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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D. C. 20549**

# FORM 10-K

**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

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

**For the Fiscal Year Ended December 31, 2008**

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

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

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

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

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

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

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

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

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

Large Accelerated Filer ☒ 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 ☒

The aggregate market value of the registrant’s outstanding common stock held by non-affiliates of the registrant on June 30, 2008 was $1,528,632,124 based on a closing market price of $23.84 as quoted on the NASDAQ Global Select Market. There were 62,064,628 shares of common stock outstanding as of February 25, 2009.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on May 6, 2009 are incorporated herein by reference in Part III.

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**ADTRAN, Inc.**
**Annual Report on Form 10-K**
**For the Fiscal Year Ended December 31, 2008**

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# PART I

## *ITEM 1. BUSINESS*

### ***Overview***

ADTRAN, Inc. designs, manufactures, markets and services network access solutions for communications networks. Our solutions are widely deployed by providers of telecommunications services (serviced by our Carrier Networks Division), and small and mid-sized businesses (SMBs) and enterprises (serviced 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.

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

### ***Products and Services***

We maintain two operating divisions based on our product and service offerings: the Carrier Networks Division and the Enterprise Networks Division. These divisions serve two distinct markets and support sales in the United States and in other countries around the world, operating as two reportable segments. In 2008, sales of Carrier Networks products accounted for 78.3% of total revenue, while sales of Enterprise Networks products accounted for 21.7%. Sales to countries outside of the United States are included in these aggregate divisional figures, but when accounted for separately, comprise 6.0% of total revenue. For more financial information about these divisions and geographic areas, see Note 9 to the Consolidated Financial Statements included in this report.

Our Carrier Networks Division provides products used by service providers to deliver voice, data and video services from their equipment, whether it is located in a central office or remote terminal location, to a customer’s premises. Our Enterprise Networks Division provides products used by enterprise customers to construct voice, data and video networks within the customer’s site or among distributed sites. Our combined product portfolio for both divisions consists of approximately 1,700 high-speed network access and communication devices. In both service provider and enterprise networks, these products are used primarily, but not exclusively, in the “last mile,” or local loop, of a service provider’s network, and in local area networks on a customer’s premises. The last mile is that segment of the network that connects end-user subscribers to a service provider’s closest facility by either copper or fiber. Local area networks are that segment connecting routers, switches, PCs, printers, phones, faxes, and other communications devices within a given building or campus. Our products typically connect two ends of a circuit and serve to transmit, route, and/or switch the data, voice, and/or video traffic traveling across that circuit. The bandwidth requirements of the circuit, along with the type of technology being used, determine the type of equipment needed.

Both of our divisions are positioned with product and service offerings that compete in many segments of the global telecommunications industry and, specifically, in the areas of Ethernet and Internet Protocol (IP) based networks. As networks migrate to IP-based architectures to deliver and utilize higher bandwidth services, ADTRAN ® has strengthened its technologies in its primary growth areas: Broadband Access, Optical Access and Internetworking.

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

### ***Network Access Infrastructure for Advanced Services***

Networks are continuing to undergo a fundamental shift from voice-centric technologies to data-centric technologies, and converged networks are being implemented to address both voice and data requirements in the business network. When voice was the dominant type of traffic in the network, networks were engineered to carry voice, integrating data into the architecture as necessary. Today, data is becoming the dominant traffic type, and networks are evolving to increase bandwidth and transport data, voice and video in an integrated architecture. As networks migrate toward integrated communications and entertainment services, carriers and businesses alike are transitioning their networks to packet-based technologies, such as Ethernet and IP. We are well positioned to support both existing services and newer advanced services.

We develop, market, and support high-speed network access solutions for use across IP, Asynchronous Transfer Mode (ATM), and Time Division Multiplexed (TDM) architectures in both wireline and wireless network applications. Our solutions are used to deploy new broadband networks and to upgrade slower, established networks using copper, fiber, and wireless technologies both in the United States and abroad.

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.

**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.

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.

### *Carrier Networks*

Carrier services continue to evolve to next generation networks, and carrier service providers are generating additional revenue by connecting greater numbers of customers to their infrastructure by offering broadband digital services. Our Carrier Networks Division supplies the network access products that these service providers require to connect their customers to core transmission and switching networks. Specifically, we deliver copper and fiber-based solutions that enable these types of services. Our customer base includes all of the major United States Incumbent Local Exchange Carriers (ILECs), many independent operating companies, Competitive Local Exchange Carriers (CLECs), major international carriers and wireless service providers. We have focused on opportunities in North America, with increasing emphasis on expanding into the Asia-Pacific region, Canada, Latin America, Europe, the Middle East and Africa.

Services enabled using our systems include traditional voice services, VoIP, IPTV, high-speed Internet access and data services based upon frame relay, TDM, ATM, and Ethernet networks, connecting the network with user components such as switches, routers, IADs, PBX and key telephone systems. ADTRAN devices, deployed at the business site, are enabling carriers to provide Ethernet services to SMBs and distributed enterprises. Our solutions provide a complete end-to-end solution for carriers that allow them to reuse their existing copper infrastructure, lowering their overall costs to deploy advanced Ethernet services to SMBs and distributed enterprises.

### *Service Provider Networks*

Telecommunications networks are transitioning from traditional TDM and circuit-switched technology to IP and Ethernet based packet networks that offer services such as high-speed Internet access, VoIP, and IPTV. We design solutions that allow service providers to leverage existing network assets, by providing a migration path to new broadband technologies and services.

