



BOUNDLESS POSSIBILITIES

B O U N D L E S S P O S S I B I L I T I E S

ADTRAN®

2012 ANNUAL REPORT



Visualization of the relative densities of Internet connectivity across the globe. The stronger the contrast, the more connectivity.

B O U N D L E S S P O S S I B I L I T I E S

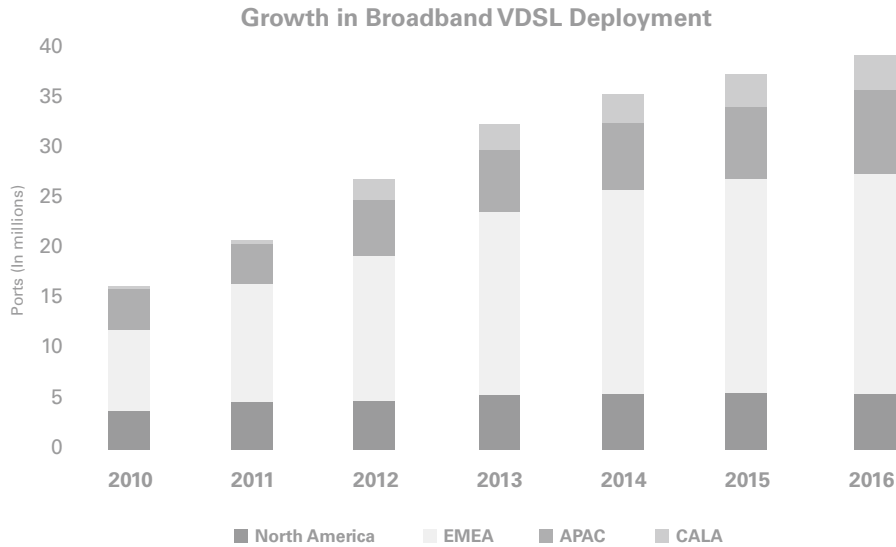
The ability to overcome challenges is a key to success for any business. In an environment marked by tough economic conditions and reduced carrier and enterprise infrastructure spending, we continued to execute our strategic plan, focusing on global expansion and customer diversification. We made exciting progress in both of these areas in 2012 despite the macroeconomic environment, and as a result, we believe ADTRAN is well positioned for 2013 and beyond.

Global Growth and Customer Diversification

The first, and perhaps the most important, of our initiatives was global growth. With the completion of the acquisition of Nokia Siemens Networks' Broadband Access

Business (BBA) in 2012, the company is positioned for significant growth outside of its traditional geographic customer base. To this end, we have extended ADTRAN operations to more than 20 new countries and entered into approximately 100 new carrier customer contracts. In addition, the acquisition has provided a complementary portfolio of broadband access solutions designed for, and well established in, the global market. This was further complemented with the addition of over 300 new team members in engineering, sales, services and support. Following the acquisition, ADTRAN has been firmly established as a top-tier global provider of fixed-broadband solutions and the company is now positioned to compete with leading European and Chinese vendors in the global market. We ended the year with 24 percent of our revenue coming from the international market, doubling our percentage from the previous year.





“VDSL port shipments will grow steadily through CY16, as operators deliver higher-margin premium broadband services to subscribers to support IPTV, VoIP, and online video services.” ~ Infonetics

Perfect Timing

Long-term business success is driven by many factors, with proper timing being one of the most important. The timing of our acquisition and the corresponding increase in Research and Development (R&D) efforts coincides with the emergence of a significant wave of investment by carriers around the world. Bolstered by our combined R&D resources, we have been able to rapidly respond to global broadband expansion initiatives in areas like VDSL2 and GPON/Gigabit Ethernet Fiber-to-the-Premises (FTTP) technologies. Cross-product integration is enabling us to fully utilize our key product innovations throughout our entire solution portfolio. By accelerating time to market for new solutions like vectoring, we are enabling service providers around the world to offer new, higher-speed services to better meet the requirements of their customers. These investments in product development have been well timed as major service providers around the globe have recently announced broadband build out plans that will position their networks for future growth.

Indicative of this wave of investment, in Europe, Deutsche Telekom (DT) has announced plans to considerably increase capital expenditures over the next three years. Approximately €6 billion has been earmarked for broadband

infrastructure rollout in the German fixed network with optical fiber and vectoring between 2013 and 2020. Similarly, in the United States, AT&T announced in November that it will invest \$14 billion over three years to expand and upgrade its existing wireline and wireless networks. Of this, \$6 billion will be dedicated to wireline investment. Carriers from BT to Telecom Italia have joined the list of service providers around the world who have announced significant investments. Combined, these projects will substantially increase global investment in broadband infrastructure for years to come. Each of these opportunities brings boundless possibilities for growth, innovation and success.

Growth in the Tier 2 and Tier 3 Customer Base

The Tier 2 and Tier 3 carrier markets are target areas for customer diversification and areas where we achieved significant market share gains. During the year, we successfully secured major market share awards in several strategic Tier 2 accounts for multi-year broadband rollouts. This was complemented by continued market share and revenue increases in the Tier 3 market.

Expanding the VAR Channel

Expanding sales of our enterprise products within the Value-Added Reseller (VAR) channel was yet another area of diversification in 2012. In our enterprise business, we solidly executed on our goals to diversify and grow the VAR channel as well as strengthen the VAR partner program. Internetworking sales for our U.S. VAR channel increased, bolstered by sales of our Bluesocket® wireless local area network products. Our product innovation and success were further reinforced by growth in our VAR partner base, which is now more than 3,500 partners strong. We realize the importance of the VAR channel to our continued success and as a result, we are investing in the future growth and development of this channel and the programs that support it.

The Year in Review

Another key component of long-term business success is execution. During the year, we were able to increase customer presence in key markets and deliver on all significant customer commitments - all while maintaining the excellence in service and support we are known for throughout the industry.

Financially, we continued our strong commitment to R&D investing \$126 million. We reported total revenues of \$621 million, operating income of \$56 million and cash flow from operations of \$86 million. While these results are a decline from the record numbers posted in 2011, we continued to build on our strong history of profitability and continued to provide dividends to our shareholders.

Inner Strength

The many accomplishments of 2012 would not have been possible without our team of dedicated, loyal employees. Now more than 2,000 strong, the ADTRAN family consistently goes above and beyond to meet our customers' needs, whatever they may be. I am fortunate to work alongside these individuals each day. Our employees have always been, and continue to be, the secret to our success. Thank you for a job well done!

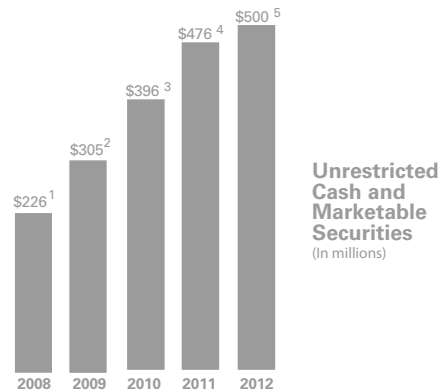
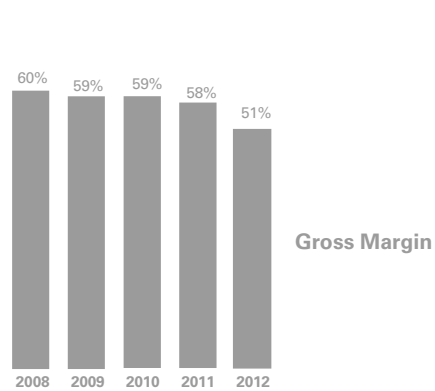
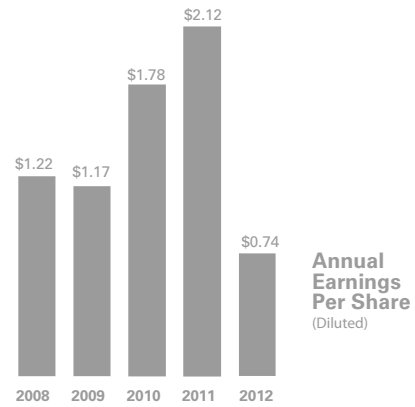
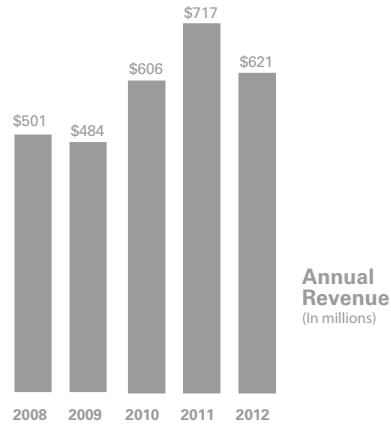
The Future is Bright

We enter 2013 with a solid plan in place and boundless possibilities before us. We will continue to focus on global growth and customer diversification. Our efforts to develop and deliver innovative solutions in the areas of high-speed broadband, cloud connectivity and mobility are well timed. Carriers both large and small are investing to meet their customers' needs and we believe ADTRAN is uniquely positioned to continue to gain meaningful market share as a top-tier global supplier of these solutions.

As the macroeconomic environment improves, regulatory issues are resolved and fiscal policies are solidified, carrier and enterprise spending will return to normal levels. In addition, ADTRAN stands to benefit from large carrier infrastructure investments, continued market share growth within the U.S. Tier 2 and Tier 3 markets and continued growth from enterprise VAR channel expansion. With a firm focus on our strategic plan and continued investment in R&D, we are confident that ADTRAN is well positioned to take its place as a global leader in telecommunications.



Tom Stanton
Chairman & Chief Executive Officer



Consolidated Statements of Income Data

(In thousands, except per share amounts)

Years Ended December 31	2012	2011
Total sales	\$620,614	\$717,229
Income before provision for income taxes	\$72,965	\$206,142
Net income	\$47,263	\$138,577
Earnings per common share (Diluted)	\$0.74	\$2.12

Consolidated Balance Sheets Data

(In thousands)

Years Ended December 31	2012	2011
Working capital ⁶	\$339,405	\$329,311
Total assets	\$886,381	\$817,514
Stockholders' equity	\$692,406	\$692,131

¹ Net of \$64 million in stock repurchases and \$23 million in dividend payments during 2008

² Net of \$16 million in stock repurchases and \$22 million in dividend payments during 2009

³ Net of \$18 million in stock repurchases and \$23 million in dividend payments during 2010

⁴ Net of \$36 million in stock repurchases and \$23 million in dividend payments during 2011

⁵ Net of \$39 million in stock repurchases and \$23 million in dividend payments during 2012

⁶ Working capital consists of current assets less current liabilities

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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, 2012. 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 7, 2013, ADTRAN had 224 stockholders of record and approximately 30,600 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

2012	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	\$38.42	\$31.07	\$29.55	\$20.14
Low	\$29.01	\$28.02	\$17.28	\$15.65
2011	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	\$47.24	\$43.20	\$42.55	\$34.30
Low	\$36.28	\$37.31	\$26.46	\$25.99

The following table shows the shareholder dividends paid in each quarter of 2012 and 2011. 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

2012	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2011	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09

