ADTRAN INC
Form 10-Q
November 05, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended September 30, 2014

OR

¨ **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 No.)**

901 Explorer Boulevard, Huntsville, Alabama 35806-2807

(Address of principal executive offices, including zip code)

(256) 963-8000

(Registrant s telephone number, including area code)

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 twelve 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 whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer , accelerated filer , and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer s classes of Common Stock, as of the latest practicable date:

Class	Outstanding at October 20, 2014
Common Stock, $.01 Par Value	54,320,170 shares

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ADTRAN, Inc.

Quarterly Report on Form 10-Q

For the Three and Nine Months Ended September 30, 2014

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FORWARD LOOKING STATEMENTS

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, our other filings with the Securities and Exchange Commission (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 you that any forward-looking statements made by us or on our behalf are subject to uncertainties and other factors that could cause such statements to be wrong. A list of factors that could materially affect our business, financial condition or operating results is included under Factors that Could Affect Our Future Results in Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Item 2 of Part I of this report. They have also been discussed in Item 1A of Part I in our most recent Annual Report on Form 10-K for the year ended December 31, 2013 filed on February 27, 2014 with the SEC. 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 a combination of factors may have on our business.

You are further cautioned not to place undue reliance on these forward-looking statements because they speak only of our views as of the date that 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.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ADTRAN, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except per share amounts)

	September 30, 2014	December 31, 2013
ASSETS		
Current Assets		
Cash and cash equivalents	$ 58,415	$ 58,298
Short-term investments	55,587	105,760
Accounts receivable, less allowance for doubtful accounts of $116 and $130 at September 30, 2014 and December 31, 2013, respectively	99,341	85,814
Other receivables	27,262	18,249
Inventory	86,879	90,111
Prepaid expenses	5,579	4,325
Deferred tax assets, net	15,697	17,083
Total Current Assets	**348,760**	**379,640**
Property, plant and equipment, net	75,201	76,739
Deferred tax assets, net	12,991	9,622
Goodwill	3,492	3,492
Other assets	11,748	11,180
Long-term investments	298,542	309,225
Total Assets	**$ 750,734**	**$ 789,898**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 49,972	$ 48,282
Unearned revenue	23,418	22,205
Accrued expenses	12,356	12,776
Accrued wages and benefits	17,591	14,040
Income tax payable, net	13,650	5,002
Total Current Liabilities	**116,987**	**102,305**
Non-current unearned revenue	13,822	14,643
Other non-current liabilities	23,548	22,144

Bonds payable	30,000	46,200
Total Liabilities	**184,357**	**185,292**
Commitments and contingencies (see Note 14)		
Stockholders Equity		
Common stock, par value $0.01 per share; 200,000 shares authorized; 79,652 shares issued and 54,320 shares outstanding at September 30, 2014 and 79,652 shares issued and 56,918 shares outstanding at December 31, 2013	797	797
Additional paid-in capital	239,878	233,511
Accumulated other comprehensive income	5,721	10,753
Retained earnings	903,741	884,451
Less treasury stock at cost: 25,332 and 22,734 shares at September 30, 2014 and December 31, 2013, respectively	(583,760)	(524,906)
Total Stockholders Equity	**566,377**	**604,606**
Total Liabilities and Stockholders Equity	**$ 750,734**	**$ 789,898**

