new product development, the enhancement of current products, and product cost reductions. Research and development expenses as a percentage of sales will fluctuate whenever there is a significant fluctuation in revenues during the periods being compared.

Interest Expense

Interest expense increased 14.8% from $1,802,000 in 2000 to $2,069,000 in 2001. ADTRAN currently pays interest on a $50,000,000 revenue bond, the proceeds of which were used to expand our facilities in Huntsville, Alabama.

Other Income, Net (Primarily Interest)

Interest income decreased 10.5% from $9,025,000 in 2000 to $8,077,000 in 2001. The decrease is largely due to lower interest rates compared to the prior year.

Net Realized Investment Gains and (Losses)

Net realized investment gains and losses decreased 100.8% from a net gain of $84,040,000 in 2000 to a net loss of $674,000 in 2001. The decrease is primarily a result of a substantial net realized investment gain in 2000 from the sale of certain marketable securities of a single issuer.

Income Taxes

Our effective tax rate declined from 34% in 2000 to 27% in 2001. Pre-tax income for financial reporting purposes was substantially lower in 2001 and the higher mix of non-taxable income and higher research and development tax credits as a percent of taxable income resulted in a substantially lower effective tax rate. Income taxes (without regard to taxes on realized investment gains in the year 2000 of $28,574,000) decreased 81.0% from $33,657,000 in 2000 to $6,409,000 in 2001.

Net Income

As a result of the above factors, net income decreased 85.7% from $120,802,000 in 2000 to $17,329,000 in 2001. As a percentage of sales, net income decreased from 26.1% in 2000 to 4.5% in 2001.

Liquidity and Capital Resources

Fifty million dollars of the expansion of Phase III of our corporate headquarters was approved for participation in an incentive program offered by the Alabama State Industrial Development Authority (the "Authority"). The incentive program enables participating companies to generate Alabama corporate income tax credits that can be used to reduce the amount of Alabama corporate income taxes that would otherwise be payable. We cannot be certain that the state of Alabama will continue to make these corporate income tax credits available in the future, and therefore, we may not realize the full benefit of these incentives. Through December 31, 2002, the Authority had issued $50,000,000 of its taxable revenue bonds pursuant to the incentive program and loaned the proceeds from the sale of the bonds to ADTRAN™. We are required to make payments to the Authority in the amounts necessary to pay the principal of and interest on the Authority's Taxable Revenue Bond, Series 1995, as amended, currently outstanding in the aggregate principal amount of $50,000,000. The bond matures on January 1, 2020, and bears interest at the rate of 5%. Included in long-term investments is $50,000,000 of restricted funds, which is a collateral deposit against the principal of this bond. 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. Our economic incentives realized for the years ended December 31, 2002, 2001 and 2000 were $1,156,000, $1,326,221 and $1,553,398, respectively.

ADTRAN's working capital, which consists of current assets less current liabilities, decreased 6.4% from $217,387,000 as of December 31, 2001 to $203,511,000 as of December 31, 2002. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 6.32 as of December 31, 2001 to 5.73 as of December 31, 2002. The current ratio, which is current assets divided by current liabilities, decreased from 9.16 as of December 31, 2001 to 7.35 as of December 31, 2002. The decrease in working capital and related ratios is primarily a result of shifting investments from short-term to long-term and our share repurchase program.