Stock Repurchases

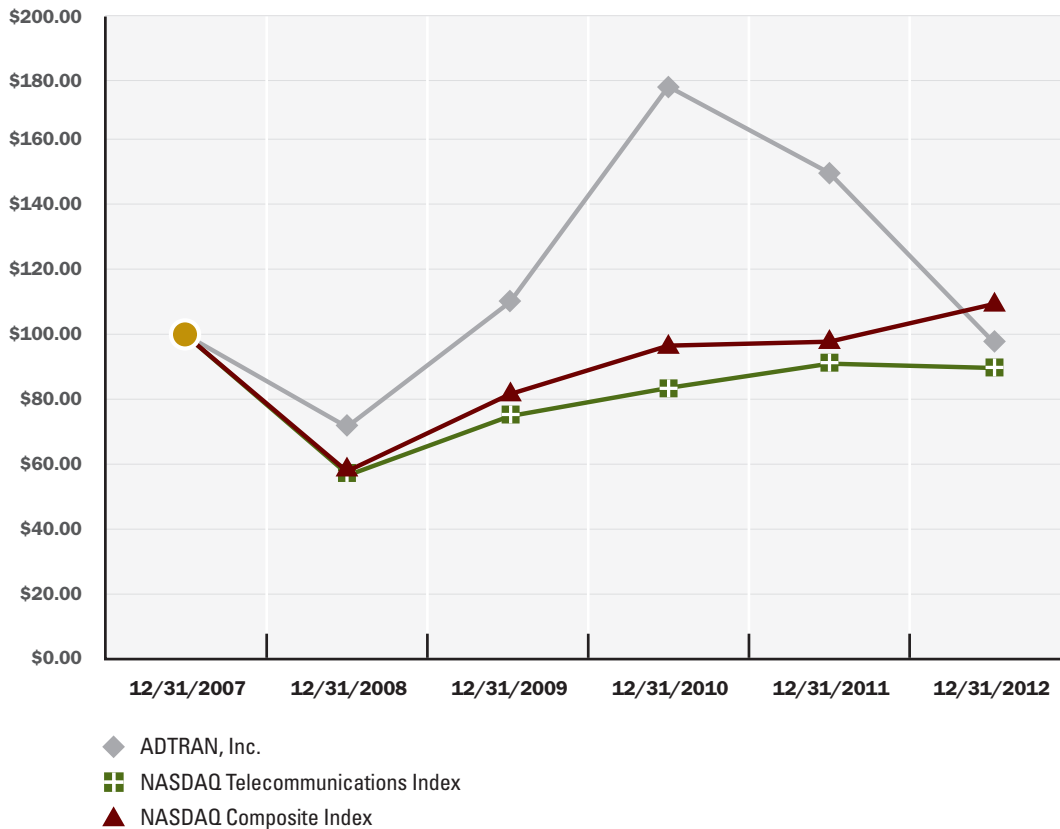
The following table sets forth repurchases of our common stock for the months indicated.

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, 2012 – October 31, 2012	200,000	\$15.74	200,000	4,478,188
November 1, 2012 – November 30, 2012	407,644	\$18.73	407,644	4,070,544
December 1, 2012 – December 31, 2012	—	—	—	4,070,544
Total	607,644		607,644	

(1) On October 11, 2011, our Board of Directors approved repurchases of up to 5,000,000 shares of our common stock. This plan is being implemented through open market 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, 2007 through December 31, 2012, 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, 2007 in each of our common stock, the NASDAQ Telecommunications Index and the NASDAQ Composite Index and also assume dividend reinvestment.



	12/31/07	12/31/08	12/31/09	12/31/10	12/31/11	12/31/12
ADTRAN, Inc.	\$100.00	\$70.89	\$109.36	\$177.92	\$149.67	\$98.47
NASDAQ Telecommunications Index	\$100.00	\$57.58	\$72.97	\$86.05	\$90.30	\$89.62
NASDAQ Composite Index	\$100.00	\$59.03	\$82.25	\$97.32	\$98.63	\$110.78

Selected Financial Data

Income Statement Data (1)

(In thousands, except per share amounts)

Year Ended December 31,	2012	2011	2010	2009	2008
Sales					
Carrier Networks Division	\$492,096	\$569,579	\$476,030	\$371,349	\$392,219
Enterprise Networks Division	128,518	147,650	129,644	112,836	108,457
Total sales	620,614	717,229	605,674	484,185	500,676
Cost of sales	303,971	302,911	246,811	197,223	201,771
Gross profit	316,643	414,318	358,863	286,962	298,905
Selling, general and administrative expenses	134,523	124,879	114,699	99,446	103,286
Research and development expenses	125,951	100,301	90,300	83,285	81,819
Operating income	56,169	189,138	153,864	104,231	113,800
Interest and dividend income	7,657	7,642	6,557	6,933	8,708
Interest expense	(2,347)	(2,398)	(2,436)	(2,430)	(2,514)
Net realized investment gain (loss)	9,550	12,454	11,008	(1,297)	(2,409)
Other income (expense), net	183	(694)	(804)	131	688
Gain on bargain purchase of a business	1,753	—	—	—	—
Income before provision for income taxes	72,965	206,142	168,189	107,568	118,273
Provision for income taxes	(25,702)	(67,565)	(54,200)	(33,347)	(39,692)
Net income	\$47,263	\$138,577	\$113,989	\$74,221	\$78,581

Year Ended December 31,	2012	2011	2010	2009	2008
Weighted average shares outstanding—basic	63,259	64,145	62,490	62,459	63,549
Weighted average shares outstanding— assuming dilution (2)	63,774	65,416	63,879	63,356	64,408
Earnings per common share—basic	\$0.75	\$2.16	\$1.82	\$1.19	\$1.24
Earnings per common share—assuming dilution (2)	\$0.74	\$2.12	\$1.78	\$1.17	\$1.22
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,	2012	2011	2010	2009	2008
Working capital (3)	\$339,405	\$329,311	\$304,952	\$278,044	\$212,740
Total assets	\$886,381	\$817,514	\$691,974	\$564,463	\$473,615
Total debt	\$46,500	\$47,000	\$48,000	\$48,250	\$48,750
Stockholders' equity	\$692,406	\$692,131	\$572,322	\$452,515	\$375,819

(1) Net income for 2012, 2011, 2010, 2009 and 2008 includes stock-based compensation expense under the Stock Compensation Topic of the Financial Accounting Standards Board Accounting Standards Codification of \$8.0 million, \$7.8 million, \$7.1 million, \$6.4 million and \$6.7 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 13 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. designs, manufactures and markets solutions and provides services and support for communications networks. Our solutions are widely deployed by providers of communications services (serviced by our Carrier Networks Division), and small, mid-sized and distributed enterprises (serviced by our Enterprise Networks Division), and enable voice, data, video and Internet communications across a variety of network infrastructures. Many of these solutions are currently in use by every major United States service provider, many global service providers, as well as many public, private and governmental organizations 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
- Loop Access.

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

Broadband Access

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

Optical

- Optical Networking Edge (ONE)
- NetVanta® 8000 Series
- OPTI and Total Access 3000 Optical products
- Small Form-Factor Pluggable (SFP) products

TDM Systems

Network Management Solutions

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

Internetworking Products

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

Integrated Access Devices (IADs)

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

- 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 \$620.6 million in 2012 compared to \$717.2 million in 2011 and \$605.7 million in 2010. Total sales of products in our three core areas, Broadband Access, Optical and Internetworking, decreased 1.7% in 2012 compared to 2011 and increased 48.2% in 2011 compared to 2010. Our gross profit margin decreased in 2012 to 51.0% from 57.8% in 2011 and 59.3% in 2010. Net income was \$47.3 million in 2012 compared to \$138.6 million in 2011 and \$114.0 million in 2010. Earnings per share, assuming dilution, were \$0.74 in 2012 compared to \$2.12 in 2011 and \$1.78 in 2010. Earnings per share in 2012, 2011 and 2010 include the effect of the repurchase of 1.8 million, 1.1 million and 0.7 million shares of our stock in those years, respectively.

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

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

Accordingly, our historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that our financial results may vary from period to period. See Note 14 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, 2012.

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.

- We review customer contracts to determine if all of the requirements for revenue recognition have been met prior to recording revenues from sales transactions. We generally record sales revenue upon shipment of our products, net of any

rebates or discounts, since: (i) we generally do not have significant post-delivery obligations, (ii) the product price is fixed or determinable, (iii) collection of the resulting receivable is probable, and (iv) product returns are reasonably estimable. We generally ship products upon receipt of a purchase order from a customer. We evaluate shipping terms and we record revenue on products shipped in accordance with the terms of each respective contract where applicable, or under our standard shipping terms for purchase orders accepted without a contract, generally FOB shipping point. In the case of consigned inventory, revenue is recognized when the customer assumes ownership of the product. Contracts that contain multiple deliverables are evaluated to determine the units of accounting, and the revenue from the arrangement is allocated to each item requiring separate revenue recognition based on the relative selling price and corresponding terms of the contract. We strive to use vendor-specific objective evidence of selling price. When this evidence is not available, we are generally not able to determine third-party evidence of selling price because of the extent of customization among competing products or services from other companies. We record revenue associated with installation services when all contractual obligations are complete. Contracts that include both installation services and product sales are evaluated for revenue recognition in accordance with the respective contract terms. As a result, depending on contract terms, installation services may be considered as a separate deliverable item or may be considered an element of the delivered product. Either the purchaser, ADTRAN, or a third party can perform installation of our products. Revenues related to maintenance services are recognized on a straight line basis over the contract term.

- Sales returns are accrued based on historical sales return experience, which we believe provides a reasonable estimate of future returns. 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 to an extensive network of value-added resellers and system integrators. Value-added resellers and system integrators may be affiliated with us as a channel partner, or they may purchase from the distributor on an unaffiliated basis. Additionally, with certain limitations, our distributors may return unused and unopened product for stock-balancing purposes when these returns are accompanied by offsetting orders for products of equal or greater value.

We 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 accrued at the time of sale and are included in selling, general and administrative 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.

Prior to issuing payment terms to a new customer, we perform a detailed credit review of the customer. Credit limits and payment terms are established for each new customer based on the results of this credit review. Collection experience is reviewed periodically in order to determine if the customer's payment terms and credit limits need to be revised. We maintain allowances for doubtful accounts for losses resulting from the inability of our customers to make required payments. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, we may be required to make additional allowances. 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 \$6 thousand at December 31, 2012 and \$8 thousand at December 31, 2011.

- 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 \$12.0 million and \$9.4 million at December 31, 2012 and 2011, respectively. Inventory write-downs charged to the reserve were \$0.5 million, \$0.7 million and \$0.8 million for the years ended December 31, 2012, 2011 and 2010, respectively.
- The objective of our short-term investment policy is to preserve principal and maintain adequate liquidity with appropriate diversification, while achieving market returns. The objective of our long-term investment policy is principal preservation and total return; that is, the aggregate return from capital appreciation, dividend income,

and interest income. These objectives are achieved through investments with appropriate diversification in fixed and variable rate income securities, public equity, and private equity portfolios. Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio. We have experienced significant volatility in the market prices of our publicly traded equity investments. These investments are recorded on the consolidated balance sheets at fair value with unrealized gains and losses reported as a component of accumulated other comprehensive income, net of tax. The ultimate realized value on these equity investments is subject to market price volatility.

We have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1 – Values based on unadjusted quoted prices 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 for substantially the full term of the asset or liability; 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. At December 31, 2012, we categorized \$47.2 million and \$395.9 million of our available-for-sale investments as Level 1 and Level 2, respectively, and \$28.1 million of our cash equivalents as Level 1. At December 31, 2011, we categorized \$39.7 million and \$401.2 million of our available-for-sale investments as Level 1 and Level 2, respectively, and \$13.7 million of our cash equivalents as Level 1.

We review our investment portfolio for potential “other-than-temporary” declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of \$17 thousand during the fourth quarter of 2012. For the years ended December 31, 2012, 2011 and 2010, we recorded charges of \$0.7 million, \$68 thousand and \$43 thousand, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities, a fixed income bond fund, 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 2012, 2011 or 2010.

