

ADTRAN INC  
Form 10-Q  
August 03, 2009  
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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 June 30, 2009

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**  
*(State of Incorporation)*

**63-0918200**

*(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)*

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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 ☒ 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 ☐ 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. (Check one)

Large Accelerated Filer ☒ 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 ☒

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 July 27, 2009 |
|-------------------------------|------------------------------|
| Common Stock, \$.01 Par Value | 62,787,171 shares            |

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**ADTRAN, INC.**

**Quarterly Report on Form 10-Q**

**For the Three and Six Months Ended June 30, 2009**

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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. You are cautioned 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, 2008 filed on February 27, 2009 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.

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ADTRAN, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except per share amounts)**

|                                                                                                                                  | <b>June 30,<br/>2009<br/>(Unaudited)</b> | <b>December 31,<br/>2008</b> |
|----------------------------------------------------------------------------------------------------------------------------------|------------------------------------------|------------------------------|
| <b>ASSETS</b>                                                                                                                    |                                          |                              |
| <b>Current Assets</b>                                                                                                            |                                          |                              |
| Cash and cash equivalents                                                                                                        | \$ 38,192                                | \$ 41,909                    |
| Short-term investments                                                                                                           | 125,779                                  | 96,277                       |
| Accounts receivable, less allowance for doubtful accounts of \$50 at June 30, 2009 and \$38 at December 31, 2008                 | 63,990                                   | 52,749                       |
| Other receivables                                                                                                                | 5,661                                    | 2,896                        |
| Inventory                                                                                                                        | 48,342                                   | 47,406                       |
| Prepaid expenses                                                                                                                 | 2,383                                    | 2,974                        |
| Deferred tax assets, net                                                                                                         | 8,788                                    | 8,653                        |
| <b>Total current assets</b>                                                                                                      | <b>293,135</b>                           | <b>252,864</b>               |
| Property, plant and equipment, net                                                                                               | 74,429                                   | 75,487                       |
| Deferred tax assets, net                                                                                                         | 1,970                                    | 3,920                        |
| Other assets                                                                                                                     | 103                                      | 103                          |
| Long-term investments                                                                                                            | 157,128                                  | 141,241                      |
| <b>Total assets</b>                                                                                                              | <b>\$ 526,765</b>                        | <b>\$ 473,615</b>            |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>                                                                                      |                                          |                              |
| <b>Current Liabilities</b>                                                                                                       |                                          |                              |
| Accounts payable                                                                                                                 | \$ 22,970                                | \$ 20,313                    |
| Unearned revenue                                                                                                                 | 6,263                                    | 6,141                        |
| Accrued expenses                                                                                                                 | 4,363                                    | 3,536                        |
| Accrued wages and benefits                                                                                                       | 10,859                                   | 9,868                        |
| Income tax payable, net                                                                                                          | 5,972                                    | 266                          |
| <b>Total current liabilities</b>                                                                                                 | <b>50,427</b>                            | <b>40,124</b>                |
| Other non-current liabilities                                                                                                    | 11,127                                   | 9,422                        |
| Bonds payable                                                                                                                    | 48,250                                   | 48,250                       |
| <b>Total liabilities</b>                                                                                                         | <b>109,804</b>                           | <b>97,796</b>                |
| <b>Commitments and contingencies (see Note 11)</b>                                                                               |                                          |                              |
| <b>Stockholders' Equity</b>                                                                                                      |                                          |                              |
| Common stock, par value \$0.01 per share; 200,000 shares authorized; 79,652 shares issued at June 30, 2009 and December 31, 2008 | 797                                      | 797                          |
| Additional paid-in capital                                                                                                       | 176,657                                  | 172,704                      |
| Accumulated other comprehensive income (loss)                                                                                    | 6,349                                    | (1,009)                      |
| Retained earnings                                                                                                                | 623,607                                  | 603,600                      |
| Less treasury stock at cost: 17,098 shares at June 30, 2009 and 17,493 shares at December 31, 2008                               | (390,449)                                | (400,273)                    |

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|                                                   |                   |                   |
|---------------------------------------------------|-------------------|-------------------|
| <b>Total stockholders' equity</b>                 | <b>416,961</b>    | <b>375,819</b>    |
| <b>Total liabilities and stockholders' equity</b> | <b>\$ 526,765</b> | <b>\$ 473,615</b> |

See notes to condensed consolidated financial statements

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## ADTRAN, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)

|                                                 | Three Months Ended<br>June 30, |                  | Six Months Ended<br>June 30, |                  |
|-------------------------------------------------|--------------------------------|------------------|------------------------------|------------------|
|                                                 | 2009                           | 2008             | 2009                         | 2008             |
| Sales                                           | \$ 121,528                     | \$ 131,183       | \$ 231,892                   | \$ 251,068       |
| Cost of sales                                   | 49,838                         | 51,789           | 92,742                       | 101,434          |
| <b>Gross profit</b>                             | <b>71,690</b>                  | <b>79,394</b>    | <b>139,150</b>               | <b>149,634</b>   |
| Selling, general and administrative expenses    | 24,885                         | 25,709           | 48,582                       | 51,256           |
| Research and development expenses               | 20,670                         | 20,215           | 41,532                       | 39,768           |
| <b>Operating income</b>                         | <b>26,135</b>                  | <b>33,470</b>    | <b>49,036</b>                | <b>58,610</b>    |
| Interest and dividend income                    | 1,837                          | 2,219            | 3,475                        | 4,502            |
| Interest expense                                | (609)                          | (660)            | (1,212)                      | (1,279)          |
| Net realized investment gain (loss)             | 995                            | (15)             | (2,203)                      | (104)            |
| Other income (expense), net                     | 100                            | 339              | (35)                         | 466              |
| <b>Income before provision for income taxes</b> | <b>28,458</b>                  | <b>35,353</b>    | <b>49,061</b>                | <b>62,195</b>    |
| Provision for income taxes                      | (9,619)                        | (12,939)         | (15,038)                     | (22,734)         |
| <b>Net income</b>                               | <b>\$ 18,839</b>               | <b>\$ 22,414</b> | <b>\$ 34,023</b>             | <b>\$ 39,461</b> |
| Weighted average shares outstanding basic       | 62,358                         | 64,239           | 62,241                       | 64,419           |
| Weighted average shares outstanding diluted     | 63,141                         | 65,340           | 62,858                       | 65,400           |
| Earnings per common share basic                 | \$ 0.30                        | \$ 0.35          | \$ 0.55                      | \$ 0.61          |
| Earnings per common share diluted               | \$ 0.30                        | \$ 0.34          | \$ 0.54                      | \$ 0.60          |
| Dividend per share                              | \$ 0.09                        | \$ 0.09          | \$ 0.18                      | \$ 0.18          |

See notes to condensed consolidated financial statements

**Table of Contents****ADTRAN, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

|                                                                                   | <b>Six Months Ended<br/>June 30,</b> |                  |
|-----------------------------------------------------------------------------------|--------------------------------------|------------------|
|                                                                                   | <b>2009</b>                          | <b>2008</b>      |
| <b>Cash flows from operating activities:</b>                                      |                                      |                  |
| Net income                                                                        | \$ 34,023                            | \$ 39,461        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                      |                  |
| Depreciation and amortization                                                     | 5,008                                | 4,823            |
| Amortization of net premium on available-for-sale investments                     | 1,643                                | 873              |
| Net realized loss on long-term investments                                        | 2,203                                | 104              |
| Gain on disposal of property, plant and equipment                                 | (22)                                 | (15)             |
| Stock-based compensation expense                                                  | 3,411                                | 3,999            |
| Deferred income taxes                                                             | (1,625)                              | (1,411)          |
| Tax benefits from stock option exercises                                          | 542                                  | 456              |
| Excess tax benefits from stock-based compensation arrangements                    | (354)                                | (247)            |
| Changes in operating assets and liabilities:                                      |                                      |                  |
| Accounts receivable, net                                                          | (11,241)                             | 7,979            |
| Other receivables                                                                 | (2,765)                              | 231              |
| Inventory                                                                         | (936)                                | (1,279)          |
| Prepaid expenses and other assets                                                 | 591                                  | 714              |
| Accounts payable                                                                  | 2,657                                | 2,345            |
| Accrued expenses and other liabilities                                            | 3,642                                | 2,230            |
| Income tax payable, net                                                           | 5,706                                | 4,522            |
| <b>Net cash provided by operating activities</b>                                  | <b>42,483</b>                        | <b>64,785</b>    |
| <b>Cash flows from investing activities:</b>                                      |                                      |                  |
| Purchases of property, plant and equipment                                        | (3,928)                              | (4,615)          |
| Proceeds from sales and maturities of available-for-sale investments              | 107,512                              | 120,232          |
| Purchases of available-for-sale investments                                       | (147,580)                            | (112,590)        |
| <b>Net cash (used in) provided by investing activities</b>                        | <b>(43,996)</b>                      | <b>3,027</b>     |
| <b>Cash flows from financing activities:</b>                                      |                                      |                  |
| Proceeds from stock option exercises                                              | 8,420                                | 1,724            |
| Purchases of treasury stock                                                       | (1,430)                              | (14,871)         |
| Dividend payments                                                                 | (11,179)                             | (11,624)         |
| Excess tax benefits from stock-based compensation arrangements                    | 354                                  | 247              |
| <b>Net cash used in financing activities</b>                                      | <b>(3,835)</b>                       | <b>(24,524)</b>  |
| Net (decrease) increase in cash and cash equivalents                              | (5,348)                              | 43,288           |
| Effect of exchange rate changes                                                   | 1,631                                | 625              |
| <b>Cash and cash equivalents, beginning of period</b>                             | <b>41,909</b>                        | <b>13,941</b>    |
| <b>Cash and cash equivalents, end of period</b>                                   | <b>\$ 38,192</b>                     | <b>\$ 57,854</b> |

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See notes to condensed consolidated financial statements

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**ADTRAN, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(In thousands, except per share amounts)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The accompanying unaudited condensed 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, 2008 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 included 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, 2008, filed on February 27, 2009 with the SEC.