Continued competition from cable and wireless providers is forcing traditional wireline service providers to react with price incentives, service bundling, network investments and modifications. To offer higher speed DSL services in support of delivering Internet access and IPTV, the carriers are “shortening” copper loop lengths in order to increase bandwidth and gain a competitive advantage. Our multi-service access and aggregation platform and the FTTN series of outside plant DSLAM products are used to shorten copper loop lengths so that wireline providers can deliver higher-speed network services. With these platforms, wireline providers can offer higher Internet access speeds as well as VoIP and IPTV. ADTRAN optical technologies also enable subscriber access solutions for FTTN and Fiber-To-The-Premises architectures. Many ADTRAN platforms offer Gigabit Ethernet capability, increasing rates within the access network.

Our products marketed under the Total Access ® brand fit the decentralized networking model most carriers are using today both in the United States and abroad. Currently, these products comprise the flagship product line for the Carrier Networks Division and offer service providers a single platform that can accommodate demand for a variety of high-speed Internet, voice, data and video services from businesses and residential customers. These modular, scalable, and geographically distributed products offer advantages such as lower start-up costs, more flexible service deployment, greater network interface options, increased bandwidth, grow-as-you-go modularity, and centralized network management. We provide Total Access products that connect to copper and fiber optic network backbones, making them suitable for installation in many parts of the network and enabling deployment of a wide range of voice and data services around the world. The Total Access ® products and other ADTRAN products are accepted by the USDA Rural Utilities Service (RUS) as suitable for use in RUS-financed telecommunications systems. Deployed in central offices, remote terminals, or multi-tenant units, the system encompasses carrier class solutions for fiber and copper broadband multi-service access, DSL access, and narrowband multi-service access.

***Advanced IP Services***

For wireline service providers, our broadband access products provide the ability to increase bandwidth and improve the quality of services to customers. These products are used in high-density central office applications, along with lower density applications that include remote terminals and outside plant deployments. Also, these products are available in models that are temperature hardened for use in harsh, outside plant environments and provide support for legacy ATM networks as well as Ethernet for delivering advanced IP services over fiber or copper.

***High-speed Residential Services***

Gigabit Passive Optical Network (GPON) technology has been added to the Total Access ® platform. Our GPON module provides 2.5 Gbps to each optical line terminal port, enabling the delivery of advanced, very high bandwidth services such as high definition IPTV. The multi-service capabilities of the Total Access ® 5000 allow for the support of native Ethernet services like GPON, from the same platform used to support POTS, DSL, Bonded Copper, ATM and legacy copper services. Service providers of all sizes are looking to fiber access technologies, like GPON, for ultra-bandwidth delivery to residential customers as well as to provide high-speed Ethernet and voice services to businesses. The ADTRAN optical network terminals work in conjunction with the Total Access ® 5000 to support a wide range of applications for both residential and business applications, ranging from DS1 to Gigabit Ethernet. The ADTRAN Total Access ® 5000 also provides fully integrated voice options, including support for both TDM trunk interfaces as well as future migration to VoIP, eliminating the need for costly external solutions.

Very-high-data-rate Digital Subscriber Line (VDSL2) is being added to our leading Total Access ® DSLAMS. These DSLAMs allow service providers to realize ultra-broadband speeds over their existing copper infrastructure, economically securing the broadband connection to the home and enabling the delivery of advanced communications and entertainment services. Total Access ® 1100 Series broadband access products provide an innovative approach to the successful deployment of FTTN architectures. Recognizing the technological and economic barriers of traditional cabinet-based DSL deployments, ADTRAN designed this product series to eliminate the need for expensive cabinet enclosures, heat exchangers and site construction, which account for a large portion of the total cost of deployment. In many cases, Total Access ® 1100 Series DSLAMs can deliver FTTN-based services for significantly less than traditional cabinet-based systems. This allows carriers to more economically utilize the capacity of the existing copper network over the last mile.

***Metro Ethernet Services***

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

***Ethernet over Copper Services***

As demand grows for mid-rate (2-40 Mbps) Ethernet services worldwide, the service providers have seen a need to deliver these Ethernet services over copper in addition to fiber. To enable this, enhancements in SHDSL technology (eSHDSL) have been developed to increase the rate delivered per copper pair up to 5 Mbps and to bond pairs together (G.bond) to offer rates not attainable over a single pair. Ethernet over Copper (EoCu) technology uses eSHDSL and G.bond to deliver these mid-rate Ethernet services over several (typically one to eight) “bonded” pairs. ADTRAN has EoCu solutions that enable our carrier customers to deploy high-speed Ethernet services in places where fiber deployments are not currently available and new construction is not cost effective.

ADTRAN has also developed solutions that allow service providers to deliver Ethernet services over their existing TDM (EoTDM) infrastructure. ADTRAN's dominant position in DS1 delivery technology (HDSL) allows us to have a unique advantage in our ability to integrate EoCu and EoTDM into a comprehensive Ethernet access solution for service providers.

