. Inventory disposals charged against the reserve were \$2.1 million, \$0.4 million and \$0.5 million for the years ended December 31, 2014, 2013 and 2012, 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 marketable equity securities. 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 marketable equity securities is subject to market price volatility.

We have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1 – Values based on unadjusted, quoted prices in active markets for identical assets or liabilities; Level 2 – Values based on inputs other than quoted prices included within Level 1 that are directly or indirectly observable for the asset or liability; Level 3 – Values based on unobservable inputs for the asset or liability. These inputs

include information supplied by investees. At December 31, 2014, we categorized \$54.5 million and \$241.5 million of our available-for-sale investments as Level 1 and Level 2, respectively, and \$1.2 million of our cash equivalents as Level 1. 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.

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. For the years ended December 31, 2014, 2013 and 2012, we recorded charges of \$0.1 million, \$25 thousand and \$0.7 million, 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 2014, 2013 or 2012.

- For purposes of determining the estimated fair value of our stock option awards on the date of grant, we use the Black-Scholes Model. This model requires the input of certain assumptions that require subjective judgment. These assumptions include, but are not limited to, expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors. Because our stock option awards have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, the existing model may not provide a reliable single measure of the fair value of our stock option awards. For purposes of determining the estimated fair value of our performance-based restricted stock unit awards on the date of grant, we use a Monte Carlo Simulation valuation method. The restricted stock units are subject to a market condition based on the relative total shareholder return of ADTRAN against all of the companies in the NASDAQ Telecommunications Index and vest at the end of a three-year performance period. The fair value of restricted stock issued to our Directors is equal to the closing price of our stock on the date of grant. Management will continue to assess the assumptions and methodologies used to calculate the estimated fair value of stock-based compensation. Circumstances may change and additional data may become available over time, which could result in changes to these assumptions and methodologies and thereby materially impact our fair value determination. If factors change in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period.
- We estimate our income tax provision or benefit in each of the jurisdictions in which we operate, including estimating exposures related to examinations by taxing authorities. We also make judgments regarding the realization of deferred tax assets, and establish valuation allowances where we believe it is more likely than not that future taxable income in certain jurisdictions will be insufficient to realize these deferred tax assets. Our estimates regarding future taxable income and income tax provision or benefit may vary due to changes in market conditions, changes in tax laws, or other factors. If our assumptions, and consequently our estimates, change in the future, the valuation allowances we have established may be increased or decreased, impacting future income tax expense. At December 31, 2014 and 2013 respectively, the valuation allowance was \$7.5 million and \$8.8 million. As of December 31, 2014, we have state research tax credit carry-forwards of \$3.9 million, which will expire between 2015 and 2029. 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, 2014, we have a deferred tax asset of \$9.2 million relating to net operating loss carry-forwards which



will expire between 2015 and 2030. These carry-forwards are the result of acquisitions in 2009 and in 2011. 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 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 \$8.4 million and \$9.0 million at December 31, 2014 and 2013, 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 \$10.2 million and \$2.6 million at December 31, 2014 and 2013, respectively. 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 2014; therefore, we did not complete a quantitative assessment. As a result, there were no impairment losses recognized during 2014, 2013 or 2012.

## Results of Operations

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

Year Ended December 31,	2014	2013	2012
<b>Sales</b>			
Carrier Networks Division	81.0%	78.0%	79.3%
Enterprise Networks Division	19.0	22.0	20.7
<b>Total sales</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>
Cost of sales	50.6	51.9	49.0
<b>Gross profit</b>	<b>49.4</b>	<b>48.1</b>	<b>51.0</b>
Selling, general and administrative expenses	20.9	20.2	21.7
Research and development expenses	21.0	20.4	20.3
<b>Operating income</b>	<b>7.5</b>	<b>7.6</b>	<b>9.1</b>
Interest and dividend income	0.8	1.1	1.2
Interest expense	(0.1)	(0.4)	(0.4)
Net realized investment gain	1.2	1.3	1.5
Other income (expense), net	0.2	(0.1)	—
Gain on bargain purchase of a business	—	—	0.3
<b>Income before provision for income taxes</b>	<b>9.5</b>	<b>9.5</b>	<b>11.8</b>
Provision for income taxes	(2.4)	(2.3)	(4.1)
<b>Net income</b>	<b>7.1%</b>	<b>7.1%</b>	<b>7.6%</b>

## Acquisition Expenses

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, 2014, 2013 and 2012 for this transaction is as follows:

<i>(In Thousands)</i>	2014	2013	2012
Amortization of acquired intangible assets	\$1,153	\$1,174	\$762
Amortization of other purchase accounting adjustments	1,117	1,378	2,305
Acquisition related professional fees, travel and other expenses	282	345	4,860
<b>Total acquisition related expenses, amortizations and adjustments</b>	<b>2,552</b>	<b>2,897</b>	<b>7,927</b>
<b>Tax effect</b>	<b>(791)</b>	<b>(898)</b>	<b>(2,589)</b>
<b>Total acquisition related expenses, amortizations and adjustments, net of tax</b>	<b>\$1,761</b>	<b>\$1,999</b>	<b>\$5,338</b>

The acquisition related expenses, amortizations and adjustments above were recorded in the following Consolidated Statements of Income categories for the years ended December 31, 2014, 2013 and 2012:

<i>(In Thousands)</i>	2014	2013	2012
Revenue (adjustments to unearned revenue recognized in the period)	\$595	\$856	\$1,225
Cost of goods sold	171	196	946
<b>Subtotal</b>	<b>766</b>	<b>1,052</b>	<b>2,171</b>
Selling, general and administrative expenses	311	399	4,510
Research and development expenses	1,475	1,446	1,246
<b>Subtotal</b>	<b>1,786</b>	<b>1,845</b>	<b>5,756</b>
<b>Total acquisition related expenses, amortizations and adjustments</b>	<b>2,552</b>	<b>2,897</b>	<b>7,927</b>
<b>Tax effect</b>	<b>(791)</b>	<b>(898)</b>	<b>(2,589)</b>
<b>Total acquisition related expenses, amortizations and adjustments, net of tax</b>	<b>\$1,761</b>	<b>\$1,999</b>	<b>\$5,338</b>

## 2014 Compared to 2013

### Sales

Our sales decreased 1.8% from \$641.7 million in 2013 to \$630.0 million in 2014. The decrease in sales is primarily attributable to a \$27.2 million decrease in sales of our HDSL and other legacy products and a \$12.2 million decrease in sales of our Internetworking products, partially offset by a \$27.9 million increase in sales of our Broadband Access products.

Carrier Networks sales increased 1.9% from \$500.7 million in 2013 to \$510.4 million in 2014. 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 and other legacy products. The increase in sales of our Broadband Access products is primarily attributable to an increase in hiX product sales in the EMEA region. The increase in sales of our Internetworking products is primarily attributable to increases in Carrier Ethernet sales and FTTP ONT sales to carriers in North America. The increase in sales of our Optical products is primarily attributable to increased sales of Optical products for broadband access globally and increased sales of our OPTI-6100 products to a domestic tier 1 carrier for Ethernet services to enterprises for wireless backhaul. The decreases in sales of HDSL and other legacy products in North America have 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 decreased 15.2% from \$141.0 million in 2013 to \$119.6 million in 2014. The decrease is attributable to a decrease in sales of our Internetworking products. The decrease in sales of our Internetworking products for this division is primarily attributable to softer demand in North America and an inventory reduction, primarily at two distribution partners. Internetworking product sales attributable to Enterprise Networks were 93.6% of the division's sales in 2014 and 2013. Legacy products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales decreased from 22.0% in 2013 to 19.0% in 2014.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 33.9% from \$185.7 million in 2013 to \$248.6 million in 2014. International sales, as a percentage of total sales, increased from 28.9% in 2013 to 39.5% in 2014. The increase in international sales is primarily attributable to increases in sales in the EMEA region and Latin America, partially offset by a decrease in sales in the Asia-Pacific region.

Carrier Systems product sales increased \$14.8 million in 2014 compared to 2013 primarily due to a \$27.9 million increase in Broadband Access product sales, partially offset by a \$12.8 million decrease in legacy product sales. The increase in Carrier Systems product sales is primarily attributable to the factors discussed above.

Business Networking product sales decreased \$11.9 million in 2014 compared to 2013 primarily due to a \$19.9 million decrease in Internetworking product sales in the EN division, partially offset by a \$7.7 million increase in Internetworking product sales in the CN division. The changes in sales of our Internetworking products in both of our divisions are primarily attributable to the factors discussed above.

Loop Access product sales decreased \$14.7 million in 2014 compared to 2013 primarily due to a \$13.8 million decrease in HDSL product sales, which is further discussed above.

### Cost of Sales

As a percentage of sales, cost of sales decreased from 51.9% in 2013 to 50.6% in 2014. The decrease is primarily attributable to improving gross margins in our international business, primarily related to lower product costs, partially offset by shifts in domestic customer mix and a higher services mix.

Carrier Networks cost of sales decreased from 53.4% of sales in 2013 to 52.3% of sales in 2014. The decrease in Carrier Networks cost of sales as a percentage of sales is primarily attributable to improving gross margins in our international business, partially offset by shifts in domestic customer mix and a higher services mix.

Enterprise Networks cost of sales decreased from 46.3% of sales in 2013 to 43.1% of sales in 2014. The decrease in Enterprise Networks cost of sales as a percentage of sales is primarily attributable to shifts in customer mix and lower product costs.

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 2.0% from \$129.4 million in 2013 to \$132.0 million in 2014. 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 attributable to increases in travel expenses, marketing expenses, contract services, and legal expenses, partially offset by a decrease in compensation expense. The increase in travel and marketing expenses is primarily attributable to our increased participation in trade shows in the U.S. and the EMEA region.

Selling, general and administrative expenses as a percentage of sales increased from 20.2% for the year ended December 31, 2013 to 20.9% for the year ended December 31, 2014. 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 0.9% from \$131.1 million in 2013 to \$132.3 million in 2014. The increase in research and development expenses is primarily attributable to increases in compensation costs and travel expenses, partially offset by a decrease in independent contractor expense.