*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. ADTRAN's more significant estimates include the allowance for doubtful accounts, obsolete and excess inventory reserves, warranty reserves, customer rebates, allowance for sales returns, determination of the deferred revenue components of multiple element sales agreements, estimated income tax contingencies, the fair value of stock-based compensation, and the evaluation of other-than-temporary declines in the value of investments. Actual amounts could differ significantly from these estimates.

*Recent Accounting Pronouncements*

In April 2009, the Financial Accounting Standards Board (FASB) released FASB Staff Position (FSP) Financial Accounting Standard (FAS) 107-1 and Accounting Principles Board (APB) Opinion No. 28-1, *Interim Disclosures about Fair Value of Financial Instruments* (FAS 107-1 and APB 28-1). This FSP amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements. The proposal also amends APB Opinion No. 28, *Interim Financial Reporting*, to require those disclosures in all interim financial statements. This FSP is effective for interim periods ending after June 15, 2009. We adopted FSP FAS 107-1 and APB 28-1 in the second quarter of 2009, and have provided the disclosures required for the period ending June 30, 2009.

In April 2009, the FASB released FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FAS 157-4). This FSP provides additional guidance in determining whether a market for a financial asset is not active and a transaction is not distressed for fair value measurement purposes as defined in FASB Statement No. 157, *Fair Value Measurements*. FSP FAS 157-4 is effective for interim periods ending after June 15, 2009. We adopted the provisions of FSP FAS 157-4 for the period ending June 30, 2009, with no effect on our consolidated results of operations and financial condition for the three and six months ended June 30, 2009.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-than-Temporary Impairments*. This FSP provides guidance in determining whether impairments in debt securities are other-than-temporary, and modifies the presentation and disclosures surrounding such instruments. This FSP is effective for interim periods ending after June 15, 2009. We adopted the provisions of this FSP for the period ending June 30, 2009, with no effect on our consolidated results of operations and financial condition for the three and six months ended June 30, 2009.



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In May 2009, the FASB issued SFAS No. 165, *Subsequent Events* (SFAS 165), which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 is effective for financial statements issued for interim and annual reporting periods ending after June 15, 2009. We adopted SFAS 165 for the period ended June 30, 2009, and have provided the disclosures required for the period ending June 30, 2009.

In June 2009, the FASB issued SFAS No. 168, *The FASB Accounting Standards Codification and Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162* (SFAS 168). SFAS 168 establishes the FASB Standards Accounting Codification ( Codification ) as the source of authoritative U.S. generally accepted accounting principles ( GAAP ) recognized by the FASB to be applied to nongovernmental entities and rules and interpretive releases of the SEC as authoritative GAAP for SEC registrants. The Codification will supersede all the existing non-SEC accounting and reporting standards upon its effective date and subsequently, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. SFAS 168 also replaces FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles* given that once in effect, the Codification will carry the same level of authority. We do not anticipate that the adoption of this statement will have a material impact on our consolidated results of operations or financial condition.

During the first quarter of 2009, we adopted the following accounting standards, none of which had a material effect on our consolidated results of operations or financial condition:

FASB Statement No. 141, (revised 2007), *Business Combinations* (SFAS 141R), establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree in a business combination. SFAS 141R establishes principles stipulating how goodwill acquired in a business combination or a gain from a bargain purchase should be recognized and measured. The statement also expands the disclosure requirements related to the nature and financial impact of business combinations. We adopted SFAS 141R as of January 1, 2009. The adoption of SFAS 141R had no effect on our consolidated results of operations and financial condition for the three and six months ended June 30, 2009.

FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51* (SFAS 160), establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. SFAS 160 also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 also provides guidance when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners of a subsidiary. We adopted SFAS 160 as of January 1, 2009. The adoption of SFAS 160 had no effect on our consolidated results of operations and financial condition for the three and six months ended June 30, 2009.

FASB FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, establishes that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. In contrast, the right to receive dividends or dividend equivalents that the holder will forfeit if the award does not vest does not constitute a participation right and such an award does not meet the definition of a participating security in its current form (that is, prior to the requisite service having been rendered for the award). We adopted FSP EITF 03-6-1 as of January 1, 2009. The adoption of FSP EITF 03-6-1 had no effect on our consolidated results of operations and financial condition for the three and six months ended June 30, 2009.

**Table of Contents****2. INCOME TAXES**

Our effective tax rate decreased from 36.6% in the six months ended June 30, 2008 to 30.7% in the six months ended June 30, 2009. During the first quarter of 2009, ADTRAN completed a review of its estimated tax deductions for the years 2005, 2006 and 2007 relating to the deduction for manufacturer's domestic production activities concerning the domestic content of the products that we manufacture, under Internal Revenue Code Section 199. This review resulted in a \$1.7 million benefit for the first six months of 2009, or a 3.4 percentage point decrease in our effective tax rate in the first six months of 2009. Amended income tax returns were filed during the first quarter of 2009 in association with this benefit. The tax provision for the first six months of 2009 also included the benefit from the research and development tax credit. The tax provision rate for the first six months of 2008 did not include the benefit from the research and development tax credit which had expired as of December 31, 2007. Legislation to extend the research and development tax credits to the tax years 2008 and 2009 was signed into law on October 3, 2008. The exclusion of the benefit from the research and development tax credits resulted in approximately a 1.9 percentage point increase in our effective tax rate in the first six months of 2008.

**3. STOCK-BASED COMPENSATION**

The following table summarizes the stock-based compensation expense related to stock options and restricted stock units (RSUs) under SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), for the three and six months ended June 30, 2009 and 2008, which was recognized as follows:

|                                                                        | Three Months Ended<br>June 30, |                 | Six Months Ended<br>June 30, |                 |
|------------------------------------------------------------------------|--------------------------------|-----------------|------------------------------|-----------------|
|                                                                        | 2009                           | 2008            | 2009                         | 2008            |
| <i>(In thousands)</i>                                                  |                                |                 |                              |                 |
| <b>Stock-based compensation expense included in cost of sales</b>      | <b>\$ 59</b>                   | <b>\$ 79</b>    | <b>\$ 130</b>                | <b>\$ 158</b>   |
| Selling, general and administrative expense                            | 674                            | 889             | 1,502                        | 1,843           |
| Research and development expense                                       | 859                            | 992             | 1,779                        | 1,998           |
| <b>Stock-based compensation expense included in operating expenses</b> | <b>1,533</b>                   | <b>1,881</b>    | <b>3,281</b>                 | <b>3,841</b>    |
| <b>Total stock-based compensation expense</b>                          | <b>1,592</b>                   | <b>1,960</b>    | <b>3,411</b>                 | <b>3,999</b>    |
| Tax benefit for expense associated with non-qualified options          | (156)                          | (196)           | (296)                        | (404)           |
| <b>Total stock-based compensation expense, net of tax</b>              | <b>\$ 1,436</b>                | <b>\$ 1,764</b> | <b>\$ 3,115</b>              | <b>\$ 3,595</b> |

The fair value of ADTRAN's options was 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 month period ended June 30, 2009. The weighted-average assumptions and value of options granted for the six months ended June 30, 2009 and the three and six months ended June 30, 2008 are summarized as follows:

|                                  | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|----------------------------------|--------------------------------|---------|------------------------------|---------|
|                                  | 2009                           | 2008    | 2009                         | 2008    |
| Expected volatility              |                                | 41.42%  | 42.79%                       | 41.56%  |
| Risk-free interest rate          |                                | 3.12%   | 1.45%                        | 3.08%   |
| Expected dividend yield          |                                | 1.54%   | 2.35%                        | 1.59%   |
| Expected life (in years)         |                                | 4.90    | 4.88                         | 4.91    |
| Weighted-average estimated value | \$                             | \$ 8.25 | \$ 4.77                      | \$ 8.02 |

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ADTRAN uses the Monte Carlo Simulation valuation technique to value its RSUs. No RSUs were granted to employees during the six months ended June 30, 2009 or 2008.

Stock-based compensation expense recognized in our Condensed Consolidated Statements of Income for the three and six months ended June 30, 2009 and 2008 is based on options and RSUs ultimately expected to vest, and has been reduced for estimated forfeitures. Estimated forfeitures for stock options were based upon historical experience and approximate 5% annually. We estimated a 0% forfeiture rate for our RSUs due to the limited number of recipients and lack of historical experience for these awards.

As of June 30, 2009, total compensation cost related to non-vested stock options and RSUs not yet recognized was approximately \$11.7 million, which is expected to be recognized over an average remaining recognition period of 2.3 years using the ratable single-option approach.