***Optical Access***

We also offer a set of solutions that provide backhaul transport over fiber and copper facilities for mobile wireless networks. These products are designed to optimize network performance and perform bandwidth management functions. Our OPTI ® product family includes a multi-service provisioning platform, the OPTI-6100 ®, delivering DS1/E1, DS3/E3, OC-3/STM-1, OC-12/STM-4, OC-48 and 10/100/1000Mb Ethernet connectivity and transport to cellular sites. Our OPTI-3 ® fiber multiplexer changed the economic model for providing the fullest use of OC-3 capacity in terminal mode and DS3 range extension applications. The OPTI-6100 ® MX (medium) chassis consolidates discrete optical and multiplexer network elements into one, small 2U chassis that addresses DS1/E1, DS3/E3, STS-1, OC-3/STM-1 and Ethernet services delivery to the subscriber. Our OPTI-6100 ® LMX (large) chassis provides high density termination options and utilizes many common modules from the other OPTI ® chassis. The OPTI-6100 ® SMX (small) chassis provides a very compact 3.5" tall chassis for low density applications, with a variety of mounting options to meet unique customer requirements. Our solutions provide for low density optical transport in very compact enclosures for cell site traffic backhaul and feature single fiber operation for maximum facility utilization and integration with the ADTRAN Total Access ® 3000 family of products and associated multiplexers.

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

***Business-class Services***

HDSL is a common technique for delivering bandwidth at rates of 1.544 Mbps (known as the DS1 or T1 rate) for infrastructure support, business customer services and wireless network backhaul services. The T1 interface is universally accepted throughout the United States, and HDSL is the most common method of delivering the T1 interface in nearly every application. ADTRAN HDSL products are manufactured in a variety of configurations for use in every major DS1 deployment platform for voice and data services.

SHDSL products were developed to provide symmetrical solutions for the transport of high-speed business-class services. The International Telecommunications Union (ITU), Alliance for Telecommunications Industry Solutions (ATIS) and the European Telecommunications Standards Institute (ETSI) have established standards for 2-wire and 4-wire SHDSL solutions.

We contributed significantly to ITU, ATIS and ETSI SHDSL standards. Because of this involvement, we delivered the industry's first SHDSL customer device. Our SHDSL products, like many of our products, are standards-based, which ensures interoperability with other standards-based products.

***Network Management***

As networks become more complex, the need for carrier class management systems becomes apparent to ensure operational efficiencies. We develop and support systems to centralize the configuration, provisioning, and management of our network access products. These systems are used to configure, monitor, and control ADTRAN equipment installed on local loop circuits. The systems ensure communication with the service provider's central management system to reduce technician dispatches and operating costs. Our Total Access ® Element Management System is an all-Java application that provides configuration, performance, network assurance, and provisioning functions for ADTRAN Total Access ® products.

***Enterprise Networks***

Our Enterprise Networks Division specializes in internetworking solutions to help SMBs implement high-speed voice, data, Internet, and video connectivity over wide and local area networks. Domestic and global businesses and distributed enterprises with multiple sites use these products to implement high-speed communications between geographically dispersed locations or employees. Service providers also integrate these products into their solution offerings for their customers, including both SMBs and distributed enterprises. These products are typically installed in equipment rooms and wiring closets, and help to connect headquarters, branch offices, and telecommuters to corporate information resources.

We consider the SMB networking market to be businesses with 1,000 or fewer employees and distributed enterprises to be businesses with multiple sites, each housing 1,000 or less employees. These businesses use our internetworking products to implement a converged, cost-efficient, high-speed network for voice, data and Internet services.

Marketed mainly under the brand name NetVanta ®, these products include: multi-service access routers; managed Layer 2 and Layer 3 Fast Ethernet, Gigabit, and Power over Ethernet switches; Internet security appliances; and VoIP phone systems and IP phones. The Enterprise Network products typically replace or connect to the user's equipment, such as telephones, PBXs, fax machines, computers, servers and videoconferencing gear. These products deliver high-speed connectivity, ranging from 56/64 Kbps to one Gigabit over wireline, fiber, and wireless facilities. Products range from simple, single-circuit termination units to more complex Ethernet switches, multi-service access routers, multiplexers, Virtual Private Network (VPN) devices, and firewalls. Functionality ranges from low-cost, unmanaged devices to modular, remotely manageable devices.

We view the development and implementation of a centralized operating system as critical to our success in internetworking markets. As such, the ADTRAN Operating System (AOS) is incorporated into our internetworking product lines, simplifying product development efforts and shortening time to market for new products and features. It also offers Local Area Network-to-Wide Area Network (LAN-to-WAN) integration, ensuring common configuration practices, policies, protection schemes, and management interfaces enterprise-wide.

Our equipment permits customers to satisfy the connectivity needs of many applications (data, voice, videoconferencing, or integrated data/voice). Customers can usually obtain all the necessary equipment from ADTRAN to support different geographic locations in their wide area networks using multiple transmission technologies, as well as their local area networks requiring switching, routing and voice capabilities. Many of the products available from the Enterprise Networks Division have applications in service provider networks as well. These products are typically installed by the service provider at the customer premises as part of a bundled service package.

***Data Solutions***

ADTRAN access routers move data between networked computers over public or private IP, Frame Relay, MultiProtocol Label Switching leased-line infrastructures or carrier supplied Ethernet services. These devices include features to route traffic between multiple destinations, secure the network against cyber attacks, secure the privacy of data as it is transported across the Internet, and restore communications in the event of equipment or network failure. ADTRAN access routers provide Internet access and interconnect corporate locations and then route data to an ADTRAN Ethernet LAN switch which moves the data to the appropriate computer or server. ADTRAN switches range in connectivity speeds from 10Mbps to Gigabits and also provide Power over Ethernet options.