- 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 in 2012 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 reserves 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, 2012 and 2011 respectively, the valuation allowance was \$10.9 million and \$7.6 million. As of December 31, 2012, we have state research tax credit carry-forwards of \$3.1 million, which will expire between 2015 and 2027. 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, 2012, we have a deferred tax asset of \$8.2 million relating to current losses and net operating loss carry-forwards generated by our domestic and foreign subsidiaries which will expire between 2013 and 2030. These carry-forwards are the result of acquisitions in 2009 and in 2011, plus losses generated in 2012 by a foreign entity. The acquired net operating losses are in excess of the amount of estimated earnings. We believe it is more likely than not that we will not realize the full benefits of our deferred tax asset arising from these credits and net operating losses, and accordingly, have provided a valuation allowance against them. This valuation allowance is included in non-current deferred tax liabilities in the accompanying balance sheets.
- 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 returns totaled \$9.7 million and \$4.1 million at December 31, 2012 and 2011, respectively. These liabilities are included in accrued expenses 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 2012 and 2011; therefore, we did not complete a quantitative assessment. As a result, there were no impairment losses recognized during 2012 or 2011.

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,	2012	2011	2010
Sales			
Carrier Networks Division	79.3%	79.4%	78.6%
Enterprise Networks Division	20.7	20.6	21.4
Total sales	100.0%	100.0%	100.0%
Cost of sales	49.0	42.2	40.7
Gross profit	51.0	57.8	59.3
Selling, general and administrative expenses	21.7	17.4	19.0
Research and development expenses	20.3	14.0	14.9
Operating income	9.1	26.4	25.4
Interest and dividend income	1.2	1.1	1.1
Interest expense	(0.4)	(0.3)	(0.4)
Net realized investment gain	1.5	1.7	1.8
Other income (expense), net	—	(0.1)	(0.1)
Gain on bargain purchase of a business	(0.3)	—	—
Income before provision for income taxes	11.8	28.7	27.8
Provision for income taxes	(4.1)	(9.4)	(9.0)
Net income	7.6%	19.3%	18.8%

Acquisition Expenses

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

<i>(In Thousands)</i>	2012	2011
Bluesocket, Inc. Acquisition		
Amortization of acquired intangible assets	\$1,020	\$495
Amortization of other purchase accounting adjustments	443	521
Acquisition related professional fees, travel and other expenses	—	730
Subtotal	\$1,463	\$1,746
NSN BBA Acquisition		
Amortization of acquired intangible assets	\$762	—
Amortization of other purchase accounting adjustments	2,305	—
Acquisition related professional fees, travel and other expenses	4,860	2,027
Subtotal	\$7,927	\$2,027
Total acquisition related expenses, amortizations and adjustments	\$9,390	\$3,773
Tax effect	(3,148)	(1,434)
Total acquisition related expenses, amortizations and adjustments, net of tax	\$6,242	\$2,339

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

<i>(In Thousands)</i>	2012	2011
Revenue (adjustments to unearned revenue recognized in the period)	\$1,528	\$362
Cost of goods sold	1,086	165
Subtotal	\$2,614	\$527
Selling, general and administrative expenses	4,510	2,557
Research and development expenses	2,266	689
Subtotal	\$6,776	\$3,246
Total acquisition related expenses, amortizations and adjustments	\$9,390	\$3,773
Tax effect	(3,148)	(1,434)
Total acquisition related expenses, amortizations and adjustments, net of tax	\$6,242	\$2,339

2012 Compared to 2011

Sales

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

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

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

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

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

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

Loop Access product sales decreased \$63.1 million in 2012 compared to 2011 primarily due to a \$60.0 million decrease in HDSL product sales. The declining trend in HDSL and other legacy products has been expected as we evolve our products towards packet-based technologies, but was larger than anticipated due to a large carrier customer that initiated a significant acceleration of their installed inventory reuse program.

Cost of Sales

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

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

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

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

Selling, General and Administrative Expenses

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

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

Research and Development Expenses

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

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

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

Interest and Dividend Income

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

Interest Expense

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

Net Realized Investment Gain (Loss)

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

Other Income (Expense), net

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

Income Taxes

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

Net Income

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

2011 Compared to 2010**Sales**

ADTRAN’s sales increased 18.4% from \$605.7 million in 2010 to \$717.2 million in 2011. This increase in sales is primarily attributable to a \$113.7 million increase in sales of our Broadband Access products, a \$40.4 million increase in sales of our Internetworking products, a \$16.3 million increase in sales of our Optical products, partially offset by a \$58.8 million decrease in sales of our HDSL and other legacy products.

Carrier Networks sales increased 19.7% from \$476.0 million in 2010 to \$569.6 million in 2011. The increase is primarily attributable to increases in Broadband Access, Optical and Internetworking NTE product sales, partially offset by a decrease in HDSL and other legacy product sales.

Enterprise Networks sales increased 13.9% from \$129.6 million in 2010 to \$147.7 million in 2011. The increase is primarily attributable to an increase in sales of Internetworking products, partially offset by decreases in sales of legacy products. Internetworking product sales attributable to Enterprise Networks were 87.4% of the division’s sales in 2011 compared with 77.3% in 2010. Legacy products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales decreased from 21.4% in 2010 to 20.6% in 2011.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 165.3% from \$31.8 million in 2010 to \$84.4 million in 2011. International sales, as a percentage of total sales, increased from 5.3% in 2010 to 11.8% in 2011. The increase in international sales in 2011 was primarily due to an increase in sales to Latin America, Asia-Pacific and Europe regions.

Carrier Systems product sales increased \$131.0 million in 2011 compared to 2010 primarily due to a \$113.7 million increase in Broadband Access product sales and a \$16.3 million increase in Optical product sales. The increase in Broadband Access product sales was primarily attributable to continued growth in deployments of our Total Access 5000 and Fiber-to-the-Node platforms.

Business Networking product sales increased \$35.0 million in 2011 compared to 2010 primarily due to a \$40.4 million increase in Internetworking product sales across both divisions, partially offset by a \$5.8 million decrease in legacy product sales. The decrease in sales of legacy products is a result of customers shifting to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales decreased \$54.4 million in 2011 compared to 2010 primarily due to a \$50.3 million decrease in HDSL product sales.

Cost of Sales

As a percentage of sales, cost of sales increased from 40.7% in 2010 to 42.2% in 2011. The increase was primarily the result of higher services related revenue including cabinet shipments, and specific customer price movements related to market share expansion. These effects were partially offset by cost absorption and manufacturing efficiencies achieved at the higher production volumes.

Carrier Networks cost of sales increased from 40.5% of sales in 2010 to 42.4% of sales in 2011. The increase in Carrier Networks cost of sales as a percentage of sales was primarily attributable to higher services related revenue including cabinet shipments, and specific customer price movements related to market share expansion.

Enterprise Networks cost of sales decreased from 41.7% of sales in 2010 to 41.4% of sales in 2011. The decrease in Enterprise Networks cost of sales as a percentage of sales was primarily attributable to cost absorption and manufacturing efficiencies achieved at 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 increased 8.9% from \$114.7 million in 2010 to \$124.9 million in 2011. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing, and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, trade show expenses, and related travel costs. The increase in selling, general and administrative expenses is primarily related to increases in staffing and fringe benefit costs due to increased headcount, contract services, professional services, recruiting expenses and travel expenses. These increases included expenses related to Bluesocket, Inc., which was acquired on August 4, 2011, and the announced planned acquisition of Nokia Siemens Networks Broadband Access business.

Selling, general and administrative expenses as a percentage of sales decreased from 18.9% for the year ended December 31, 2010 to 17.4% for the year ended December 31, 2011. Selling, general and administrative expenses as a percent 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 11.1% from \$90.3 million in 2010 to \$100.3 million in 2011. The increase in research and development expense is primarily related to increases in staffing and fringe benefit costs due to increased headcount. These increases included research and development expenses related to Bluesocket, Inc., and amortization of intangible assets related to the acquisition of Bluesocket, Inc.

Research and development expenses as a percentage of sales decreased from 14.9% for the year ended December 31, 2010 to 14.0% for the year ended December 31, 2011. 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 increased 16.5% from \$6.6 million in 2010 to \$7.6 million in 2011. This increase was primarily attributable to a 19.9% increase in our average investment balances, partially offset by a 22.6% reduction in the average rate of return on our investments as a result of lower interest rates.

Interest Expense

Interest expense remained consistent at \$2.4 million in 2011 and 2010, as we had no substantial change in our fixed rate borrowing. See "Liquidity and Capital Resources" below for additional information.

Net Realized Investment Gain (Loss)

Net realized investment gain (loss) increased from an \$11.0 million gain in 2010 to a \$12.5 million gain in 2011. This change is related to a \$0.7 million increase related to sales of marketable equity securities and an increase of \$0.8 million related to distributions from two private equity funds. 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, decreased from \$0.8 million of expense in 2010 to \$0.7 million of expense in 2011.

Income Taxes

Our effective tax rate increased from 32.2% in 2010 to 32.8% in 2011. This increase is primarily due to the reduced impact of available statutory tax benefits applied to the increased level of pretax income in 2011. The statutory benefits include the research tax credit, deduction for domestic manufacturing under Internal Revenue Code Section 199 and stock option related tax benefits.

Net Income

As a result of the above factors, net income increased from \$114.0 million in 2010 to \$138.6 million in 2011. As a percentage of sales, net income increased from 18.8% in 2010 to 19.3% in 2011.

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 the foreseeable future.

At December 31, 2012, cash on hand was \$68.5 million and short-term investments were \$160.5 million, which placed our short-term liquidity at \$228.9 million. At December 31, 2011, our cash on hand of \$43.0 million and short-term investments of \$159.3 million placed our short-term liquidity at \$202.3 million. The increase in short-term liquidity from 2011 to 2012 primarily reflects funds provided by our operating activities, proceeds from stock option exercises, cash received from NSN as a result of our acquisition of the NSN BBA business and long-term corporate bonds moving to short-term status, partially offset by equipment acquisitions, share repurchases and shareholder dividends.

Operating Activities

Our working capital, which consists of current assets less current liabilities, increased 3.1% from \$329.3 million as of December 31, 2011 to \$339.4 million as of December 31, 2012. The quick ratio, defined as cash and cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 4.50 as of December 31, 2011 to 2.90 as of December 31, 2012. The current ratio, defined as current assets divided by current liabilities, decreased from 6.32 as of December 31, 2011 to 4.18 as of December 31, 2012. The changes in our working capital, quick ratio and current ratio are primarily attributable to changes in the underlying assets and liabilities, including unearned revenue balances, relating to the acquired NSN BBA business.

Net accounts receivable increased 6.7% from \$76.1 million at December 31, 2011 to \$81.2 million at December 31, 2012. Our allowance for doubtful accounts decreased from \$8 thousand at December 31, 2011 to \$6 thousand at December 31, 2012. Quarterly accounts receivable days sales outstanding (DSO) increased from 40 days as of December 31, 2011 to 53 days as of December 31, 2012. The change in net accounts receivable and DSO is due to an increase in international sales as a percentage of our total sales, which typically have longer payment terms than our U.S. customers. Other receivables increased from \$9.7 million at December 31, 2011 to \$16.3 million at December 31, 2012. At December 31, 2012, other receivables included an estimated receivable due from NSN related to working capital adjustments under negotiation. Other receivables will also fluctuate due to the timing of shipments and collections for materials supplied to our contract manufacturers during the quarter.

Quarterly inventory turnover decreased from 3.5 turns as of December 31, 2011 to 2.8 turns as of December 31, 2012. Inventory increased 16.8% from December 31, 2011 to December 31, 2012. The increase in inventory is primarily attributable to inventories acquired during the acquisition of the NSN BBA business, increased installation services business and the timing of acceptances of broadband stimulus projects. 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 43.4% from \$29.4 million at December 31, 2011 to \$42.2 million at December 31, 2012. The increase in accounts payable is primarily attributable to accounts payable related to the acquired NSN BBA business. Additionally, 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 \$12.1 million, \$11.9 million and \$9.9 million for the years ended December 31, 2012, 2011 and 2010, 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. 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. We are currently negotiating the final working capital adjustments in accordance with the provisions of the underlying purchase agreement.