See notes to consolidated financial statements

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ADTRAN, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Sales	$ 162,892	$ 177,404	$ 486,025	$ 482,650
Cost of sales	84,635	94,857	243,181	250,628
Gross Profit	**78,257**	**82,547**	**242,844**	**232,022**
Selling, general and administrative expenses	32,438	32,794	100,165	96,082
Research and development expenses	33,324	32,543	99,547	98,114
Operating Income	**12,495**	**17,210**	**43,132**	**37,826**
Interest and dividend income	992	1,579	3,340	5,021
Interest expense	(150)	(581)	(525)	(1,737)
Net realized investment gain	2,687	1,751	7,219	6,949
Other income (expense), net	(963)	22	(1,615)	(1,521)
Income before provision for income taxes	**15,061**	**19,981**	**51,551**	**46,538**
Provision for income taxes	(3,735)	(3,776)	(16,223)	(12,584)
Net Income	**$ 11,326**	**$ 16,205**	**$ 35,328**	**$ 33,954**
Weighted average shares outstanding basic	54,521	57,947	55,552	59,561
Weighted average shares outstanding diluted	54,824	58,617	55,976	59,929
Earnings per common share basic	$ 0.21	$ 0.28	$ 0.64	$ 0.57
Earnings per common share diluted	$ 0.21	$ 0.28	$ 0.63	$ 0.57
Dividend per share	$ 0.09	$ 0.09	$ 0.27	$ 0.27

See notes to consolidated financial statements

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ADTRAN, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Net Income	$ 11,326	$ 16,205	$ 35,328	$ 33,954
Other Comprehensive Income (Loss), net of tax:				
Net unrealized gains (losses) on available-for-sale securities	(3,148)	2,562	(2,850)	(780)
Foreign currency translation	(2,568)	(108)	(2,182)	(1,498)
Other Comprehensive Income (Loss), net of tax	**(5,716)**	**2,454**	**(5,032)**	**(2,278)**
Comprehensive Income, net of tax	**$ 5,610**	**$ 18,659**	**$ 30,296**	**$ 31,676**

See notes to consolidated financial statements

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ADTRAN, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Cash flows from operating activities:		
Net income	$ 35,328	$ 33,954
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,127	11,021
Amortization of net premium on available-for-sale investments	3,363	4,688
Net realized gain on long-term investments	(7,219)	(6,949)
Net loss on disposal of property, plant and equipment	109	6
Stock-based compensation expense	6,296	6,516
Deferred income taxes	(122)	(1,296)
Tax benefit from stock option exercises	71	113
Excess tax benefits from stock-based compensation arrangements	(53)	(106)
Changes in operating assets and liabilities:		
Accounts receivable, net	(15,957)	(25,844)
Other receivables	(10,576)	(3,724)
Inventory	2,413	8,584
Prepaid expenses and other assets	(4,095)	(417)
Accounts payable	3,563	30,073
Accrued expenses and other liabilities	7,507	(4,339)
Income tax payable, net	9,265	(678)
Net cash provided by operating activities	**41,020**	**51,602**
Cash flows from investing activities:		
Purchases of property, plant and equipment	(8,162)	(6,123)
Proceeds from disposals of property, plant and equipment	1	
Proceeds from sales and maturities of available-for-sale investments	187,013	275,581
Purchases of available-for-sale investments	(127,074)	(216,129)
Net cash provided by investing activities	**51,778**	**53,329**
Cash flows from financing activities:		
Proceeds from stock option exercises	2,311	2,332
Purchases of treasury stock	(62,144)	(104,147)
Dividend payments	(15,060)	(16,220)
Payments on long-term debt	(16,500)	

Excess tax benefits from stock-based compensation arrangements	53	106
Net cash used in financing activities	**(91,340)**	**(117,929)**
Net increase (decrease) in cash and cash equivalents	1,458	(12,998)
Effect of exchange rate changes	(1,341)	(1,148)
Cash and cash equivalents, beginning of period	**58,298**	**68,457**
Cash and cash equivalents, end of period	**$ 58,415**	**$ 54,311**
Supplemental disclosure of non-cash investing activities:		
Purchases of property, plant and equipment included in accounts payable	$ 598	$ 494

See notes to consolidated financial statements

ADTRAN, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements of ADTRAN®, Inc. and its subsidiaries (ADTRAN) have been prepared pursuant to the rules and regulations for reporting on Quarterly Reports on Form 10-Q. Accordingly, certain information and notes required by generally accepted accounting principles for complete financial statements are not included herein. The December 31, 2013 Consolidated Balance Sheet is derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States.