The following schedule summarizes the activity in our stock option plans for the six months ended June 30, 2009:

| <i>(In thousands, except per share amounts)</i> | Number of<br>Options | Weighted Avg.<br>Exercise<br>Price | Weighted Avg.<br>Remaining<br>Contractual<br>Life in Years | Aggregate<br>Intrinsic<br>Value |
|-------------------------------------------------|----------------------|------------------------------------|------------------------------------------------------------|---------------------------------|
| <b>Options outstanding, December 31, 2008</b>   | <b>6,826</b>         | <b>\$ 19.43</b>                    | <b>5.79</b>                                                | <b>\$ 6,889</b>                 |
| Options granted                                 | 13                   | \$ 15.29                           |                                                            |                                 |
| Options cancelled/forfeited                     | (28)                 | \$ 24.25                           |                                                            |                                 |
| Options exercised                               | (495)                | \$ 17.10                           |                                                            |                                 |
| <b>Options outstanding, June 30, 2009</b>       | <b>6,316</b>         | <b>\$ 19.56</b>                    | <b>5.56</b>                                                | <b>\$ 23,344</b>                |
| <b>Options exercisable, June 30, 2009</b>       | <b>4,172</b>         | <b>\$ 19.34</b>                    | <b>4.25</b>                                                | <b>\$ 18,092</b>                |

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic value (the difference between ADTRAN's closing stock price on the last trading day of 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 June 30, 2009. The aggregate intrinsic value will change based on the fair market value of ADTRAN's stock. The total pre-tax intrinsic value of options exercised during the three and six month period ended June 30, 2009 was \$1.8 million.

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At June 30, 2009, we held the following securities and investments, recorded at either fair value or cost.

| <i>(In thousands)</i>                                                                     | Amortized<br>Cost | Gross Unrealized |                 | Fair Value /<br>Carrying<br>Value |
|-------------------------------------------------------------------------------------------|-------------------|------------------|-----------------|-----------------------------------|
|                                                                                           |                   | Gains            | Losses          |                                   |
| Deferred compensation plan assets investments                                             | \$ 2,665          | \$ 229           | \$ (76)         | \$ 2,818                          |
| Municipal fixed-rate bonds                                                                | 119,066           | 1,259            | (6)             | 120,319                           |
| Municipal variable rate demand notes                                                      | 64,269            |                  |                 | 64,269                            |
| Corporate bonds (FDIC guaranteed)                                                         | 27,175            | 152              | (5)             | 27,322                            |
| Fixed income bond fund                                                                    | 867               | 127              |                 | 994                               |
| Marketable equity securities                                                              | 9,191             | 7,591            | (555)           | 16,227                            |
| <b>Available-for-sale securities held at fair value</b>                                   | <b>\$ 223,233</b> | <b>\$ 9,358</b>  | <b>\$ (642)</b> | <b>\$ 231,949</b>                 |
| <b>Restricted investments held at cost</b>                                                |                   |                  |                 | <b>48,750</b>                     |
| <b>Other investments held at cost</b>                                                     |                   |                  |                 | <b>2,208</b>                      |
| <b>Total carrying value of available-for-sale securities and investments held at cost</b> |                   |                  |                 | <b>\$ 282,907</b>                 |

At June 30, 2009, we held \$2.8 million of deferred compensation plan assets, carried at fair value.

At June 30, 2009, we held \$120.3 million of municipal fixed-rate bonds. At June 30, 2009, approximately 67% of our municipal fixed-rate bond portfolio had a credit rating of AAA, 30% had a credit rating of AA, and the remaining 3% had a credit rating of A. These bonds are classified as available-for-sale investments and had an average duration of 1.2 years at June 30, 2009. 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.

At June 30, 2009, we held \$64.3 million of municipal variable rate demand notes, all of which are classified as available-for-sale short-term investments. At June 30, 2009, 98% of our municipal variable rate demand notes had a credit rating of VMIG-1 or A-1+ with the remaining 2% rated A-2 and all contained put options of seven days. Thus, despite the long-term nature of their stated contractual maturities, we believe we have the ability to quickly liquidate these securities. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. We have the ability to sell our variable rate demand notes 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. Approximately 36% of our variable rate demand notes are supported by letters of credit from banks that we believe to be in good financial condition. As a result, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments at June 30, 2009. 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.

At June 30, 2009, we held \$27.3 million of corporate bonds issued by various banks that are guaranteed by the Federal Deposit Insurance Corporation (FDIC). These bonds are classified as available-for-sale and had an average duration of 2.6 years at June 30, 2009. All of these bonds had a credit rating of AAA at June 30, 2009. Because of the high quality and short duration of these issues, we are able to obtain prices for these bonds derived from observable market inputs on a daily basis.

At June 30, 2009, we held \$1.0 million of a fixed income bond fund.

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At June 30, 2009, we held \$16.2 million of marketable equity securities, including a single security, of which we held 2.1 million shares, carried at a fair value of \$7.5 million. We sold 400 thousand shares of this security during the six months ended June 30, 2009. The sale resulted in proceeds of \$1.2 million and a realized gain of \$1.1 million. This single security traded approximately 183 thousand shares per day in the first six months of 2009, in an active market on a European stock exchange. This single security carried \$6.7 million of the gross unrealized gains included in the fair market value of our marketable equity securities at June 30, 2009. The remaining \$0.9 million of unrealized gains and \$0.6 million of gross unrealized losses were spread among more than 300 issues.

At June 30, 2009, we held a \$48.8 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). At June 30, 2009, the estimated fair value of the Bond was approximately \$47.0 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of AA. ADTRAN has the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness. 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.

At June 30, 2009, we held \$2.2 million of other investments carried at cost, consisting of interests in two private equity funds and an investment in a privately held telecommunications equipment manufacturer. The fair value of these investments was estimated to be approximately \$10.4 million at June 30, 2009, based on unobservable inputs including information supplied by the companies. We have committed to invest up to an aggregate of \$7.9 million in the two private equity funds, and we have contributed \$7.9 million as of June 30, 2009, of which \$7.4 million has been applied toward these commitments. As of June 30, 2009, we have received distributions related to these two private equity funds of \$6.3 million, of which \$0.6 million was recorded as a realized investment gain. These investments are carried at cost, net of distributions, with distributions in excess of our investment recorded as a realized investment gain. The duration of each of the commitments in the equity funds is ten years with \$0.2 million expiring in 2010 and \$0.3 million expiring in 2012.

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. Because of the strained credit markets and deterioration in the equity markets experienced beginning in the fourth quarter of 2008, we expanded the impairment review of our investments to assess the impact of these factors on our ability to recover our cost of every security whose value had declined from its original or adjusted cost by more than 25%, regardless of the historical duration of the decline. We then evaluated individual securities to determine the amount of the write-down, if any. As a result, we recorded an other-than-temporary impairment charge of \$0.1 million and \$2.0 million during the three and six months ending June 30, 2009, respectively, related to eight and 107 marketable equity securities. In addition to the impairment charge we recorded on our marketable equity securities, we recorded an impairment of \$0.4 million related to our investment in a fixed income bond fund and \$0.5 million related to our deferred compensation plan during the six months ending June 30, 2009 as a result of similar reviews. There were no such charges during the three months ended June 30, 2009 related to the fixed income bond fund or deferred compensation plan assets. As long as current market conditions continue to exist, we will continue to complete a similar review of individual securities for impairment each quarter. For the six months ended June 30, 2008, we had a charge of \$0.2 million related to the impairment of 17 publicly traded equity securities. There were no such charges during the three months ended June 30, 2008.

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In accordance with SFAS No. 157, we have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1 - Values based on unadjusted quoted prices for identical assets or liabilities in an active market; Level 2 - Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability; Level 3 - Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs include information supplied by investees.

|                                                         | Fair Value Measurements at June 30, 2009 Using |                                                                |                                               |                                           |
|---------------------------------------------------------|------------------------------------------------|----------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                                         | Fair Value                                     | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <i>(In thousands)</i>                                   |                                                |                                                                |                                               |                                           |
| <b>Cash equivalents</b>                                 |                                                |                                                                |                                               |                                           |
| Money market funds                                      | \$ 16,110                                      | \$ 16,110                                                      | \$                                            | \$                                        |
| <b>Available-for-sale securities held at fair value</b> |                                                |                                                                |                                               |                                           |
| Deferred compensation plan assets                       | 2,818                                          | 2,818                                                          |                                               |                                           |
| Municipal fixed-rate bonds                              | 120,319                                        |                                                                | 120,319                                       |                                           |
| Municipal variable rate demand notes                    | 64,269                                         |                                                                | 64,269                                        |                                           |
| Corporate bonds (FDIC guaranteed)                       | 27,322                                         |                                                                | 27,322                                        |                                           |
| Fixed income bond fund                                  | 994                                            | 994                                                            |                                               |                                           |
| Marketable equity securities                            | 16,227                                         | 16,227                                                         |                                               |                                           |
| <b>Available-for-sale securities held at fair value</b> | <b>\$ 231,949</b>                              | <b>\$ 20,039</b>                                               | <b>\$ 211,910</b>                             | <b>\$</b>                                 |
| <b>Total</b>                                            | <b>\$ 248,059</b>                              | <b>\$ 36,149</b>                                               | <b>\$ 211,910</b>                             | <b>\$</b>                                 |

