ADTRAN INC
Form 10-K
February 24, 2015
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS

PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

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

For the Fiscal Year Ended December 31, 2014

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

For the Transition Period from __________ to __________

Commission file number 0-24612

ADTRAN, Inc.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

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

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

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

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

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

The aggregate market value of the registrant s outstanding common stock held by non-affiliates of the registrant on June 30, 2014 was $1,228,547,070 based on a closing market price of $22.56 as quoted on the NASDAQ Global Select Market. There were 53,440,375 shares of common stock outstanding as of February 9, 2015.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 13, 2015 are incorporated herein by reference in Part III.

Table of Contents

ADTRAN, Inc.

Annual Report on Form 10-K

For the Fiscal Year Ended December 31, 2014

Table of Contents

Table of Contents

PART I

ITEM 1. BUSINESS

Overview

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

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

Products and Services

We maintain two operating divisions based on our product and service offerings: the Carrier Networks Division and the Enterprise Networks Division. These divisions serve two distinct markets and support sales globally, operating as two reportable segments. In 2014, sales of Carrier Networks products accounted for 81.0% of total revenue, while sales of Enterprise Networks products accounted for 19.0% of total revenue. Sales to countries outside of the United States are included in these aggregate divisional figures, but when accounted for separately, comprised 39.5% of total revenue. For more financial information about these divisions and geographic areas, see Note 12 to the Consolidated Financial Statements included in this report.

Our Carrier Networks Division offers broadband and optical infrastructure products and services used by service providers to aggregate, transport, and deliver voice, data, and video services to their customers premises and mobile network cell sites. These products are typically located in central office exchanges or outside plant cabinets, infrastructure locations for business services and mobile backhaul networks, and residential and business premises. Our Enterprise Networks Division provides cloud connectivity solutions, such as IP business gateways and access routers, which provide business access to service provider networks, and enterprise communications solutions, which enable businesses to construct voice, data and video networks at a single customer premises or among a distributed enterprise s multiple sites. These products are sold through service providers in the form of bundled business services and solutions resale and through value-added resellers (VARs).

Both ADTRAN divisions are positioned with product and service offerings that compete in the global communications industry, specifically, in the areas of Ethernet and Internet Protocol (IP) based networks, as service providers and enterprises continue to transition to an all IP-based network to cost-effectively deliver and scale higher-bandwidth video and data services. Service providers are also planning to ubiquitously offer services up to 1 Gigabit and higher in a cost effective manner. To that end, we have strengthened our technologies in our core product areas: Broadband Access, Optical, and Internetworking.

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

Broadband Access Infrastructure for Advanced Services

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

Table of Contents

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

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

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

- Broadband Access
  - Total Access® 5000 Series of Multi-Service Access Node (MSAN)
  - hiX 5600 Series of MSANs
  - Total Access 1100/1200 Series of Fiber to the Node (FTTN) products
  - hiX 1100 Series of Fiber to the Node (FTTN) products
  - VDSL2 Vectoring based Digital Subscriber Line Access Multiplexer (DSLAM) products
  - ADTRAN 500 Series of FTTdp G.fast Distribution Point Units (DPU)
- Optical
  - Optical Networking Edge (ONE)
  - NetVanta 8000 Series of Fiber Ethernet Access Devices (EAD)
  - NetVanta 8400 Series of 10Gig Multi-service Edge Switches

- OPTI-6100 and Total Access 3000 optical Multi-Service Provisioning Platforms (MSPP)

- Pluggable Optical Products, including SFP, XFP, and SFP+

Time Division Multiplexed (TDM) systems

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

Internetworking products

- Total Access IP Business Gateways

- Optical Network Terminals (ONTs)

- Bluesocket® virtual Wireless LAN (vWLAN®)

- NetVanta®

    - Access Routers

    - Enterprise Session Border Controllers (eSBC)

    - Managed Ethernet Switches

    - IP Business Gateways

    - Unified Communications (UC) solutions

    - Carrier Ethernet Network Terminating Equipment (NTE)

    - Carrier Ethernet Routers and Gateways

- Network Management Solutions

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

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

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

Carrier Networks Division

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

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

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

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

Advanced IP Services

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

High-speed Residential Services

Designed with fiber deployment in mind, our Total Access 5000 Series provides high-capacity switching and bandwidth for Fiber-to-the-Premises (FTTP) services based on advanced optical standards. It also provides other ultra-broadband services based on advanced copper technologies used in Fiber-to-the-Node, Cabinet or distribution point (FTTN/FTTCab/FTTdp). FTTP networks are based on the Gigabit Passive Optical Networks (GPON) standard. There are two key network components, the Optical Line Terminal (OLT) and the customer-side ONT. The OLT is typically located in communications exchanges and other network Central Offices within MSANs. For ADTRAN, both the hiX 5600 and the Total Access 5000 Series MSANs house the OLT modules. The OLT provides Gigabit levels of bandwidth shared or dedicated across thousands of subscribers enabling the delivery of advanced solutions like IPTV across an all-Ethernet architecture. On the other end of the FTTP network, every subscriber s home has a provider-owned ONT that terminates the fiber optics from the OLT and converts the optical signals to electric signals, enabling the in-home network to deliver voice, Internet and video services. Customer-owned devices, such as computers, usually expect Ethernet, a standard networking technology, making an all-Ethernet solution preferable. Our portfolio of ONTs, including the Total Access 300 Series, and next generation ADTRAN 400 and 500 Series ONTs provides carriers with a widely differentiated set of service delivery options for residential, business and mobile backhaul opportunities.

Table of Contents

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

To further the competitiveness of operators using FTTCab and FTTdp architectures ADTRAN has G.fast ultra-broadband trials underway with service providers in Europe, North America and Asia-Pacific. The trials demonstrate that G.fast is moving beyond a technology concept toward a commercial reality supported by a portfolio of FTTdp environmentally sealed platforms. ADTRAN s G.fast solutions are helping service providers address the unique and varied deployment scenarios encountered where fiber-to-the-home (FTTH) is cost prohibitive.

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

The hiX 5600 Series can be positioned as a residential MSAN delivering high-density DSL and voice technologies. The hiX 5600 Series MSAN also supports residential point-to-point fiber applications. This product series leverages the latest technology in next generation VDSL2 - vectoring. Additionally, hiX platforms offer a comprehensive voice feature set for ETSI markets.

Business Ethernet Services

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

We have a complete portfolio of solutions for Business Ethernet services utilizing Fiber (EoF), Copper (EoCu) and TDM (EoTDM). These solutions enable cost-effective business Ethernet service delivery across a variety of network infrastructures. The Total Access 5000 supports standards-based copper pair bonding of xDSL loops for direct Ethernet service delivery. Leveraging a complete end-to-end solution with NetVanta 800 Series, NetVanta 8000 Series and NetVanta 8400 Series network termination equipment, the Total Access 5000 and hiX 5600 also offer an innovative approach to delivering Ethernet services by aggregating bonded copper, bonded circuits, and fiber, while supporting multi-megabit rates for MEF-certified carrier Ethernet circuits. This combination allows carriers to offer Ethernet services across the entire network, enabling new revenue-generating services for businesses.

Packet Optical Networking, Optical Access and Optical Transport

Mobile networks that were originally built for voice communications are now being optimized for data applications, putting strain on the mobile backhaul network. With the introduction of carrier-class Ethernet technologies, operators can now take advantage of fiber facilities to achieve the highest traffic carrying capacity utilization of their embedded investment and provide a network migration path toward an all-packet network. With the integration of EoF in the Total Access 5000 and NetVanta 8000/8400 platforms, we offer a scalable solution that supports service migration as providers continue to strive to meet the customer demand for greater bandwidth. As wireless needs continue to grow, EoF is an ideal transport method for mobile backhaul networks and enables long-haul reach to residential and business networks.

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

Table of Contents

NetVanta® 8400 Series 10G Multi-service Edge Switch has achieved MEF Carrier Ethernet 2.0 (CE2.0) certification. MEF CE2.0 compliance ensures support for SLA-based Carrier Ethernet services, a critical requirement for service providers looking to support Gigabit services in Multiple Dwelling Unit (MDU) environments. The coexistence of commercial and residential customers presents the opportunity to converge premium Gigabit services across a range of market verticals from Gigabit broadband to 1 GE and 10 GE SLA-based services for both business cloud connectivity and small-cell backhaul segments.