In the opinion of management, all adjustments necessary for a fair presentation of these interim statements have been recorded and are of a normal and recurring nature. The results of operations for an interim period are not necessarily indicative of the results for the full year. The interim statements should be read in conjunction with the financial statements and notes thereto included in ADTRAN s Annual Report on Form 10-K for the year ended December 31, 2013, filed on February 27, 2014 with the SEC.

Changes in Classifications

We corrected immaterial misclassifications between the operating and investing sections of our consolidated statements of cash flows and adjusted our cash flows for the nine months ended September 30, 2013 in these categories by $0.4 million in order to be consistent with the 2014 presentation.

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 $0.5 million understatement of net income in the first two quarters of 2013. We evaluated the impact of the adjustments on the results of our previously issued financial statements for each of the prior periods affected and concluded that the impact was not material. We also evaluated the impact of the cumulative effect of the adjustments in 2013 and concluded that the impact is not material to our results for the year 2013. Accordingly, during the three months ended September 30, 2013 we recorded an out of period adjustment to correct these issues.

Use of Estimates

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

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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.

2. INCOME TAXES

Our effective tax rate increased from 27.0% in the nine months ended September 30, 2013 to 31.5% in the nine months ended September 30, 2014. The increase in the effective tax rate between the two periods is primarily attributable to the net effect of the exclusion of a benefit for the research tax credit, which expired on December 31, 2013, partially offset by the release of a valuation allowance attributable to a foreign subsidiary in 2014.

3. PENSION BENEFIT PLAN

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

The following table summarizes the components of net periodic pension cost for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	**2014**	**2013**	**2014**	**2013**
Service cost	$ 299	$ 297	$ 910	$ 891
Interest cost	209	185	640	554
Expected return on plan assets	(272)	(250)	(831)	(751)
Net periodic pension cost	**$ 236**	**$ 232**	**$ 719**	**$ 694**

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4. STOCK-BASED COMPENSATION

The following table summarizes the stock-based compensation expense related to stock options, restricted stock units (RSUs) and restricted stock for the three and nine months ended September 30, 2014 and 2013, which was recognized as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	2014	2013	2014	2013
Stock-based compensation expense included in cost of sales	**$ 124**	**$ 118**	**$ 359**	**$ 334**
Selling, general and administrative expense	1,048	1,024	3,089	3,129
Research and development expense	975	1,034	2,848	3,053
Stock-based compensation expense included in operating expenses	**2,023**	**2,058**	**5,937**	**6,182**
Total stock-based compensation expense	**2,147**	**2,176**	**6,296**	**6,516**
Tax benefit for expense associated with non-qualified options	(298)	(307)	(878)	(924)
Total stock-based compensation expense, net of tax	**$ 1,849**	**$ 1,869**	**$ 5,418**	**$ 5,592**

The fair value of our stock options is estimated using the Black-Scholes model. The determination of the fair value of stock options on the date of grant using the Black-Scholes model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables that may have a significant impact on the fair value estimate.

There were no options granted during the three months ended September 30, 2014 or the three and nine months ended September 30, 2013. The weighted-average assumptions and value of options granted for the nine months ended September 30, 2014 are summarized as follows:

	Nine Months Ended September 30, 2014
Expected volatility	39.57%
Risk-free interest rate	1.86%
Expected dividend yield	1.38%
Expected life (in years)	6.25
Weighted-average estimated value	$ 9.28

The fair value of our RSUs is calculated using a Monte Carlo Simulation valuation method. No RSUs were granted, forfeited, or vested during the three and nine months ended September 30, 2014 or 2013.

The fair value of restricted stock is equal to the closing price of our stock on the date of grant. We granted four thousand shares of restricted stock during the nine months ended September 30, 2014 at a fair value of $21.30 per share. No restricted stock was forfeited or vested during the three and nine months ended September 30, 2014 or 2013.