|                                                         | Fair Value Measurements at December 31, 2008 Using |                                                                |                                               |                                           |
|---------------------------------------------------------|----------------------------------------------------|----------------------------------------------------------------|-----------------------------------------------|-------------------------------------------|
|                                                         | Fair Value                                         | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <i>(In thousands)</i>                                   |                                                    |                                                                |                                               |                                           |
| <b>Cash equivalents</b>                                 |                                                    |                                                                |                                               |                                           |
| Money market funds                                      | \$ 25,389                                          | \$ 25,389                                                      | \$                                            | \$                                        |
| <b>Available-for-sale securities held at fair value</b> |                                                    |                                                                |                                               |                                           |
| Deferred compensation plan assets                       | 2,457                                              | 2,457                                                          |                                               |                                           |
| Government agency security                              | 1,999                                              |                                                                | 1,999                                         |                                           |
| Municipal fixed-rate bonds                              | 116,943                                            |                                                                | 116,943                                       |                                           |
| Municipal variable rate demand notes                    | 52,633                                             |                                                                | 52,633                                        |                                           |
| Fixed income bond fund                                  | 884                                                | 884                                                            |                                               |                                           |
| Marketable equity securities                            | 11,644                                             | 11,644                                                         |                                               |                                           |
| <b>Available-for-sale securities held at fair value</b> | <b>\$ 186,560</b>                                  | <b>\$ 14,985</b>                                               | <b>\$ 171,575</b>                             | <b>\$</b>                                 |
| <b>Total</b>                                            | <b>\$ 211,949</b>                                  | <b>\$ 40,374</b>                                               | <b>\$ 171,575</b>                             | <b>\$</b>                                 |

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At June 30, 2009 and December 31, 2008, inventory consisted of the following:

| <i>(In thousands)</i> | <b>June 30,<br/>2009</b> | <b>December 31,<br/>2008</b> |
|-----------------------|--------------------------|------------------------------|
| Raw materials         | \$ 35,182                | \$ 32,591                    |
| Work in progress      | 3,012                    | 1,552                        |
| Finished goods        | 18,152                   | 20,991                       |
| Inventory reserves    | (8,004)                  | (7,728)                      |
| <b>Total</b>          | <b>\$ 48,342</b>         | <b>\$ 47,406</b>             |

**6. STOCKHOLDERS' EQUITY**

A summary of the changes in stockholders' equity for the six months ended June 30, 2009 is as follows:

| <i>(In thousands)</i>                                                                  | <b>Stockholders<br/>Equity</b> |
|----------------------------------------------------------------------------------------|--------------------------------|
| <b>Balance, December 31, 2008</b>                                                      | <b>\$ 375,819</b>              |
| Net income                                                                             | 34,023                         |
| Dividend payments                                                                      | (11,179)                       |
| Dividends accrued for unvested restricted stock units                                  | (3)                            |
| Change in unrealized gains and losses on marketable securities (net of deferred taxes) | 4,185                          |
| Reclassification adjustment for amounts included in net income (net of deferred taxes) | 1,542                          |
| Foreign currency translation adjustment                                                | 1,631                          |
| Proceeds from stock option exercises                                                   | 8,420                          |
| Tax benefits from stock option exercises                                               | 542                            |
| Stock-based compensation expense                                                       | 3,411                          |
| Purchases of treasury stock                                                            | (1,430)                        |
| <b>Balance, June 30, 2009</b>                                                          | <b>\$ 416,961</b>              |

*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 30 million shares of our common stock. During the six months ended June 30, 2009, we repurchased 0.1 million shares of our common stock at an average price of \$14.51 per share, and all of these repurchases occurred in the first quarter of 2009. We have the authority to purchase an additional 3.4 million shares of our common stock under the plan approved by the Board of Directors on April 14, 2008.

*Stock Option Exercises*

We issued 0.5 million shares of treasury stock during the six months ended June 30, 2009 to accommodate employee stock option exercises. The stock options had exercise prices ranging from \$8.70 to \$18.03. We received proceeds totaling \$8.4 million from the exercise of these stock options during the first six months of 2009.

*Dividend Payments*

During 2009, ADTRAN has paid cash dividends as follows (in thousands except per share amounts):

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| Record Date      | Payment Date      | Per Share Amount | Total Dividend Paid |
|------------------|-------------------|------------------|---------------------|
| February 5, 2009 | February 19, 2009 | \$ 0.09          | \$ 5,568            |
| April 30, 2009   | May 14, 2009      | \$ 0.09          | \$ 5,611            |

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### Comprehensive Income

Comprehensive income consists of net income, foreign currency translation adjustments, reclassification adjustments for amounts included in net income and unrealized gains and losses on marketable securities.

|                                                                                       | Three Months Ended<br>June 30, |                  | Six Months Ended<br>June 30, |                  |
|---------------------------------------------------------------------------------------|--------------------------------|------------------|------------------------------|------------------|
|                                                                                       | 2009                           | 2008             | 2009                         | 2008             |
| <i>(In thousands)</i>                                                                 |                                |                  |                              |                  |
| Net income                                                                            | \$ 18,839                      | \$ 22,414        | \$ 34,023                    | \$ 39,461        |
| Foreign currency translation adjustment                                               | 1,622                          | 318              | 1,631                        | 625              |
| Reclassification adjustment for amounts included in net income, net of deferred taxes | (72)                           | 41               | 1,542                        | 143              |
| Change in unrealized gains and losses on marketable securities, net of deferred taxes | 3,621                          | (246)            | 4,185                        | (2,062)          |
| <b>Total comprehensive income</b>                                                     | <b>\$ 24,010</b>               | <b>\$ 22,527</b> | <b>\$ 41,381</b>             | <b>\$ 38,167</b> |

## 7. EARNINGS PER SHARE

A summary of the calculation of basic and diluted earnings per share for the three and six months ended June 30, 2009 and 2008 is as follows:

|                                                 | Three Months<br>Ended<br>June 30, |           | Six Months Ended<br>June 30, |           |
|-------------------------------------------------|-----------------------------------|-----------|------------------------------|-----------|
|                                                 | 2009                              | 2008      | 2009                         | 2008      |
| <i>(In thousands, except per share amounts)</i> |                                   |           |                              |           |
| <b>Numerator</b>                                |                                   |           |                              |           |
| Net income                                      | \$ 18,839                         | \$ 22,414 | \$ 34,023                    | \$ 39,461 |
| <b>Denominator</b>                              |                                   |           |                              |           |
| Weighted average number of shares basic         | 62,358                            | 64,239    | 62,241                       | 64,419    |
| Effect of dilutive securities                   |                                   |           |                              |           |
| Stock options                                   | 783                               | 1,101     | 617                          | 981       |
| Restricted stock units                          |                                   |           |                              |           |
| Weighted average number of shares diluted       | 63,141                            | 65,340    | 62,858                       | 65,400    |
| Net income per share basic                      | \$ 0.30                           | \$ 0.35   | \$ 0.55                      | \$ 0.61   |
| Net income per share diluted                    | \$ 0.30                           | \$ 0.34   | \$ 0.54                      | \$ 0.60   |

Anti-dilutive options to purchase common stock outstanding were excluded from the above calculations. Anti-dilutive options totaled 3.4 million and 3.3 million for the three months ended June 30, 2009 and 2008, respectively. Anti-dilutive options totaled 4.7 million and 3.5 million for the six months ended June 30, 2009 and 2008, respectively.

## 8. SEGMENT INFORMATION

ADTRAN operates in two reportable segments: (1) the Carrier Networks Division and (2) the Enterprise Networks Division. We evaluate the performance of our segments based on gross profit; therefore, selling, general and administrative expenses, research and development expenses, interest and dividend income, interest expense, net realized investment gain/loss, other income/expense, net and provision for income taxes are reported on an entity-wide basis only. There are no inter-segment revenues.

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The following table presents information about the reported sales and gross profit of our reportable segments for the three and six months ended June 30, 2009 and 2008. Asset information by reportable segment is not reported, since ADTRAN does not produce such information internally.

| (In thousands)      | Three Months Ended |                  |                   |                  |
|---------------------|--------------------|------------------|-------------------|------------------|
|                     | June 30, 2009      |                  | June 30, 2008     |                  |
|                     | Sales              | Gross Profit     | Sales             | Gross Profit     |
| Carrier Networks    | \$ 91,766          | \$ 53,508        | \$ 104,591        | \$ 64,213        |
| Enterprise Networks | 29,762             | 18,182           | 26,592            | 15,181           |
| <b>Total</b>        | <b>\$ 121,528</b>  | <b>\$ 71,690</b> | <b>\$ 131,183</b> | <b>\$ 79,394</b> |

| (In thousands)      | Six Months Ended  |                   |                   |                   |
|---------------------|-------------------|-------------------|-------------------|-------------------|
|                     | June 30, 2009     |                   | June 30, 2008     |                   |
|                     | Sales             | Gross Profit      | Sales             | Gross Profit      |
| Carrier Networks    | \$ 178,850        | \$ 107,763        | \$ 199,063        | \$ 119,958        |
| Enterprise Networks | 53,042            | 31,387            | 52,005            | 29,676            |
| <b>Total</b>        | <b>\$ 231,892</b> | <b>\$ 139,150</b> | <b>\$ 251,068</b> | <b>\$ 149,634</b> |