Research and development expenses as a percentage of sales increased from 20.4% for the year ended December 31, 2013 to 21.0% for the year ended December 31, 2014. 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 \$7.0 million in 2013 to \$5.0 million in 2014. The decrease in interest and dividend income is primarily attributable to an \$18.3 million reduction of restricted funds that serves as a collateral deposit against our taxable revenue bond during the first quarter of 2014 and a reduction in the interest rate of that investment from 4.8% to 1.6% (see "Interest Expense" below for corresponding decrease in the interest rate of our taxable revenue bond). See "Liquidity and Capital Resources" below for additional information on our taxable revenue bond.

### **Interest Expense**

Interest expense, which is primarily related to our taxable revenue bond, decreased from \$2.3 million in 2013 to \$0.7 million in 2014. The decrease is primarily attributable to a \$16.5 million principal payment made on our taxable revenue bond during the first quarter of 2014. In connection with this payment, we negotiated a reduction in the interest rate of that bond from 5.0% to 2.0%, and, as noted above, a reduction in the interest rate on the collateral supporting the bond. See "Liquidity and Capital Resources" below for additional information on our taxable revenue bond.

### **Net Realized Investment Gain**

Net realized investment gain decreased from \$8.6 million in 2013 to \$7.3 million in 2014. The decrease in realized investment gains is primarily attributable to lower gains from the sale of equity securities in 2014. 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 resulting from foreign currency exchange rate movements, and investment account management fees, changed from \$0.9 million of expense in 2013 to \$1.2 million of income in 2014. The change is primarily attributable to a \$2.4 million gain recorded in the fourth quarter of 2014 related to the settlement of working capital items from an acquisition transaction that closed in 2012, partially offset by investment account management fees.

## Income Taxes

Our effective tax rate increased from 24.7% in 2013 to 25.5% in 2014. The increase in the effective tax rate between the two periods is primarily attributable to two years of research tax credits being recognized in 2013, partially offset by an additional foreign tax benefit from the elimination of a valuation allowance recorded in 2014. Based upon our results of operations in 2014 and expected profitability in future years in a certain international jurisdiction, we concluded that it is more likely than not certain foreign deferred tax assets will be realized.

## Net Income

As a result of the above factors, net income decreased from \$45.8 million in 2013 to \$44.6 million in 2014. As a percentage of sales, net income was 7.1% in 2013 and 2014.

## 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 TDM and SONET/SDH architectures to Ethernet-based packet networks. We offer Ethernet-based solutions within our Optical products that address this technology change, and we expect sales of our Optical products will increase over time due to this transition. The decrease in sales of HDSL and other legacy products has been expected as customers continue to upgrade their networks to deliver higher bandwidth services by migrating to newer technologies, including to our core products from our Broadband Access, Internetworking and Optical product lines. While we expect that revenues from HDSL and our other legacy products will continue to decline over time, these revenues may continue for years because of the time required for our customers to transition to newer technologies.

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

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

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

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

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

### **Cost of Sales**

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

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

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

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

### **Selling, General and Administrative Expenses**

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

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

### **Research and Development Expenses**

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

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

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

### **Interest and Dividend Income**

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

### **Interest Expense**

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

### **Net Realized Investment Gain**

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

### **Other Income (Expense), net**

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

### **Income Taxes**

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

### **Net Income**

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

## **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, 2014, cash on hand was \$73.4 million and short-term investments were \$46.9 million, which placed our short-term liquidity at \$120.4 million. At December 31, 2013, our cash on hand of \$58.3 million and short-term investments of \$105.8 million placed our short-term liquidity at \$164.1 million. The decrease in short-term liquidity from 2013 to 2014 primarily reflects funds used for share repurchases, shareholder dividends, and equipment acquisitions, partially offset by funds provided by our operating activities and proceeds from stock option exercises.

### **Operating Activities**

Our working capital, which consists of current assets less current liabilities, decreased 16.3% from \$277.3 million as of December 31, 2013 to \$232.1 million as of December 31, 2014. The quick ratio, defined as cash and cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 2.44 as of December 31, 2013 to 1.74 as of December 31, 2014. The current ratio, defined as current assets divided by current liabilities, decreased from 3.71 as of December 31, 2013 to 2.95 as of December 31, 2014. The changes in our working capital, quick ratio and current ratio are primarily attributable to a decrease in short-term investments and an increase in accounts payable and income tax payable, partially offset by an increase in other receivables. Short-term investments were used to fund share repurchases during 2014.

Net accounts receivable increased 0.4% from \$85.8 million at December 31, 2013 to \$86.2 million at December 31, 2014. Our allowance for doubtful accounts was \$0.1 million at December 31, 2013 and 2014. Quarterly accounts receivable days sales outstanding (DSO) increased from 50 days as of December 31, 2013 to 55 days as of December 31, 2014. 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 \$18.2 million at December 31, 2013 to \$35.6 million at December 31, 2014. The increase in other receivables is primarily attributable to the timing of filing returns and collections of value-added tax receivables in our international subsidiaries. At December 31, 2014 and 2013, other receivables also included a receivable for additional consideration due from NSN for settlement of the working capital items. 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 decreased from 3.6 turns as of December 31, 2013 to 3.5 turns as of December 31, 2014. Inventory decreased 3.8% from \$90.1 million at December 31, 2013 to \$86.7 million at December 31, 2014. 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 16.8% from \$48.3 million at December 31, 2013 to \$56.4 million at December 31, 2014. 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 \$11.3 million, \$8.2 million and \$12.3 million for the years ended December 31, 2014, 2013 and 2012, 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 as defined in the purchase agreement. During the fourth quarter of 2014, the parties settled final working capital items, and as a result, we recorded a \$2.4 million gain in other income (expense), net. Additionally, \$3.5 million is included in other receivables at December 31, 2014 for additional consideration due from NSN related to the settlement of the working capital items. This receivable was subsequently collected in January 2015.

Our combined short-term and long-term investments decreased \$87.4 million from \$415.0 million at December 31, 2013 to \$327.6 million at December 31, 2014. 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, 2014 these investments included corporate bonds of \$111.3 million, municipal fixed-rate bonds of \$127.8 million and municipal variable rate demand notes of \$2.5 million. 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. As of December 31, 2014, 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 0.9 years with an average credit rating of AA-. 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 9.2% from \$309.2 million at December 31, 2013 to \$280.6 million at December 31, 2014. Long-term investments at December 31, 2014 and December 31, 2013 included an investment in a certificate of deposit of \$30.0 million and \$48.3 million, respectively, which serves as collateral for our revenue bonds, as discussed below. We have investments in various marketable equity securities classified as long-term investments at a cost of \$26.4 million and \$24.7 million, and with a fair value of \$38.3 million and \$38.5 million, at December 31, 2014 and December 31, 2013, respectively.

Long-term investments at December 31, 2014 and 2013 also included \$16.3 million and \$15.1 million, respectively, related to our deferred compensation plan, and \$1.5 million and \$1.7 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.

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. For the years ended December 31, 2014, 2013, and 2012, we recorded charges of \$0.1 million, \$25 thousand and \$0.7 million, 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 2% 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, 2014 was approximately \$29.7 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of AAA. 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, 2014 is \$30.0 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, 2014, 2013 and 2012, we realized economic incentives related to payroll withholdings totaling \$1.3 million, \$1.3 million and \$1.4 million, respectively.

We made a principal payment of \$16.5 million for the year ended December 31, 2014. We did not make a principal payment for the year-ended December 31, 2013. We anticipate making a principal payment in 2015. At December 31, 2014, \$1.2 million of the bond debt was classified as a current liability in accounts payable in the Consolidated Balance Sheets.

The following table shows dividends paid to our shareholders in each quarter of 2014, 2013 and 2012. During 2014, 2013 and 2012, we paid shareholder dividends totaling \$19.9 million, \$21.4 million and \$22.8 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

2014	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2013	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2012	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09

## Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 40.0 million shares of our common stock. On May 14, 2014, 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 45.0 million), which commenced upon completion of the repurchase plan announced on May 1, 2013. This new authorization is being implemented through open market or private purchases from time to time as conditions warrant. For the years 2014, 2013 and 2012, we repurchased 3.7 million shares, 5.6 million shares and 1.8 million shares, respectively, for a cost of \$80.6 million, \$124.3 million and \$39.4 million, respectively, at an average price of \$21.96, \$22.16 and \$22.03 per share, respectively. We currently have the authority to purchase an additional 4.8 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 0.1 million shares of treasury stock for \$2.8 million during the year ended December 31, 2014, 0.2 million shares of treasury stock for \$3.6 million during the year ended December 31, 2013, and 0.4 million shares of treasury stock for \$6.0 million during the year ended December 31, 2012.

### 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, 2014.

### Contractual Obligations

<i>(In millions)</i>	Total	2015	2016	2017	2018	After 2018
Long-term debt	\$30.0	\$1.2	\$—	\$—	\$—	\$28.8
Interest on long-term debt	3.0	0.6	0.6	0.6	0.6	0.6
Purchase obligations	81.8	78.0	2.7	0.5	0.5	0.1
Operating lease obligations	18.7	4.9	3.7	3.2	1.6	5.3
<b>Totals</b>	<b>\$133.5</b>	<b>\$84.7</b>	<b>\$7.0</b>	<b>\$4.3</b>	<b>\$2.7</b>	<b>\$34.8</b>

We are required to make payments necessary to pay the interest on the Amended and Restated Bond, currently outstanding in the aggregate principal amount of \$30.0 million. The bond matures on January 1, 2020, and bears interest at the rate of 2% per annum. Included in long-term investments are \$30.0 million of restricted funds, which is a collateral deposit against the principal amount of this bond. We made a principal payment of \$16.5 million for the year ended December 31, 2014. We did not make a principal payment for the year-ended December 31, 2013. We anticipate making a principal payment in 2015. At December 31, 2014 and 2013, \$1.2 million and \$0.3 million, respectively, of the bond debt were classified as a current liability in accounts payable in the Consolidated Balance Sheets. See Note 9 of Notes to Consolidated Financial Statements for additional information.

Purchase obligations primarily relate to open purchase orders to our contract manufacturers, component suppliers, and other vendors.

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, 2014, of which \$7.7 million has been applied to these commitments. The additional \$0.2 million commitment has been excluded from the table above due to uncertainty of when it will be applied.

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

### Effect of Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09), which supersedes the revenue recognition requirements in Topic 605, *Revenue Recognition*, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is not permitted. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. We are currently evaluating the transition method that will be elected and the impact that the adoption of ASU 2014-09 will have on our financial position, results of operations and cash flows.