Our NetVanta ® router products include multi-service access routers, modular access routers and fixed-port routers. All of these products are VoIP-ready with end-to-end quality of service, provide secure network connections using a firewall, protect data as it is transported across the Internet using VPN, restore communications in the event of equipment or network failure and provide growth for future applications. Additional features include URL filtering and Voice Quality Monitoring, which allows network administrators to analyze and troubleshoot voice quality down to a packet level.

We provide products with 802.11a/b/g wireless LAN capabilities. These Wi-Fi products, the NetVanta ® 1335 and NetVanta ® 150, address the increasing demands for wireless solutions and allow businesses to streamline and improve operational efficiencies, expand customer service offerings, and increase flexibility for employees.

Broadband 3G wireless capability has further expanded our wireless portfolio. The NetVanta ® 3G Network Interface Module (NIM) provides a wireless WAN service to our NetVanta ® line of routers and provides a rapid, secure and cost-effective connectivity option when used in conjunction with one of our modular routers. 3G service allows customers to take advantage of flexible deployment options at broadband speeds from a single platform. The solution is ideal for a number of applications including use as a reliable network failover/backup option for large businesses. For smaller businesses, the NetVanta ® 3G NIM is used as a primary connection in applications requiring broadband speeds or rapid deployment or where wireline connections are not readily available.

***Voice Solutions***

VoIP represents an important revenue opportunity for service providers seeking to add new, more attractive service offerings in order to retain and expand their subscriber base. ADTRAN IP Business Gateways are deployed by the service provider and sit at the customer premises to deliver VoIP applications. These products offer a single, cost-effective platform for delivering VoIP services to business customers. Services include hosted PBX, Session Initiation Protocol (SIP) networking, and premises-based VoIP PBX. With this functionality, service provider customers can quickly enable their networks for VoIP deployment, lowering their communications costs.

ADTRAN IP Business Gateways combine the voice functionality of our IADs with IP routing, security and Quality of Service features required for VoIP networks. These solutions allow carriers to expedite deployments of VoIP, SIP trunking and hosted PBX applications to small, medium, and large enterprise customers.

The Total Access ® 900 and 900e Series allow Network Service Providers, ILECs and CLECs to implement IP network architecture for hosted VoIP service offerings. These products incorporate networking features into a single system to deliver IP voice, high-speed Internet, and higher-capacity data networking, without the traditional expense and delays of a multi-box installation.

These solutions reduce telecommunications costs by collapsing multiple voice and data circuits into a lower cost architecture. This convergence, the integration of multiple technologies into a single service or platform, also simplifies network administration and enables new features and services. These IP business gateways also incorporate the AOS, providing network management capabilities for hosted deployments.

***Configuration and Network Management***

We develop and support network productivity tools and systems to centralize the configuration and management of our internetworking products. These tools aid in the management of networks powered by ADTRAN internetworking products. In 2008, a new management tool, n-Command ® Managed Service Provider (MSP), was introduced. It is a powerful, easy-to-use network management platform for remote monitoring and management of ADTRAN NetVanta ® or Total Access ® networking solutions. A web-based platform, n-Command ® MSP simplifies new device deployment and enables Managed Service Providers, service providers and enterprise IT organizations to deliver on Service Level Agreements, improve customer service response times, reduce network downtimes and proactively monitor and report the performance of VoIP networks, all while reducing operational costs.

***Service and Support***

In addition to our product portfolio, we offer technical support services to help ensure that we are responsive to our customers who have deployed networking and infrastructure solutions. We provide pre- and post-sales telephone technical support and a variety of training options. We offer installation and maintenance services designed to protect customers' networks from unnecessary downtime. ADTRAN Custom Extended Services, which we refer to as "ACES", guarantees priority access to technical support engineers and on-site product replacement in as few as four hours, depending on the service plan selected. Our service and support offerings are available to customers in both our Carrier Networks Division and Enterprise Networks Division.

***Customers***

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

Customers of our **Carrier Networks Division** in the United States include all of the major ILECs, large and small independent telephone companies, competitive service providers, Internet service providers, long distance service providers (known as Interexchange Carriers), and wireless service providers. Worldwide, this division also serves incumbent carriers and competitive service providers in selected regions.

ILECs and most other service providers require product approval prior to adopting a vendor's products for use in their networks. We are involved in a constant process of submitting new and succeeding generations of products for approval and ADTRAN products are widely deployed in these service provider networks. However, we cannot be certain that we will obtain these approvals in the future, or that sales of these products will continue to occur. Further, any attempt by an ILEC or other service provider to seek out additional or alternative suppliers, or to undertake, as permitted under applicable regulations, the production of these products internally, could have a material adverse effect on our operating results.

Customers within our **Enterprise Networks Division** are classified as end users, and include a large number of private and public organizations in numerous vertical markets. The markets most often include retail, food service, healthcare, finance, government, education, manufacturing, military, transportation, hospitality, and energy/utility. However, the majority of the products from this division are sold through indirect sales channels, and we reach those end user customers through a network of partners. These partners are comprised of several large technology distributors, numerous value-added resellers, and service providers as described in "Distribution, Sales and Marketing" below.

Our major customers include the following:

| | |
|---|---|
| AT&T Inc. | Tech Data Corporation |
| Embarq Corporation | Verizon Communications, Inc. |
| CenturyTel, Inc. | Walker and Associates, Inc. |
| Ingram Micro, Inc. | Windstream Corporation |
| Qwest Communications International, Inc. | |

Single customers comprising more than 10% of our revenue in 2008 include AT&T Inc. at 24%, Qwest Communications International, Inc. at 16%, Verizon Communications, Inc. at 12% and Embarq Corporation at 10%. The revenues from all of these customers are reported in both the Carrier Networks and Enterprise Networks segments. No other customer accounted for 10% or more of our sales in 2008.