Our combined short-term and long-term investments increased \$1.9 million from \$491.4 million at December 31, 2011 to \$493.2 million at December 31, 2012. This increase reflects the impact of additional funds available for investment provided by our operating activities and proceeds from stock option exercises by our employees, reduced by our cash needs for equipment acquisitions, share repurchases and shareholder dividends, as well as net realized and unrealized losses and amortization of net premiums on our combined investments.

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, 2012 these investments included corporate bonds of \$186.4 million, municipal fixed-rate bonds of \$175.1 million and municipal variable rate demand notes of \$34.4 million. At December 31, 2011, these investments included corporate bonds of \$156.8 million, municipal fixed-rate bonds of \$174.8 million and municipal variable rate demand notes of \$69.7 million. As of December 31, 2012, 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 1.03 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 increased 0.2% from \$332.0 million at December 31, 2011 to \$332.7 million at December 31, 2012. Long-term investments at December 31, 2012 and December 31, 2011 included an investment in a certificate of deposit of \$48.3 million, which serves as collateral for our revenue bonds, as discussed below. We have various equity investments included in long-term investments at a cost of \$21.0 million and \$12.8 million, and with a fair value of \$35.2 million and \$31.3 million, at December 31, 2012 and December 31, 2011, respectively.

Long-term investments at December 31, 2012 and 2011 also included \$11.5 million and \$7.7 million, respectively, related to our deferred compensation plan; \$1.9 million and \$2.1 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; and \$0.5 million and \$0.7 million, respectively, of a fixed income bond fund.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25%

or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of \$17 thousand during the fourth quarter of 2012 related to three marketable equity securities. For the years ended December 31, 2012, 2011 and 2010 we recorded charges of \$0.7 million, \$68 thousand and \$43 thousand, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities, a fixed income bond fund, and our deferred compensation plan assets.

Financing Activities

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the "Authority"). Pursuant to the program, on January 13, 1995, the Authority issued \$20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the "Bondholder"), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to \$50.0 million. An Amended and Restated Taxable Revenue Bond ("Amended and Restated Bond") was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 5% per annum. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond at December 31, 2012 was approximately \$48.8 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A. We are required to make payments to the Authority in amounts necessary to pay the principal of and interest on the Amended and Restated Bond. Included in long-term investments at December 31, 2012 is \$48.3 million which is invested in a restricted certificate of deposit. These funds serve as a collateral deposit against the principal of this bond, and we have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness.

In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. For the years ended December 31, 2012, 2011 and 2010, we realized economic incentives related to payroll withholdings totaling \$1.4 million, \$1.9 million and \$1.5 million, respectively.

We are required to make payments in the amounts necessary to pay the principal and interest on the amounts currently outstanding. Based on positive cash flow from operating activities, we have decided to continue early partial redemptions of the Bond. We made principal payments of \$0.5 million and \$1.0 million for the years ended December 31, 2012 and 2011, respectively. It is our intent to make annual principal payments in addition to the interest amounts that are due. In connection with this decision, \$0.5 million of the bond debt has been reclassified to a current liability in accounts payable in the Consolidated Balance Sheets at December 31, 2012 and 2011.

The following table shows dividends paid to our shareholders in each quarter of 2012, 2011 and 2010. During 2012, 2011 and 2010, we paid shareholder dividends totaling \$22.8 million, \$23.1 million and \$22.5 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

2012	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2011	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2010	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09

Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 35 million shares of our common stock. For the years 2012, 2011 and 2010, we repurchased 1.8 million shares, 1.1 million shares and 0.7 million shares, respectively, for a cost of \$39.4 million, \$35.6 million and \$18.3 million, respectively, at an average price of \$22.03, \$31.97 and \$25.12 per share, respectively. We currently have the authority to purchase an additional 4.1 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 0.4 million shares of treasury stock for \$6.0 million during the year ended December 31, 2012, 1.8 million shares of treasury stock for \$34.1 million during the year ended December 31, 2011, and 1.5 million shares of treasury stock for \$24.9 million during the year ended December 31, 2010.

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, 2012.

Contractual Obligations

<i>(In millions)</i>	Total	2013	2014	2015	2016	After 2016
Long-term debt	\$46.5	\$0.5	\$—	\$—	\$—	\$46.0
Interest on long-term debt	16.3	2.3	2.3	2.3	2.3	7.1
Purchase obligations	53.3	52.4	0.9	—	—	—
Operating lease obligations	16.3	4.4	3.7	3.2	2.3	2.7
Totals	\$132.4	\$59.6	\$6.9	\$5.5	\$4.6	\$55.8

We are required to make payments necessary to pay the interest on the Taxable Revenue Bond, Series 1995, as amended, currently outstanding in the aggregate principal amount of \$46.5 million. The bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. Included in long-term investments are \$48.3 million of restricted funds, which is a collateral deposit against the principal amount of this bond. Due to continued positive cash flow from operating activities, we made a business decision in 2006 to begin an early partial redemption of the Bond. We made principal payments of \$0.5 million and \$1.0 million for the years ended December 31, 2012 and 2011, respectively. It is our intent to make annual principal payments in addition to the interest amounts that are due. In connection with this decision, \$0.5 million of the bond debt has been reclassified to a current liability in accounts payable in the Consolidated Balance Sheets at December 31, 2012. See Note 8 of Notes to Consolidated Financial Statements for additional information.

We have committed to invest up to an aggregate of \$7.9 million in two private equity funds, and we have contributed \$8.4 million as of December 31, 2012, 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 9 of Notes to Consolidated Financial Statements for additional information.

Effect of Recent Accounting Pronouncements

During 2012, we adopted the following accounting standards, which had no material effect on our consolidated results of operations or financial condition:

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 requires companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. While ASU 2011-05 changes the presentation of comprehensive income, it does not change the components that are recognized in net income or comprehensive income under current accounting guidance. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We adopted this amendment during the first quarter of 2012, and we have provided the revised financial statement presentation required for the period ended December 31, 2012.

In December 2011, the FASB issued Accounting Standards Update No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12). ASU 2011-12 defers the effective date for certain presentation requirements that relate to reclassification adjustments and the effect of those reclassification adjustments on the financial statements. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We adopted this amendment during the first quarter of 2012. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the period ended December 31, 2012.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. The amendments are of two types: (i) those that clarify the Board's intent about the application of existing fair value measurement and disclosure requirements and (ii) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This update is effective for annual periods beginning after December 15, 2011. We adopted this amendment during the first quarter of 2012, and we have provided the disclosures required for the period ended December 31, 2012.

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02). ASU 2013-02 requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component either on the face of the financial statements or in the footnotes. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. This update is effective prospectively for reporting periods beginning after December 15, 2012. We do not expect the adoption of this amendment will have an effect on our consolidated results of operations, financial condition or cash flows.

Subsequent Events

On January 15, 2013, 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 7, 2013. The quarterly dividend payment was \$5.6 million and was paid on February 21, 2013.

As of February 28, 2013, we have repurchased 0.9 million shares of our common stock through open market purchases at an average cost of \$22.45 per share. We currently have the authority to purchase an additional 3.2 million shares of our common stock under the current plan approved by the Board of Directors.

Quantitative and Qualitative Disclosures About Market Risk

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

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of December 31, 2012, \$46.7 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, 2012, approximately \$412.5 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, 2012, we held \$169.4 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, 2012 would reduce annualized interest income on our cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes by approximately \$0.6 million. In addition, we held \$352.9 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, 2012 would reduce the fair value of our municipal and corporate bonds by approximately \$1.7 million.

As of December 31, 2011, interest income on approximately \$417.4 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, 2011 would have reduced annualized interest income on our money market instruments 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, 2011 would have reduced the fair value of our municipal fixed-rate bonds and corporate bonds by approximately \$1.7 million.

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

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, 2012. 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*.

Based on our assessment and those criteria, management has concluded that ADTRAN maintained effective internal control over financial reporting as of December 31, 2012.

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, 2012 and December 31, 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report On Internal Control Over Financial Reporting*. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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



PricewaterhouseCoopers LLP
Birmingham, Alabama
February 28, 2013

Financial Statements

ADTRAN, INC.

Consolidated Balance Sheets

December 31, 2012 and 2011

(In thousands, except per share amounts)

Assets	2012	2011
Current Assets		
Cash and cash equivalents	\$68,457	\$42,979
Short-term investments	160,481	159,347
Accounts receivable, less allowance for doubtful accounts of \$6 and \$8 at December 31, 2012 and 2011, respectively	81,194	76,130
Other receivables	16,253	9,743
Inventory	102,583	87,800
Prepaid expenses	4,148	3,119
Deferred tax assets, net	13,055	12,125
Total Current Assets	446,171	391,243
Property, plant and equipment, net	80,246	75,295
Deferred tax assets, net	10,261	8,345
Goodwill	3,492	3,492
Other assets	13,482	7,131
Long-term investments	332,729	332,008
Total Assets	\$886,381	\$817,514
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	\$42,173	\$29,404
Unearned revenue	38,051	9,965
Accrued expenses	10,309	5,876
Accrued wages and benefits	15,022	13,518
Income tax payable, net	1,211	3,169
Total Current Liabilities	106,766	61,932
Non-current unearned revenue	23,803	4,874
Other non-current liabilities	17,406	12,077
Bonds payable	46,000	46,500
Total Liabilities	193,975	125,383
Commitments and contingencies (see Note 12)		
Stockholders' Equity		
Common stock, par value \$0.01 per share; 200,000 shares authorized; 79,652 shares issued and 62,310 shares outstanding at December 31, 2012 and 79,652 shares issued and 63,703 shares outstanding at December 31, 2011	797	797
Additional paid-in capital	224,517	213,560
Accumulated other comprehensive income	11,268	13,102
Retained earnings	861,465	840,206
Less treasury stock at cost: 17,342 and 15,949 shares at December 31, 2012 and 2011, respectively	(405,641)	(375,534)
Total Stockholders' Equity	692,406	692,131
Total Liabilities and Stockholders' Equity	\$886,381	\$817,514

See notes to consolidated financial statements.

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

Years ended December 31, 2012, 2011 and 2010

<i>(In thousands, except per share amounts)</i>	2012	2011	2010
Sales	\$620,614	\$717,229	\$605,674
Cost of sales	303,971	302,911	246,811
Gross Profit	316,643	414,318	358,863
Selling, general and administrative expenses	134,523	124,879	114,699
Research and development expenses	125,951	100,301	90,300
Operating Income	56,169	189,138	153,864
Interest and dividend income	7,657	7,642	6,557
Interest expense	(2,347)	(2,398)	(2,436)
Net realized investment gain	9,550	12,454	11,008
Other income (expense), net	183	(694)	(804)
Gain on bargain purchase of a business	1,753	—	—
Income before provision for income taxes	72,965	206,142	168,189
Provision for income taxes	(25,702)	(67,565)	(54,200)
Net Income	\$47,263	\$138,577	\$113,989
Weighted average shares outstanding—basic	63,259	64,145	62,490
Weighted average shares outstanding—diluted	63,774	65,416	63,879
Earnings per common share—basic	\$0.75	\$2.16	\$1.82
Earnings per common share—diluted	\$0.74	\$2.12	\$1.78

See notes to consolidated financial statements.