## Sales by Geographic Region

The table below presents sales information by geographic region for the three and six months ended June 30, 2009 and 2008.

| (In thousands) | Three Months Ended |                   | Six Months Ended  |                   |
|----------------|--------------------|-------------------|-------------------|-------------------|
|                | June 30, 2009      | June 30, 2008     | June 30, 2009     | June 30, 2008     |
|                |                    |                   |                   |                   |
| United States  | \$ 115,085         | \$ 123,422        | \$ 218,503        | \$ 236,861        |
| International  | 6,443              | 7,761             | 13,389            | 14,207            |
| <b>Total</b>   | <b>\$ 121,528</b>  | <b>\$ 131,183</b> | <b>\$ 231,892</b> | <b>\$ 251,068</b> |

## Sales by Product

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

**Carrier Systems** products are used by telecommunications service providers to provide last mile access in support of data, voice and video services to consumers and enterprises. The Carrier Systems category includes our broadband access products comprising Total Access® 5000 multi-access and aggregation platform products, Fiber-To-The-Node (FTTN) products and Digital Subscriber Line Access Multiplexer (DSLAM) products. Our broadband access products are used by service providers to deliver high speed Internet access, Voice over Internet Protocol (VoIP), IP Television (IPTV), and/or Ethernet services from central office or remote terminal locations to customer premises. The Carrier Systems category also includes our optical access products. These products consist of optical access multiplexers including our family of OPTI® products. Optical access products are used to deliver higher bandwidth services, or to aggregate large numbers of low bandwidth services for transportation across fiber optic infrastructure. Total Access® 1500 products, 303 concentrator products, M13 multiplexer products and wireless network backhaul products are also included in the Carrier Systems product category.

**Business Networking** products provide enterprises access to telecommunication networks and facilitate networking capabilities for voice, data and video networks. The Business Networking category includes Internetworking products and Integrated Access Devices (IADs). Internetworking products consist of our IP Business Gateways and NetVanta® product lines. NetVanta® products include IP multi-service access routers, Ethernet switches, Internet security/firewall appliances, IP Private Branch Exchange (PBX) products, IP phone products and Carrier Ethernet Network Terminating Equipment.



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**Loop Access** products are used by carrier and enterprise customers for access to copper-based telecommunications networks. The Loop Access category includes products such as Digital Data Service (DDS) and Integrated Services Digital Network (Total Reach®) products, High bit-rate Digital Subscriber Line (HDSL) products including Total Access® 3000 based HDSL and Time Division Multiplexed-Symmetrical HDSL (TDM-SHDSL) products, T1/E1/T3, Channel Service Units/Data Service Units, and TRACER® fixed wireless products.

The table below presents sales information by product category for the three and six months ended June 30, 2009 and 2008.

| (In thousands)      | Three Months Ended<br>June 30, |                   | Six Months Ended<br>June 30, |                   |
|---------------------|--------------------------------|-------------------|------------------------------|-------------------|
|                     | 2009                           | 2008              | 2009                         | 2008              |
| Carrier Systems     | \$ 56,210                      | \$ 57,684         | \$ 98,939                    | \$ 108,886        |
| Business Networking | 26,432                         | 21,771            | 46,444                       | 42,757            |
| Loop Access         | 38,886                         | 51,728            | 86,509                       | 99,425            |
| <b>Total</b>        | <b>\$ 121,528</b>              | <b>\$ 131,183</b> | <b>\$ 231,892</b>            | <b>\$ 251,068</b> |

In addition, we identify sub-categories of product revenues, which we divide into growth products, representing our primary growth areas, and traditional products. Our growth products consist of broadband access and optical access products (included in Carrier Systems) and Internetworking products (included in Business Networking) and our traditional products include HDSL products (included in Loop Access) and other products.

Subcategory revenues included in the above are as follows:

| (In thousands)                                                                               | Three Months Ended<br>June 30, |                   | Six Months Ended<br>June 30, |                   |
|----------------------------------------------------------------------------------------------|--------------------------------|-------------------|------------------------------|-------------------|
|                                                                                              | 2009                           | 2008              | 2009                         | 2008              |
| <b>Growth Products</b>                                                                       |                                |                   |                              |                   |
| Broadband Access (included in Carrier Systems)                                               | \$ 31,391                      | \$ 31,309         | \$ 53,610                    | \$ 59,911         |
| Optical Access (included in Carrier Systems)                                                 | 13,514                         | 13,383            | 24,166                       | 24,549            |
| Internetworking (NetVanta & Multi-service Access Gateways) (included in Business Networking) | 20,427                         | 15,986            | 35,742                       | 30,899            |
| <b>Total</b>                                                                                 | <b>65,332</b>                  | <b>60,678</b>     | <b>113,518</b>               | <b>115,359</b>    |
| <b>Traditional Products</b>                                                                  |                                |                   |                              |                   |
| HDSL (does not include T1) (included in Loop Access)                                         | 34,349                         | 45,348            | 77,270                       | 87,298            |
| Other products (included in the preceding table)                                             | 21,847                         | 25,157            | 41,104                       | 48,411            |
| <b>Total</b>                                                                                 | <b>56,196</b>                  | <b>70,505</b>     | <b>118,374</b>               | <b>135,709</b>    |
| <b>Total</b>                                                                                 | <b>\$ 121,528</b>              | <b>\$ 131,183</b> | <b>\$ 231,892</b>            | <b>\$ 251,068</b> |

## 9. LIABILITY FOR WARRANTY RETURNS

Our products generally include warranties of one 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. These products will require more warranty repairs to be completed at the installed location due to their size and complexity, rather than at a manufacturing site or repair depot. This field service obligation, as well as the increasing complexity of our products, may 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

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arise. Should our actual experience relative to these factors be higher 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.

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The liability for warranty returns totaled \$2.8 million at June 30, 2009 and December 31, 2008. These liabilities are included in accrued expenses in the accompanying Condensed Consolidated Balance Sheets.

A summary of warranty expense and write-off activity for the six months ended June 30, 2008 and 2009 is as follows:

| <i>(In thousands)</i>                                  | Six Months Ended |                 |
|--------------------------------------------------------|------------------|-----------------|
|                                                        | June 30, 2009    | June 30, 2008   |
| Balance at beginning of period                         | \$ 2,812         | \$ 2,944        |
| Plus: amounts acquired or charged to cost and expenses | 1,225            | 1,148           |
| Less: deductions                                       | (1,265)          | (1,197)         |
| <b>Balance at end of period</b>                        | <b>\$ 2,772</b>  | <b>\$ 2,895</b> |

**10. RELATED PARTY TRANSACTIONS**

We employ the law firm of our director emeritus for legal services. All bills for services rendered by this firm are reviewed and approved by our chief financial officer. We believe that the fees for such services are comparable to those charged by other firms for services rendered to us. We paid \$40 thousand during the three month period ended June 30, 2009 and \$30 thousand during the three month period ended June 30, 2008 for legal services rendered. We paid \$50 thousand during the six month period ended June 30, 2009 and \$60 thousand during the six month period ended June 30, 2008 for legal services rendered.

**11. COMMITMENTS AND CONTINGENCIES**

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

We have committed to invest up to an aggregate of \$7.9 million in two private equity funds, and we have contributed \$7.9 million to date, of which \$7.4 million has been applied to these commitments. See Note 4 of Notes to Condensed Consolidated Financial Statements for additional information.

**12. SUBSEQUENT EVENTS**

On July 14, 2009, ADTRAN announced that our Board of Directors declared a quarterly cash dividend of \$0.09 per common share to be paid to stockholders of record at the close of business on July 30, 2009. The payment date will be August 13, 2009. The quarterly dividend payment will be approximately \$5.6 million. In July 2003, our Board of Directors elected to begin declaring quarterly dividends on our common stock considering the tax treatment of dividends and adequate levels of Company liquidity.

We have evaluated all subsequent events through August 3, 2009, the date the financial statements were issued.

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### **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*The following discussion should be read in conjunction with the Consolidated Financial Statements and the related notes that appear elsewhere in this document.*

#### **OVERVIEW**

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

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

Our three major product categories are Carrier Systems, Business Networking and Loop Access. Carrier Systems products are used by telecommunications service providers to provide last mile access in support of data, voice and video services to consumers and enterprises. Business Networking products provide enterprises access to telecommunication networks and facilitate networking capabilities for voice, data and video networks. Loop Access products are used by carrier and enterprise customers for access to copper-based telecommunications networks.

In addition, we identify sub-categories of product revenues, which we divide into growth products, representing our primary growth areas, and traditional products. Our growth products consist of Broadband Access and Optical Access products (included in Carrier Systems) and Internetworking products (included in Business Networking) and our traditional products include HDSL products (included in Loop Access) and other products. Many of our customers are migrating their networks to deliver higher bandwidth services by utilizing newer technologies. We believe that products in our primary growth areas position the Company well for this migration. We anticipate that revenues of many of our traditional products, including HDSL, may continue for years because of the time required for our customers to transition to newer technologies.

See Note 8 of Notes to Condensed Consolidated Financial Statements in this report for further information regarding these product categories.