### Subsequent Events

On January 20, 2015, 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 5, 2015. The quarterly dividend payment was \$4.8 million and was paid on February 19, 2015.

# 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, 2014, \$69.6 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, 2014, approximately \$258.4 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, 2014, we held \$112.0 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, 2014 would reduce annualized interest income on our cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes by approximately \$0.5 million. In addition, we held \$239.0 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, 2014 would reduce the fair value of our municipal and corporate bonds by approximately \$1.1 million.

As of December 31, 2013, interest income on approximately \$329.3 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, 2013 would have reduced 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, a hypothetical 50 bps increase in interest rates as of December 31, 2013 would have reduced the fair value of our municipal and corporate bonds by approximately \$1.4 million.

We are exposed to changes in foreign currency exchange rates to the extent that such changes affect our revenue and gross margin on revenue derived from international customers, expenses, and assets and liabilities held in non-functional currencies related to our foreign subsidiaries. Our primary exposure to foreign currency exchange rates is with our German subsidiary, whose functional currency is the Euro, and our Australian subsidiary, whose functional currency is the Australian dollar. We are exposed to changes in foreign currency exchange rates to the extent of our German subsidiaries use of contract manufacturers and raw material suppliers whom we pay in U.S. dollars. As a result, changes in currency exchange rates could cause variations in gross margin in the products that we sell in the EMEA region.

We have certain international customers who are invoiced or pay in a non-functional 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 Saudi Arabian Riyal is the predominant currency of the customers who are billed in their local currency. Taking into account the effects of foreign currency fluctuations of the Riyal versus the Euro, a hypothetical 10% weakening of the Euro as of December 31, 2014 would provide a gain on foreign currency of approximately \$0.1 million. Conversely, a hypothetical 10% strengthening of the Euro as of December 31, 2014 would provide a loss on foreign currency of approximately \$0.1 million. Any gain or loss would be significantly mitigated by the hedges discussed in the following paragraph.

As of December 31, 2014, we had no material contracts, other than accounts receivable, accounts payable, and loans to a subsidiary, denominated in foreign currencies. As of December 31, 2014, we had forward contracts outstanding with notional amounts totaling €12.5 million (\$15.1 million), which mature at various times throughout early 2015. The fair value of these forward contracts was a net asset of approximately \$0.2 million as of December 31, 2014.

# 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, 2014. 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 (2013)*.

Based on our assessment and those criteria, management has concluded that ADTRAN maintained effective internal control over financial reporting as of December 31, 2014.

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



# Report of Independent Registered Public Accounting Firm

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

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of ADTRAN, Inc. and its subsidiaries at December 31, 2014 and December 31, 2013 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report On Internal Control Over Financial Reporting*. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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



PricewaterhouseCoopers LLP  
Birmingham, Alabama  
February 24, 2015

# Financial Statements

## ADTRAN, INC.

### Consolidated Balance Sheets

December 31, 2014 and 2013

(In thousands, except per share amounts)

Assets	2014	2013
<b>Current Assets</b>		
Cash and cash equivalents	\$73,439	\$58,298
Short-term investments	46,919	105,760
Accounts receivable, less allowance for doubtful accounts of \$136 and \$130 at December 31, 2014 and 2013, respectively	86,158	85,814
Other receivables	35,639	18,249
Inventory, net	86,710	90,111
Prepaid expenses	5,129	4,325
Deferred tax assets, net	17,095	17,083
<b>Total Current Assets</b>	<b>351,089</b>	<b>379,640</b>
Property, plant and equipment, net	74,828	76,739
Deferred tax assets, net	17,694	9,622
Goodwill	3,492	3,492
Other assets	10,942	11,180
Long-term investments	280,649	309,225
<b>Total Assets</b>	<b>\$738,694</b>	<b>\$789,898</b>
<b>Liabilities and Stockholders' Equity</b>		
<b>Current Liabilities</b>		
Accounts payable	\$56,414	\$48,282
Unearned revenue	22,762	22,205
Accrued expenses	11,077	12,776
Accrued wages and benefits	13,855	14,040
Income tax payable, net	14,901	5,002
<b>Total Current Liabilities</b>	<b>119,009</b>	<b>102,305</b>
Non-current unearned revenue	10,948	14,643
Other non-current liabilities	30,924	22,144
Bonds payable	28,800	46,200
<b>Total Liabilities</b>	<b>189,681</b>	<b>185,292</b>
Commitments and contingencies (see Note 13)		
<b>Stockholders' Equity</b>		
Common stock, par value \$0.01 per share; 200,000 shares authorized; 79,652 shares issued and 53,431 shares outstanding at December 31, 2014 and 79,652 shares issued and 56,918 shares outstanding at December 31, 2013	797	797
Additional paid-in capital	241,829	233,511
Accumulated other comprehensive income (loss)	(75)	10,753
Retained earnings	907,751	884,451
Less treasury stock at cost: 26,221 and 22,734 shares at December 31, 2014 and 2013, respectively	(601,289)	(524,906)
<b>Total Stockholders' Equity</b>	<b>549,013</b>	<b>604,606</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$738,694</b>	<b>\$789,898</b>

See notes to consolidated financial statements.

**ADTRAN, INC.****Consolidated Statements of Income**

Years ended December 31, 2014, 2013 and 2012

<i>(In thousands, except per share amounts)</i>	2014	2013	2012
Sales	\$630,007	\$641,744	\$620,614
Cost of sales	318,680	332,858	303,971
<b>Gross Profit</b>	<b>311,327</b>	<b>308,886</b>	<b>316,643</b>
Selling, general and administrative expenses	131,958	129,366	134,523
Research and development expenses	132,258	131,055	125,951
<b>Operating Income</b>	<b>47,111</b>	<b>48,465</b>	<b>56,169</b>
Interest and dividend income	5,019	7,012	7,657
Interest expense	(677)	(2,325)	(2,347)
Net realized investment gain	7,278	8,614	9,550
Other income (expense), net	1,175	(911)	183
Gain on bargain purchase of a business	—	—	1,753
<b>Income before provision for income taxes</b>	<b>59,906</b>	<b>60,855</b>	<b>72,965</b>
Provision for income taxes	(15,286)	(15,061)	(25,702)
<b>Net Income</b>	<b>\$44,620</b>	<b>\$45,794</b>	<b>\$47,263</b>
Weighted average shares outstanding—basic	55,120	59,001	63,259
Weighted average shares outstanding—diluted	55,482	59,424	63,774
Earnings per common share—basic	\$0.81	\$0.78	\$0.75
Earnings per common share—diluted	\$0.80	\$0.77	\$0.74

*See notes to consolidated financial statements.*

**ADTRAN, INC.****Consolidated Statements of Comprehensive Income**

Years ended December 31, 2014, 2013 and 2012

<i>(In thousands)</i>	2014	2013	2012
<b>Net Income</b>	<b>\$44,620</b>	<b>\$45,794</b>	<b>\$47,263</b>
Other Comprehensive Loss, net of tax:			
Net unrealized gains (losses) on available-for-sale securities	(1,773)	629	(52)
Defined benefit plan adjustments	(4,866)	1,061	(1,952)
Foreign currency translation	(4,189)	(2,205)	170
<b>Other Comprehensive Loss, net of tax</b>	<b>\$(10,828)</b>	<b>\$(515)</b>	<b>\$(1,834)</b>
<b>Comprehensive Income, net of tax</b>	<b>\$33,792</b>	<b>\$45,279</b>	<b>\$45,429</b>

*See notes to consolidated financial statements.*

**ADTRAN, INC.**
**Consolidated Statements of Changes in Stockholders' Equity**

Years ended December 31, 2014, 2013 and 2012

<i>(In thousands)</i>	Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Stockholders' Equity
<b>Balance, December 31, 2011</b>	<b>79,652</b>	<b>\$797</b>	<b>\$213,560</b>	<b>\$840,206</b>	<b>\$(375,534)</b>	<b>\$13,102</b>	<b>\$692,131</b>
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
<b>Balance, December 31, 2012</b>	<b>79,652</b>	<b>\$797</b>	<b>\$224,517</b>	<b>\$861,465</b>	<b>\$(405,641)</b>	<b>\$11,268</b>	<b>\$692,406</b>
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
<b>Balance, December 31, 2013</b>	<b>79,652</b>	<b>\$797</b>	<b>\$233,511</b>	<b>\$884,451</b>	<b>\$(524,906)</b>	<b>\$10,753</b>	<b>\$604,606</b>
Net income				44,620			44,620
Other comprehensive loss, net of tax						(10,828)	(10,828)
Dividend payments				(19,947)			(19,947)
Dividends accrued for unvested restricted stock units				(19)			(19)
Stock options exercised				(558)	3,397		2,839
Restricted stock units vested			(326)	(796)	796		(326)
Purchase of treasury stock: 3,669 shares					(80,576)		(80,576)
Income tax benefit from exercise of stock options			81				81
Stock-based compensation expense			8,563				8,563
<b>Balance, December 31, 2014</b>	<b>79,652</b>	<b>\$797</b>	<b>\$241,829</b>	<b>\$907,751</b>	<b>\$(601,289)</b>	<b>\$(75)</b>	<b>\$549,013</b>

We issued 182 shares, 217 shares and 393 shares of treasury stock to accommodate employee stock option exercises, vesting of restricted stock, and vesting of restricted stock units during 2014, 2013 and 2012, respectively.

See notes to consolidated financial statements.