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

Years ended December 31, 2012, 2011 and 2010

<i>(In thousands)</i>	2012	2011	2010
Net Income	\$47,263	\$138,577	\$113,989
Other Comprehensive Income (Loss), net of tax:			
Net change in unrealized gains (losses) on marketable securities, net of deferred tax (expense) benefit of \$120, \$7,427 and \$(5,223) for the years ended December 31, 2012, 2011 and 2010, respectively	(187)	(13,004)	8,700
Reclassification adjustments for amounts included in net income, net of deferred tax (expense) benefit of \$(86), \$389 and \$598 for the years ended December 31, 2012, 2011 and 2010, respectively	135	(688)	(999)
Defined benefit plan adjustments	(1,952)	—	—
Foreign currency translation	170	(154)	1,394
Other Comprehensive Income (Loss), net of tax	(1,834)	(13,846)	9,095
Comprehensive Income, net of tax	\$45,429	\$124,731	\$123,084

See notes to consolidated financial statements.

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

Years ended December 31, 2012, 2011 and 2010

<i>(In thousands)</i>	Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance, December 31, 2009	79,652	\$797	\$181,240	\$649,256	\$(396,631)	\$17,853	\$452,515
Net income				113,989			113,989
Other comprehensive income, net of tax						9,095	9,095
Dividend payments				(22,502)			(22,502)
Dividends accrued for unvested restricted stock units				(27)			(27)
Stock options exercised: Various prices per share				(8,754)	33,696		24,942
Purchase of treasury stock: 729 shares					(18,316)		(18,316)
Income tax benefit from exercise of stock options			4,909				4,909
Stock-based compensation expense			7,717				7,717
Balance, December 31, 2010	79,652	\$797	\$193,866	\$731,962	\$(381,251)	\$26,948	\$572,322
Net income				138,577			138,577
Other comprehensive income, net of tax						(13,846)	(13,846)
Dividend payments				(23,124)			(23,124)
Dividends accrued for unvested restricted stock units				(52)			(52)
Stock options exercised: Various prices per share				(6,345)	40,470		34,125
Restricted stock units vested				(812)	812		—
Purchase of treasury stock: 1,112 shares					(35,565)		(35,565)
Income tax benefit from exercise of stock options			10,525				10,525
Stock-based compensation expense			9,169				9,169
Balance, December 31, 2011	79,652	\$797	\$213,560	\$840,206	\$(375,534)	\$13,102	\$692,131
Net income				47,263			47,263
Other comprehensive income, 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: Various prices per share				(2,659)	8,708		6,049
Restricted stock units vested			(212)	(547)	547		(212)
Purchase of treasury stock: 1,786 shares					(39,362)		(39,362)
Income tax benefit from exercise of stock options			1,905				1,905
Stock-based compensation expense			9,264				9,264
Balance, December 31, 2012	79,652	\$797	\$224,517	\$861,465	\$(405,641)	\$11,268	\$692,406

ADTRAN issued 393 shares, 1,813 shares and 1,483 shares of treasury stock to accommodate employee stock option exercises and vesting of restricted stock units during 2012, 2011 and 2010, respectively. During 2011 and 2010, ADTRAN received 7 shares and 4 shares, respectively, previously held by employees for at least six months as payment of the exercise price for employee stock options. None of the transactions with respect to these shares were made in the open market. The average price paid per share with respect to these transactions was based on the closing price of the common stock on the NASDAQ Global Select Market on the date of the transaction. There were no such transactions during 2012.

See notes to consolidated financial statements.

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

Years ended December 31, 2012, 2011 and 2010

<i>(In thousands)</i>	2012	2011	2010
Cash flows from operating activities			
Net income	\$47,263	\$138,577	\$113,989
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	14,079	11,499	10,545
Amortization of net premium on available-for-sale investments	8,257	6,617	4,380
Net realized gain on long-term investments	(9,550)	(12,454)	(11,008)
Net (gain) loss on disposal of property, plant, and equipment	(214)	6	2
Gain on bargain purchase of a business	(1,753)	—	—
Stock-based compensation expense	9,264	9,169	7,717
Deferred income taxes	(3,785)	575	(1,324)
Tax benefit from stock option exercises	1,905	10,525	4,909
Excess tax benefits from stock-based compensation arrangements	(1,456)	(9,373)	(4,404)
Change in operating assets and liabilities:			
Accounts receivable, net	(4,365)	(4,939)	(2,849)
Other receivables	2,977	(5,781)	135
Income tax receivable, net	—	2,741	(2,741)
Inventory	7,163	(12,734)	(28,600)
Prepaid expenses and other assets	(1,045)	522	(574)
Accounts payable	7,265	6,178	(2,997)
Accrued expenses and other liabilities	11,583	6,309	8,626
Income taxes payable, net	(1,960)	3,169	(3,017)
Net cash provided by operating activities	85,628	150,606	92,789
Cash flows from investing activities			
Purchases of property, plant, and equipment	(12,075)	(11,912)	(9,872)
Proceeds from disposals of property, plant and equipment	266	—	—
Proceeds from sales and maturities of available-for-sale investments	282,039	466,243	275,442
Purchases of available-for-sale investments	(282,740)	(554,629)	(340,489)
Acquisition of business, net of cash acquired	7,496	(22,661)	—
Net cash used in investing activities	(5,014)	(122,959)	(74,919)
Cash flows from financing activities			
Proceeds from stock option exercises	6,049	34,125	24,942
Purchases of treasury stock	(39,362)	(35,565)	(18,316)
Dividend payments	(22,813)	(23,124)	(22,502)
Payments on long-term debt	(500)	(1,000)	(250)
Excess tax benefits from stock-based compensation arrangements	1,456	9,373	4,404
Net cash used in financing activities	(55,170)	(16,191)	(11,722)
Net increase in cash and cash equivalents	25,444	11,456	6,148
Effect of exchange rate changes	34	(154)	1,394
Cash and cash equivalents, beginning of year	42,979	31,677	24,135
Cash and cash equivalents, end of year	\$68,457	\$42,979	\$31,677
Supplemental disclosure of cash flow information			
Cash paid during the year for interest	\$2,348	\$2,396	\$2,411
Cash paid during the year for income taxes	\$31,021	\$51,402	\$57,662

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1 Nature of Business and Summary of Significant Accounting Policies

ADTRAN, Inc. designs, manufactures and markets solutions and provides services and support for communications networks. Our solutions are widely deployed by providers of communications services (served by our Carrier Networks Division), and small, mid-sized and distributed enterprises (served by our Enterprise Networks Division), and enable voice, data, video and Internet communications across a variety of network infrastructures. Many of these solutions are currently in use by every major United States service provider, many global service providers, as well as many public, private and governmental organizations worldwide.

Principles of Consolidation

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

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, 2012, \$46.7 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the immediate or short-term maturity of these financial instruments. The carrying amount reported for bonds payable was \$46.5 million compared to an estimated fair value of \$48.8 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A.

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

Long-term investments represent a restricted certificate of deposit held at cost, municipal fixed-rate bonds, corporate bonds, a fixed income bond fund, marketable equity securities, and other equity investments. Marketable equity securities are reported at fair value as determined by the most recently traded price of the securities at the balance sheet date, although the securities may not be readily marketable due to the size of the available market. Unrealized gains and losses, net of tax, are reported as a separate component of stockholders' equity. Realized gains and losses on sales of securities are computed under the specific identification method and are included in current income. We periodically review our investment portfolio for investments considered to have sustained an other-than-temporary decline in value. Impairment charges for other-than-temporary declines in value are recorded as realized losses in the accompanying consolidated statements of income. All of our investments at December 31, 2012 and 2011 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, 2012, one customer accounted for 10.4% of our total accounts receivable. At December 31, 2011, three customers, each of which accounted for more than 10% of our accounts receivable, accounted for 57.3% of our total accounts receivable in the aggregate.

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 make additional allowances. 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 \$6 thousand at December 31, 2012 and \$8 thousand at December 31, 2011.

Other Receivables

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

Inventory

Inventory is carried at the lower of cost or market, with cost being determined using the first-in, first-out method. Standard costs for material, labor and manufacturing overhead are used to value inventory. Standard costs are updated at least quarterly; therefore, inventory costs approximate actual costs at the end of each reporting period. We establish reserves for estimated excess, obsolete or unmarketable inventory equal to the difference between the cost of the inventory and the estimated fair value of the inventory based upon assumptions about future demand and market conditions. When we dispose of excess and obsolete inventories, the related write-downs are charged against the inventory reserve. See Note 5 of Notes to Consolidated Financial Statements for additional information.

Property, Plant and Equipment

Property, plant and equipment, which is stated at cost, is depreciated using the straight-line method over the estimated useful lives of the assets. We depreciate building and land improvements from five to 39 years, office machinery and equipment from three to seven years, engineering machinery and equipment from three to seven years and computer software from three to five years. Expenditures for repairs and maintenance are charged to expense as incurred. Betterments that materially prolong the lives of the assets are capitalized. The cost of assets retired or otherwise disposed of and the related accumulated depreciation are removed from the accounts, and the gain or loss on such disposition is included in other income (expense), net in the accompanying consolidated statements of income. See Note 6 of Notes to Consolidated Financial Statements for additional information.

Liability for Warranty

Our products generally include warranties of 90 days to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled \$9.7 million and \$4.1 million at December 31, 2012 and 2011, 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, 2012 and 2011 is as follows:
(In thousands)

Year Ended December 31,	2012	2011
Balance at beginning of period	\$4,118	\$3,304
Plus: Amounts charged to cost and expenses	5,363	2,860
Amounts assumed on acquisition	3,781	33
Less: Deductions	(3,609)	(2,079)
Balance at end of period	\$9,653	\$4,118

Pension Benefit Plan Obligations

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 and expected return on plan assets. Actual results that differ from the assumptions and changes in assumptions affect future expenses and obligations.

Stock-Based Compensation

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

Under the provisions of our approved plans, we made grants of performance-based restricted stock units to five of our executive officers in 2012, 2011 and 2010. 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 2012, 2011 and 2010 was approximately \$9.3 million, \$9.2 million and \$7.7 million, respectively. As of December 31, 2012, total compensation cost related to non-vested stock options, restricted stock units and restricted stock not yet recognized was approximately \$19.3 million, which is expected to be recognized over an average remaining recognition period of 2.5 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 2012, 2011 or 2010.

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 2012 or 2011. Purchased intangible assets with finite lives are carried at cost, less accumulated amortization. Amortization is computed 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 \$126.0 million, \$100.3 million and \$90.3 million for the years ended December 31, 2012, 2011 and 2010, respectively.

Comprehensive Income

Comprehensive income consists of all changes in equity (net assets) during a period from non-owner sources. Items included in comprehensive income include net income, changes in unrealized gains and losses on marketable securities, defined benefit plan adjustments and foreign currency translation adjustments. Comprehensive income is presented in the Consolidated Statements of Comprehensive Income.

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. Employment related economic incentives are reported as a reduction in the state income tax provision. 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.

Foreign Currency

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

Revenue Recognition

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 revenue from the arrangement is allocated to each item requiring separate revenue recognition based on the relative selling price and corresponding terms of the contract. We strive to use vendor-specific objective evidence of selling price. When this evidence is not available, we are generally not able to determine third-party evidence of selling price because of the extent of customization among competing products or services from other companies. We record revenue associated with installation services when all contractual obligations are complete. Contracts that include both installation services and product sales are evaluated for revenue recognition in accordance with contract terms. As a result, depending on contract terms, installation services may be considered as a separate deliverable item or may be considered an element of the delivered product. 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. Also, revenue is recorded when the product price is fixed or determinable, collection of the resulting receivable is probable, and product returns are reasonably estimable. 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 to an extensive network of value-added resellers and system integrators. Value-added resellers and system integrators may be affiliated with us as a channel partner, or they may purchase from the distributor in an unaffiliated fashion. Additionally, with certain limitations our distributors may return unused and unopened product for stock-balancing purposes when such returns are accompanied by offsetting orders for products of equal or greater value.