One of the challenges presented in the MDU environment is how to preserve a high quality experience as Gigabit services converge for multiple vertical markets. As high-bandwidth services are delivered over the access network, the effective aggregation of those services is required. Network operators are, as a result, deploying both fiber-based access and packet-optical aggregation solutions closer to the customer edge to support both inter- and intra-building premium service delivery and aggregation. This enhanced scalability and quality assurance allows the service expansion to address gaps in mobile services coverage that can be found in high-rise residential/commercial buildings, making them ideal targets for small cell deployments that require 50-100 Mbps, scalable to 1 GE, of specialized backhaul access from multiple locations in a building.

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

Service and Support

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

Network and Services Management

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

Services Automation and Software-Defined Networks (SDN)

ADTRAN is expanding its ability to automate and manage a broader range of premise-based devices for the home and enterprise. This will enable service providers to accelerate new revenue streams afforded by the Internet of Things. There are billions of devices that connect to the Internet and billions more coming online over the next few years.

Service providers deliver broadband connectivity to these same devices and recognize the incremental revenue opportunities that can be captured when leveraging agile service automation and extended network visibility. The SDN expansion to our services management ecosystem expands these requisite agile services delivery and elastic services management capabilities in our residential broadband and business Ethernet access solutions.

Enterprise Networks Division

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

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

Table of Contents

Cloud Connectivity

Our Cloud Connectivity solutions allow service providers to deliver hosted and bundled service offerings that enable businesses to connect to the public or private cloud. These bundled service offerings are enabled by our Total Access and NetVanta IP Business Gateway (IPBG) and NetVanta Access Router solutions. Service offerings that are delivered utilizing our Cloud Connectivity solutions include: Hosted Voice and Unified Communications, Hosted Wireless Local Area Networking (WLAN), Business Internet Access, MEF-compliant Carrier Ethernet, Private Network, Session Initiation Protocol (SIP) Trunking, Enterprise Session Border Control (eSBC) functionality, Managed UC, and SIP Trunking with PBX. Our Enterprise Network Division solutions offered as key elements of these service provider business bundles are our Cloud Connectivity portfolio of IPBGs and Access Routers (used to provide connectivity to the business location), and our Enterprise Communications portfolio of vWLAN, Ethernet Switches, and UC solutions (used to provide the business productivity component of the service provider bundled services).

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

Enterprise Communications

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

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

Our NetVanta managed Layer 2 and Layer 3 (L2/L3) Ethernet switches complement our Bluesocket vWLAN solutions, providing integrated wireless/wireline LAN deployments and connectivity from the WAN to the end user s desktop computer and IP Phone. Our managed L2/L3 switches offer speeds up to 10 Gigabit per second and include Power over Ethernet (PoE) options for powering IP phones, wireless network access points, IP cameras and other critical business networking devices.

Our NetVanta UC solutions enable businesses with up to 2,000 employees to realize the benefits of UC. These UC products deliver end-to-end Unified Communications that bridge the gap between telephony, desktop communications productivity and business processes. Utilizing CEBP, NetVanta UC solutions enable businesses to increase workforce productivity and improve customer service. Our 7000 Series IP Communications solutions deliver an integrated, single-box solution for small business communications needs and combine the features of an IP PBX with the functionality of an Ethernet switch, a multi-service router, security features and WAN connectivity.

Common Internetworking Software

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

Table of Contents

Configuration and Network Management

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

Service and Support

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

In 2014, we continued to add customers for both our ProCloud and ProCloud Plus cloud-based managed service offerings through our ProServices organization. ProCloud offers a managed, business-class WiFi infrastructure service built on Bluesocket vWLAN. Our ProCloud Plus offering expands upon the base ProCloud service by including management of the WiFi access points in addition to the underlying infrastructure. ProCloud offers a 7x24 service providing network monitoring and management reports to reduce IT support burdens. When coupled with ProStart and ProCare, our ProCloud service offers turnkey wireless LAN installation, maintenance, and management.

Customers

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

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

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

Two customers, CenturyLink, Inc. and Deutsche Telekom, AG, individually comprised more than 10 percent of our revenue in 2014. The revenues from these customers are reported in both the Carrier Networks and Enterprise Networks segments.

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

Distribution, Sales and Marketing

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

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

Table of Contents

Similar to Carrier Networks products, Enterprise Networks products are fulfilled through a combination of direct sales and major technology distribution companies. This is supported by a direct sales organization for major accounts, and a channel-based sales organization to facilitate sales to our partners. VARs and system integrators may be affiliated with the company as a channel partner, or they may purchase from a distributor in an unaffiliated fashion. Affiliated partners participate with us at various program levels, based on sales volume and other factors, to receive benefits such as product discounts, market development funds, technical support and training. We maintain field offices worldwide to support direct sales, distributors, VARs and system integrators.

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

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

Research and Development

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

During 2014, 2013, and 2012, product development expenditures totaled $132.3 million, $131.1 million, and $126.0 million, respectively. Our product development activities are an important part of our strategy. Because of rapidly changing technology and evolving industry standards, we plan to maintain an emphasis on product development each year.

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

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

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

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

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

Table of Contents

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

For a discussion of risks associated with our research and development activities, see Risk Factors We must continue to update and improve our products and develop new products in order to compete and to keep pace with improvements in communications technology and Risk Factors We engage in research and development activities to improve the application of developed technologies, and as a consequence may miss certain market opportunities enjoyed by larger companies with substantially greater research and development efforts who may focus on more leading edge development , in Item 1A of this report.

Manufacturing and Operations

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

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

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

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

Competition

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

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

Table of Contents

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

Help the customer solve networking problems within the confines of restrained capital budgets;

Offer globally competitive solutions against a different set of competitors than in the United States;

Deliver solutions that fit the distributed networking model being deployed by most service providers;

Deliver solutions for service provider networks as they increasingly focus on network transformation, convergence, and integration of services;

Deliver solutions at attractive price points;

Deliver reliability and redundancy, especially for higher bandwidth products;

Adapt to new network technologies as they evolve;

Compete effectively against large companies with greater resources;

Deliver products when needed by the customer;

Deliver responsive customer service, technical support and training; and

Assist customers requiring pre-assembled, turnkey systems and professional services.

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

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

Satisfy the customer s need for a cost-efficient alternative to established internetworking suppliers;

Satisfy the customer s need to utilize the most cost-effective combination of transmission technologies to connect geographically dispersed locations;

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

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

Continue to develop and support established platforms;

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

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

Adapt to new network technologies as they evolve;

Deliver responsive customer service, technical support and training; and

Assist customers requiring hands-on installation and maintenance.

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

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

Table of Contents

Seasonality

We have experienced quarterly fluctuations in customer activity due to seasonal considerations. We typically experience reductions in order volume toward the beginning and end of the calendar year, which may result in lower revenues in the first and fourth quarters of our fiscal year. These seasonal effects may vary and do not always correlate to our operating results. Accordingly, they should not be considered a reliable indicator of our future revenue or operating results.

Backlog and Inventory

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

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

For further discussion of risks associated with managing our inventory, see Risk Factors Managing our inventory is complex and may include write-downs of excess or obsolete inventory , in Item 1A of this report.

Government Regulation

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

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

Employees

As of December 31, 2014, we had 2,080 full-time employees in the United States and in our international subsidiaries located in Canada, Mexico, the Asia-Pacific region, Europe and the Middle East region. The majority of ADTRAN GmbH employees, our subsidiary in Germany, are subject to collective bargaining agreements of either the Association of Metal and Electrical Industry in Berlin and Brandenburg e.V. or NORDMETALL Association of Metal and Electrical Industry e.V. A small number of our other employees are represented by a collective bargaining agreement. We have never experienced a work stoppage and we believe that our relationship with our employees is good.

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

Intellectual Property

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

We have ownership of over 520 patents worldwide related to our products and have over 170 additional patent applications pending, of which at least 7 have been approved and are in the process of being issued by various patent offices worldwide. Our patents expire at various dates between March 2015 and March 2033. We will continue to seek additional patents from time to time related to our research and development activities. We do not derive any material amount of revenue from the licensing of our patents.