Sales were \$121.5 million and \$231.9 million for the three and six months ended June 30, 2009 compared to \$131.2 million and \$251.1 million for the three and six months ended June 30, 2008. Product revenues for our three primary growth areas, Broadband Access, Optical Access and Internetworking, were \$65.3 million and \$113.5 million for the three and six months ended June 30, 2009 compared to \$60.7 million and \$115.4 million for the three and six months ended June 30, 2008. Our gross margin decreased for the three months ended June 30, 2009 to 59.0% compared to 60.5% for the three months ended June 30, 2008, while increasing for the six months ended June 30, 2009 to 60.0% compared to 59.6% for the six months ended June 30, 2008. Our operating margin decreased to 21.5% and 21.1% for the three and six months ended June 30, 2009 from 25.5% and 23.3% for the three and six months ended June 30, 2008. Net income was \$18.8 million and \$34.0 million for the three and six months ended June 30, 2009 compared to \$22.4 million and \$39.5 million for the three and six months ended June 30, 2008. Our effective tax rate decreased from 36.6% for the three and six months ended June 30, 2008 to 33.8% and 30.7% for the three and six months ended June 30, 2009.

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Earnings per share, assuming dilution, were \$0.30 and \$0.54 for the three and six months ended June 30, 2009 compared to \$0.34 and \$0.60 for the three and six months ended June 30, 2008. Earnings per share for the three and six months ended June 30, 2009 compared to the same period in 2008 reflects a lower weighted average number of shares outstanding in 2009 due to stock repurchases under the share repurchase plans approved by our Board of Directors.

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. We normally operate with very little order backlog. A majority of our sales in each quarter result from orders booked in that quarter and firm purchase orders released in that quarter by customers under agreements containing non-binding purchase commitments. Many of our customers require prompt delivery of products. This results in a limited backlog of orders for these products and 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.

Beginning in the latter part of the third quarter of 2008 and extending through the second quarter of 2009, we experienced an overall decline in order rates across most of our product categories. We believe this decline in order rates was the result of slowing macroeconomic conditions. If the macroeconomic conditions experienced in the second quarter of 2009 remain constant, we believe that it is likely that ADTRAN will experience lower revenue levels in the third quarter of 2009 than we realized in the third quarter of 2008.

Our operating results may also fluctuate as a result of a number of other factors, including increased competition, customer order patterns, changes in product mix, timing differences between price decreases and product cost reductions, product warranty returns, 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 such 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 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. 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. These factors have also been discussed in more detail in Item 1A of Part I in our most recent Annual Report on Form 10-K for the year ended December 31, 2008, filed on February 27, 2009 with the SEC.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our critical accounting policies and estimates have not changed significantly from those detailed in our most recent Annual Report on Form 10-K for the year ended December 31, 2008, filed on February 27, 2009 with the SEC.

## **EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS**

See Note 1 to the Consolidated Financial Statements in Item 1 of this Form 10-Q for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operation and financial condition, which is incorporated herein by reference.

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**RESULTS OF OPERATIONS THREE AND SIX MONTHS ENDED JUNE 30, 2009 COMPARED TO THREE AND SIX MONTHS ENDED JUNE 30, 2008**

**SALES**

ADTRAN's sales decreased 7.4% from \$131.2 million in the three months ended June 30, 2008 to \$121.5 million in the three months ended June 30, 2009, and decreased 7.6% from \$251.1 million in the six months ended June 30, 2008 to \$231.9 million in the six months ended June 30, 2009.

Carrier Networks sales decreased 12.3% from \$104.6 million in the three months ended June 30, 2008 to \$91.8 million in the three months ended June 30, 2009. Carrier Networks sales decreased 10.2% from \$199.1 million in the six months ended June 30, 2008 to \$178.9 million in the six months ended June 30, 2009. The decrease in Carrier Networks sales for the three months ended June 30, 2009 compared to the three months ended June 30, 2008 is primarily attributable to decreases in sales of HDSL and other traditional TDM products. The decrease in Carrier Networks sales for the six months ended June 30, 2009 compared to the six months ended June 30, 2008 is primarily attributable to decreases in sales of HDSL and other traditional TDM products, and Broadband Access products.

Enterprise Networks sales increased 11.9% from \$26.6 million in the three months ended June 30, 2008 to \$29.8 million in the three months ended June 30, 2009 and increased 2.0% from \$52.0 million in the six months ended June 30, 2008 to \$53.0 million in the six months ended June 30, 2009. The increase in Enterprise Networks sales for the three months ended June 30, 2009 compared to the three months ended June 30, 2008 is primarily attributable to an increase in Internetworking products sales, partially offset by a decrease in enterprise T1 products sales. The increase in Enterprise Networks sales for the six months ended June 30, 2009 compared to the six months ended June 30, 2008 is primarily attributable to an increase in Internetworking products sales, partially offset by decreases in sales of traditional IAD products and enterprise T1 products. Internetworking product sales were 65.8% and 64.7% of Enterprise Network sales in the three and six months ended June 30, 2009 compared with 57.7% in the three and six months ended June 30, 2008. Traditional products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales increased from 20.3% for the three months ended June 30, 2008 to 24.5% for the three months ended June 30, 2009 and increased from 20.7% for the six months ended June 30, 2008 to 22.9% for the six months ended June 30, 2009.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, decreased 17.0% from \$7.8 million in the three months ended June 30, 2008 to \$6.4 million in the three months ended June 30, 2009 and decreased 5.8% from \$14.2 million in the six months ended June 30, 2008 to \$13.4 million in the six months ended June 30, 2009. International sales, as a percentage of total sales, decreased from 5.9% for the three months ended June 30, 2008 to 5.3% for the three months ended June 30, 2009, and increased from 5.7% for the six months ended June 30, 2008 to 5.8% for the six months ended June 30, 2009. International sales decreased in the three and six month periods of 2009 compared to the 2008 periods due primarily to slowing macroeconomic conditions.

Carrier Systems product sales decreased \$1.5 million and \$9.9 million in the three and six months ended June 30, 2009 compared to the three and six months ended June 30, 2008 due primarily to decreases in sales of traditional TDM products and Broadband Access products.

Business Networking product sales increased \$4.7 million and \$3.7 million in the three and six months ended June 30, 2009 compared to the three and six months ended June 30, 2008 primarily due to an increase in sales of Internetworking products.

Loop Access product sales decreased \$12.8 million and \$12.9 million in the three and six months ended June 30, 2009 compared to the three and six months ended June 30, 2008 primarily due to decreases in sales of HDSL and enterprise T1 products.

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### ***COST OF SALES***

As a percentage of sales, cost of sales increased from 39.5% in the three months ended June 30, 2008 to 41.0% in the three months ended June 30, 2009 and decreased from 40.4% in the six months ended June 30, 2008 to 40.0% in the six months ended June 30, 2009. The increase for the three month period ended June 30, 2009 is primarily related to expediting costs and costs related to a new product release. The decrease for the six month period ended June 30, 2009 is primarily related to lower freight costs.

Carrier Networks cost of sales, as a percent of division sales, increased from 38.6% in the three months ended June 30, 2008 to 41.7% in the three months ended June 30, 2009 and remained constant at 39.7% in the six months ended June 30, 2008 and 2009. The increase for the three month period ended June 30, 2009 was primarily related to expediting costs and costs related to a new product release.

Enterprise Networks cost of sales, as a percent of division sales, decreased from 42.9% in the three months ended June 30, 2008 to 38.9% in the three months ended June 30, 2009 and decreased from 42.9% in the six months ended June 30, 2008 to 40.8% in the six months ended June 30, 2009. These decreases for the three and six month periods ended June 30, 2009 were primarily related to lower product costs and a shift in product mix to a lower average cost mix.

### ***SELLING, GENERAL AND ADMINISTRATIVE EXPENSES***

Selling, general and administrative expenses decreased 3.2% from \$25.7 million in the three months ended June 30, 2008 to \$24.9 million in the three months ended June 30, 2009 and decreased 5.2% from \$51.3 million in the six months ended June 30, 2008 to \$48.6 million in the six months ended June 30, 2009. The decrease in selling, general and administrative expenses for the three and six months ended June 30, 2009 compared to the three and six months ended June 30, 2008 is primarily related to a reduction in discretionary expenditures including temporary labor, travel and various promotional expenses.

Selling, general, and administrative expenses as a percentage of sales increased from 19.6% in the three months ended June 30, 2008 to 20.5% in the three months ended June 30, 2009 and increased from 20.4% in the six months ended June 30, 2008 to 21.0% in the six months ended June 30, 2009.

### ***RESEARCH AND DEVELOPMENT EXPENSES***

Research and development expenses increased 2.3% from \$20.2 million in the three months ended June 30, 2008 to \$20.7 million in the three months ended June 30, 2009 and increased 4.4% from \$39.8 million in the six months ended June 30, 2008 to \$41.5 million in the six months ended June 30, 2009. The increase in research and development expenses primarily reflects increased staffing, engineering and testing expense primarily related to customer specific product development activities, as well as costs related to product approvals primarily for one or more of the top three U.S. carriers.

As a percentage of sales, research and development expenses increased from 15.4% in the three months ended June 30, 2008 to 17.0% in the three months ended June 30, 2009 and increased from 15.8% in the six months ended June 30, 2008 to 17.9% in the six months ended June 30, 2009.