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

Unearned Revenue

Unearned revenue primarily represents customer billings on our maintenance service programs and unearned revenues relating to multiple element contracts where we still have contractual obligations to our customers. We currently offer maintenance contracts ranging from one to five years, primarily on Enterprise Networks Division products sold through distribution channels. Revenue attributable to maintenance contracts is recognized on a straight-line basis over the related contract term. In addition, we provide software maintenance and a variety of hardware maintenance services to Carrier Networks Division customers, which include customers of the acquired NSN BBA business, under contracts with terms up to ten years. At December 31, 2012 and 2011, unearned revenue was as follows:

<i>(In thousands)</i>	2012	2011
Current unearned revenue	\$38,051	\$9,965
Non-current unearned revenue	23,803	4,874
Total	\$61,854	\$14,839

Other Income (Expense), Net

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

Earnings per Share

Earnings per common share, and earnings per common share assuming dilution, are based on the weighted average number of common shares and, when dilutive, common equivalent shares outstanding during the year. See Note 13 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, 2012, 2011 and 2010, we paid \$22.8 million, \$23.1 million and \$22.5 million, respectively, in shareholder dividends. On January 15, 2013, 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 7, 2013. The ex-dividend date was February 5, 2013 and the payment date was February 21, 2013. The quarterly dividend payment was \$5.6 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.

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 allowance for doubtful accounts, obsolete and excess inventory reserves, warranty reserves, customer rebates, allowance for sales returns, determination of the unearned revenue components of multiple element sales agreements, estimated costs to complete obligations associated with unearned revenues, estimated income tax contingencies, the fair value of stock-based compensation, impairment of goodwill, value and estimated lives of intangible assets, and the evaluation of other-than-temporary declines in the value of investments. Actual amounts could differ significantly from these estimates.

Recently Issued Accounting Standards

During 2012, we adopted the following accounting standards, which had no material effect on our consolidated results of operations or financial condition:

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 requires companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. While ASU 2011-05 changes the presentation of comprehensive income, it does not change the components that are recognized in net income or comprehensive income under current accounting guidance. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We adopted this amendment during the first quarter of 2012, and we have provided the revised financial statement presentation required for the period ended December 31, 2012.

In December 2011, the FASB issued Accounting Standards Update No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12). ASU 2011-12 defers the effective date for certain presentation requirements that relate to reclassification adjustments and the effect of those reclassification adjustments on the financial statements. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We adopted this amendment during the first quarter of 2012. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the period ended December 31, 2012.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. The amendments are of two types: (i) those that clarify the Board's intent about the application of existing fair value measurement and disclosure requirements and (ii) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This update is effective for annual periods beginning after December 15, 2011. We adopted this amendment during the first quarter of 2012, and we have provided the disclosures required for the period ended December 31, 2012.

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-02). ASU 2013-02 requires entities to provide information about the amounts reclassified out of accumulated other comprehensive income by component either on the face of the financial statements or in the footnotes. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. This update is effective prospectively for reporting periods beginning after December 15, 2012. We do not expect the adoption of this amendment will have an effect on our consolidated results of operations, financial condition or cash flows.

2 Business Combinations

On May 4, 2012, we acquired the NSN Broadband Access business (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.

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

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

<i>(In thousands)</i>	
Other receivables	\$9,486
Inventory	22,278
Property, plant and equipment	5,035
Accounts payable	(5,194)
Unearned revenue	(19,413)
Accrued expenses	(1,931)
Accrued wages and benefits	(2,251)
Deferred tax liability	(788)
Non-current unearned revenue	(21,316)
Net liabilities assumed	(14,094)
Customer relationships	5,162
Developed technology	3,176
Other	13
Gain on bargain purchase of a business, net of tax	(1,753)
Net consideration received by buyer	\$(7,496)

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

The actual revenue and pre-tax loss included in our Consolidated Statements of Income from the acquisition date to December 31, 2012 is as follows:

<i>(In thousands)</i>	
May 4, 2012 to December 31, 2012	
Revenue	\$68,170
Pre-tax loss	\$(8,562)

For the twelve months ended December 31, 2012, we incurred acquisition and integration related expenses and amortization of acquired intangibles of \$7.9 million related to this acquisition.

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

(In thousands) (Unaudited)

Twelve Months Ended December 31,	2012	2011
Pro forma revenue	\$119,600	\$196,256
Pro forma pre-tax loss	\$(23,621)	\$(36,980)
Weighted average exchange rate during the period (EURO/USD)	€1.00/\$1.29	€1.00/\$1.38

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

(In thousands)

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

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

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

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

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

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

For the twelve months ended December 31, 2012, we incurred integration related expenses and amortization of acquired intangibles of \$1.5 million related to this acquisition.

3 Stock Incentive Plans

Stock Incentive Program Descriptions

Our Board of Directors adopted the 1996 Employee Incentive Stock Option Plan (1996 Plan) effective February 14, 1996, as amended, under which 17.0 million shares of common stock were authorized for issuance to certain employees and officers through incentive stock options and non-qualified stock options. Options granted under the 1996 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four or five-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. The 1996 Plan expired February 14, 2006, and expiration dates of options outstanding at December 31, 2012 under the 1996 Plan range from 2013 to 2015.

On January 23, 2006, the Board of Directors adopted the 2006 Employee Stock Incentive Plan (2006 Plan), which authorizes 13.0 million shares of common stock for issuance to certain employees and officers through incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. The 2006 Plan was adopted by stockholder approval at our annual meeting of stockholders held on May 9, 2006. Options granted under the 2006 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. Expiration dates of options outstanding at December 31, 2012 under the 2006 Plan range from 2016 to 2022.

Our stockholders approved the 2010 Directors Stock Plan (2010 Directors Plan) on May 5, 2010, under which 0.5 million shares of common stock have been reserved. This plan replaces the 2005 Directors Stock Option Plan. The 2010 Directors Plan provides that the Company may issue stock options, restricted stock and restricted stock units to our non-employee directors. Stock awards issued under the 2010 Directors Plan normally become vested in full on the first anniversary of the grant date. Options issued under the 2010 Directors Plan have a ten-year contractual term. We currently also have options outstanding under the 1995 Directors Plan, as amended, and the 2005 Directors Plan. Expiration dates of options outstanding under both plans at December 31, 2012 range from 2013 to 2019.

The following table is a summary of our stock options outstanding as of December 31, 2011 and 2012 and the changes that occurred during 2012:

<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
Options outstanding, December 31, 2011	5,400	\$25.66	6.78	\$27,270
Options granted	1,104	\$17.93		
Options cancelled/forfeited	(106)	\$25.73		
Options exercised	(370)	\$16.36		
Options outstanding, December 31, 2012	6,028	\$24.82	6.71	\$5,138
Options exercisable, December 31, 2012	3,552	\$24.83	5.20	\$2,566

All of the options above were issued at exercise prices that approximate fair market value at the date of grant. At December 31, 2012, 7.2 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 2012 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, 2012. 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 2012, 2011 and 2010 was \$4.5 million, \$39.8 million and \$20.3 million, respectively. The fair value of options fully vesting during 2012, 2011 and 2010 was \$7.7 million, \$7.3 million and \$6.9 million, respectively.

The following table further describes our stock options outstanding as of December 31, 2012:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Options Outstanding at 12/31/12 (in thousands)	Weighted Avg. Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable at 12/31/12 (in thousands)	Weighted Average Exercise Price
\$14.88 – 16.96	601	5.86	\$15.27	598	\$15.27
\$16.97 – 20.46	1,026	9.65	\$17.03	30	\$19.19
\$20.47 – 23.02	1,040	4.07	\$22.67	1,037	\$22.67
\$23.03 – 27.90	935	6.96	\$24.09	618	\$23.72
\$27.91 – 30.36	1,327	7.19	\$30.24	587	\$30.14
\$30.37 – 41.92	1,099	6.15	\$33.40	682	\$33.16
	6,028			3,552	

Restricted Stock Program Description

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

The following table is a summary of our RSUs and restricted stock outstanding as of December 31, 2011 and 2012 and the changes that occurred during 2012:

(In thousands except per share amounts)	Number of Shares	Weighted Average Grant Date Fair Value
Unvested RSUs and restricted stock outstanding, December 31, 2011	90	\$34.21
RSUs and restricted stock granted	51	\$19.50
RSUs and restricted stock vested	(21)	\$27.75
RSUs and restricted stock cancelled/forfeited	—	\$—
Adjustments to shares granted due to shares earned at vesting	(17)	\$26.65
Unvested RSUs and restricted stock outstanding, December 31, 2012	103	\$29.25

At December 31, 2012, total compensation cost related to non-vested stock options not yet recognized was approximately \$17.4 million, which is expected to be recognized over an average remaining recognition period of 2.6 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, 2012, 2011 and 2010, which was recognized as follows:

<i>(In thousands)</i>	2012	2011	2010
Stock-based compensation expense included in cost of sales	\$422	\$412	\$317
Selling, general and administrative expense	4,351	4,316	3,575
Research and development expense	4,491	4,441	3,825
Stock-based compensation expense included in operating expenses	8,842	8,757	7,400
Total stock-based compensation expense	9,264	9,169	7,717
Tax benefit for expense associated with non-qualified options	(1,234)	(1,321)	(650)
Total stock-based compensation expense, net of tax	\$8,030	\$7,848	\$7,067

At December 31, 2012, total compensation cost related to non-vested stock options not yet recognized was approximately \$17.4 million, which is expected to be recognized over an average remaining recognition period of 2.6 years.

The stock option pricing model requires the use of several significant 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 2012 to the methodology used to determine our assumptions.

The weighted-average estimated fair value of stock options granted to employees and directors during the twelve months ended December 31, 2012, 2011 and 2010 was \$5.60 per share, \$9.53 per share and \$11.69 per share, respectively, with the following weighted-average assumptions:

	2012	2011	2010
Expected volatility	39.46%	38.32%	39.57%
Risk-free interest rate	0.96%	1.01%	1.35%
Expected dividend yield	2.05%	1.19%	1.08%
Expected life (in years)	6.18	5.15	5.78

We based our estimate of expected volatility for the 12 months ended December 31, 2012, 2011 and 2010 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 in 2012, 2011 and 2010 was \$19.46 per share, \$38.73 per share and \$39.21 per share, respectively, with the following assumptions:

	2012	2011	2010
Expected volatility	37.75%	39.32%	40.82%
Risk-free interest rate	0.38%	0.37%	0.51%
Expected dividend yield	2.12%	1.08%	1.07%

Stock-based compensation expense recognized in our Consolidated Statements of Income for the 12 months ended December 31, 2012, 2011 and 2010 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 1.6% 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, 2012, 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	\$10,688	\$846	\$(7)	\$11,527
Corporate bonds	185,464	966	(18)	186,412
Municipal fixed-rate bonds	174,530	627	(73)	175,084
Municipal variable rate demand notes	34,375	—	—	34,375
Fixed income bond fund	444	12	—	456
Marketable equity securities	20,966	14,630	(392)	35,204
Available-for-sale securities held at fair value	\$426,467	\$17,081	\$(490)	\$443,058
Restricted investment held at cost				48,250
Other investments held at cost				1,902
Total carrying value of available-for-sale investments				\$493,210

At December 31, 2011, 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	\$7,994	\$119	\$(401)	\$7,712
Corporate bonds	159,077	181	(2,505)	156,753
Municipal fixed-rate bonds	174,300	579	(53)	174,826
Municipal variable rate demand notes	69,660	—	—	69,660
Fixed income bond fund	527	194	—	721
Marketable equity securities	12,771	19,098	(559)	31,310
Available-for-sale securities held at fair value	\$424,329	\$20,171	\$(3,518)	\$440,982
Restricted investment held at cost				48,250
Other investments held at cost				2,123
Total carrying value of available-for-sale investments				\$491,355

As of December 31, 2012, 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	\$61,318	\$60,745
One to two years	97,414	40,981
Two to three years	27,680	21,983
Three to five years	—	51,375
Total	\$186,412	\$175,084

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

We review our investment portfolio for potential “other-than-temporary” declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of \$17 thousand during the fourth quarter of 2012. For each of the years ended December 31, 2012, 2011 and 2010 we recorded a charge of \$0.7 million, \$68 thousand and \$43 thousand, respectively, related to the other-than-temporary impairment of certain marketable equity securities, a fixed income bond fund 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.