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

### ***Distribution, Sales and Marketing***

We sell our **Carrier Networks** products in the United States through a combination of a direct sales organization and a distribution network. Our direct sales organization supports major accounts and has offices located throughout the United States. Sales to most competitive service providers and independent telephone companies are fulfilled through a combination of direct sales and major technology distribution companies such as Embarq Logistics, Windstream Corporation, Walker and Associates and Power & Tel.

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

The majority of **Enterprise Networks** products are sold in the United States through a non-exclusive distribution network that consists, at the top level, of several major technology distributors, such as Tech Data, Ingram Micro, Jenne Distributors, Interlink Communications Systems and Catalyst Telecom. These organizations then distribute products to an extensive network of Value-Added Resellers (VARs) and system integrators.

VARs and system integrators may be affiliated with ADTRAN as channel partners, or they may purchase from a distributor in an unaffiliated fashion. Affiliated partners participate with us at various program levels based on sales volume and other factors to receive benefits such as product discounts, co-op advertising funds, technical support, and training. We maintain field offices nationwide to support distributors, VARs and system integrators. The Enterprise Networks Division maintains a channel-based sales organization to manage our partners.

A growing portion of our Enterprise Networks products are being sold to service providers for provisioning of hosted VoIP service offerings for SMB and enterprise branch office end users.

Outside of the United States, both Carrier and Enterprise products are sold through distribution arrangements customized for each region. Each region is supported by an ADTRAN field office that offers sales and support functions, and in some cases, warehousing and manufacturing support. In some regions, Carrier products are sold to carriers through our direct sales organization.

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

### ***Research and Development***

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

During 2008, 2007, and 2006, product development expenditures totaled $81.8 million, $75.4 million, and $70.7 million, respectively. Our product development activities are an important part of our strategy. Because of rapidly changing technology and evolving industry standards, we expect to sustain, and possibly increase, product development levels each year.

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

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

Product development activities center on products to support both existing and emerging technologies in the telecommunications industry in segments of our markets that we consider viable revenue opportunities. We are actively engaged in developing and refining technologies to support data, voice, and video transport over TDM, ATM, and IP network architectures. Our work involves Ethernet transport, DSL transport (VDSL2, ADSL2+, ADSL, SHDSL, and HDSLx), fiber optic transport, access routing, Ethernet switching, integrated access, VoIP, and network management and services.

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

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

We are also involved in other standards development efforts related to maximizing the bandwidth potential of the copper pair to enable new applications. We contributed to the development of the VDSL2 ITU-Telecommunications (ITU-T) standard. Upon completion of the various wireline telecommunications standards, the industry-wide interoperability and performance testing requirements become the responsibility of the DSL Forum. We have continued our contributions toward ADSL2+ and VDSL2 development through our work in the DSL Forum.

Our efforts in industry standards also extend beyond the copper loop. We continue to be involved in the evolution of Ethernet technology by participating in the Institute of Electrical and Electronics Engineers 802 LAN/MAN standards committee, the ITU-T and the MEF, which are standardizing technologies such as Carrier Ethernet traffic management, Resilient Packet Ring, provider networking, Ethernet Operations, Administration and Management and Connectivity Fault Management. In the past year, we have worked in the SDOs to bring more interoperability between GPON equipment. These efforts have included helping ATIS establish a new subcommittee focusing on optical access networks (NIPP-OAN) and increasing our participation in GPON work in the DSL Forum.

*For a discussion of risks associated with our research and development activities, see “Risk Factors – We must continue to update and improve our products and develop new products in order to compete and to keep pace with improvements in telecommunications technology” and “Risk Factors – 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”, in Item 1A of this report.*

***Manufacturing and Operations***

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

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

Most shipments of products to customers occur from our facilities in Huntsville, Alabama. Our facilities are certified pursuant to the most current releases of ISO9000, TL9000, ISO14001, and are Customs-Trade Partnership Against Terrorism certified. Our products are also certified to certain other telephone company standards, including those relating to emission of electromagnetic energy and safety specifications.

*For a discussion of risks associated with manufacturing activities, see "Risk Factors – Our strategy of outsourcing a portion of our manufacturing requirements to subcontractors located in Asia may result in us not meeting our cost, quality or performance standards" and "Risk Factors – 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", in Item 1A of this report.*

***Competition***

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

The markets for our products are intensely competitive. Numerous competitors exist in each of our product segments. New manufacturers have also entered the markets in recent years, offering products that compete with ours. Under the harsh competitive conditions of the past few years, and the recent decline in economic activity, some of our competitors have consolidated or ceased operations. In addition, certain companies have, in recent years, increased consumer acceptance of alternative communications technologies, such as coaxial cable and cellular-based services, which compete with our products. Competition might further increase if new companies enter the market, or existing competitors expand their product lines.

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

- Help the customer solve networking problems within the confines of restrained capital budgets;
- Offer globally competitive solutions against a different set of competitors than in the United States;
- Deliver solutions that fit the distributed networking model being deployed by most service providers;
- Deliver solutions for service provider networks as they increasingly focus on network transformation, convergence and integration of services;
- Deliver solutions at attractive price points;
- Deliver reliability and redundancy, especially for higher bandwidth products;
- Adapt to new network technologies as they evolve;
- Compete effectively against large firms with greater resources;
- Deliver products when needed by the customer;
- Deliver responsive customer service, technical support, and training; and
- Assist customers requiring pre-assembled, turnkey systems.