**ADTRAN, INC.****Consolidated Statements of Cash Flows**

Years ended December 31, 2014, 2013 and 2012

<i>(In thousands)</i>	2014	2013	2012
<b>Cash flows from operating activities</b>			
Net income	\$44,620	\$45,794	\$47,263
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	14,845	14,628	14,079
Amortization of net premium on available-for-sale investments	4,360	5,956	8,257
Net realized gain on long-term investments	(7,278)	(8,614)	(9,550)
Net (gain) loss on disposal of property, plant, and equipment	142	3	(214)
Gain on bargain purchase of a business	—	—	(1,753)
Stock-based compensation expense	8,563	9,073	9,264
Deferred income taxes	(5,526)	(4,058)	(3,785)
Tax benefit from stock option exercises	81	169	1,905
Excess tax benefits from stock-based compensation arrangements	(63)	(158)	(1,456)
Change in operating assets and liabilities:			
Accounts receivable, net	(2,769)	(5,541)	(2,847)
Other receivables	(20,439)	(1,549)	2,977
Inventory	1,953	10,265	8,333
Prepaid expenses and other assets	(3,627)	(11)	(1,045)
Accounts payable	9,973	5,206	7,510
Accrued expenses and other liabilities	(166)	(15,146)	8,895
Income taxes payable, net	11,168	3,747	(1,960)
<b>Net cash provided by operating activities</b>	<b>55,837</b>	<b>59,764</b>	<b>85,873</b>
<b>Cash flows from investing activities</b>			
Purchases of property, plant, and equipment	(11,256)	(8,173)	(12,320)
Proceeds from disposals of property, plant and equipment	1	—	266
Proceeds from sales and maturities of available-for-sale investments	230,019	343,567	282,039
Purchases of available-for-sale investments	(142,695)	(261,625)	(282,740)
Acquisition of business, net of cash acquired	—	—	7,496
<b>Net cash provided by (used in) investing activities</b>	<b>76,069</b>	<b>73,769</b>	<b>(5,259)</b>
<b>Cash flows from financing activities</b>			
Proceeds from stock option exercises	2,839	3,629	6,049
Purchases of treasury stock	(80,576)	(124,267)	(39,362)
Dividend payments	(19,947)	(21,412)	(22,813)
Payments on long-term debt	(16,500)	—	(500)
Excess tax benefits from stock-based compensation arrangements	63	158	1,456
<b>Net cash used in financing activities</b>	<b>(114,121)</b>	<b>(141,892)</b>	<b>(55,170)</b>
Net increase (decrease) in cash and cash equivalents	17,785	(8,359)	25,444
Effect of exchange rate changes	(2,644)	(1,800)	34
<b>Cash and cash equivalents, beginning of year</b>	<b>58,298</b>	<b>68,457</b>	<b>42,979</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$73,439</b>	<b>\$58,298</b>	<b>\$68,457</b>
Supplemental disclosure of cash flow information			
Cash paid during the year for interest	\$758	\$2,325	\$2,348
Cash paid during the year for income taxes	\$9,856	\$15,431	\$31,021
Supplemental disclosure of non-cash investing activities			
Purchases of property, plant and equipment included in accounts payable	\$467	\$444	\$108

See notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

## 1 Nature of Business and Summary of Significant Accounting Policies

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

### Principles of Consolidation

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

### Changes in Classifications

We corrected immaterial misclassifications between the operating and investing sections of our consolidated statements of cash flows and adjusted our 2012 cash flows in these categories by \$0.2 million, in order to be consistent with the 2014 and 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 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, 2014, \$69.6 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

### Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the immediate or short-term maturity of these financial instruments. The carrying amount reported for bonds payable was \$30.0 million, compared to an estimated fair value of \$29.7 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of AAA.

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, deferred compensation plan assets, 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, 2014 and 2013 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, 2014, two customers accounted for 24.5% of our total accounts receivable. At December 31, 2013, one customer accounted for 13.1% 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 \$0.1 million at December 31, 2014 and December 31, 2013.

### **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, amounts due from various jurisdictions for value-added tax, and amounts due from employee stock option exercises. At December 31, 2014 and 2013, other receivables also included a receivable due from NSN related to working capital items settled during the fourth quarter of 2014 and collected in January 2015.

### **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 disposals are charged against the inventory reserve. See Note 6 of Notes to Consolidated Financial Statements for additional information.

### **Property, Plant and Equipment**

Property, plant and equipment, which is stated at cost, is depreciated using the straight-line method over the estimated useful lives of the assets. We depreciate building and land improvements from five to 39 years, office machinery and equipment from three to seven years, engineering machinery and equipment from three to seven years, and computer software from three to five years. Expenditures for repairs and maintenance are charged to expense as incurred. Betterments that materially prolong the lives of the assets are capitalized. 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 \$8.4 million and \$9.0 million at December 31, 2014 and 2013, 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, 2014, 2013 and 2012 is as follows:

*(In thousands)*

<b>Year Ended December 31,</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Balance at beginning of period	\$8,977	\$9,653	\$4,118
Plus: Amounts charged to cost and expenses	3,103	4,051	5,363
Amounts assumed on acquisition	—	—	3,781
Less: Deductions	(3,665)	(4,727)	(3,609)
<b>Balance at end of period</b>	<b>\$8,415</b>	<b>\$8,977</b>	<b>\$9,653</b>

### Pension Benefit Plan Obligations

We maintain 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 certain of our executive officers in 2014, 2013, and 2012. The restricted stock units are subject to a market condition based on the relative total shareholder return of ADTRAN against all the companies in the NASDAQ Telecommunications Index and vest at the end of a three-year performance period. The restricted stock units are converted into shares of common stock upon vesting. Depending on the relative total shareholder return over the performance period, the executive officers may earn from 0% to 150% of the number of restricted stock units granted. The fair value of the award is based on the market price of our common stock on the date of grant, adjusted for the expected outcome of the impact of market conditions using a Monte Carlo Simulation valuation method. The recipients of the restricted stock units also earn dividend credits during the performance period, which will be paid in cash upon the issuance of common stock for the restricted stock units.

Stock-based compensation expense recognized in 2014, 2013 and 2012 was approximately \$8.6 million, \$9.1 million and \$9.3 million, respectively. As of December 31, 2014, total compensation cost related to non-vested stock options, restricted stock units and restricted stock not yet recognized was approximately \$17.7 million, which is expected to be recognized over an average remaining recognition period of 2.8 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 2014, 2013 or 2012.

### 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 2014, 2013 or 2012. 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 \$132.3 million, \$131.1 million and \$126.0 million for the years ended December 31, 2014, 2013 and 2012, respectively.

### Other Comprehensive Income

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

The following table presents changes in accumulated other comprehensive income, net of tax, by component for the years ended December 31, 2012, 2013 and 2014:

<i>(In thousands)</i>	Unrealized Gains (Losses) on Available-for-Sale Securities	Defined Benefit Plan Adjustments	Foreign Currency Adjustments	Total
<b>Balance at December 31, 2011</b>	<b>\$10,160</b>	<b>\$—</b>	<b>\$2,942</b>	<b>\$13,102</b>
Other comprehensive income (loss) before reclassifications	5,426	(1,952)	170	3,644
Amounts reclassified from accumulated other comprehensive income	(5,478)	—	—	(5,478)
<b>Balance at December 31, 2012</b>	<b>\$10,108</b>	<b>\$(1,952)</b>	<b>\$3,112</b>	<b>\$11,268</b>
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)
<b>Balance at December 31, 2013</b>	<b>\$10,737</b>	<b>\$(891)</b>	<b>\$907</b>	<b>\$10,753</b>
Other comprehensive income (loss) before reclassifications	2,363	(4,866)	(4,189)	(6,692)
Amounts reclassified from accumulated other comprehensive income	(4,136)	—	—	(4,136)
<b>Balance at December 31, 2014</b>	<b>\$8,964</b>	<b>\$(5,757)</b>	<b>\$3,282</b>	<b>\$(75)</b>



The following tables present the details of reclassifications out of accumulated other comprehensive income for the years ended December 31, 2014, 2013 and 2012:

<i>(In thousands)</i>	<b>2014</b>	
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	\$6,895	Net realized investment gain
Impairment expense	(115)	Net realized investment gain
Total reclassifications for the period, before tax	6,780	
Tax (expense) benefit	(2,644)	
<b>Total reclassifications for the period, net of tax</b>	<b>\$4,136</b>	

<i>(In thousands)</i>	<b>2013</b>	
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)	
<b>Total reclassifications for the period, net of tax</b>	<b>\$4,879</b>	

<i>(In thousands)</i>	<b>2012</b>	
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)	
<b>Total reclassifications for the period, net of tax</b>	<b>\$5,478</b>	

The following tables present the tax effects related to the change in each component of other comprehensive income for the years ended December 31, 2014, 2013 and 2012:

<i>(In thousands)</i>	<b>2014</b>		
	Before-Tax Amount	Tax (Expense) Benefit	Net-of-Tax Amount
Unrealized gains (losses) on available-for-sale securities	\$3,874	\$(1,511)	\$2,363
Reclassification adjustment for amounts included in net income	(6,780)	2,644	(4,136)
Defined benefit plan adjustments	(7,052)	2,186	(4,866)
Foreign currency translation adjustment	(4,189)	—	(4,189)
<b>Total Other Comprehensive Income (Loss)</b>	<b>\$(14,147)</b>	<b>\$3,319</b>	<b>\$(10,828)</b>

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

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

### 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 functional currency with any transaction gains or losses reported in other income (expense). Our primary exposure to foreign currency exchange rate movements is with our German subsidiary, whose functional currency is the Euro, and our Australian subsidiary, whose functional currency is the Australian dollar. 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. In these instances, we use best estimates to allocate consideration to each respective unit of accounting. These estimates include analysis of respective bills of material and review and analysis of similar product and service offerings. We record revenue

associated with installation services when respective contractual obligations are complete. In instances where customer acceptance is required, revenue is deferred until respective 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, 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 (VARs) and system integrators. VARs and system integrators may be affiliated with us as a channel partner, or they may purchase from the distributor in an unaffiliated fashion. Additionally, with certain limitations our distributors may return unused and unopened product for stock-balancing purposes when such returns are accompanied by offsetting orders for products of equal or greater value.

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

#### **Unearned Revenue**

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

#### **Other Income (Expense), Net**

Other income (expense), net, is comprised primarily of miscellaneous income and expense, gains and losses on foreign currency transactions, and investment account management fees. For the year ended December 31, 2014, other income (expense), net included a \$2.4 million gain related to the settlement of working capital items from an acquisition transaction that closed in 2012.

#### **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, 2014, 2013 and 2012, we paid \$19.9 million, \$21.4 million and \$22.8 million, respectively, in shareholder dividends. On January 20, 2015, 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 5, 2015. The ex-dividend date was February 3, 2015 and the payment date was February 19, 2015. The quarterly dividend payment was \$4.8 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

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (ASU 2014-09), which supersedes the revenue recognition requirements in Topic 605, Revenue Recognition, including most industry-specific revenue recognition guidance throughout the Industry Topics of the Codification. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early application is not permitted. ASU 2014-09 allows for either full retrospective or modified retrospective adoption. We are currently evaluating the transition method that will be elected and the impact that the adoption of ASU 2014-09 will have on our financial position, results of operations and cash flows.