ADTRAN expects to continue to incur research and development expenses in connection with its new and existing products and its expansion into international markets. ADTRAN continually evaluates new product opportunities and engages in intensive research and product development efforts which provide for new product development, enhancement of existing products and product cost reductions. ADTRAN expenses all product research and development costs as incurred. As a result, ADTRAN may incur significant research and development expenses prior to the receipt of revenues from a major new product group or market expansion.

### ***INTEREST AND DIVIDEND INCOME***

Interest and dividend income decreased 17.2% from \$2.2 million in the three months ended June 30, 2008 to \$1.8 million in the three months ended June 30, 2009 and decreased 22.8% from \$4.5 million in the six months ended June 30, 2008 to \$3.5 million in the six months ended June 30, 2009. The decrease is primarily driven by a 45% reduction in the average rate of return on these investments for the six month period of 2009 compared to 2008 as a result of lower interest rates, partially offset by a 6% increase in our average investment balances.



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### ***INTEREST EXPENSE***

Interest expense, which is primarily related to our taxable revenue bond, remained relatively constant at \$0.7 million and \$0.6 million for the three months ended June 30, 2008 and 2009 and \$1.3 million and \$1.2 million for six months ended June 30, 2008 and June 30, 2009, respectively. See *Liquidity and Capital Resources* below for additional information on our revenue bond.

### ***NET REALIZED INVESTMENT GAIN (LOSS)***

Net realized investment gain (loss) decreased from a \$15 thousand loss in the three months ended June 30, 2008 to a \$1.0 million gain in the three months ended June 30, 2009 and increased from a \$0.1 million loss in the six months ended June 30, 2008 to a \$2.2 million loss in the six months ended June 30, 2009. 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 scrap raw material sales, decreased from \$0.3 million of income in the three months ended June 30, 2008 to \$0.1 million of income in the three months ended June 30, 2009 and decreased from \$0.5 million of income in the six months ended June 30, 2008 to \$35 thousand of expense in the six months ended June 30, 2009.

### ***INCOME TAXES***

Our effective tax rate decreased from 36.6% in the three months ended June 30, 2008 to 33.8% in the three months ended June 30, 2009 and from 36.6% in the six months ended June 30, 2008 to 30.7% in the six months ended June 30, 2009. During the first quarter of 2009, ADTRAN completed a review of its estimated tax deductions for the years 2005, 2006 and 2007 relating to the deduction for manufacturer's domestic production activities concerning the domestic content of the products that we manufacture, under Internal Revenue Code Section 199. This review resulted in a \$1.7 million benefit for the first six months of 2009, or a 3.4 percentage point decrease in our effective tax rate in the first six months of 2009. Amended income tax returns were filed during the first quarter of 2009 in association with this benefit. The tax provision for the first six months of 2009 also included the benefit from the research and development tax credit. The tax provision rate for the first six months of 2008 did not include the benefit from the research and development tax credit which had expired as of December 31, 2007. Legislation to extend the research and development tax credits to the tax years 2008 and 2009 was signed into law on October 3, 2008. The exclusion of the benefit from the research and development tax credits resulted in approximately a 1.9 percentage point increase in our effective tax rate in the first six months of 2008.

### ***NET INCOME***

As a result of the above factors, net income decreased \$3.6 million from \$22.4 million in the three months ended June 30, 2008 to \$18.8 million in the three months ended June 30, 2009 and decreased \$5.4 million from \$39.5 million in the six months ended June 30, 2008 to \$34.0 million in the six months ended June 30, 2009.

As a percentage of sales, net income decreased from 17.1% in the three months ended June 30, 2008 to 15.5% in the three months ended June 30, 2009 and decreased from 15.7% in the six months ended June 30, 2008 to 14.7% in the six months ended June 30, 2009.

## ***LIQUIDITY AND CAPITAL RESOURCES***

### ***Liquidity***

At June 30, 2009, cash on hand was \$38.2 million and short-term investments were \$125.8 million, which resulted in available short-term liquidity of \$164.0 million. At December 31, 2008, our cash on hand of \$41.9 million and short-term investments of \$96.3 million resulted in available short-term liquidity of \$138.2 million. The increase in liquidity from December 31, 2008 to June 30, 2009 primarily reflects an increase in investments of variable rate demand notes purchased as a result of cash generated from operations.

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### *Operating Activities*

Our working capital, which consists of current assets less current liabilities, increased 14.1% from \$212.7 million as of December 31, 2008 to \$242.7 million as of June 30, 2009. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 4.76 as of December 31, 2008 to 4.52 as of June 30, 2009. The current ratio, defined as current assets divided by current liabilities, decreased from 6.30 as of December 31, 2008 to 5.81 as of June 30, 2009. The quick ratio and the current ratio decreased mainly due to an increase of accounts payable and accrued expenses of \$4.5 million and an increase in income taxes payable of \$5.7 million.

Net accounts receivable increased from \$52.7 million at December 31, 2008 to \$64.0 million at June 30, 2009. Our allowance for doubtful accounts was \$38 thousand at December 31, 2008 and \$50 thousand at June 30, 2009. Quarterly accounts receivable days sales outstanding (DSO) increased from 43 days as of December 31, 2008 to 48 days as of June 30, 2009. Net accounts receivable and DSO increased for the quarter ended June 30, 2009 due to the timing of sales during the quarter.

Quarterly inventory turnover increased from 3.8 turns as of December 31, 2008 to 4.1 turns as of June 30, 2009. Inventory increased 2.0% from December 31, 2008 to June 30, 2009. We expect inventory levels to fluctuate as we attempt to maintain sufficient inventory to ensure competitive lead times while managing the risk of inventory obsolescence that may occur due to rapidly changing technology and customer demand.

Accounts payable increased 13.1% from \$20.3 million at December 31, 2008 to \$23.0 million at June 30, 2009. Generally, the change in accounts payable is 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 \$3.9 million and \$4.6 million for the six months ended June 30, 2009 and 2008, respectively. These expenditures were primarily used to purchase manufacturing and test equipment and computer software and hardware.

Our combined short-term and long-term investments increased \$45.4 million from \$237.5 million at December 31, 2008 to \$282.9 million at June 30, 2009, primarily reflecting our investment of cash generated from operations.

We invest all available cash not required for immediate use in operations primarily in securities that we believe bear minimal risk of loss. At June 30, 2009, these investments included municipal variable rate demand notes of \$64.3 million, municipal fixed-rate bonds of \$120.3 million and corporate bonds of \$27.3 million that are guaranteed by the Federal Deposit Insurance Corporation (FDIC) and issued by various banks. At December 31, 2008, these investments included municipal variable rate demand notes of \$52.6 million, municipal fixed-rate bonds of \$116.9 million and a government agency security of \$2.0 million.

Our municipal variable rate demand notes are classified as available-for-sale short-term investments and 98% had a credit rating of VMIG-1 or A-1+ with the remaining 2% rated A-2 at June 30, 2009. Despite the long-term nature of their stated contractual maturities, we believe that we have the ability to quickly liquidate these securities. Our investments in these securities are recorded at fair value and the interest rates reset every seven days. As a result, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments. 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.

At June 30, 2009, approximately 67% of our municipal fixed-rate bond portfolio had a credit rating of AAA, 30% had a credit rating of AA, and the remaining 3% had a credit rating of A. These bonds are classified as available-for-sale investments and had an average duration of 1.2 years at June 30, 2009. 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.

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At June 30, 2009, we held \$27.3 million of corporate bonds issued by various banks that are guaranteed by the FDIC. These bonds are classified as available-for-sale and had an average duration of 2.6 years at June 30, 2009. All of these bonds had a credit rating of AAA at June 30, 2009. Because of the high quality and short duration of these issues, we are able to obtain prices for these bonds derived from observable market inputs on a daily basis.

Our long-term investments increased 11.3% from \$141.2 million at December 31, 2008 to \$157.1 million at June 30, 2009. The primary reason for the increase in our long-term investments during the first six months of 2009 was the purchase of corporate bonds issued by various banks. The primary reason for our investment in corporate bonds was to increase the yield on our fixed rate portfolio. Long-term investments at June 30, 2009 and December 31, 2008 included an investment in a certificate of deposit of \$48.8 million which serves as collateral for our revenue bonds, as discussed below. We have various equity investments included in long-term investments at a cost of \$9.2 million and \$12.0 million, and with a fair value of \$16.2 million and \$11.6 million, at June 30, 2009 and December 31, 2008, respectively, including a single equity security, of which we held 2.1 million shares, carried at \$7.5 million and \$2.5 million of fair value at June 30, 2009 and December 31, 2008, respectively. We sold 400 thousand shares of this security during the six months ended June 30, 2009. The sale resulted in proceeds of \$1.2 million and a realized gain of \$1.1 million. The single security traded approximately 183 thousand shares per day in the first six months of 2009, in an active market on a European stock exchange. Of the gross unrealized gains included in the fair value of our marketable securities at June 30, 2009, this single security carried \$6.7 million of this unrealized gain. Long-term investments at June 30, 2009 also include \$2.8 million related to our deferred compensation plan; \$2.2 million of other investments carried at cost, consisting of interests in two private equity funds and an investment in a privately held telecommunications equipment manufacturer; and a \$1.0 million fixed income bond fund.