Stock-based compensation expense recognized in our Consolidated Statements of Income for the three and nine months ended September 30, 2014 and 2013 is based on options, RSUs and restricted stock ultimately expected to vest, and has been reduced for estimated forfeitures. Estimated forfeitures for stock options are based upon historical experience and approximate 2.5% annually. We estimated a 0% forfeiture rate for our RSUs and restricted stock due to the limited number of recipients and historical experience for these awards.

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As of September 30, 2014, total compensation expense related to non-vested stock options, RSUs and restricted stock not yet recognized was approximately $11.6 million, which is expected to be recognized over an average remaining recognition period of 2.3 years.

The following table is a summary of our stock options outstanding as of December 31, 2013 and September 30, 2014 and the changes that occurred during the nine months ended September 30, 2014:

(In thousands, except per share amounts)	Number of Options	Weighted Avg. Exercise Price	Weighted Avg. Remaining Contractual Life In Years	Aggregate Intrinsic Value
Options outstanding, December 31, 2013	**6,358**	**$ 24.43**	**6.60**	**$ 25,878**
Options granted	2	$ 26.03		
Options cancelled/forfeited	(203)	$ 25.86		
Options exercised	(117)	$ 19.66		
Options outstanding, September 30, 2014	**6,040**	**$ 24.47**	**5.85**	**$ 5,699**
Options exercisable, September 30, 2014	**3,961**	**$ 25.14**	**4.59**	**$ 3,295**

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic value (the difference between the closing price of our stock on the last trading day of the quarter and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on September 30, 2014. The aggregate intrinsic value will change based on the fair market value of our stock.

The total pre-tax intrinsic value of options exercised during the three and nine months ended September 30, 2014 was $0.1 million and $0.6 million, respectively.

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5. INVESTMENTS

At September 30, 2014, we held the following securities and investments, recorded at either fair value or cost.

(In thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Value
Deferred compensation plan assets	$ 12,852	$ 2,660	$ (14)	$ 15,498
Corporate bonds	102,196	345	(21)	102,520
Municipal fixed-rate bonds	150,098	691	(16)	150,773
Municipal variable rate demand notes	18,000			18,000
Marketable equity securities	26,542	9,996	(757)	35,781
Available-for-sale securities held at fair value	**$ 309,688**	**$ 13,692**	**$ (808)**	**$ 322,572**
Restricted investment held at cost				**30,000**
Other investments held at cost				**1,557**
Total carrying value of available-for-sale investments				**$ 354,129**

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

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

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As of September 30, 2014, our corporate bonds and municipal fixed-rate bonds had the following contractual maturities:

(In thousands)	Corporate bonds	Municipal fixed-rate bonds
Less than one year	$ 4,643	$ 31,631
One to two years	64,168	69,253
Two to three years	33,709	39,809
Three to five years		10,080
Total	**$ 102,520**	**$ 150,773**

Actual maturities may differ from contractual maturities because some borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

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.

At September 30, 2014, we held a $30.0 million restricted certificate of deposit, which is carried at cost. This investment serves as a collateral deposit against the principal amount outstanding under loans made to ADTRAN pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond). During the first quarter of 2014, we made a principal payment on the Bond of $16.5 million. At September 30, 2014, the estimated fair value of the Bond using a level 2 valuation technique was approximately $29.8 million, based on a debt security with a comparable interest rate and maturity and a Standard and Poor s credit rating of AAA. For more information on the Bond, see Debt under Liquidity and Capital Resources in the Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Item 2 of Part I of this report.

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 three and nine months ended September 30, 2014 and 2013, other-than-temporary impairment charges were not significant.

Realized gains and losses on sales of securities are computed under the specific identification method. The following table presents gross realized gains and losses related to our investments.

	Three Months Ended	Nine Months Ended

(In thousands)	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
Gross realized gains	$ 2,728	$ 1,797	$ 7,363	$ 7,252
Gross realized losses	$ (41)	$ (46)	$ (144)	$ (303)

As of September 30, 2014 and 2013, gross unrealized losses related to individual securities in a continuous loss position for 12 months or longer were not significant.