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

Table of Contents

The communications industry is characterized by the existence of an ever-increasing volume of patent litigation and licensing activities. From time to time we receive and may continue to receive notices of claims alleging that we are infringing upon patents or other intellectual property. We cannot predict whether we will prevail in any claims or litigation over alleged infringements, or whether we will be able to license any valid and infringed patents, or other intellectual property, on commercially reasonable terms. It is possible that litigation may result in significant legal costs and judgments. Any intellectual property infringement claims, or related litigation against or by us, could have a material adverse effect on our business and operating results.

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

Available Information

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

ITEM 1A. RISK FACTORS

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

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

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

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

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

Fluctuations in demand for our products and services, especially with respect to significant network expansion projects undertaken by communications service providers;

Continued growth of communications network traffic and the adoption of communication services and applications by enterprise and consumer end users;

Changes in sales and implementation cycles for our products and reduced visibility into our customers spending plans and associated revenue;

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

Our ability to maintain appropriate inventory levels and purchase commitments;

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

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

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

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

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

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

Manufacturing and customer order lead times;

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

Our ability to achieve cost reductions;

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

Our ability to execute on our strategy and operating plans;

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

The effects of climate change and other natural events;

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

Changes in tax laws and regulations, or accounting pronouncements.

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

- Changes in customer, geographic, or product mix, including the mix of configurations and professional services revenue within each product group;

- Introduction of new products by competitors, including products with price-performance advantages;

- Our ability to reduce product cost;

- Increases in material or labor cost;

- Foreign currency exchange rate movements;

- Expediting costs incurred to meet customer delivery requirements;

Excess inventory and inventory holding charges;

Obsolescence charges;

Changes in shipment volume;

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

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

Lower than expected benefits from value engineering;

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

Changes in distribution channels;

Increased warranty cost;

Liquidated damages costs relating to customer contractual terms; and

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

Table of Contents

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Historically, a large percentage of our sales have been made to major service providers and larger independent communications companies. In 2014, these customers continued to comprise over half of our revenue. As long as the major and larger independent communications companies represent such a substantial percentage of our total sales, our future success will significantly depend upon certain factors which are not within our control, including:

- the timing and size of future purchase orders, if any, from these customers;
- the product requirements of these customers;
- the financial and operational success of these customers;
- the impact of legislative and regulatory changes on these customers;
- the success of these customers   services deployed using our products; and
- the impact of work stoppages at these customers.

16

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

- costs associated with fixing software or hardware defects;

- high service and warranty expenses;
- high inventory obsolescence expense;
- delays in collecting accounts receivable;
- payment of liquidated damages for performance failures; and
- a decline in sales to existing customers.

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

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

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

We are expanding our presence in international markets, which represented 39.5% of our net sales for 2014, and as a result, we anticipate increased sales and operating costs in these markets. This international expansion may increase our operational risks and impact our results of operations, including:

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

Potential exposure to natural disasters, epidemics and acts of war or terrorism.

If we are unable to successfully address the potential risks associated with our overall international expansion, our operating results and financial condition may be negatively impacted.

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

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

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

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

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

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

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

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

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

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

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

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

In the ordinary course of business, we may be subject to various legal proceedings and claims, including employment disputes, patent claims, disputes over contract agreements and other commercial disputes. In some cases, claimants seek damages, or other relief, such as royalty payments related to patents, which, if granted, could require significant expenditures. Any such disputes may be resolved before trial, or if litigated, may be resolved in our favor; however, the cost of claims sustained in litigation, and costs associated with the litigation process, may not be covered by our insurance. Such costs, and the demands on management time during such an event, could harm our business and have a material adverse effect on our liquidity, results of operations and financial condition.

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

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

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

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

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

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

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

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

We have significant investments in corporate and municipal fixed-rate bonds and municipal variable rate demand notes. Through December 31, 2014, we have not been required to impair any of these investments; however, we may experience a reduction in value or loss of liquidity in these investments, which may have an adverse effect on our results of operations, liquidity and financial condition. Fixed rate interest securities may have their fair value adversely impacted due to a rise in interest rates, while variable rate securities may produce less income than expected if interest rates fall. Our investments are subject to general credit, liquidity, market, and interest rate risks, which may increase because of conditions in the financial markets and related credit liquidity issues. Consequently, our future investment income may fall short of expectations due to changes in interest rates, or we may suffer losses in principal if we are forced to sell securities that decline in fair value due to changes in interest rates.

Our long-term investments include $38.3 million of marketable equity securities. At December 31, 2014, our total marketable equity securities, which included 443 individual securities, had unrealized gains of $12.4 million. If market conditions deteriorate in 2015, we may be required to record impairment charges related to our marketable equity securities.

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

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

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

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

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

Our success depends on attracting and retaining key personnel.

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

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

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

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

Table of Contents

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

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

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

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

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

These cancelable and non-cancelable leases expire at various times through 2025. For more information, see Note 13 of the Notes to Consolidated Financial Statements included in this report.

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

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below, in accordance with General Instruction G(3) of Form 10-K and Instruction 3 of Item 401(b) of Regulation S-K, is certain information regarding the executive officers of ADTRAN. Unless otherwise indicated, the information set forth is as of December 31, 2014.

Thomas R. Stanton	Age 50
2007 to present	Chief Executive Officer and Chairman of the Board
2005 2007	Chief Executive Officer and Director
2001 2005	Senior Vice President and General Manager, Carrier Networks
1999 2001	Vice President and General Manager, Carrier Networks
1995 1999	Vice President, Carrier Networks Marketing
1995	Vice President, Marketing & Engineering Transcrypt International, Inc.
1994 1995	Senior Director, Marketing E.F. Johnson Company
1993 1994	Director, Marketing E.F. Johnson Company
James E. Matthews	Age 58
2007 to present	Senior Vice President Finance, Chief Financial Officer, Treasurer, Secretary and Director
2001 2007	Senior Vice President Finance, Chief Financial Officer and Treasurer
1999 2001	Chief Financial Officer Home Wireless Networks, Inc.
1998 1999	Chief Executive Officer Miltope Group, Inc.
1995 1998	Vice President, Finance and Chief Financial Officer Miltope Group, Inc.
1992 1995	Controller Hughes Training, Inc.
Michael K. Foliano	Age 54
2006 to present	Senior Vice President, Global Operations
2005 2006	Senior Vice President, Sales, Services and Supply Chain Somera Communications Inc.
2004 2005	Senior Vice President, Global Operations Somera Communications Inc.
2002 2004	Senior Director, Global Logistics and Customer Operations Lucent Technologies
2001 2002	Executive General Manager, Mobility Supply Chain Lucent Technologies
2000 2001	Stanford University Sloan Fellow Lucent Technologies
1997 2000	Vice President, Global Provisioning Center Lucent Technologies
1995 1997	Manufacturing Operations Plant Manager Lucent Technologies/AT&T Network Systems
Kevin P. Heering	Age 43
2014 to present	Senior Vice President, Quality and Administration
2010 2014	Vice President, Quality
2007 2010	Engineering Director, Enterprise Network Systems
1999 2007	Engineering Manager, Enterprise Network Systems
1994 1999	Design Engineer, Enterprise Network Systems
Raymond R. Schansman	Age 58
2006 to present	Senior Vice President and General Manager, Enterprise Networks
2001 2006	Vice President, Carrier Networks Engineering
1998 2001	Engineering Director, Carrier Networks Systems

1996 1998	Engineering Manager, Enterprise Networks Systems
1989 1996	Program Manager SCI Systems, Inc.
1986 1989	Vice President, System and Product Engineering General Digital Industries
1983 1986	Senior Design Engineer General Digital Industries
Eduard Scheiterer	Age 61
2014 to present	Senior Vice President and Managing Director, International Markets
2012 2014	Managing Director Adtran GmbH, a German wholly owned subsidiary of Adtran, Inc.
2009 2012	Head of Broadband Access Nokia (formerly Nokia Siemens Networks), Germany
2007 2009	Head of Product Management and R&D of Business Support Systems Nokia

Table of Contents

James D. Wilson, Jr.	Age 44
2006 to present	Senior Vice President and General Manager, Carrier Networks
2005 2006	Vice President, Product Marketing, Carrier Networks
2002 2005	Director, Product Management, Carrier Networks
1998 2002	Director, Product Management, Loop Technologies, Carrier Networks
1996 1998	Manager, Engineering Operations Wyle Laboratories, Inc.
1992 1996	Manager, Program Development Wyle Laboratories, Inc.
Robert A. Fredrickson	Age 64
1996 to present	Vice President Carrier Networks Sales
1996	Vice President, Broadband Business Development DSC Communications Corporation
1991 1996	Senior Director, Access Products DSC Communications Corporation
Kevin W. Schneider	Age 51
2003 to present	Vice President Chief Technology Officer
1999 2003	Vice President Technology
1996 1999	Chief Scientist
1992 1996	Staff Scientist

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

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

ADTRAN s common stock is traded on the NASDAQ Global Select Market under the symbol ADTN. As of February 5, 2015, ADTRAN had 202 stockholders of record and approximately 7,266 beneficial owners of shares held in street name. The following table shows the high and low closing prices per share for our common stock as reported by NASDAQ for the periods indicated.