We review our investment portfolio for potential other-than-temporary declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. Because of the strained credit markets and deterioration in the equity markets experienced beginning in the fourth quarter of 2008, we expanded the impairment review of our investments to assess the impact of these factors on our ability to recover our cost in every security whose value had declined from its original or adjusted cost by more than 25%, regardless of the historical duration of the decline. We then evaluated individual securities to determine the amount of the write-down, if any. As a result, we recorded an other-than-temporary impairment charge of \$0.1 million during the second quarter of 2009 related to eight marketable equity securities and \$2.0 million during the first six months of 2009 related to 107 marketable equity securities. In addition to the impairment charge we recorded on our marketable equity securities, we recorded an impairment of \$0.4 million related to our investment in a fixed income bond fund and \$0.5 million related to our deferred compensation plan during the six months ending June 30, 2009 as a result of similar reviews. There were no such charges during the three months ended June 30, 2009 related to the fixed income bond fund or deferred compensation plan assets. As long as current market conditions continue to exist, we will continue to complete a similar review of individual securities for impairment each quarter. For the six months ended June 30, 2008, we had a charge of \$0.2 million related to the impairment of 17 publicly traded equity securities.

### *Financing Activities*

#### *Dividends*

In July 2003, our Board of Directors elected to begin declaring quarterly dividends on our common stock considering the tax treatment of dividends and adequate levels of Company liquidity. During the six months ended June 30, 2009, ADTRAN paid dividends totaling \$11.2 million.

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### *Debt*

We have amounts outstanding under loans made pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond) which totaled \$48.8 million at June 30, 2009 and December 31, 2008. At June 30, 2009, the estimated fair value of the Bond was approximately \$47.0 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of AA. Included in long-term investments are restricted funds in the amount of \$48.8 million at June 30, 2009 and December 31, 2008, which is a collateral deposit against the principal amount of the Bond. 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. The Bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. 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 we are required to remit to the state for those employment positions that qualify under this program.

We are required to make payments in the amounts necessary to pay the principal and interest on the amounts currently outstanding. Due to continued positive cash flow from operating activities, we made a business decision to begin an early partial redemption of the Bond. It is our intent to make annual principal payments in addition to the interest amounts that are due. In connection with this decision, \$0.5 million of the Bond debt has been classified as a current liability in the Condensed Consolidated Balance Sheet.

### *Stock Repurchase Program*

During the six months ended June 30, 2009, we repurchased 0.1 million shares of our common stock at an average price of \$14.51 per share under the repurchase plans approved by our Board of Directors. All of these repurchases occurred during the first quarter of 2009. Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions. We have the authority to purchase an additional 3.4 million shares of our common stock under the plan approved by the Board of Directors on April 14, 2008. To accommodate employee stock option exercises, we issued 0.5 million shares of treasury stock for \$8.4 million during the six months ended June 30, 2009. During the six months ended June 30, 2008, we issued 0.1 million shares of treasury stock for \$1.7 million.

### *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. During the six months ended June 30, 2009, there have been no material changes in contractual obligations and commercial commitments from those discussed in our most recent Annual Report on Form 10-K for the year ended December 31, 2008 filed on February 27, 2009 with the SEC.

We have committed to invest up to an aggregate of \$7.9 million in two private equity funds, and we have contributed \$7.9 million as of June 30, 2009, of which \$7.4 million has been applied to these commitments. See Note 4 of Notes to Condensed Consolidated Financial Statements for additional information.

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, dividend payments, and other general corporate purposes, including (i) product development activities to enhance our existing products and develop new products and (ii) expansion of sales and marketing activities. We believe our cash and cash equivalents, investments and cash generated from operations to be adequate to meet our operating and capital needs for the foreseeable future.

## **FACTORS THAT COULD AFFECT OUR FUTURE RESULTS**

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



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

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.

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

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

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

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

If our products do not interoperate with our customers' networks, installations will be delayed or cancelled and could harm our business.

We primarily engage in research and development 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.

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

The lengthy approval process required by Incumbent Local Exchange Carriers (ILECs) and other service providers could result in fluctuations in our revenue.

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

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

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

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.

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

Increased sales volume in international markets could result in increased costs or loss of revenue due to factors inherent in these markets.

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

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

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

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

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

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.

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

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

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

Our success depends on attracting and retaining key personnel.

While we believe our 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.

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



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The foregoing list of risks is not exclusive. For a more detailed description of the risk factors associated with our business, see Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2008, filed on February 27, 2009 with the SEC.

### **ITEM 3. 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. At June 30, 2009, 98% of our municipal variable rate demand notes had a credit rating of VMIG-1 or A-1+ while the remaining 2% had a rating of A-2. Approximately 67% of our municipal fixed-rate bonds had a credit rating of AAA, 30% had a credit rating of AA, and the remaining 3% had a credit rating of A. We also held \$27.3 million of corporate bonds that are guaranteed by the Federal Deposit Insurance Corporation and issued by various banks. At June 30, 2009, all of our corporate bonds had a credit rating of AAA.

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 June 30, 2009, \$20.1 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. The Temporary Liquidity Guarantee Program adopted during 2008 by the Federal Deposit Insurance Corporation provides full coverage of our domestic depository accounts through December 2009.

As of June 30, 2009, approximately \$244.5 million of our cash and investments may be directly affected by changes in interest rates. We have performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps), 100 bps and 150 bps for the entire year, while all other variables remain constant. At June 30, 2009, we held \$101.8 million of cash and money market instruments and municipal variable rate demand notes where a change in interest rates would impact our interest income. Hypothetical 50 bps, 100 bps and 150 bps declines in interest rates as of June 30, 2009 would reduce annualized interest income on our cash and money market instruments and municipal variable rate demand notes by approximately \$0.5 million, \$1.0 million and \$1.5 million, respectively. In addition, we held \$142.7 million of fixed-rate municipal bonds and corporate bonds whose fair values may be directly affected by a change in interest rates. Hypothetical 50 bps, 100 bps and 150 bps increases in interest rates as of June 30, 2009 would reduce the fair value of our municipal fixed-rate bonds and corporate bonds by approximately \$0.8 million, \$1.6 million and \$2.4 million, respectively.

As of June 30, 2008, interest income on approximately \$93.4 million of our cash and investments was subject to being directly affected by changes in interest rates. We performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps), 100 bps and 150 bps, while all other variables remain constant. Hypothetical 50 bps, 100 bps and 150 bps declines in interest rates as of June 30, 2008 would have reduced annualized interest income on our money market instruments and municipal variable rate demand notes by approximately \$0.5 million, \$0.9 million and \$1.4 million, respectively. In addition, hypothetical 50 bps, 100 bps and 150 bps increases in interest rates as of June 30, 2008 would have reduced the fair value of our municipal fixed-rate bonds by approximately \$0.7 million, \$1.3 million and \$2.0 million, respectively.

For further information about the fair value of our available-for-sale investments as of June 30, 2009 see Note 4 of Notes to Condensed Consolidated Financial Statements.

**Table of Contents****ITEM 4. CONTROLS AND PROCEDURES**

(a) *Evaluation of disclosure controls and procedures.* Our chief executive officer and chief financial officer are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) for ADTRAN. Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report, have concluded that our disclosure controls and procedures are effective.

(b) *Changes in internal control over financial reporting.* There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION****ITEM 1A. RISK FACTORS**

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. There have been no material changes to the risk factors as disclosed in Item 1A of Part I of our most recent Annual Report on Form 10-K for the year ended December 31, 2008 filed on February 27, 2009 with the SEC.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The 2009 Annual Meeting of Stockholders of ADTRAN was held on May 6, 2009. Proxies with regard to the matters voted upon at the Annual Meeting were solicited under Regulation 14A of the Securities Exchange Act of 1934, as amended. Set forth below is a brief description of each matter voted upon at the Annual Meeting and the results of voting on each such matter.

- (a) Election of each director named below to serve until the next Annual Meeting of Stockholders. There was no solicitation in opposition to any of the nominees listed in the proxy statement, and all of the nominees were elected.

| Nominees          | Votes      |           |
|-------------------|------------|-----------|
|                   | For        | Withheld  |
| Thomas R. Stanton | 56,467,941 | 764,787   |
| James E. Matthews | 54,181,448 | 3,051,280 |
| H. Fenwick Huss   | 56,938,842 | 293,887   |
| Ross K. Ireland   | 56,893,467 | 339,261   |
| William L. Marks  | 56,755,012 | 477,716   |
| Balan Nair        | 56,945,663 | 287,065   |
| Roy J. Nichols    | 56,754,824 | 477,905   |

- (b) Ratification of the appointment of PricewaterhouseCoopers LLP as ADTRAN's independent registered public accounting firm for 2009.

|            | Votes<br>Against | Abstain |
|------------|------------------|---------|
| For        | 243,478          | 5,928   |
| 56,983,322 |                  |         |

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**ITEM 6. EXHIBITS**

Exhibits.

| <b>Exhibit No.</b> | <b>Description</b>                      |
|--------------------|-----------------------------------------|
| 31                 | Rule 13a-14(a)/15d-14(a) Certifications |
| 32                 | Section 1350 Certifications             |

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**ADTRAN, INC.**

*(Registrant)*

Date: August 3, 2009

/s/ James E. Matthews  
James E. Matthews

Senior Vice President Finance,

Chief Financial Officer, Treasurer,

Secretary and Director

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**EXHIBIT INDEX**

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