## 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. During the fourth quarter of 2014, the parties settled final working capital items, and as a result, we recorded a \$2.4 million gain in other income (expense), net. Additionally, \$3.5 million is included in other receivables at December 31, 2014 for additional consideration due from NSN for settlement of the working capital items. 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)
<b>Net liabilities assumed</b>	<b>(14,094)</b>
Customer relationships	5,162
Developed technology	3,176
Other	13
Gain on bargain purchase of a business, net of tax	(1,753)
<b>Net consideration received by seller</b>	<b>\$(7,496)</b>

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, 2014, 2013 and 2012, we incurred acquisition and integration related expenses and amortization of acquired intangibles of \$2.5 million, \$2.9 million, and \$7.9 million, respectively, related to this acquisition.

The following supplemental pro forma information presents the financial results of the combined entity for the years ended December 31, 2012 and 2011. The pro forma results of the acquired NSN BBA business for the period January 1, 2012 to May 4, 2012 and January 1, 2011 to December 31, 2011 were not included in our consolidated financial results for the years ended December 31, 2012 or 2011. There were no material, non-recurring pro forma adjustments to the historical data.

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.

<i>(In thousands) (Unaudited)</i>	2012	2011
Pro forma revenue	\$672,044	\$913,485
Pro forma pre-tax income	\$57,906	\$169,162
Weighted average exchange rate during the period (EURO/USD)	€1.00/\$1.29	€1.00/\$1.38

### 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 all options outstanding under the 1996 Plan at December 31, 2014 expire during 2015.

On January 23, 2006, the Board of Directors adopted the 2006 Employee Stock Incentive Plan (2006 Plan), which authorizes 13.0 million shares of common stock for issuance to certain employees and officers through incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. The 2006 Plan was adopted by stockholder approval at our annual meeting of stockholders held on May 9, 2006. Options granted under the 2006 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. Expiration dates of options outstanding at December 31, 2014 under the 2006 Plan range from 2016 to 2024.

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 also currently have options outstanding under the 2005 Directors Stock Option Plan. Expiration dates of options outstanding under both plans at December 31, 2014 range from 2015 to 2019.



The following table is a summary of our stock options outstanding as of December 31, 2013 and 2014 and the changes that occurred during 2014:

<i>(In thousands, except per share amounts)</i>	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
<b>Options outstanding, December 31, 2013</b>	<b>6,358</b>	<b>\$24.43</b>	<b>6.60</b>	<b>\$25,878</b>
Options granted	1,181	\$18.98		
Options forfeited	(150)	\$23.28		
Options cancelled	(261)	\$24.87		
Options exercised	(147)	\$19.27		
<b>Options outstanding, December 31, 2014</b>	<b>6,981</b>	<b>\$23.62</b>	<b>6.45</b>	<b>\$10,625</b>
<b>Options vested and expected to vest, December 31, 2014</b>	<b>6,787</b>	<b>\$23.69</b>	<b>6.38</b>	<b>\$9,381</b>
<b>Options exercisable, December 31, 2014</b>	<b>4,397</b>	<b>\$25.15</b>	<b>4.99</b>	<b>\$5,153</b>

All of the options above were issued at exercise prices that approximate fair market value at the date of grant. At December 31, 2014, 5.2 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 2014 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, 2014. 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 2014, 2013 and 2012 was \$0.7 million, \$1.1 million and \$4.5 million, respectively. The fair value of options fully vesting during 2014, 2013 and 2012 was \$7.7 million.

The following table further describes our stock options outstanding as of December 31, 2014:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Options Outstanding at 12/31/14 <i>(in thousands)</i>	Weighted Avg. Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable at 12/31/14 <i>(in thousands)</i>	Weighted Average Exercise Price	
\$14.88 – 18.07	1,340	6.40	\$16.36	895	\$16.06	
\$18.08 – 22.40	1,201	9.71	\$19.02	28	\$21.35	
\$22.41 – 23.46	1,415	3.65	\$23.12	1,415	\$23.12	
\$23.47 – 30.04	1,421	6.71	\$25.47	671	\$27.20	
\$30.05 – 41.92	1,604	6.30	\$31.94	1,388	\$32.17	
	<b>6,981</b>			<b>4,397</b>		

#### 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, up to 3.0 million shares of common stock may be granted to certain employees and officers for awards other than stock options, including RSUs. 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 are 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, 2013 and 2014 and the changes that occurred during 2014:

<i>(In thousands except per share amounts)</i>	Number of Shares	Weighted Average Grant Date Fair Value
<b>Unvested RSUs and restricted stock outstanding, December 31, 2013</b>	<b>95</b>	<b>\$28.38</b>
RSUs and restricted stock granted	50	\$21.97
RSUs and restricted stock vested	(24)	\$34.56
Adjustments to shares granted due to shares earned at vesting	(17)	\$38.73
<b>Unvested RSUs and restricted stock outstanding, December 31, 2014</b>	<b>104</b>	<b>\$22.81</b>

At December 31, 2014, total compensation cost related to the non-vested portion of RSUs and restricted stock not yet recognized was approximately \$1.6 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, 2014, 2013 and 2012, which was recognized as follows:

<i>(In thousands)</i>	2014	2013	2012
<b>Stock-based compensation expense included in cost of sales</b>	<b>\$479</b>	<b>\$465</b>	<b>\$422</b>
Selling, general and administrative expense	4,185	4,443	4,351
Research and development expense	3,899	4,165	4,491
<b>Stock-based compensation expense included in operating expenses</b>	<b>8,084</b>	<b>8,608</b>	<b>8,842</b>
<b>Total stock-based compensation expense</b>	<b>8,563</b>	<b>9,073</b>	<b>9,264</b>
Tax benefit for expense associated with non-qualified options	(1,157)	(1,298)	(1,234)
<b>Total stock-based compensation expense, net of tax</b>	<b>\$7,406</b>	<b>\$7,775</b>	<b>\$8,030</b>

At December 31, 2014, total compensation cost related to non-vested stock options not yet recognized was approximately \$16.0 million, which is expected to be recognized over an average remaining recognition period of 2.9 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 2014 to the methodology used to determine our assumptions.

The weighted-average estimated fair value of stock options granted to employees during the years ended December 31, 2014, 2013 and 2012 was \$6.31 per share, \$8.35 per share and \$5.60 per share, respectively, with the following weighted-average assumptions:

	2014	2013	2012
Expected volatility	39.05%	39.92%	39.46%
Risk-free interest rate	1.79%	1.71%	0.96%
Expected dividend yield	1.90%	1.52%	2.05%
Expected life (in years)	6.33	6.36	6.18

We based our estimate of expected volatility for the years ended December 31, 2014, 2013 and 2012 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, 2014, 2013 and 2012 was \$22.11 per share, \$27.72 per share and \$19.46 per share, respectively, with the following assumptions:

	2014	2013	2012
Expected volatility	36.40%	38.83%	37.75%
Risk-free interest rate	0.96%	0.61%	0.38%
Expected dividend yield	1.89%	1.52%	2.12%

Stock-based compensation expense recognized in our Consolidated Statements of Income for the years ended December 31, 2014, 2013 and 2012 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 3.1% annually. We estimated a 0% forfeiture rate for our RSUs and restricted stock due to the limited number of recipients and historical experience for these awards.

## 4 Investments

At December 31, 2014, we held the following securities and investments, recorded at either fair value or cost:

<i>(In thousands)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value/ Carrying Value
Deferred compensation plan assets	\$13,897	\$2,409	\$(12)	\$16,294
Corporate bonds	111,261	186	(186)	111,261
Municipal fixed-rate bonds	127,341	480	(34)	127,787
Municipal variable rate demand notes	2,465	—	—	2,465
Marketable equity securities	26,399	12,395	(539)	38,255
<b>Available-for-sale securities held at fair value</b>	<b>\$281,363</b>	<b>\$15,470</b>	<b>\$(771)</b>	<b>\$296,062</b>
<b>Restricted investment held at cost</b>				<b>30,000</b>
<b>Other investments held at cost</b>				<b>1,506</b>
<b>Total carrying value of available-for-sale investments</b>				<b>\$327,568</b>

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

<i>(In thousands)</i>	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
<b>Available-for-sale securities held at fair value</b>	<b>\$347,407</b>	<b>\$17,939</b>	<b>\$(300)</b>	<b>\$365,046</b>
<b>Restricted investment held at cost</b>				<b>48,250</b>
<b>Other investments held at cost</b>				<b>1,689</b>
<b>Total carrying value of available-for-sale investments</b>				<b>\$414,985</b>

As of December 31, 2014, corporate and municipal fixed-rate bonds had the following contractual maturities:

<i>(In thousands)</i>	Corporate bonds	Municipal fixed-rate bonds
Less than one year	\$20,413	\$22,730
One to two years	67,732	69,680
Two to three years	23,116	34,160
Three to five years	—	1,217
<b>Total</b>	<b>\$111,261</b>	<b>\$127,787</b>

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. For each of the years ended December 31, 2014, 2013 and 2012, we recorded a charge of \$0.1 million, \$25 thousand and \$0.7 million, respectively, related to the other-than-temporary impairment of certain marketable equity securities and our deferred compensation plan assets.

Realized gains and losses on sales of securities are computed under the specific identification method. The following table presents gross realized gains and losses related to our investments for the years ended December 31, 2014, 2013 and 2012:

*(In thousands)*

<b>Year Ended December 31,</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Gross realized gains	\$7,586	\$8,932	\$11,006
Gross realized losses	\$(308)	\$(318)	\$(1,456)

The following table presents the breakdown of investments with unrealized losses at December 31, 2014:

<i>(In thousands)</i>	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	\$49	\$(3)	\$278	\$(9)	\$327	\$(12)
Corporate bonds	31,021	(186)	—	—	31,021	(186)
Municipal fixed-rate bonds	30,339	(34)	—	—	30,339	(34)
Marketable equity securities	4,824	(478)	208	(61)	5,032	(539)
<b>Total</b>	<b>\$66,233</b>	<b>\$(701)</b>	<b>\$486</b>	<b>\$(70)</b>	<b>\$66,719</b>	<b>\$(771)</b>

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

<i>(In thousands)</i>	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)
<b>Total</b>	<b>\$37,236</b>	<b>\$(278)</b>	<b>\$440</b>	<b>\$(22)</b>	<b>\$37,676</b>	<b>\$(300)</b>

The increase in unrealized losses during 2014, as reflected in the table above result from changes in market positions associated with our equity investment portfolio. At December 31, 2014, a total of 265 of our marketable equity securities were in an unrealized loss position.