Common Stock Prices

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

The following table shows the shareholder dividends paid in each quarter of 2014 and 2013. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

Dividends per Common Share

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

Stock Repurchases

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

Period	Total Number of	Average Price Paid	Total Number of Shares Purchased as Part of	Maximum Number of Shares that May Yet Be

	Shares Purchased	per Share	Publicly Announced Plans or Programs (1)	Purchased Under the Plans or Programs
October 1, 2014 October 31, 2014	180,422	$ 20.47	180,422	5,541,295
November 1, 2014 November 30, 2014	748,510	$ 19.69	748,510	4,792,785
December 1, 2014 December 31, 2014				4,792,785
Total	928,932		928,932	

(1) Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 40.0 million shares of our common stock. On May 14, 2014, our Board of Directors authorized the repurchase of an additional 5.0 million shares of our common stock (bringing the total shares authorized for repurchase to 45.0 million), which commenced upon completion of the repurchase plan announced on May 1, 2013. This new authorization is being implemented through open market or private purchases from time to time as conditions warrant.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA

Income Statement Data [1]

(In thousands, except per share amounts)

Year Ended December 31,	*2014*	*2013*	*2012*	*2011*	*2010*
Sales					
Carrier Networks Division	$ 510,373	$ 500,733	$ 492,096	$ 569,579	$ 476,030
Enterprise Networks Division	119,634	141,011	128,518	147,650	129,644
Total sales	**630,007**	**641,744**	**620,614**	**717,229**	**605,674**
Cost of sales	318,680	332,858	303,971	302,911	246,811
Gross profit	**311,327**	**308,886**	**316,643**	**414,318**	**358,863**
Selling, general and administrative expenses	131,958	129,366	134,523	124,879	114,699
Research and development expenses	132,258	131,055	125,951	100,301	90,300
Operating income	**47,111**	**48,465**	**56,169**	**189,138**	**153,864**
Interest and dividend income	5,019	7,012	7,657	7,642	6,557
Interest expense	(677)	(2,325)	(2,347)	(2,398)	(2,436)
Net realized investment gain	7,278	8,614	9,550	12,454	11,008
Other income (expense), net	1,175	(911)	183	(694)	(804)
Gain on bargain purchase of a business			1,753		
Income before provision for income taxes	**59,906**	**60,855**	**72,965**	**206,142**	**168,189**
Provision for income taxes	(15,286)	(15,061)	(25,702)	(67,565)	(54,200)
Net income	**$ 44,620**	**$ 45,794**	**$ 47,263**	**$ 138,577**	**$ 113,989**

Year Ended December 31,	*2014*	*2013*	*2012*	*2011*	*2010*
Weighted average shares outstanding basic	55,120	59,001	63,259	64,145	62,490
Weighted average shares outstanding assuming dilution [2]	55,482	59,424	63,774	65,416	63,879
Earnings per common share basic	$ 0.81	$ 0.78	$ 0.75	$ 2.16	$ 1.82
Earnings per common share assuming dilution [2]	$ 0.80	$ 0.77	$ 0.74	$ 2.12	$ 1.78
Dividends declared and paid per common share	$ 0.36	$ 0.36	$ 0.36	$ 0.36	$ 0.36

Balance Sheet Data (In thousands)

At December 31,	***2014***	***2013***	***2012***	***2011***	***2010***
Working capital [3]	$ 232,080	$ 277,335	$ 337,979	$ 329,311	$ 304,952
Total assets	$ 738,694	$ 789,898	$ 883,656	$ 817,514	$ 691,974
Total debt	$ 30,000	$ 46,500	$ 46,500	$ 47,000	$ 48,000
Stockholders equity	$ 549,013	$ 604,606	$ 692,406	$ 692,131	$ 572,322

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

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

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

Table of Contents

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

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

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

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

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

- Broadband Access
  - Total Access® 5000 Series of Multi-Service Access Node (MSAN)
  - hiX 5600 Series of MSANs
  - Total Access 1100/1200 Series of Fiber to the Node (FTTN) products
  - hiX 1100 Series of Fiber to the Node (FTTN) products
  - VDSL2 Vectoring based Digital Subscriber Line Access Multiplexer (DSLAM) products
  - ADTRAN 500 Series of FTTdp G.fast Distribution Point Units (DPU)

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

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

- Internetworking products
  - Total Access IP Business Gateways
  - Optical Network Terminals (ONTs)
  - Bluesocket® virtual Wireless LAN (vWLAN®)
  - NetVanta®
    - Access Routers
    - Enterprise Session Border Controllers (eSBC)
    - Managed Ethernet Switches

IP Business Gateways

Unified Communications (UC) solutions

Carrier Ethernet Network Terminating Equipment (NTE)

Carrier Ethernet Routers and Gateways

Network Management Solutions

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

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

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

Sales were $630.0 million in 2014 compared to $641.7 million in 2013 and $620.6 million in 2012. Total sales of products in our three core areas, Broadband Access, Optical and Internetworking, increased 2.8% in 2014 compared to 2013 and increased 8.9% in 2013 compared to 2012. Our gross profit margin was 49.4% in 2014 compared to 48.1% in 2013 and 51.0% in 2012. Net income was $44.6 million in 2014 compared to $45.8 million in 2013 and $47.3 million in 2012. Earnings per share, assuming dilution, were $0.80 in 2014 compared to $0.77 in 2013 and $0.74 in 2012. Earnings per share in 2014, 2013 and 2012 include the effect of the repurchase of 3.7 million, 5.6 million and 1.8 million shares of our stock in those years, respectively.

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

Our operating results may also fluctuate as a result of a number of other factors, including a decline in general economic and market conditions, increased competition, customer order patterns, changes in product and services mix, foreign currency exchange rate movements, timing differences between price decreases and product cost reductions, product warranty returns, expediting costs, and announcements of new products by us or our competitors.

Additionally, maintaining sufficient inventory levels to assure prompt delivery of our products increases the amount of inventory that may become obsolete and increases the risk that the obsolescence of this inventory may have an adverse effect on our business and operating results. Also, not maintaining sufficient inventory levels to assure prompt delivery of our products may cause us to incur expediting costs to meet customer delivery requirements, which may negatively impact our operating results in a given quarter.

Accordingly, our historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that our financial results may vary from period to period. See Note 15 of Notes to Consolidated Financial Statements for additional information. *For a discussion of risks associated with our operating results, see Item 1A of this report.*

Table of Contents

Critical Accounting Policies and Estimates

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

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

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

We carry our inventory at the lower of cost or market, with cost being determined using the first-in, first-out method. We use standard costs for material, labor, and manufacturing overhead to value our inventory. Our standard costs are updated on at least a quarterly basis and any variances are expensed in the current period; therefore, our inventory costs approximate actual costs at the end of each reporting period. We write down our inventory for estimated obsolescence or unmarketable inventory by an amount equal to the difference between the cost of inventory and the estimated fair value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, we may be required to make additional inventory write-downs. Our reserve for excess and obsolete inventory was $24.7 million and $23.0 million at December 31, 2014 and 2013, respectively. Inventory disposals charged against the reserve were $2.1 million, $0.4 million and $0.5 million for the years ended December 31, 2014, 2013 and 2012, respectively.