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

		Fair Value Measurements at September 30, 2014 Using		
(In thousands)	**Fair Value**	**Quoted Prices in Active Market for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Cash equivalents				
Money market funds	$ 9,861	$ 9,861	$	$
Available-for-sale securities				
Deferred compensation plan assets	15,498	15,498		
Available-for-sale debt securities				
Corporate bonds	102,520		102,520	
Municipal fixed-rate bonds	150,773		150,773	
Municipal variable rate demand notes	18,000		18,000	
Available-for-sale marketable equity securities				
Marketable equity securities technology industry	8,879	8,879		
Marketable equity securities other	26,902	26,902		
Available-for-sale securities	**322,572**	**51,279**	**271,293**	
Total	**$ 332,433**	**$ 61,140**	**$ 271,293**	**$**

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	Fair Value Measurements at December 31, 2013 Using							
(In thousands)	Fair Value		Quoted Prices in Active Market for Identical Assets (Level 1)		Significant Other Observable Inputs (Level 2)		Significant Unobservable Inputs (Level 3)	
Cash equivalents								
Money market funds	$	3,949	$	3,949	$		$	
Available-for-sale securities								
Deferred compensation plan assets		15,123		15,123				
Available-for-sale debt securities								
Corporate bonds		166,859				166,859		
Municipal fixed-rate bonds		136,302				136,302		
Municipal variable rate demand notes		8,310				8,310		
Available-for-sale marketable equity securities								
Marketable equity securities technology industry		11,398		11,398				
Marketable equity securities other		27,054		27,054				
Available-for-sale securities		**365,046**		**53,575**		**311,471**		
Total	**$**	**368,995**	**$**	**57,524**	**$**	**311,471**	**$**	

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

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

6. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

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

As of September 30, 2014, we had forward contracts outstanding with notional amounts totaling 20.1 million ($25.4 million), which mature through 2014.

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The fair values of our derivative instruments recorded in the Consolidated Balance Sheet as of September 30, 2014 and December 31, 2013 were as follows:

(In thousands)		Balance Sheet Location	September 30, 2014	December 31, 2013
Derivatives Not Designated as Hedging Instruments (Level 2):				
Foreign exchange contracts	asset derivatives	Other receivables	$ 99	$ 18
Foreign exchange contracts	liability derivatives	Accounts payable	$ (22)	$ (15)

The change in the fair values of our derivative instruments recorded in the Consolidated Statements of Income during the three and nine months ended September 30, 2014 were as follows:

		Three Months Ended September 30,		Nine Months Ended September 30,	
(In thousands)	Income Statement Location	2014	2013	2014	2013
Derivatives Not Designated as Hedging Instruments:					
Foreign exchange contracts	Other income (expense)	$ (191)	$ 52	$ (739)	$ (34)

7. INVENTORY

At September 30, 2014 and December 31, 2013, inventory consisted of the following:

(In thousands)	September 30, 2014	December 31, 2013
Raw materials	$ 37,856	$ 44,093
Work in process	3,920	3,484
Finished goods	45,103	42,534
Total	**$ 86,879**	**$ 90,111**

We establish reserves for estimated excess, obsolete, or unmarketable inventory equal to the difference between the cost of the inventory and the estimated fair value of the inventory based upon assumptions about future demand and market conditions. At September 30, 2014 and December 31, 2013, raw materials reserves totaled $17.1 million and $16.9 million, respectively, and finished goods inventory reserves totaled $6.3 million and $6.1 million, respectively.

8. GOODWILL AND INTANGIBLE ASSETS

We evaluate the carrying value of goodwill, generated from our acquisition of Bluesocket, Inc. and assigned to our Enterprise Networks division, during the fourth quarter of each year. We may perform additional evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit s carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. There have been no impairment losses recorded since acquisition.