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

#### Fair Value Measurements at December 31, 2014 Using

<i>(In thousands)</i>	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<b>Cash equivalents</b>				
Money market funds	\$1,163	\$1,163	\$—	\$—
<b>Available-for-sale securities</b>				
Deferred compensation plan assets	16,294	16,294	—	—
<b>Available-for-sale debt securities</b>				
Corporate bonds	111,261	—	111,261	—
Municipal fixed-rate bonds	127,787	—	127,787	—
Municipal variable rate demand notes	2,465	—	2,465	—
<b>Available-for-sale marketable equity securities</b>				
Marketable equity securities— technology industry	9,661	9,661	—	—
Marketable equity securities—other	28,594	28,594	—	—
<b>Available-for-sale securities</b>	<b>296,062</b>	<b>54,549</b>	<b>241,513</b>	<b>—</b>
<b>Total</b>	<b>\$297,225</b>	<b>\$55,712</b>	<b>\$241,513</b>	<b>\$—</b>

#### Fair Value Measurements at December 31, 2013 Using

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

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



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

## 5 Derivative Instruments and Hedging Activities

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

As of December 31, 2014, we had forward contracts outstanding with notional amounts totaling €12.5 million (\$15.1 million), which mature at various times throughout early 2015.

The fair values of our derivative instruments recorded in the Consolidated Balance Sheet as of December 31, 2014 and 2013 were as follows:

<i>(In thousands)</i>	<b>Balance Sheet Location</b>	<b>2014</b>	<b>2013</b>
<b>Derivatives Not Designated as Hedging Instruments (Level 2):</b>			
Foreign exchange contracts – asset derivatives	Other receivables	\$249	\$18
Foreign exchange contracts – liability derivatives	Accounts payable	\$(10)	\$(15)

The change in the fair values of our derivative instruments recorded in the Consolidated Statements of Income during the years ended December 31, 2014 and 2013 were as follows:

<i>(In thousands)</i>	<b>Income Statement Location</b>	<b>2014</b>	<b>2013</b>
<b>Derivatives Not Designated as Hedging Instruments:</b>			
Foreign exchange contracts	Other income (expense)	\$1,852	\$750

## 6 Inventory

At December 31, 2014 and 2013, inventory was comprised of the following:

<i>(In thousands)</i>	<b>2014</b>	<b>2013</b>
Raw materials	\$34,831	\$44,093
Work in process	3,750	3,484
Finished goods	48,129	42,534
<b>Total Inventory, net</b>	<b>\$86,710</b>	<b>\$90,111</b>

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, 2014 and 2013, raw materials reserves totaled \$16.9 million, and finished goods inventory reserves totaled \$7.8 million and \$6.1 million, respectively.

## 7 Property, Plant and Equipment

At December 31, 2014 and 2013, property, plant and equipment were comprised of the following:

<i>(In thousands)</i>	2014	2013
Land	\$4,575	\$4,263
Building and land improvements	22,374	21,776
Building	68,301	68,479
Furniture and fixtures	16,468	16,465
Computer hardware and software	74,603	70,468
Engineering and other equipment	109,501	104,584
<b>Total Property, Plant and Equipment</b>	<b>295,822</b>	<b>286,035</b>
Less accumulated depreciation	(220,994)	(209,296)
<b>Total Property, Plant and Equipment, net</b>	<b>\$74,828</b>	<b>\$76,739</b>

Depreciation expense was \$12.5 million, \$12.2 million and \$12.1 million in 2014, 2013, and 2012, respectively.

## 8 Goodwill and Intangible Assets

Goodwill, all of which relates to our acquisition of Bluesocket, Inc. and is included in our Enterprise Networks division, was \$3.5 million at December 31, 2014 and 2013. 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. We have elected to first assess the qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit to which the goodwill is assigned is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step impairment test. If we determine that it is more likely than not that its fair value is less than its carrying amount, then the two-step impairment test will be performed. Based on the results of our qualitative assessment in 2014, we concluded that it was not necessary to perform the two-step impairment test. There were no impairment losses recognized during 2014, 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, 2014 and 2013:

<i>(In thousands)</i>	2014			2013		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Customer relationships	\$6,310	\$(2,136)	\$4,174	\$6,996	\$(1,555)	\$5,441
Developed technology	6,005	(3,577)	2,428	6,537	(2,692)	3,845
Intellectual property	2,340	(1,520)	820	2,340	(1,185)	1,155
Trade names	270	(205)	65	270	(145)	125
Other	12	(11)	1	14	(8)	6
<b>Total</b>	<b>\$14,937</b>	<b>\$(7,449)</b>	<b>\$7,488</b>	<b>\$16,157</b>	<b>\$(5,585)</b>	<b>\$10,572</b>

Amortization expense was \$2.3 million, \$2.4 million and \$2.0 million for the years ended December 31, 2014, 2013 and 2012, respectively.

As of December 31, 2014, the estimated future amortization expense of intangible assets is as follows:

<i>(In thousands)</i>	Amount
2015	\$2,027
2016	1,757
2017	1,209
2018	732
2019	336
Thereafter	1,427
<b>Total</b>	<b>\$7,488</b>

## 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 2% 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, 2014 was approximately \$29.7 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of AAA. 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, 2014 is \$30.0 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, 2014, 2013 and 2012, we realized economic incentives related to payroll withholdings totaling \$1.3 million, \$1.3 million and \$1.4 million, respectively.

We made a principal payment of \$16.5 million for the year ended December 31, 2014. We did not make a principal payment for the year-ended December 31, 2013. At December 31, 2014, \$1.2 million of the bond debt was classified as a current liability in accounts payable in the Consolidated Balance Sheets.

## 10 Income Taxes

A summary of the components of the provision for income taxes for the years ended December 31, 2014, 2013 and 2012 is as follows:

<i>(In thousands)</i>	2014	2013	2012
<b>Current</b>			
Federal	\$7,626	\$15,641	\$26,225
State	599	2,041	3,766
International	12,587	1,437	(504)
<b>Total Current</b>	<b>20,812</b>	<b>19,119</b>	<b>29,487</b>
<b>Deferred</b>			
Federal	(1,083)	(3,606)	(3,395)
State	(123)	(412)	(388)
International	(4,320)	(40)	(2)
<b>Total Deferred</b>	<b>(5,526)</b>	<b>(4,058)</b>	<b>(3,785)</b>
<b>Total Provision for Income Taxes</b>	<b>\$15,286</b>	<b>\$15,061</b>	<b>\$25,702</b>

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

	2014	2013	2012
Tax provision computed at the federal statutory rate	35.00%	35.00%	35.00%
State income tax provision, net of federal benefit	2.69	3.98	3.78
Federal research credits	(4.05)	(9.24)	—
Foreign taxes	(7.26)	(2.93)	3.80
Tax-exempt income	(1.25)	(1.11)	(1.01)
State tax incentives	(2.21)	(2.19)	(4.46)
Stock-based compensation	3.06	2.97	2.36
Domestic production activity deduction	(1.15)	(1.80)	(3.21)
Other, net	0.69	0.07	(1.03)
<b>Effective Tax Rate</b>	<b>25.52%</b>	<b>24.75%</b>	<b>35.23%</b>

Income before provision for income taxes for the years ended December 31, 2014, 2013 and 2012 is as follows:

<i>(In thousands)</i>	2014	2013	2012
U.S. entities	\$23,812	\$51,752	\$80,926
International entities	36,094	9,103	(7,961)
<b>Total</b>	<b>\$59,906</b>	<b>\$60,855</b>	<b>\$72,965</b>

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:

<i>(In thousands)</i>	2014	2013
<b>Current deferred tax assets</b>		
Accounts receivable	\$53	\$51
Inventory	10,405	9,877
Accrued expenses	6,637	7,155
<b>Total Current Deferred Tax Assets</b>	<b>17,095</b>	<b>17,083</b>
<b>Non-current deferred tax assets</b>		
Accrued expenses	1,232	140
Deferred compensation	6,424	5,972
Stock-based compensation	5,832	5,331
Uncertain tax positions related to state taxes and related interest	1,176	1,107
Pensions	4,844	301
Foreign losses	3,547	5,702
State losses and credit carry-forwards	4,023	3,737
Federal loss and research carry-forwards	6,998	8,322
Valuation allowance	(7,463)	(8,842)
<b>Total Non-current Deferred Tax Assets</b>	<b>26,613</b>	<b>21,770</b>
<b>Total Deferred Tax Assets</b>	<b>\$43,708</b>	<b>\$38,853</b>
<b>Non-current deferred tax liabilities</b>		
Property, plant and equipment	\$(3,632)	\$(5,499)
Intellectual property	(711)	(1,006)
Investments	(4,576)	(5,643)
<b>Total Non-current Deferred Tax Liabilities</b>	<b>\$(8,919)</b>	<b>\$(12,148)</b>
<b>Net Deferred Tax Assets</b>	<b>\$34,789</b>	<b>\$26,705</b>

At December 31, 2014 and 2013, non-current deferred taxes related to our investments and our defined benefit pension plan, reflect deferred taxes on the net unrealized gains on available-for-sale investments and deferred taxes on unrealized losses in our pension plan. The net change in non-current deferred taxes associated with these items, a deferred tax benefit of \$3.3 million in 2014 and a deferred tax expense of \$0.4 million in 2013, is recorded as an adjustment to other comprehensive income, presented in the Consolidated Statements of Comprehensive Income.

Based upon our results of operations in 2014 and expected profitability in future years in a certain international jurisdiction, we concluded that it is more likely than not certain foreign deferred tax assets will be realized. A reversal of the valuation allowance on these deferred tax assets, which includes a change in estimate of the years beginning balance, resulted in a deferred income tax benefit totaling \$4.6 million in 2014. As of December 31, 2014, the remaining valuation allowance primarily relates to deferred tax assets related to state credit carry-forwards 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 and net operating losses in foreign jurisdictions. We believe it is more likely than not that we will not realize the full benefits of the deferred tax assets arising from these losses and credits, and accordingly, we have provided a valuation allowance against these deferred tax assets. The deferred tax assets for foreign and domestic carry-forwards, unamortized research and development costs, and state credit carry-forwards of \$15.5 million will expire between 2015 and 2030. The loss carry-forwards were acquired through acquisitions in 2009 and 2011. We will continue to assess the realization of our deferred tax assets and related valuations allowances. 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. It is impracticable to determine the amount of any unrecognized deferred tax liability for temporary differences related to investments in foreign subsidiaries.