Competitors of our Carrier Networks Division include large, established firms such as Alcatel Lucent, Cisco Systems, Fujitsu Limited, Nortel Networks, Huawei, Ericsson, Tellabs and Siemens. There are also a number of smaller, specialized firms with which we compete, such as ADC Telecommunications, Zhone Technologies, Occam Networks, Calix Networks and other privately held firms.

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

- Satisfy the customer's need for a cost-efficient alternative to established internetworking suppliers;
- Satisfy the customer's need to utilize the most cost-effective combination of transmission technologies to connect geographically dispersed locations;
- Increase network performance and lower the customer's cost for communications services and equipment;
- Add capacity and migrate to new or different technologies without a major system upgrade;
- Continue to develop and support established platforms;
- Offer products to address new networking technologies in a timely manner;
- Deliver reliability and system backup, especially for higher bandwidth products;
- Adapt to new network technologies as they evolve;
- Deliver products when needed by the customer;
- Deliver responsive customer service, technical support, and training; and
- Assist customers requiring hands-on installation and maintenance.

Competitors of our Enterprise Networks Division include Cisco Systems, Juniper Networks, Avaya, Nortel Networks, 3Com, Hewlett Packard, Enterasys Networks, Extreme Networks, Allied Telesyn, and other smaller companies. Some of these companies compete in a single product segment, while others compete across multiple product lines.

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

### ***Backlog and Inventory***

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

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

### ***Government Regulation***

In the United States, our products must comply with various regulations and standards defined by the Federal Communications Commission and Underwriters Laboratories. Products sold internationally may be required to comply with regulations or standards established by telecommunications authorities in various countries, as well as those of certain international bodies. For instance, environmental legislation within the European Union (EU) may increase our cost of doing business internationally as we amend our products to comply with these requirements. The EU issued a Directive on the restriction of certain hazardous substances in electronic and electrical equipment (RoHS), enacted the Waste Electrical and Electronic Equipment (WEEE) Directive to mandate the funding, collection, treatment, recycling and recovery of WEEE by producers of electrical or electronic equipment into Europe, and enacted a regulation concerning the Registration, Evaluation, Authorization and Restriction of Chemicals (REACH). We continue to implement measures to comply with the RoHS Directive, the WEEE Directive and the REACH Regulation as individual countries issue their implementation guidance.

*For further discussion of risks associated with government regulation, see "Risk Factors – Our products may not continue to comply with the regulations governing their sale, which may harm our business", in Item 1A of this report.*

### ***Employees***

As of December 31, 2008, we had 1,606 full-time employees in the United States and 38 full-time employees in our international subsidiaries, located in Canada, Mexico, the Asia-Pacific region and Europe. Of our total employees, 278 were in sales, marketing and service; 466 were in research and development; 776 were in manufacturing operations and quality assurance; and 124 were in administration. None of our employees are represented by a collective bargaining agreement, nor have we ever experienced any work stoppage. We believe that our relationship with our employees is good.

### ***Intellectual Property***

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

We have ownership of at least 223 patents related to our products and have approximately 104 additional patent applications pending, of which at least six have been approved and are in the process of being issued by the U.S. Patent and Trademark Office. The average remaining duration of our patents as of December 31, 2008 was approximately 11 years. We will continue to seek additional patents from time to time related to our research and development activities. We do not derive any material amount of revenue from the licensing of our patents.

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

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

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

***Available Information***

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

## *ITEM 1A. RISK FACTORS*

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

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

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

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

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

- Fluctuations in demand for our products and services, especially with respect to significant network expansion projects undertaken by telecommunications service providers;
- Continued growth of communications network traffic and the adoption of communication services and applications by enterprise and consumer end users;
- Changes in sales and implementation cycles for our products and reduced visibility into our customers' spending plans and associated revenue;
- Our ability to maintain appropriate inventory levels and purchase commitments;
- Price and product competition in the communications and networking industries, which can change rapidly due to technological innovation;
- The overall movement toward industry consolidation among both our competitors and our customers;

- Our dependence on sales of our products by channel partners, the timing of their replenishment orders, the potential for conflicts and competition involving our channel partners and large end use customers and the potential for consolidation among our channel partners;
- Variations in sales channels, product cost or mix of products sold;
- Delays in receiving product acceptance from certain customers as defined under contract, for shipments near the end of a reporting period;
- Manufacturing and customer lead times;
- Fluctuations in our gross margin, and the factors that contribute to this as described below;
- Our ability to achieve targeted cost reductions;
- The ability of our customers, channel partners, and suppliers to obtain financing or to fund capital expenditures;
- Our ability to execute on our strategy and operating plans; and
- Benefits anticipated from our investments in engineering, sales and marketing activities.

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

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

As a result of the many factors discussed in this report, our revenue for a particular quarter is difficult to predict and will fluctuate from quarter to quarter. Our net sales may grow at a slower rate than in previous quarters or may decline. Our ability to meet financial expectations could also be affected if the variable sales patterns seen in prior quarters recur in future quarters. We have experienced periods of time during which manufacturing issues have delayed shipments, leading to variable shipping patterns. In addition, to the extent that manufacturing issues and any related component shortages result in delayed shipments in the future, and particularly in quarters in which we and our subcontractors are operating at higher levels of capacity, it is possible that revenue for a quarter could be adversely affected, and we may not be able to remediate the conditions within the same quarter.