The objective of our short-term investment policy is to preserve principal and maintain adequate liquidity with appropriate diversification, while achieving market returns. The objective of our long-term investment policy is principal preservation and total return; that is, the aggregate return from capital appreciation, dividend income, and interest income. These objectives are achieved through investments with appropriate diversification in fixed and variable rate income securities, public equity, and private equity portfolios. Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio. We have experienced significant volatility in the market prices of our publicly traded marketable equity securities. These investments are recorded on the consolidated balance sheets at fair value with unrealized gains and losses reported as a component of accumulated other comprehensive income, net of tax. The ultimate realized value on these marketable equity securities is subject to market price volatility.

Table of Contents

We have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1 Values based on unadjusted, quoted prices in active markets for identical assets or liabilities; Level 2 Values based on inputs other than quoted prices included within Level 1 that are directly or indirectly observable for the asset or liability; Level 3 Values based on unobservable inputs for the asset or liability. These inputs include information supplied by investees. At December 31, 2014, we categorized $54.5 million and $241.5 million of our available-for-sale investments as Level 1 and Level 2, respectively, and $1.2 million of our cash equivalents as Level 1. At December 31, 2013, we categorized $53.6 million and $311.5 million of our available-for-sale investments as Level 1 and Level 2, respectively, and $3.9 million of our cash equivalents as Level 1.

We review our investment portfolio for potential other-than-temporary declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. For the years ended December 31, 2014, 2013 and 2012, we recorded charges of $0.1 million, $25 thousand and $0.7 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities and our deferred compensation plan assets. Actual losses, if any, could ultimately differ from these estimates. Future adverse changes in market conditions or poor operating results of underlying investments could result in additional losses that may not be reflected in an investment s current carrying value, thereby possibly requiring an impairment charge in the future. See Note 4 of Notes to the Consolidated Financial Statements in this report for more information about our investments.

We also invest in privately held entities and private equity funds and record these investments at cost. We review these investments periodically in order to determine if circumstances (both financial and non-financial) exist that indicate that we will not recover our initial investment. Impairment charges are recorded on investments having a cost basis that is greater than the value that we would reasonably expect to receive in an arm s length sale of the investment. We have not been required to record any impairment losses relating to these investments in 2014, 2013 or 2012.

For purposes of determining the estimated fair value of our stock option awards on the date of grant, we use the Black-Scholes Model. This model requires the input of certain assumptions that require subjective judgment. These assumptions include, but are not limited to, expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors. Because our stock option awards have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, the existing model may not provide a reliable single measure of the fair value of our stock option awards. For purposes of determining the estimated fair value of our performance-based restricted stock unit awards on the date of grant, we use a Monte Carlo Simulation valuation method. The restricted stock units are subject to a market condition based on the relative total shareholder return of ADTRAN against all of the companies in the NASDAQ Telecommunications Index and vest at the end of a three-year performance period. The fair value of restricted stock issued to our Directors is equal to the closing price of our stock on the date of grant.

Management will continue to assess the assumptions and methodologies used to calculate the estimated fair value of stock-based compensation. Circumstances may change and additional data may become available over time, which could result in changes to these assumptions and methodologies and thereby materially impact our fair value determination. If factors change in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period.

Table of Contents

We estimate our income tax provision or benefit in each of the jurisdictions in which we operate, including estimating exposures related to examinations by taxing authorities. We also make judgments regarding the realization of deferred tax assets, and establish valuation allowances where we believe it is more likely than not that future taxable income in certain jurisdictions will be insufficient to realize these deferred tax assets. Our estimates regarding future taxable income and income tax provision or benefit may vary due to changes in market conditions, changes in tax laws, or other factors. If our assumptions, and consequently our estimates, change in the future, the valuation allowances we have established may be increased or decreased, impacting future income tax expense. At December 31, 2014 and 2013 respectively, the valuation allowance was $7.5 million and $8.8 million. As of December 31, 2014, we have state research tax credit carry-forwards of $3.9 million, which will expire between 2015 and 2029. These carry-forwards were caused by tax credits in excess of our annual tax liabilities to an individual state where we no longer generate sufficient state income. In addition, as of December 31, 2014, we have a deferred tax asset of $9.2 million relating to net operating loss carry-forwards which will expire between 2015 and 2030. These carry-forwards are the result of acquisitions in 2009 and in 2011. The acquired net operating losses are in excess of the amount of estimated earnings. We believe it is more likely than not that we will not realize the full benefits of our deferred tax asset arising from these credits and net operating losses, and accordingly, have provided a valuation allowance against them. This valuation allowance is included in non-current deferred tax liabilities in the accompanying balance sheets.

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

Our products generally include warranties of 90 days to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled $8.4 million and $9.0 million at December 31, 2014 and 2013, respectively. These liabilities are included in accrued expenses in the accompanying Consolidated Balance Sheets.

Pension benefit plan obligations are based on various assumptions used by our actuaries in calculating these amounts. These assumptions include discount rates, compensation rate increases, expected return on plan assets, retirement rates, and mortality rates. Actual results that differ from the assumptions and changes in assumptions could affect future expenses and obligations. Our net pension liability totaled $10.2 million and $2.6 million at December 31, 2014 and 2013, respectively. This liability is included in other non-current liabilities in the accompanying Consolidated Balance Sheets.

We use the acquisition method to account for business combinations. Under the acquisition method of accounting, we recognize the assets acquired and liabilities assumed at their fair value on the acquisition date. Goodwill is measured as the excess of the consideration transferred over the net assets acquired. The acquisition method of accounting requires us to exercise judgment and make significant estimates and assumptions regarding the fair value of the assets acquired and liabilities assumed, including the fair values of inventory, unearned revenue, warranty liabilities, identifiable intangible assets and deferred tax asset valuation allowances. This method also requires us to refine these estimates over a one-year measurement period to reflect information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the asset and liabilities recorded on that date, which could affect our net income.

We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If we determine that the two-step quantitative test is necessary, then we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit s carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. We passed the qualitative assessment in 2014; therefore, we did not complete a quantitative assessment. As a result, there were no impairment losses recognized during 2014, 2013 or 2012.

Table of Contents

Results of Operations

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

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

Table of Contents

Acquisition Expenses

On May 4, 2012, we closed on the acquisition of the NSN BBA business. Acquisition related expenses, amortizations and adjustments for the years ended December 31, 2014, 2013 and 2012 for this transaction is as follows:

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

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

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

34

Table of Contents

2014 Compared to 2013

Sales

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

Carrier Networks sales increased 1.9% from $500.7 million in 2013 to $510.4 million in 2014. The increase in sales is primarily attributable to increases in sales of Broadband Access products, Internetworking products, and Optical products, partially offset by a decrease in sales of our HDSL and other legacy products. The increase in sales of our Broadband Access products is primarily attributable to an increase in hiX product sales in the EMEA region. The increase in sales of our Internetworking products is primarily attributable to increases in Carrier Ethernet sales and FTTP ONT sales to carriers in North America. The increase in sales of our Optical products is primarily attributable to increased sales of Optical products for broadband access globally and increased sales of our OPTI-6100 products to a domestic tier 1 carrier for Ethernet services to enterprises for wireless backhaul. The decreases in sales of HDSL and other legacy products in North America have been expected as customers continue to upgrade their networks to deliver higher bandwidth services by migrating to newer technologies, including to our core products from our Broadband Access, Internetworking and Optical product lines. While we expect that revenues from HDSL and our other legacy products will continue to decline over time, these revenues may continue for years because of the time required for our customers to transition to newer technologies.

Enterprise Networks sales decreased 15.2% from $141.0 million in 2013 to $119.6 million in 2014. The decrease is attributable to a decrease in sales of our Internetworking products. The decrease in sales of our Internetworking products for this division is primarily attributable to softer demand in North America and an inventory reduction, primarily at two distribution partners. Internetworking product sales attributable to Enterprise Networks were 93.6% of the division s sales in 2014 and 2013. Legacy products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales decreased from 22.0% in 2013 to 19.0% in 2014.

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

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

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

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

Cost of Sales

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

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

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

Table of Contents

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

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 2.0% from $129.4 million in 2013 to $132.0 million in 2014. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing, and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, trade show expenses, and related travel costs. The increase in selling, general and administrative expenses is primarily attributable to increases in travel expenses, marketing expenses, contract services, and legal expenses, partially offset by a decrease in compensation expense. The increase in travel and marketing expenses is primarily attributable to our increased participation in trade shows in the U.S. and the EMEA region.