During 2014, 2013 and 2012, we recorded an income tax benefit of \$0.1 million, \$0.2 million and \$1.9 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 the years ended December 31, 2014, 2013 and 2012 is reconciled below:

<i>(In thousands)</i>	2014	2013	2012
<b>Balance at beginning of period</b>	<b>\$3,240</b>	<b>\$2,926</b>	<b>\$2,970</b>
<b>Increases for tax position related to:</b>			
Prior years	—	89	965
Current year	522	549	302
<b>Decreases for tax positions related to:</b>			
Prior years	—	—	(49)
Settlements with taxing authorities	—	(141)	(507)
Expiration of applicable statute of limitations	(428)	(183)	(755)
<b>Balance at end of period</b>	<b>\$3,334</b>	<b>\$3,240</b>	<b>\$2,926</b>

As of December 31, 2014, 2013, and 2012, our total liability for unrecognized tax benefits was \$3.3 million, \$3.2 million, and \$2.9 million, respectively, of which \$2.6 million, \$2.5 million, and \$2.2 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, 2014, 2013 and 2012, the balances of accrued interest and penalties were \$1.0 million, \$1.0 million and \$0.8 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 are currently under audit by the Internal Revenue Service. Generally, we are not subject to changes in income taxes by any taxing jurisdiction for the years prior to 2011.

## 11 Employee Benefit Plans

### Pension Benefit Plan

We maintain a defined benefit pension plan covering employees in certain foreign countries.

The pension benefit plan obligations and funded status at December 31, 2014 and 2013, are as follows:

<i>(In thousands)</i>	2014	2013
<b>Change in projected benefit obligation:</b>		
Projected benefit obligation at beginning of period	\$(23,354)	\$(21,181)
Service cost	(1,189)	(1,198)
Interest cost	(836)	(745)
Actuarial gain (loss)	(8,166)	779
Benefit payments	2	1
Effects of foreign currency exchange rate changes	3,036	(1,010)
<b>Projected benefit obligation at end of period</b>	<b>\$(30,507)</b>	<b>\$(23,354)</b>
<b>Change in plan assets:</b>		
Fair value of plan assets at beginning of period	\$20,773	\$18,620
Actual return on plan assets	2,315	1,281
Effects of foreign currency exchange rate changes	(2,750)	872
<b>Fair value of plan assets at end of period</b>	<b>\$20,338</b>	<b>\$20,773</b>
<b>Funded status at end of period</b>	<b>\$(10,169)</b>	<b>\$(2,581)</b>

The accumulated benefit obligation was \$29.2 million and \$22.9 million at December 31, 2014 and 2013, respectively. The increase in the accumulated benefit obligation and actuarial loss is primarily attributable to a decrease in the discount rate used in 2014 to determine the accumulated benefit obligation.

The net amounts recognized in the balance sheet for the unfunded pension liability as of December 31, 2014 and 2013 are as follows:

<i>(In thousands)</i>	2014	2013
Current liability	\$—	\$—
Non-current liability	(10,169)	(2,581)
<b>Total</b>	<b>\$(10,169)</b>	<b>\$(2,581)</b>

The components of net periodic pension cost and amounts recognized in other comprehensive income for the years ended December 31, 2014 and 2013 and the period May 4, 2012 to December 31, 2012 are as follows:

<i>(In thousands)</i>	Year Ended December 31, 2014	Year Ended December 31, 2013	May 4, 2012 to December 31, 2012
<b>Net periodic benefit cost:</b>			
Service cost	\$1,189	\$1,198	\$766
Interest cost	836	745	494
Expected return on plan assets	(1,086)	(1,010)	(674)
<b>Net periodic benefit cost</b>	<b>939</b>	<b>933</b>	<b>586</b>
<b>Other changes in plan assets and benefit obligations recognized in other comprehensive income:</b>			
<b>Net actuarial (gain) loss</b>	<b>7,052</b>	<b>(1,061)</b>	<b>1,952</b>
<b>Total recognized in net periodic benefit cost and other comprehensive income</b>	<b>\$7,991</b>	<b>\$(128)</b>	<b>\$2,538</b>



The amounts recognized in accumulated other comprehensive income as of December 31, 2014 and 2013 are as follows:

<i>(In thousands)</i>	2014	2013
Net actuarial (gain) loss	\$7,943	\$891

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 years ended December 31, 2014 and 2013 and the period May 4, 2012 to December 31, 2012 are as follows:

	Year Ended December 31, 2014	Year Ended December 31, 2013	May 4, 2012 to December 31, 2012
Discount rates	3.70%	3.50%	3.96%
Rate of compensation increase	2.25%	2.25%	2.25%
Expected long-term rates of return	5.40%	5.40%	5.40%

The weighted-average assumptions that were used to determine the benefit obligation at December 31, 2014 and 2013:

	2014	2013
Discount rates	2.20%	3.70%
Rate of compensation increase	2.25%	2.25%

Actuarial gains and losses are recorded in accumulated other comprehensive income. To the extent unamortized gains and losses exceed 10% of the higher of the market-related value of assets or the projected benefit obligation, the excess is amortized as a component of net periodic pension cost over the remaining service period of active participants. We estimate that \$0.4 million will be amortized from accumulated other comprehensive income into net periodic pension cost in 2015 for the net actuarial loss.

We do not anticipate making a contribution to our pension plan in 2015. The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid to participants:

<i>(In thousands)</i>	
2015	\$249
2016	284
2017	459
2018	628
2019	812
2020-2023	5,444
<b>Total</b>	<b>\$7,876</b>

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, 2014 Using

<i>(In thousands)</i>	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	\$—	\$—
<b>Available-for-sale securities</b>				
<b>Bond funds</b>				
Corporate bonds	12,587	12,587	—	—
Government bonds	2,172	2,172	—	—
<b>Equity funds</b>				
Large cap blend	4,488	4,488	—	—
Large cap value	268	268	—	—
Balanced fund	819	819	—	—
<b>Available-for-sale securities</b>	<b>20,334</b>	<b>20,334</b>	<b>—</b>	<b>—</b>
<b>Total</b>	<b>\$20,338</b>	<b>\$20,338</b>	<b>\$—</b>	<b>\$—</b>

#### Fair Value Measurements at December 31, 2013 Using

<i>(In thousands)</i>	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	\$—	\$—
<b>Available-for-sale securities</b>				
<b>Bond funds</b>				
Corporate bonds	12,976	12,976	—	—
Government bonds	1,915	1,915	—	—
<b>Equity funds</b>				
Large cap blend	4,720	4,720	—	—
Large cap value	287	287	—	—
Balanced fund	871	871	—	—
<b>Available-for-sale securities</b>	<b>20,769</b>	<b>20,769</b>	<b>—</b>	<b>—</b>
<b>Total</b>	<b>\$20,773</b>	<b>\$20,773</b>	<b>\$—</b>	<b>\$—</b>

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

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

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

#### 401(k) Savings Plan

We maintain the ADTRAN, Inc. 401(k) Retirement Plan (Savings Plan) for the benefit of our eligible employees. The Savings Plan is intended to qualify under Sections 401(a) and 401(k) of the Internal Revenue Code of 1986, as amended (Code), and is intended to be a “safe harbor” 401(k) plan under Code Section 401(k)(12). The Savings Plan allows employees to save for retirement by contributing part of their compensation to the plan on a tax-deferred basis. The Savings Plan also requires us to contribute a “safe harbor” amount each year. We match up to 4% of employee contributions (100% of an employee’s first 3% of contributions and 50% of their next 2% of contributions), beginning on the employee’s one year anniversary date. In calculating our matching contribution, we only use compensation up to the statutory maximum under the Code (\$260 thousand for 2014). 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, \$4.5 million and \$4.6 million in 2014, 2013 and 2012, 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:

<i>(In thousands)</i>	2014	2013
<b>Fair Value of Plan Assets</b>		
Long-term Investments	\$16,294	\$15,123
<b>Total Fair Value of Plan Assets</b>	<b>\$16,294</b>	<b>\$15,123</b>
<b>Amounts Payable to Plan Participants</b>		
Non-current Liabilities	\$16,294	\$15,123
<b>Total Amounts Payable to Plan Participants</b>	<b>\$16,294</b>	<b>\$15,123</b>

Interest and dividend income of the Trust have been included in interest and dividend income in the accompanying 2014, 2013 and 2012 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 2014 and 2013 Consolidated Balance Sheets. Changes in the fair value of the deferred compensation liability are included as selling, general and administrative expense in the accompanying 2014, 2013 and 2012 Consolidated Statements of Income. Based on the changes in the total fair value of the Trust’s assets, we recorded deferred compensation expense in 2014, 2013 and 2012 of \$0.7 million, \$2.8 million and \$0.9 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, 2014 and 2013, this liability totaled \$0.2 million.

## 12 Segment Information and Major Customers

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

The following table presents information about the reported sales and gross profit of our reportable segments for each of the years ended December 31, 2014, 2013 and 2012. Asset information by reportable segment is not reported, since we do not produce such information internally.