(In thousands)

Year Ended December 31,	2012	2011	2010
Gross realized gains	\$11,006	\$13,641	\$12,191
Gross realized losses	\$(1,456)	\$(1,187)	\$(1,183)

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

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

The following table presents the breakdown of investments with unrealized losses at December 31, 2011.

(In thousands)	Continuous Unrealized Loss Position for Less than 12 Months		Continuous Unrealized Loss Position for 12 Months or Greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Deferred compensation plan assets	\$5,655	\$(401)	\$—	\$—	\$5,655	\$(401)
Corporate bonds	112,345	(2,505)	—	—	112,345	(2,505)
Municipal fixed-rate bonds	20,076	(53)	—	—	20,076	(53)
Marketable equity securities	4,418	(543)	48	(16)	4,466	(559)
Total	\$142,494	\$(3,502)	\$48	\$(16)	\$142,542	\$(3,518)

The decrease in unrealized losses during 2012, as reflected in the table above, is primarily due to credit yield spreads tightening during 2012 primarily impacting our corporate bonds. At December 31, 2012, a total of 152 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, 2012 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				
Money market funds	\$28,071	\$28,071	\$—	\$—
Available-for-sale securities				
Deferred compensation plan assets	11,527	11,527	—	—
Available-for-sale debt securities				
Corporate bonds	186,412	—	186,412	—
Municipal fixed-rate bonds	175,084	—	175,084	—
Municipal variable rate demand notes	34,375	—	34,375	—
Fixed income bond fund	456	456	—	—
Available-for-sale marketable equity securities				
Marketable equity securities— technology industry	14,099	14,099	—	—
Marketable equity securities—other	21,105	21,105	—	—
Available-for-sale securities	443,058	47,187	395,871	—
Total	\$471,129	\$75,258	\$395,871	\$—

Fair Value Measurements at December 31, 2011 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				
Money market funds	\$13,696	\$13,696	\$—	\$—
Available-for-sale securities				
Deferred compensation plan assets	7,712	7,712	—	—
Available-for-sale debt securities				
Corporate bonds	156,753	—	156,753	—
Municipal fixed-rate bonds	174,826	—	174,826	—
Municipal variable rate demand notes	69,660	—	69,660	—
Fixed income bond fund	721	721	—	—
Available-for-sale marketable equity securities				
Marketable equity securities— technology industry	18,743	18,743	—	—
Marketable equity securities—other	12,567	12,567	—	—
Available-for-sale securities	440,982	39,743	401,239	—
Total	\$454,678	\$53,439	\$401,239	\$—

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 Inventory

At December 31, 2012 and 2011, inventory was comprised of the following:

<i>(In thousands)</i>	2012	2011
Raw materials	\$47,054	\$44,588
Work in process	3,262	3,954
Finished goods	52,267	39,258
Total	\$102,583	\$87,800

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, 2012 and 2011, raw materials reserves totaled \$9.9 million and \$7.9 million, respectively, and finished goods inventory reserves totaled \$2.1 million and \$1.5 million, respectively.

6 Property, Plant and Equipment

At December 31, 2012 and 2011, property, plant and equipment were comprised of the following:

<i>(In thousands)</i>	2012	2011
Land	\$4,263	\$4,263
Building and land improvements	20,915	16,857
Building	68,479	68,479
Furniture and fixtures	16,631	16,433
Computer hardware and software	68,596	64,053
Engineering and other equipment	99,081	91,232
Total Property, Plant and Equipment	277,965	261,317
Less accumulated depreciation	(197,719)	(186,022)
Total Property, Plant and Equipment (net)	\$80,246	\$75,295

Depreciation expense was \$12.1 million, \$10.8 million and \$10.2 million in 2012, 2011 and 2010, respectively.

7 Goodwill and Intangible Assets

The changes in the carrying value of goodwill, all of which is included in our Enterprise Networks division, for the year ended December 31, 2012 are as follows:

<i>(In thousands)</i>	
Balance, December 31, 2011	\$3,492
Acquisitions	—
Impairment losses	—
Balance, December 31, 2012	\$3,492
Balance as of December 31, 2012	
Goodwill	\$3,492
Accumulated impairment losses	—
Total Goodwill	\$3,492

We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. There were no impairment losses recognized during 2012 or 2011.

The following table presents our intangible assets as of December 31, 2012 and 2011. 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.

<i>(In thousands)</i>	December 31, 2012			December 31, 2011		
	Gross Value	Accumulated Amortization	Net Value	Gross Value	Accumulated Amortization	Net Value
Customer relationships	\$6,769	\$(766)	\$6,003	\$1,623	\$(194)	\$1,429
Developed technology	6,397	(1,354)	5,043	3,230	(303)	2,927
Intellectual property	2,340	(851)	1,489	2,340	(525)	1,815
Trade names	270	(85)	185	270	(28)	242
Other	13	(3)	10	—	—	—
Total	\$15,789	\$(3,059)	\$12,730	\$7,463	\$(1,050)	\$6,413

Amortization expense was \$2.0 million, \$0.7 million and \$0.4 million in 2012, 2011 and 2010, respectively.

As of December 31, 2012, the estimated future amortization expense of intangible assets is as follows:

<i>(In thousands)</i>	Amount
2013	\$2,438
2014	2,284
2015	2,149
2016	1,876
2017	1,273
Thereafter	2,710
Total	\$12,730

8 Alabama State Industrial Development Authority Financing and Economic Incentives

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the "Authority"). Pursuant to the program, on January 13, 1995, the Authority issued \$20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the "Bondholder"), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to \$50.0 million. An Amended and Restated Taxable Revenue Bond ("Amended and Restated Bond") was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 5% per annum. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond at December 31, 2012 was approximately \$48.8 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A. We are required to make payments to the Authority in amounts necessary to pay the principal of and interest on the Amended and Restated Bond. Included in long-term investments at December 31, 2012 is \$48.3 million which is invested in a restricted certificate of deposit. These funds serve as a collateral deposit against the principal of this bond, and we have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness.

In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. For the years ended December 31, 2012, 2011 and 2010, we realized economic incentives related to payroll withholdings totaling \$1.4 million, \$1.9 million and \$1.5 million, respectively.

Due to continued positive cash flow from operating activities, we made a business decision in 2006 to begin an early partial redemption of the Bond. We made principal payments of \$0.5 million and \$1.0 million for the years ended December 31, 2012 and 2011, respectively. It is our intent to make annual principal payments in addition to the interest amounts that are due. In connection with this decision, \$0.5 million of the bond debt has been reclassified to a current liability in accounts payable in the Consolidated Balance Sheets at December 31, 2012 and 2011.

9 Income Taxes

A summary of the components of the provision for income taxes as of December 31, 2012, 2011 and 2010 is as follows:

<i>(In thousands)</i>	2012	2011	2010
Current			
Federal	\$26,225	\$59,382	\$48,870
State	3,766	7,177	6,380
International	(504)	431	274
Total current	29,487	66,990	55,524
Deferred tax expense (benefit)	(3,785)	575	(1,324)
Total Provision for Income Taxes	\$25,702	\$67,565	\$54,200

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

	2012	2011	2010
Tax provision computed at the federal statutory rate	35.00%	35.00%	35.00%
State income tax provision, net of federal benefit	3.78	3.19	3.33
Federal research credits	—	(2.50)	(2.90)
Valuation allowance on losses of foreign subsidiaries	3.80	—	—
Tax-exempt income	(1.01)	(0.27)	(0.46)
State tax incentives	(4.46)	(0.90)	(0.86)
Stock-based compensation	2.36	0.03	0.34
Domestic production activity deduction	(3.21)	(1.84)	(2.37)
Other, net	(1.03)	0.07	0.15
Effective Tax Rate	35.23%	32.78%	32.23%

Income before provision for income taxes for the years ended December 31, 2012, 2011 and 2010 is as follows:

<i>(In thousands)</i>	2012	2011	2010
U.S. entities	\$80,926	\$204,652	\$167,118
International	(7,961)	1,490	1,071
Total	\$72,965	\$206,142	\$168,189

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>	2012	2011
Current deferred tax assets		
Accounts receivable	\$2	\$4
Inventory	7,507	6,709
Accrued expenses	5,546	5,412
Total Current Deferred Tax Assets	13,055	12,125
Non-current deferred tax assets		
Accrued expenses	116	113
Deferred compensation	4,456	3,177
Stock-based compensation	4,569	3,808
Uncertain tax positions related to state taxes and related interest	1,005	947
Pensions	605	—
Foreign and state losses and state credit carry-forwards	11,327	7,891
Federal loss and research carry-forwards	12,210	14,778
Valuation allowance	(10,939)	(7,585)
Total Non-current Deferred Tax Assets	23,349	23,129
Total Deferred Tax Assets	\$36,404	\$35,254
Non-current Deferred Tax Liabilities		
Accumulated depreciation	\$(6,405)	\$(7,081)
Intellectual property	(1,839)	(2,594)
Investments	(4,844)	(5,109)
Total Non-current Deferred Tax Liabilities	\$(13,088)	\$(14,784)
Net Deferred Tax Assets	\$23,316	\$20,470

At December 31, 2012 and 2011, non-current deferred tax liabilities and non-current deferred tax assets, respectively, related to investments reflect deferred taxes on unrealized gains and losses on available-for-sale investments. The net change in non-current deferred taxes associated with these investments, a deferred tax benefit of \$34 thousand in 2012 and a deferred tax benefit of \$7.8 million in 2011, is recorded as an adjustment to other comprehensive income, presented in the Consolidated Statements of Comprehensive Income.

We have deferred tax assets for foreign and domestic loss carry-forwards, unamortized research and development costs and state credit carry-forwards of \$23.5 million which will expire between 2013 and 2030. The foreign loss carry-forwards were generated through the acquisition of a foreign entity in 2009 and through current losses at a foreign subsidiary. The unamortized research and development costs are related to our acquisition of Bluesocket in 2011. The state credit carry-forwards result from tax credits in excess of our annual tax liability to an individual state where we do not generate sufficient state income to offset the credit. We believe it is more likely than not that we will not realize the full benefits of the deferred tax asset arising from these losses and credits in various states and foreign countries, and accordingly, we have provided a valuation allowance against these deferred tax assets. We do not provide for U.S. income tax on undistributed earnings of our foreign operations, whose earnings are intended to be permanently reinvested. These earnings are not required to service debt or fund our U.S. operations.

During 2012, 2011 and 2010, we recorded an income tax benefit of \$1.9 million, \$10.5 million and \$4.9 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 2012, 2011 and 2010 is reconciled below:

<i>(In thousands)</i>	2012	2011	2010
Balance at beginning of period	\$2,970	\$2,593	\$2,919
Increases for tax position related to:			
Prior years	965	—	197
Current year	302	840	818
Decreases for tax positions related to:			
Prior years	(49)	(92)	(16)
Settlements with taxing authorities	(507)	(354)	(630)
Expiration of applicable statute of limitations	(755)	(17)	(695)
Balance at end of period	\$2,926	\$2,970	\$2,593

As of December 31, 2012, 2011, and 2010, our total liability for unrecognized tax benefits was \$2.9 million, \$3.0 million, and \$2.6 million, respectively, of which \$2.2 million, \$2.4 million, and \$2.0 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, 2012, 2011 and 2010, the balances of accrued interest and penalties were \$0.8 million, \$1.2 million and \$1.0 million, respectively.