Selling, general and administrative expenses as a percentage of sales increased from 20.2% for the year ended December 31, 2013 to 20.9% for the year ended December 31, 2014. Selling, general and administrative expenses as a percentage of sales will generally fluctuate whenever there is a significant fluctuation in revenues for the periods being compared.

Research and Development Expenses

Research and development expenses increased 0.9% from $131.1 million in 2013 to $132.3 million in 2014. The increase in research and development expenses is primarily attributable to increases in compensation costs and travel expenses, partially offset by a decrease in independent contractor expense.

Research and development expenses as a percentage of sales increased from 20.4% for the year ended December 31, 2013 to 21.0% for the year ended December 31, 2014. Research and development expenses as a percentage of sales will fluctuate whenever there are incremental product development activities or a significant fluctuation in revenues for the periods being compared.

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

Interest and Dividend Income

Interest and dividend income decreased from $7.0 million in 2013 to $5.0 million in 2014. The decrease in interest and dividend income is primarily attributable to an $18.3 million reduction of restricted funds that serves as a collateral deposit against our taxable revenue bond during the first quarter of 2014 and a reduction in the interest rate of that investment from 4.8% to 1.6% (see Interest Expense below for corresponding decrease in the interest rate of our taxable revenue bond). See Liquidity and Capital Resources below for additional information on our taxable revenue bond.

Interest Expense

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

Net Realized Investment Gain

Net realized investment gain decreased from $8.6 million in 2013 to $7.3 million in 2014. The decrease in realized investment gains is primarily attributable to lower gains from the sale of equity securities in 2014. See Investing Activities in Liquidity and Capital Resources below for additional information.

Table of Contents

Other Income (Expense), net

Other income (expense), net, comprised primarily of miscellaneous income, gains and losses resulting from foreign currency exchange rate movements, and investment account management fees, changed from $0.9 million of expense in 2013 to $1.2 million of income in 2014. The change is primarily attributable to a $2.4 million gain recorded in the fourth quarter of 2014 related to the settlement of working capital items from an acquisition transaction that closed in 2012, partially offset by investment account management fees.

Income Taxes

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

Net Income

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

2013 Compared to 2012

Sales

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

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

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

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

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

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

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

Cost of Sales

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

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

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

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

Selling, General and Administrative Expenses

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

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

Research and Development Expenses

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

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

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

Interest and Dividend Income

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

Interest Expense

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

Net Realized Investment Gain

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

Other Income (Expense), net

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

Income Taxes

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

Net Income

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

Liquidity and Capital Resources

Liquidity

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

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

Operating Activities

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

Net accounts receivable increased 0.4% from $85.8 million at December 31, 2013 to $86.2 million at December 31, 2014. Our allowance for doubtful accounts was $0.1 million at December 31, 2013 and 2014. Quarterly accounts receivable days sales outstanding (DSO) increased from 50 days as of December 31, 2013 to 55 days as of December 31, 2014. The change in net accounts receivable and DSO is due to changes in customer mix and the timing of sales and collections during the quarter. Certain international customers can have longer payment terms than U.S. customers. Other receivables increased from $18.2 million at December 31, 2013 to $35.6 million at December 31, 2014. The increase in other receivables is primarily attributable to the timing of filing returns and collections of value-added tax receivables in our international subsidiaries. At December 31, 2014 and 2013, other receivables also included a receivable for additional consideration due from NSN for settlement of the working capital items. Other receivables will also fluctuate due to the timing of shipments and collections for materials supplied to our contract manufacturers during the quarter.

Quarterly inventory turnover decreased from 3.6 turns as of December 31, 2013 to 3.5 turns as of December 31, 2014. Inventory decreased 3.8% from $90.1 million at December 31, 2013 to $86.7 million at December 31, 2014. We expect inventory levels to fluctuate as we attempt to maintain sufficient inventory in response to seasonal cycles of our business ensuring competitive lead times while managing the risk of inventory obsolescence that may occur due to rapidly changing technology and customer demand.

Accounts payable increased 16.8% from $48.3 million at December 31, 2013 to $56.4 million at December 31, 2014. Accounts payable will fluctuate due to variations in the timing of the receipt of supplies, inventory and services and our subsequent payments for these purchases.

Investing Activities

Capital expenditures totaled approximately $11.3 million, $8.2 million and $12.3 million for the years ended December 31, 2014, 2013 and 2012, respectively. These expenditures were primarily used to purchase computer hardware, software and manufacturing and test equipment.

On May 4, 2012, we acquired the NSN BBA business. This acquisition provides us with an established customer base in key markets and complementary, market-focused products and was accounted for as a business combination. Upon acquisition, we received a cash payment of $7.5 million from NSN and recorded a bargain purchase gain of $1.8 million, net of income taxes, subject to customary working capital adjustments between the parties as defined in the purchase agreement. During the fourth quarter of 2014, the parties settled final working capital items, and as a result, we recorded a $2.4 million gain in other income (expense), net. Additionally, $3.5 million is included in other receivables at December 31, 2014 for additional consideration due from NSN related to the settlement of the working capital items. This receivable was subsequently collected in January 2015.

Our combined short-term and long-term investments decreased $87.4 million from $415.0 million at December 31, 2013 to $327.6 million at December 31, 2014. This decrease reflects the impact of our cash needs for share repurchases, shareholder dividends, equipment acquisitions, as well as net realized and unrealized losses and amortization of net premiums on our combined investments, partially offset by additional funds available for investment provided by our operating activities and stock option exercises by our employees.

We invest all available cash not required for immediate use in operations primarily in securities that we believe bear minimal risk of loss. At December 31, 2014 these investments included corporate bonds of $111.3 million, municipal fixed-rate bonds of $127.8 million and municipal variable rate demand notes of $2.5 million. At December 31, 2013, these investments included corporate bonds of $166.9 million, municipal fixed-rate bonds of $136.3 million and municipal variable rate demand notes of $8.3 million. As of December 31, 2014, our corporate bonds, municipal fixed-rate bonds, and municipal variable rate demand notes were classified as available-for-sale and had a combined duration of 0.9 years with an average credit rating of AA-. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

Our long-term investments decreased 9.2% from $309.2 million at December 31, 2013 to $280.6 million at December 31, 2014. Long-term investments at December 31, 2014 and December 31, 2013 included an investment in a certificate of deposit of $30.0 million and $48.3 million, respectively, which serves as collateral for our revenue bonds, as discussed below. We have investments in various marketable equity securities classified as long-term investments at a cost of $26.4 million and $24.7 million, and with a fair value of $38.3 million and $38.5 million, at December 31, 2014 and December 31, 2013, respectively.

Long-term investments at December 31, 2014 and 2013 also included $16.3 million and $15.1 million, respectively, related to our deferred compensation plan, and $1.5 million and $1.7 million, respectively, of other investments carried at cost, consisting of interests in two private equity funds and an investment in a privately held telecommunications equipment manufacturer.

We review our investment portfolio for potential other-than-temporary declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. For the years ended December 31, 2014, 2013, and 2012, we recorded charges of $0.1 million, $25 thousand and $0.7 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities and our deferred compensation plan assets.

Financing Activities

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the Authority). Pursuant to the program, on January 13, 1995, the Authority issued $20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the Bank). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the Bondholder), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to $50.0 million. An Amended and Restated Taxable Revenue Bond (Amended and Restated Bond) was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 2% per annum. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond using a level 2 valuation technique at December 31, 2014 was approximately $29.7 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor s credit rating of AAA. We are required to make payments to the Authority in amounts necessary to pay the interest on the Amended and Restated Bond. Included in long-term investments at December 31, 2014 is $30.0 million which is invested in a restricted certificate of deposit. These funds serve as a collateral deposit against the principal of this bond, and we have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness.

In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. For the years ended December 31, 2014, 2013 and 2012, we realized economic incentives related to payroll withholdings totaling $1.3 million, $1.3 million and $1.4 million, respectively.