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

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

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

Economic conditions in the latter part of 2008 contributed to a slowdown in telecommunications industry spending, including specific market segments in which we operate. Uncertainty concerning the potential duration and depth of these negative conditions persists. Capital spending for network infrastructure projects of our largest customers could be delayed or cancelled should reduced consumer spending, tight capital markets or declining liquidity trends continue. Sustained trends of this nature could have a material adverse affect on our revenues, results of operations and financial condition.

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

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

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

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

- Changes in customer, geographic, or product mix, including the mix of configurations within each product group;
- Introduction of new products, including products with price-performance advantages;
- Our ability to reduce product cost;
- Increases in material or labor cost;
- Expediting costs incurred to meet customer delivery requirements;
- Excess inventory and inventory holding charges;
- Obsolescence charges;
- Changes in shipment volume;
- Loss of cost savings due to changes in component pricing or charges incurred due to inventory holding periods if parts ordering does not correctly anticipate product demand;
- Lower than expected benefits from value engineering;
- Increased price competition, including competitors from Asia, especially China;
- Changes in distribution channels;
- Increased warranty cost;
- Liquidated damages costs relating to customer contractual terms; and
- Our ability to manage the impact of foreign currency exchange rate fluctuations relating to pricing to our international customers.

***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.***

The markets for our products are characterized by rapidly changing technology, evolving industry standards, and continuing improvements in the telecommunications service offerings of common service providers. If technologies or standards applicable to our products, or common service provider offerings based on our products, become obsolete or fail to gain widespread commercial acceptance, our existing products or products under development may become obsolete or unmarketable.

Moreover, the introduction of products embodying new technologies, the emergence of new industry standards, or changes in common service provider offerings could adversely affect our ability to sell our products. For instance, we offer a large number of products that apply primarily to the delivery of high-speed digital communications over the local loop utilizing copper wire. We compete favorably with our competitors by developing a high-performance line of these products. We market products that apply to fiber optic transport in the local loop. We expect, however, that use of coaxial cable and mobile wireless access in place of local loop access will increase. Also, non-traditional providers, such as cable television companies, are increasing their presence in the local loop. To meet the requirements of these new delivery systems and to maintain our market position, we may have to develop new products or modify existing products.

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

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

As discussed above under “Business – Government Regulation”, in the United States, our products must comply with various regulations and standards defined by the Federal Communications Commission and Underwriters Laboratories. Products sold internationally may be required to comply with regulations or standards established by telecommunications authorities in various countries, as well as those of certain international bodies. Although we believe our products are currently in compliance with domestic and international standards and regulations in countries in which we currently sell, there can be no assurance that we will be able to design our products to comply with evolving standards and regulations in the future. Further, the cost of complying with the evolving standards and regulations, or the failure to obtain timely domestic or foreign regulatory approvals or certification such that we may not be able to sell our products where these standards or regulations apply, may adversely affect our results of operations and financial condition.

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

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

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

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

***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.***

Our research and development efforts are primarily focused on the refinement and redefinition of access technologies that are currently accepted and commonly practiced, which may include emerging technologies not yet widely distributed across all networks. Most of our research and development efforts result in improved applications of technologies for which demand already exists or is latent. We rarely engage in research projects that represent a vast departure from the current business practices of our key customers.

This includes pioneering new services and participating in leading edge field trials or demonstration projects for new technologies. While we believe our strategy provides a higher likelihood of producing nearer term revenue streams, this strategy could reduce our ability to influence industry standards and share in the establishment of intellectual property rights associated with new technologies, and could result in lost revenue opportunities should a new technology achieve rapid and widespread market acceptance.

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

Historically, a large percentage of our sales have been made to ILECs and major independent telecommunications companies. In 2008, these customers continued to comprise over half of our revenue. As long as the ILECs and other service providers represent such a substantial percentage of our total sales, our future success will significantly depend upon certain factors which are not within our control, including:

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

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

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

***The lengthy approval process required by ILECs and other service providers could result in fluctuations in our revenue.***

In the industry in which we compete, a supplier must first obtain product approval from an ILEC or other service provider to sell its products to them. This process can last from six to 18 months, or longer, depending on the technology, the service provider, and the demand for the product from the service provider's subscribers. Consequently, we are involved in a constant process of submitting for approval succeeding generations of products, as well as products that deploy new technology or respond to new technology demands from an ILEC or other service provider. We have been successful in the past in obtaining these approvals. However, we cannot be certain that we will obtain these approvals in the future or that sales of these products will continue to occur. Furthermore, the delay in sales until the completion of the approval process, the length of which is difficult to predict, could result in fluctuations of revenue and uneven operating results from quarter to quarter or year to year.

***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.***

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

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

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

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

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

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

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

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

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

- cost associated with fixing software or hardware defects;
- high service and warranty expenses;
- high inventory obsolescence expense;
- delays in collecting accounts receivable;
- payment of liquidated damages for performance failures; and

- declining sales to existing customers.