<i>(In thousands)</i>	2014		2013		2012	
<b>Sales and Gross Profit by Market Segment</b>	Sales	Gross Profit	Sales	Gross Profit	Sales	Gross Profit
Carrier Networks	\$510,373	\$243,211	\$500,733	\$233,206	\$492,096	\$247,380
Enterprise Networks	119,634	68,116	141,011	75,680	128,518	69,263
<b>Total</b>	<b>\$630,007</b>	<b>\$311,327</b>	<b>\$641,744</b>	<b>\$308,886</b>	<b>\$620,614</b>	<b>\$316,643</b>

### 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 Series of Multi-Service Access Nodes (MSANs)
- hiX 5600 Series of MSANs
- Total Access 1100/1200 Series of Fiber to the Node (FTTN) products
- hiX 1100 Series of FTTN products
- VDSL2 Vectoring based Digital Subscriber Line Access Multiplexer (DSLAM) products
- ADTRAN 500 Series of FT Tdp G.fast Distribution Point Units (DPU)

#### Optical

- Optical Networking Edge (ONE)
- NetVanta 8000 Series of Fiber Ethernet Access Devices (EAD)
- NetVanta 8400 Series of 10 Gig Multi-service Edge Switches
- OPTI-6100 and Total Access 3000 optical Multi-Service Provisioning Platforms (MSPP)
- Pluggable Optical Products, including SFP, XFP, and SFP+

#### Time Division Multiplexed (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
  - Access Routers
  - Enterprise Session Border Controllers (eSBC)
  - Managed Ethernet Switches
  - IP Business Gateways
  - Unified Communications (UC) solutions
  - Carrier Ethernet Network Terminating Equipment (NTE)
  - Carrier Ethernet Routers and Gateways
- Network Management Solutions

**Loop Access** products are used by carrier and enterprise customers for access to copper-based communications networks. This 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, 2014, 2013 and 2012:

<i>(In thousands)</i>	2014	2013	2012
Carrier Systems	\$442,664	\$427,850	\$399,646
Business Networking	156,980	168,871	149,304
Loop Access	30,363	45,023	71,664
<b>Total</b>	<b>\$630,007</b>	<b>\$641,744</b>	<b>\$620,614</b>

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, 2014, 2013 and 2012:

<i>(In thousands)</i>	2014	2013	2012
<b>Core Products</b>			
Broadband Access (included in Carrier Systems)	\$368,464	\$340,560	\$320,076
Optical (included in Carrier Systems)	55,374	55,615	51,755
Internetworking (NetVanta and Multi-service Access Gateways) (included in Business Networking)	152,223	164,422	142,958
<b>Subtotal</b>	<b>\$576,061</b>	<b>\$560,597</b>	<b>\$514,789</b>
<b>Legacy Products</b>			
HDSL (does not include T1) (included in Loop Access)	27,829	41,666	66,974
Other products (excluding HDSL)	26,117	39,481	38,851
<b>Subtotal</b>	<b>\$53,946</b>	<b>\$81,147</b>	<b>\$105,825</b>
<b>Total</b>	<b>\$630,007</b>	<b>\$641,744</b>	<b>\$620,614</b>

The following table presents sales information by geographic area for the years ended December 31, 2014, 2013 and 2012. International sales correlate to shipments with a non-U.S. destination.

<i>(In thousands)</i>	2014	2013	2012
United States	\$381,382	\$455,996	\$470,369
Germany	150,987	97,151	26,918
Other International	97,638	88,597	123,327
<b>Total</b>	<b>\$630,007</b>	<b>\$641,744</b>	<b>\$620,614</b>

Customers comprising more than 10% of revenue can change from year to year. Single customers comprising more than 10% of our revenue in 2014 included two customers at 21% and 14%. Single customers comprising more than 10% of our revenue in 2013 included two customers at 17% and 14%. Only a single customer comprised more than 10% of our revenue in 2012 at 23%. No other customer accounted for 10% or more of our sales in 2014, 2013 or 2012. 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%, 22%, and 34% of total revenue in 2014, 2013 and 2012, 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, 2014, long-lived assets, net totaled \$74.8 million, which includes \$70.0 million held in the United States and \$4.8 million held outside the United States. 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.

### 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 2025. As of December 31, 2014, future minimum rental payments under non-cancelable operating leases with original maturities of greater than 12 months are as follows:

<i>(In thousands)</i>	
2015	\$4,894
2016	3,701
2017	3,190
2018	1,563
Thereafter	5,340
<b>Total</b>	<b>\$18,688</b>

Rental expense was \$4.7 million, \$4.8 million and \$3.9 million for the years ended December 31, 2014, 2013 and 2012, respectively.

### 14 Earnings per Share

A summary of the calculation of basic and diluted earnings per share (EPS) for the years ended December 31, 2014, 2013 and 2012 is as follows:

<i>(In thousands, except for per share amounts)</i>	2014	2013	2012
<b>Numerator</b>			
Net Income	\$44,620	\$45,794	\$47,263
<b>Denominator</b>			
Weighted average number of shares—basic	55,120	59,001	63,259
Effect of dilutive securities:			
Stock options	304	390	488
Restricted stock and restricted stock units	58	33	27
<b>Weighted average number of shares—diluted</b>	<b>55,482</b>	<b>59,424</b>	<b>63,774</b>
Net income per share—basic	\$0.81	\$0.78	\$0.75
Net income per share—diluted	\$0.80	\$0.77	\$0.74

For each of the years ended December 31, 2014, 2013 and 2012, 4.4 million, 3.2 million and 3.2 million stock options were outstanding but were not included in the computation of that year's diluted EPS because the options' exercise prices were greater than the average market price of the common shares, therefore making them anti-dilutive under the treasury stock method.



## 15 Summarized Quarterly Financial Data (Unaudited)

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

### Unaudited Quarterly Operating Results

(In thousands, except for per share amounts)

Three Months Ended	March 31, 2014	June 30, 2014	September 30, 2014	December 31, 2014
Net sales	\$147,004	\$176,129	\$162,892	\$143,982
Gross profit	\$77,790	\$86,797	\$78,257	\$68,483
Operating income	\$11,298	\$19,339	\$12,495	\$3,979
Net income	\$9,607	\$14,395	\$11,326	\$9,292
Earnings per common share	\$0.17	\$0.26	\$0.21	\$0.17
Earnings per common share assuming dilution (1)	\$0.17	\$0.26	\$0.21	\$0.17
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

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

## 16 Related Party Transactions

We employed the law firm of our director emeritus for legal services. All bills for services rendered by this firm were 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. The services of our director emeritus ended with his death on September 7, 2014. For the years ended 2014, 2013 and 2012, we incurred fees of \$0.1 million for these legal services.

## 17 Subsequent Events

On January 20, 2015, 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 5, 2015. The quarterly dividend payment was \$4.8 million and was paid on February 19, 2015. 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.

# Directors and Executive Officers

**Thomas R. Stanton**

Chairman and Chief Executive Officer

**James E. Matthews**

Senior Vice President – Finance,  
Chief Financial Officer,  
Treasurer, Secretary and Director

**H. Fenwick Huss**

Director of the Company  
Willem Kooyker Dean of the Zicklin School of Business  
at Baruch College

**William L. Marks**

Director of the Company  
Former Chairman of the Board and Chief Executive  
Officer of Whitney Holding Corp. (holding company  
for Whitney National Bank of New Orleans)

**Balan Nair**

Director of the Company  
Executive Vice President and Chief Technology Officer  
of Liberty Global, Inc.

**Roy J. Nichols**

Director of the Company  
Founder & former President of  
Nichols Research Corporation

**Kathryn A. Walker**

Director of the Company  
Managing Director for OpenAir Equity Partners

**Michael K. Foliano**

Senior Vice President – Global Operations

**Kevin P. Heering**

Senior Vice President,  
Quality and Administration

**Raymond R. Schansman**

Senior Vice President and General Manager,  
Enterprise Networks Division

**Eduard Scheiterer**

Senior Vice President and Managing Director,  
International Markets

**James D. Wilson, Jr.**

Senior Vice President and General Manager,  
Carrier Networks Division

**Robert A. Fredrickson**

Vice President – Carrier Networks Sales

**Kevin W. Schneider**

Vice President – Chief Technology Officer

**Transfer Agent**

American Stock Transfer and Trust Company  
New York, NY

**Independent Registered Public Accounting Firm**

PricewaterhouseCoopers LLP  
Birmingham, Alabama

**Special Counsel**

McKenna Long & Aldridge LLP  
Atlanta, Georgia

**Form 10-K**

ADTRAN's 2014 Annual Report on Form 10-K  
(without exhibits) as filed with the Securities and  
Exchange Commission is available to stockholders  
without charge upon written request to:

Investor Relations  
ADTRAN, Inc.  
901 Explorer Blvd.  
P.O. Box 140000  
Huntsville, Alabama 35814-4000  
256 963-8220 or 256 963-7600  
investorrelations@adtran.com (email)

**Annual Meeting**

The 2015 Annual Meeting of Stockholders will be held  
at ADTRAN corporate headquarters, 901 Explorer  
Boulevard, Huntsville, Alabama, on Wednesday,  
May 13, 2015, at 10:30 a.m. Central time.



## **Corporate Headquarters**

ADTRAN, Inc.  
901 Explorer Boulevard  
Huntsville, AL 35806  
USA  
P.O. Box 140000  
Huntsville, AL 35814-4000  
1 800 9ADTRAN  
1 256 963-8000  
1 256 963-8004 fax  
*investorrelations@adtran.com*  
*www.adtran.com*

## **International Offices**

ADTRAN Networks Pty. Ltd.  
Sydney and Melbourne, Australia

ADTRAN Singapore Pte. Ltd.  
Singapore

ADTRAN Europe Limited  
Theale, Reading, United Kingdom

ADTRAN Canada, Inc.  
Montreal and Toronto, Canada

ADTRAN Networks Canada, Inc.  
Ottawa, Canada

ADTRAN Networks S.A. de C.V.  
Mexico, D.F., Mexico

ADTRAN International, Inc.  
Hong Kong

ADTRAN Peru S.R.L.  
Lima, Peru

ADTRAN GmbH  
Berlin, Bruchsal, Greifswald, Leipzig, and Munich,  
Germany

ADTRAN Networks Comunicações Ltda.  
Campinas, São Paulo, Brazil

ADTRAN d.o.o.  
Zagreb, Croatia

ADTRAN Oy  
Helsinki, Finland

ADTRAN M.E.P.E.  
Athens, Greece

ADTRAN Networks India Private Limited  
Hyderabad, India

ADTRAN Holdings Ltd.  
Tel Aviv, Israel

ADTRAN S.R.L.  
Milan, Italy

ADTRAN K.K.  
Tokyo, Japan

ADTRAN Sp. z.o.o.  
Warsaw, Poland

ADTRAN, Unipessoal Lda.  
Lisbon, Portugal

ADTRAN LLC  
Moscow, Russia

ADTRAN s.r.o.  
Bratislava, Slovakia

ADTRAN Switzerland GmbH  
Zurich, Switzerland

ADTRAN International, Inc. – Saudi Arabia  
Riyadh, Saudi Arabia