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

10 Employee Benefit Plans

Pension Benefit Plan

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

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

<i>(In thousands)</i>	
Change in projected benefit obligation:	
Projected benefit obligation at beginning of period	\$—
Business combination	(18,063)
Service cost	(766)
Interest cost	(494)
Actuarial gain (loss)	(1,862)
Foreign currency exchange rate changes	4
Projected benefit obligation at end of period	(21,181)
Change in plan assets:	
Fair value of plan assets at beginning of period	\$—
Business combination	18,063
Actual return on plan assets	592
Foreign currency exchange rate changes	(35)
Fair value of plan assets at end of period	\$18,620
Funded status at end of period	\$(2,561)

The accumulated benefit obligation was \$20.8 million at December 31, 2012.

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

(In thousands)

Current liability	\$(609)
Non-current liability	(1,952)
Total	\$(2,561)

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

(In thousands)

Net periodic benefit cost:	
Service cost	\$766
Interest cost	494
Expected return on plan assets	(674)
Net periodic benefit cost	586
Other changes in plan assets and benefit obligations recognized in accumulated other comprehensive income:	
Net actuarial (gain) loss	1,862
Net unrealized (gain) loss on plan assets	90
Total recognized in net periodic benefit cost and accumulated other comprehensive income	\$2,538

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 period May 4, 2012 to December 31, 2012 were as follows:

Discount rates	3.96%
Rate of compensation increase	2.25%
Expected long-term rates of return	5.40%

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

Discount rates	3.50%
Rate of compensation increase	2.25%

No amounts will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2013.

We do not anticipate making a contribution to our pension plan in 2013. The following pension benefit payments, which reflect expected future service, as appropriate, are expected to be paid to participants:

(In thousands)

2013	\$339
2014	226
2015	296
2016	211
2017	370
2018-2022	4,080
Total	\$5,522

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, 2012 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	\$6	\$6	\$—	\$—
Available-for-sale securities				
Bond funds	13,880	13,880	—	—
Equity funds	3,975	3,975	—	—
Balanced funds	759	759	—	—
Available-for-sale securities	18,614	18,614	—	—
Total	\$18,620	\$18,620	\$—	\$—

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

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

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

401(k) Savings Plan

We maintain the ADTRAN, Inc. 401(k) Retirement Plan (Savings Plan) for the benefit of our eligible employees. The Savings Plan is intended to qualify under Sections 401(a) and 401(k) of the Internal Revenue Code of 1986, as amended (Code), and is intended to be a "safe harbor" 401(k) plan under Code Section 401(k)(12). The Savings Plan allows employees to save for retirement by contributing part of their compensation to the plan on a tax-deferred basis. The Savings Plan also requires us to contribute a "safe harbor" amount each year. We match up to 4% of employee contributions (100% of an employee's first 3% of contributions and 50% of their next 2% of contributions), beginning on the employee's one year anniversary date. In calculating our matching contribution, we only use compensation up to the statutory maximum under the Code (\$250 thousand for 2012). 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 \$4.6 million, \$4.3 million and \$4.6 million in 2012, 2011 and 2010, 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>	2012	2011
Fair Value of Plan Assets		
Long-term Investments	\$11,526	\$7,710
Total Fair Value of Plan Assets	\$11,526	\$7,710
Amounts Payable to Plan Participants		
Non-current Liabilities	\$11,526	\$7,710
Total Amounts Payable to Plan Participants	\$11,526	\$7,710

Interest and dividend income of the Trust have been included in interest and dividend income in the accompanying 2012, 2011 and 2010 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 2012 and 2011 Consolidated Balance Sheets. Changes in the fair value of the deferred compensation liability are included as selling, general and administrative expense in the accompanying 2012, 2011 and 2010 Consolidated Statements of Income. Based on the changes in the total fair value of the Trust's assets, we recorded deferred compensation adjustments in 2012, 2011 and 2010 of \$0.9 million, \$(0.2) million and \$0.4 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, 2012 and 2011, this liability totaled \$0.2 million.

11 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, 2012, 2011 and 2010. Asset information by reportable segment is not reported, since we do not produce such information internally.

<i>(In thousands)</i>	2012		2011		2010	
Sales and Gross Profit by Market Segment	Sales	Gross Profit	Sales	Gross Profit	Sales	Gross Profit
Carrier Networks	\$492,096	\$247,380	\$569,579	\$327,813	\$476,030	\$283,310
Enterprise Networks	128,518	69,263	147,650	86,505	129,644	75,553
Total	\$620,614	\$316,643	\$717,229	\$414,318	\$605,674	\$358,863

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 MSAP
- hiX family of MSAPs
- Total Access 1100/1200 Series of FTTN products
- UBE
- DSLAM products

Optical

- ONE
- NetVanta 8000 Series
- OPTI and Total Access 3000 Optical products
- SFP products

TDM Systems

Network Management Solutions

Business Networking products provide access to telecommunication services and facilitate the delivery of cloud connectivity, enterprise communications and virtual mobility to the SME market. This category includes the following product areas and related services:

Internetworking Products

- Total Access IP Business Gateways
- ONTs
- Bluesocket vWLAN
- NetVanta
 - Multiservice Routers
 - Managed Ethernet Switches
 - UC solutions
 - Carrier Ethernet NTE
- Network Management Solutions

IADs

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

- HDSL products
- DDS
- ISDN products
- T1/E1/T3 CSUs/DSUs
- TRACER fixed-wireless products

The table below presents sales information by product category for the years ended December 31, 2012, 2011 and 2010:

<i>(In thousands)</i>	2012	2011	2010
Carrier Systems	\$399,646	\$420,289	\$289,314
Business Networking	149,304	162,186	127,233
Loop Access	71,664	134,754	189,127
Total	\$620,614	\$717,229	\$605,674

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, 2012, 2011 and 2010:

<i>(In thousands)</i>	2012	2011	2010
Core Products			
Broadband Access (included in Carrier Systems)	\$320,076	\$289,776	\$176,116
Optical (included in Carrier Systems)	51,755	82,535	66,206
Internetworking (NetVanta and Multi-service Access Gateways) (included in Business Networking)	142,958	151,536	111,123
Subtotal	\$514,789	\$523,847	\$353,445
Legacy Products			
HDSL (does not include T1) (included in Loop Access)	66,974	126,976	177,249
Other products (excluding HDSL)	38,851	66,406	74,980
Subtotal	\$105,825	\$193,382	\$252,229
Total	\$620,614	\$717,229	\$605,674

The following table presents sales information by geographic area for the years ended December 31, 2012, 2011 and 2010. International sales correlate to shipments with a non-U.S. destination.

<i>(In thousands)</i>	2012	2011	2010
United States	\$470,369	\$632,795	\$573,845
International	150,245	84,434	31,829
Total	\$620,614	\$717,229	\$605,674

Only a single customer comprised more than 10% of our revenue in 2012 at 23%. Single customers comprising more than 10% of our revenue in 2011 included two customers at 25% and 10%, respectively. Single customers comprising more than 10% of our revenue in 2010 included three customers at 20%, 18%, and 11%, respectively. No other customer accounted for 10% or more of our sales in 2012, 2011 or 2010.

Sales to our three largest service provider customers for each year were 41%, 44% and 49% of total revenue in 2012, 2011 and 2010, respectively.

As of December 31, 2012, long-lived assets, net totaled \$80.2 million, which includes \$73.9 million held in the United States and \$6.3 million held outside the United States. As of December 31, 2011, long-lived assets, net totaled \$75.3 million, which includes \$73.9 million held in the United States and \$1.4 million held outside the United States.

12 Commitments and Contingencies

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

We lease office space and equipment under operating leases which expire at various dates through 2018. As of December 31, 2012, future minimum rental payments under non-cancelable operating leases with original maturities of greater than 12 months are approximately as follows:

(In thousands)

2013	\$4,353
2014	3,687
2015	3,214
2016	2,271
Thereafter	2,722
Total	\$16,247

Rental expense was approximately \$3.9 million, \$2.4 million and \$1.8 million for the years ended December 31, 2012, 2011 and 2010, respectively.

13 Earnings per Share

A summary of the calculation of basic and diluted earnings per share (EPS) for the years ended December 31, 2011, 2010 and 2009 is as follows:

(In thousands, except for per share amounts)

	2012	2011	2010
Numerator			
Net Income	\$47,263	\$138,577	\$113,989
Denominator			
Weighted average number of shares—basic	63,259	64,145	62,490
Effect of dilutive securities:			
Stock options	488	1,236	1,355
Restricted stock and restricted stock units	27	35	34
Weighted average number of shares—diluted	63,774	65,416	63,879
Net income per share—basic	\$0.75	\$2.16	\$1.82
Net income per share—diluted	\$0.74	\$2.12	\$1.78

For each of the years ended December 31, 2012, 2011 and 2010, 3.2 million, 1.2 million and 2.0 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.

14 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, 2012	June 30, 2012	September 30, 2012	December 31, 2012
Net sales	\$134,735	\$183,998	\$162,125	\$139,756
Gross profit	\$74,087	\$95,201	\$79,972	\$67,383
Operating income	\$16,181	\$26,838	\$10,276	\$2,874
Net income	\$12,960	\$21,070	\$9,272	\$3,961
Earnings per common share	\$0.20	\$0.33	\$0.15	\$0.06
Earnings per common share assuming dilution (1)	\$0.20	\$0.33	\$0.15	\$0.06
Three Months Ended	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011
Net sales	\$165,522	\$184,227	\$192,194	\$175,286
Gross profit	\$98,795	\$106,827	\$109,476	\$99,220
Operating income	\$45,606	\$51,310	\$51,107	\$41,115
Net income	\$34,258	\$36,943	\$36,213	\$31,163
Earnings per common share	\$0.53	\$0.57	\$0.57	\$0.49
Earnings per common share assuming dilution (1)	\$0.52	\$0.56	\$0.56	\$0.48

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

15 Related Party Transactions

We employ the law firm of our director emeritus for legal services. All bills for services rendered by this firm are reviewed and approved by our Chief Financial Officer. We believe that the fees for such services are comparable to those charged by other firms for services rendered to us. For the years ended 2012, 2011 and 2010, we incurred fees of \$10 thousand per month for these legal services.

16 Subsequent Events

On January 15, 2013, 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 7, 2013. The quarterly dividend payment was \$5.6 million and was paid on February 21, 2013. 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.

As of February 28, 2013, we have repurchased 0.9 million shares of our common stock through open market purchases at an average cost of \$22.45 per share. We currently have the authority to purchase an additional 3.2 million shares of our common stock under the current plan approved by the Board of Directors.

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
Dean of the J. Mack Robinson College of Business at
Georgia State University

Ross K. Ireland

Director of the Company
Former Senior Executive Vice President of Services and
Chief Technology Officer – SBC Communications, Inc.

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

James L. North

Director Emeritus
Counsel to the company since its incorporation
in 1985, attorney with James L. North & Associates,
Birmingham, Alabama

Michael K. Foliano

Senior Vice President – Global Operations

Raymond R. Schansman

Senior Vice President and General Manager,
Enterprise Networks Division

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

General Counsel

James L. North, Attorney at Law
Birmingham, Alabama

Special Counsel

McKenna Long & Aldridge LLP
Atlanta, Georgia

Form 10-K

ADTRAN's 2012 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 2013 Annual Meeting of Stockholders will be held
at ADTRAN corporate headquarters, 901 Explorer
Boulevard, Huntsville, Alabama, on Wednesday,
May 8, 2013, at 10:30 a.m. Central time.





Corporate Headquarters

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ADTRAN Europe Limited
Theale, Reading, United Kingdom

ADTRAN, Inc.
Beijing, China

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
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. – Abu Dhabi
Abu Dhabi, United Arab Emirates



TL191270



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