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

The following table shows dividends paid to our shareholders in each quarter of 2014, 2013 and 2012. During 2014, 2013 and 2012, we paid shareholder dividends totaling $19.9 million, $21.4 million and $22.8 million, respectively. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

Dividends per Common Share

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

Table of Contents

Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 40.0 million shares of our common stock. On May 14, 2014, our Board of Directors authorized the repurchase of an additional 5.0 million shares of our common stock (bringing the total shares authorized for repurchase to 45.0 million), which commenced upon completion of the repurchase plan announced on May 1, 2013. This new authorization is being implemented through open market or private purchases from time to time as conditions warrant. For the years 2014, 2013 and 2012, we repurchased 3.7 million shares, 5.6 million shares and 1.8 million shares, respectively, for a cost of $80.6 million, $124.3 million and $39.4 million, respectively, at an average price of $21.96, $22.16 and $22.03 per share, respectively. We currently have the authority to purchase an additional 4.8 million shares of our common stock under the current plan approved by the Board of Directors.

Stock Option Exercises

To accommodate employee stock option exercises, we issued 0.1 million shares of treasury stock for $2.8 million during the year ended December 31, 2014, 0.2 million shares of treasury stock for $3.6 million during the year ended December 31, 2013, and 0.4 million shares of treasury stock for $6.0 million during the year ended December 31, 2012.

Off-Balance Sheet Arrangements and Contractual Obligations

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

We have various contractual obligations and commercial commitments. The following table sets forth, in millions, the annual payments we are required to make under contractual cash obligations and other commercial commitments at December 31, 2014.

Contractual Obligations

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

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

Sheets. See Note 9 of Notes to Consolidated Financial Statements for additional information.

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

We have committed to invest up to an aggregate of $7.9 million in two private equity funds, and we have contributed $8.4 million as of December 31, 2014, of which $7.7 million has been applied to these commitments. The additional $0.2 million commitment has been excluded from the table above due to uncertainty of when it will be applied.

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

Table of Contents

Effect of Recent Accounting Pronouncements

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

Subsequent Events

On January 20, 2015, the Board declared a quarterly cash dividend of $0.09 per common share to be paid to shareholders of record at the close of business on February 5, 2015. The quarterly dividend payment was $4.8 million and was paid on February 19, 2015.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of December 31, 2014, $69.6 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

As of December 31, 2014, approximately $258.4 million of our cash and investments may be directly affected by changes in interest rates. We have performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps) for an entire year, while all other variables remain constant. At December 31, 2014, we held $112.0 million of cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes where a change in interest rates would impact our interest income. A hypothetical 50 bps decline in interest rates as of December 31, 2014 would reduce annualized interest income on our cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes by approximately $0.5 million. In addition, we held $239.0 million of municipal and corporate bonds whose fair values may be directly affected by a change in interest rates. A hypothetical 50 bps increase in interest rates as of December 31, 2014 would reduce the fair value of our municipal and corporate bonds by approximately $1.1 million.

As of December 31, 2013, interest income on approximately $329.3 million of our cash and investments was subject to being directly affected by changes in interest rates. We performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 bps for an entire year, while all other variables remain constant. A hypothetical 50 bps decline in interest rates as of December 31, 2013 would have reduced annualized interest income on our cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes by approximately $0.7 million. In addition, a hypothetical 50 bps increase in interest rates as of December 31, 2013 would have reduced the fair value of our municipal and corporate bonds by approximately $1.4 million.

Table of Contents

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

We have certain international customers who are invoiced or pay in a non-functional currency. Changes in the monetary exchange rates used to invoice such customers versus the functional currency of the entity billing such customers may adversely affect our results of operations and financial condition. To manage the volatility relating to these typical business exposures, we may enter into various derivative transactions, when appropriate. We do not hold or issue derivative instruments for trading or other speculative purposes. The Saudi Arabian Riyal is the predominant currency of the customers who are billed in their local currency. Taking into account the effects of foreign currency fluctuations of the Riyal versus the Euro, a hypothetical 10% weakening of the Euro as of December 31, 2014 would provide a gain on foreign currency of approximately $0.1 million. Conversely, a hypothetical 10% strengthening of the Euro as of December 31, 2014 would provide a loss on foreign currency of approximately $0.1 million. Any gain or loss would be significantly mitigated by the hedges discussed in the following paragraph.

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following consolidated financial statements are contained in this report.

Table of Contents

MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

Management assessed the effectiveness of ADTRAN s internal control over financial reporting as of December 31, 2014. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework (2013)*.

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

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

Report of Independent Registered Public Accounting Firm

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

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

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

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

/s/ PricewaterhouseCoopers LLP

Birmingham, Alabama
February 24, 2015

Table of Contents

Financial Statements

ADTRAN, INC.

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

December 31, 2014 and 2013

	2014	*2013*
ASSETS		
Current Assets		
Cash and cash equivalents	$ 73,439	$ 58,298
Short-term investments	46,919	105,760
Accounts receivable, less allowance for doubtful accounts of $136 and $130 at December 31, 2014 and 2013, respectively	86,158	85,814
Other receivables	35,639	18,249
Inventory, net	86,710	90,111
Prepaid expenses	5,129	4,325
Deferred tax assets, net	17,095	17,083
Total Current Assets	**351,089**	**379,640**
Property, plant and equipment, net	74,828	76,739
Deferred tax assets, net	17,694	9,622
Goodwill	3,492	3,492
Other assets	10,942	11,180
Long-term investments	280,649	309,225
Total Assets	**$ 738,694**	**$ 789,898**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 56,414	$ 48,282
Unearned revenue	22,762	22,205
Accrued expenses	11,077	12,776
Accrued wages and benefits	13,855	14,040
Income tax payable, net	14,901	5,002
Total Current Liabilities	**119,009**	**102,305**
Non-current unearned revenue	10,948	14,643
Other non-current liabilities	30,924	22,144
Bonds payable	28,800	46,200
Total Liabilities	**189,681**	**185,292**
Commitments and contingencies (see Note 13)		

Stockholders Equity		
Common stock, par value $0.01 per share; 200,000 shares authorized; 79,652 shares issued and 53,431 shares outstanding at December 31, 2014 and 79,652 shares issued and 56,918 shares outstanding at December 31, 2013	797	797
Additional paid-in capital	241,829	233,511
Accumulated other comprehensive income (loss)	(75)	10,753
Retained earnings	907,751	884,451
Less treasury stock at cost: 26,221 and 22,734 shares at December 31, 2014 and 2013, respectively	(601,289)	(524,906)
Total Stockholders Equity	**549,013**	**604,606**
Total Liabilities and Stockholders Equity	**$ 738,694**	**$ 789,898**

See notes to consolidated financial statements.

Table of Contents

ADTRAN, INC.

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

Years ended December 31, 2014, 2013 and 2012

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

See notes to consolidated financial statements.

Table of Contents

ADTRAN, INC.

Consolidated Statements of Comprehensive Income (In thousands)

Years ended December 31, 2014, 2013 and 2012

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

See notes to consolidated financial statements.

Table of Contents

ADTRAN, INC.

Consolidated Statements of Changes in Stockholders Equity (In thousands)

Years ended December 31, 2014, 2013 and 2012

	Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income	Total Stockholders Equity
Balance, December 31, 2011	**79,652**	**$ 797**	**$ 213,560**	**$ 840,206**	**$ (375,534)**	**$ 13,102**	**$ 692,131**
Net income				47,263			**47,263**
Other comprehensive loss, net of tax						(1,834)	**(1,834)**
Dividend payments				(22,813)			**(22,813)**
Dividends accrued for unvested restricted stock units				15			**15**
Stock options exercised				(2,659)	8,708		**6,049**
Restricted stock units vested			(212)	(547)	547		**(212)**
Purchase of treasury stock: 1,786 shares					(39,362)		**(39,362)**
Income tax benefit from exercise of stock options			1,905				**1,905**
Stock-based compensation expense			9,264				**9,264**
Balance, December 31, 2012	**79,652**	**$ 797**	**$ 224,517**	**$ 861,465**	**$ (405,641)**	**$ 11,268**	**$ 692,406**
Net income				45,794			**45,794**
Other comprehensive loss, net of tax						(515)	**(515)**
Dividend payments				(21,412)			**(21,412)**
Dividends accrued for unvested restricted stock units				(23)			**(23)**
Stock options exercised				(762)	4,391		**3,629**
Restricted stock units vested			(248)	(611)	611		**(248)**
Purchase of treasury stock: 5,608 shares					(124,267)		**(124,267)**
Income tax benefit from exercise of stock options			169				**169**
Stock-based compensation expense			9,073				**9,073**
Balance, December 31, 2013	**79,652**	**$ 797**	**$ 233,511**	**$ 884,451**	**$ (524,906)**	**$ 10,753**	**$ 604,606**
Net income				44,620			**44,620**
Other comprehensive loss, net of tax						(10,828)	**(10,828)**

Dividend payments				(19,947)			**(19,947)**
Dividends accrued for unvested restricted stock units				(19)			**(19)**
Stock options exercised				(558)	3,397		**2,839**
Restricted stock units vested			(326)	(796)	796		**(326)**
Purchase of treasury stock: 3,669 shares					(80,576)		**(80,576)**
Income tax benefit from exercise of stock options			81				**81**
Stock-based compensation expense			8,563				**8,563**
Balance, December 31, 2014	**79,652**	**$ 797**	**$ 241,829**	**$ 907,751**	**$ (601,289)**	**$ (75)**	**$ 549,013**

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

See notes to consolidated financial statements.

Table of Contents

ADTRAN, INC.

Consolidated Statements of Cash Flows (In thousands)

Years ended December 31, 2014, 2013 and 2012

	2014	***2013***	***2012***
Cash flows from operating activities			
Net income	$ 44,620	$ 45,794	$ 47,263
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	14,845	14,628	14,079
Amortization of net premium on available-for-sale investments	4,360	5,956	8,257
Net realized gain on long-term investments	(7,278)	(8,614)	(9,550)
Net (gain) loss on disposal of property, plant and equipment	142	3	(214)
Gain on bargain purchase of a business			(1,753)
Stock-based compensation expense	8,563	9,073	9,264
Deferred income taxes	(5,526)	(4,058)	(3,785)
Tax benefit from stock option exercises	81	169	1,905
Excess tax benefits from stock-based compensation arrangements	(63)	(158)	(1,456)
Change in operating assets and liabilities:			
Accounts receivable, net	(2,769)	(5,541)	(2,847)
Other receivables	(20,439)	(1,549)	2,977
Inventory	1,953	10,265	8,333
Prepaid expenses and other assets	(3,627)	(11)	(1,045)
Accounts payable	9,973	5,206	7,510
Accrued expenses and other liabilities	(166)	(15,146)	8,895
Income taxes payable, net	11,168	3,747	(1,960)
Net cash provided by operating activities	**55,837**	**59,764**	**85,873**
Cash flows from investing activities			
Purchases of property, plant and equipment	(11,256)	(8,173)	(12,320)
Proceeds from disposals of property, plant and equipment	1		266
Proceeds from sales and maturities of available-for-sale investments	230,019	343,567	282,039
Purchases of available-for-sale investments	(142,695)	(261,625)	(282,740)
Acquisition of business, net of cash acquired			7,496
Net cash provided by (used in) investing activities	**76,069**	**73,769**	**(5,259)**
Cash flows from financing activities			
Proceeds from stock option exercises	2,839	3,629	6,049
Purchases of treasury stock	(80,576)	(124,267)	(39,362)
Dividend payments	(19,947)	(21,412)	(22,813)
Payments on long-term debt	(16,500)		(500)

Excess tax benefits from stock-based compensation arrangements	63	158	1,456
Net cash used in financing activities	**(114,121)**	**(141,892)**	**(55,170)**
Net increase (decrease) in cash and cash equivalents	17,785	(8,359)	25,444
Effect of exchange rate changes	(2,644)	(1,800)	34
Cash and cash equivalents, beginning of year	**58,298**	**68,457**	**42,979**
Cash and cash equivalents, end of year	**$ 73,439**	**$ 58,298**	**$ 68,457**
Supplemental disclosure of cash flow information			
Cash paid during the year for interest	$ 758	$ 2,325	$ 2,348
Cash paid during the year for income taxes	$ 9,856	$ 15,431	$ 31,021
Supplemental disclosure of non-cash investing activities			
Purchases of property, plant and equipment included in accounts payable	$ 467	$ 444	$ 108

See notes to consolidated financial statements.

52

Table of Contents

Notes to Consolidated Financial Statements

Note 1 Nature of Business and Summary of Significant Accounting Policies

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

Principles of Consolidation

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

Changes in Classifications

We corrected immaterial misclassifications between the operating and investing sections of our consolidated statements of cash flows and adjusted our 2012 cash flows in these categories by $0.2 million, in order to be consistent with the 2014 and 2013 presentation.

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

Out of Period Adjustment

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

Use of Estimates

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

Cash and Cash Equivalents

Cash and cash equivalents represent demand deposits, money market funds, and short-term investments classified as available-for-sale with original maturities of three months or less. We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these applicable financial institutions, and determined the risk of material financial loss due to the exposure of such credit risk to be minimal. As of December 31, 2014, $69.6 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

Table of Contents

Financial Instruments

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

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

Long-term investments represent a restricted certificate of deposit held at cost, municipal fixed-rate bonds, corporate bonds, deferred compensation plan assets, marketable equity securities, and other equity investments. Marketable equity securities are reported at fair value as determined by the most recently traded price of the securities at the balance sheet date, although the securities may not be readily marketable due to the size of the available market. Unrealized gains and losses, net of tax, are reported as a separate component of stockholders equity. Realized gains and losses on sales of securities are computed under the specific identification method and are included in current income. We periodically review our investment portfolio for investments considered to have sustained an other-than-temporary decline in value. Impairment charges for other-than-temporary declines in value are recorded as realized losses in the accompanying consolidated statements of income. All of our investments at December 31, 2014 and 2013 are classified as available-for-sale securities. See Note 4 of Notes to Consolidated Financial Statements for additional information.

Accounts Receivable

We record accounts receivable at net realizable value. Prior to issuing payment terms to a new customer, we perform a detailed credit review of the customer. Credit limits are established for each new customer based on the results of this credit review. Payment terms are established for each new customer, and collection experience is reviewed periodically in order to determine if the customer s payment terms and credit limits need to be revised. At December 31, 2014, two customers accounted for 24.5% of our total accounts receivable. At December 31, 2013, one customer accounted for 13.1% of our total accounts receivable.

We maintain an allowance for doubtful accounts for losses resulting from the inability of our customers to make required payments. We regularly review the allowance for doubtful accounts and consider factors such as the age of accounts receivable balances, the current economic conditions that may affect a customer s ability to pay, significant one-time events and our historical experience. If the financial condition of a customer deteriorates, resulting in an impairment of their ability to make payments, we may be required to record an allowance for doubtful accounts. If circumstances change with regard to individual receivable balances that have previously been determined to be uncollectible (and for which a specific reserve has been established), a reduction in our allowance for doubtful accounts may be required. Our allowance for doubtful accounts was $0.1 million at December 31, 2014 and December 31, 2013.

Other Receivables

Other receivables are comprised primarily of amounts due from subcontract manufacturers for product component transfers, accrued interest on investments and on a restricted certificate of deposit, amounts due from various jurisdictions for value-added tax, and amounts due from employee stock option exercises. At December 31, 2014 and 2013, other receivables also included a receivable due from NSN related to working capital items settled during the fourth quarter of 2014 and collected in January 2015.

Inventory

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

Table of Contents

Property, Plant and Equipment

Property, plant and equipment, which is stated at cost, is depreciated using the straight-line method over the estimated useful lives of the assets. We depreciate building and land improvements from five to 39 years, office machinery and equipment from three to seven years, engineering machinery and equipment from three to seven years, and computer software from three to five years. Expenditures for repairs and maintenance are charged to expense as incurred. Betterments that materially prolong the lives of the assets are capitalized. See Note 7 of Notes to Consolidated Financial Statements for additional information.

Liability for Warranty

Our products generally include warranties of 90 days to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled $8.4 million and $9.0 million at December 31, 2014 and 2013, respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets.

A summary of warranty expense and write-off activity for the years ended December 31, 2014, 2013 and 2012 is as follows:

Year Ended December 31, *(In thousands)*	**2014**	**2013**	**2012**
Balance at beginning of period	$ 8,977	$ 9,653	$ 4,118
Plus: Amounts charged to cost and expenses	3,103	4,051	5,363
Amounts assumed on acquisition			3,781
Less: Deductions	(3,665)	&nbs	