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

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

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

We are in the process of expanding into international markets, which represented 6.0% of our net sales for 2008, and we anticipate increased sales from these markets. We currently maintain regional sales offices in each of the following locations: Melbourne and Sydney, Australia; Montreal and Toronto, Canada; Mexico, D.F., Mexico; Hong Kong and Beijing, China; Singapore; Bangkok, Thailand; and Bramley, United Kingdom. A number of factors inherent to these markets expose us to significantly more risk than domestic business, including:

- local economic and market conditions;
- exposure to unknown customs and practices;
- potential political unrest;
- foreign currency exchange rate exposure;
- unexpected changes in, or impositions of, legislative or regulatory requirements;
- less regulation of patents or other safeguards of intellectual property; and
- difficulties in collecting accounts receivable and local government’s inability to enforce lawful business practices.

Any of these factors, or others of which we are not currently aware, could result in increased costs of operation or loss of revenue.

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

Historically our sales to international customers and purchases from international suppliers have been transacted in United States dollars; therefore, we have not entered into foreign currency forward contracts or other hedging instruments. As our international sales increase or as utilization of international suppliers expands, we may transact additional business in currencies other than the United States dollar. As a result, we will be subject to the possibility of greater effects of foreign currency exchange translation on our financial statements. Sales contract commitments and accounts receivable balances based on foreign currency expose us to potential risk of loss as the value of the United States dollar fluctuates over time. In addition, for those countries outside the United States where we have significant sales or significant purchases of supplies, devaluation in the local currency could make our products more expensive for customers to purchase or increase our operating costs, thereby adversely affecting our competitiveness. In the future, we may enter into foreign currency forward contracts or other hedging instruments to protect against reductions in value and the volatility of future cash flows caused by changes in foreign currency exchange rates. If used, the contracts and other hedging instruments will be intended to reduce, but not eliminate, the impact of foreign currency exchange rate movements; therefore, we generally would not anticipate hedging all outstanding foreign currency risk. There can be no assurance that exchange rate fluctuations in the future will not have a material adverse effect on our revenue from international sales, manufacturing costs, results of operations and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We are exposed to financial market risks, including changes in interest rates and prices of marketable equity and fixed-income securities. The primary objective of the large majority of our investment activities is to preserve principal while at the same time achieving appropriate yields without significantly increasing risk. To achieve this objective, a majority of our marketable securities are investment grade municipal fixed-rate bonds, municipal variable rate demand notes and municipal money market instruments denominated in United States dollars. We have held no municipal auction rate securities since February 7, 2008.

We have significant investments in municipal fixed-rate bonds and municipal variable rate demand notes. Through December 31, 2008, we have not been required to impair any of these investments; however, due to the recent turmoil in the financial markets, we may experience a reduction in value or loss of liquidity in these investments, which may have an adverse effect on our results of operations, liquidity and financial condition. Fixed rate interest securities may have their fair value adversely impacted due to a rise in interest rates, while variable rate securities may produce less income than expected if interest rates fall. Our investments are subject to general credit, liquidity, market and interest rate risks, which may be exacerbated by recent conditions in the financial markets and related credit liquidity issues. Consequently, our future investment income may fall short of expectation due to changes in interest rates, or we may suffer losses in principal if we are forced to sell securities that decline in fair value due to changes in interest rates.

Our long-term investments include $11.6 million of marketable equity securities. Because of the strained credit markets and deteriorating equity market conditions, the value of our marketable equity securities decreased significantly during the fourth quarter of 2008. As a result, we recorded an other-than-temporary impairment charge of $1.8 million during the fourth quarter related to 96 marketable equity securities, bringing our total other-than-temporary impairment charge for 2008 to $2.4 million. At December 31, 2008, our total marketable equity securities, which included more than 350 individual securities, had net unrealized losses of $0.4 million. If market conditions do not improve or should continue to deteriorate in 2009, we may be required to record additional impairment charges related to our marketable equity securities.

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

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

We are subject to taxation in various jurisdictions, both domestically and internationally, in which we conduct business. Significant judgment is required in the determination of our provision for income taxes and this determination requires the interpretation and application of complex and sometimes uncertain tax laws and regulations. Our effective tax rate may be adversely impacted by changes in the mix of earnings between jurisdictions with different statutory tax rates, in the valuation of our deferred tax assets, and by changes in tax rules and regulations. For instance, the availability and timing of lapses in the United States research and development tax credit, tax implications of Statement of Financial Accounting Standards No. 123(R), the adoption of Financial Accounting Standards Board Interpretation No. 48 and the amount of our estimated tax deduction for manufacturer’s domestic production activities under Internal Revenue Code Section 199 may add more variability to our future effective tax rates. We currently receive corporate income tax credits under a program administered by the Alabama State Industrial Development Authority in connection with revenue bonds issued to provide funding for expansion of our corporate facilities. We cannot be certain that the state of Alabama will continue to make these corporate income tax credits available; therefore, we may not realize the full benefit of these incentives, which would increase our effective tax rate. In addition, we are subject to examination of our income tax returns by the Internal Revenue Service and various other jurisdictions in which we conduct business. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes. There can be no assurance that the outcomes from these continuous examinations will not have an adverse affect on our results of operations and financial condition.

***Our success depends on attracting and retaining key personnel.***

Our business has grown significantly since its inception. Our success is dependent in large part on the continued employment of our executive officers, including Thomas R. Stanton, our Chief Executive Officer, and other key management personnel. The unplanned departure of one or more of these individuals could adversely affect our business. In addition, for ADTRAN to continue as a successful entity we must also be able to attract and retain key engineers and technicians whose expertise helps us maintain competitive advantages. We do not have employment contracts or non-compete agreements with any of our employees. We believe that our future success will depend, in large part, upon our ability to continue to attract, retain, train, and motivate highly-skilled employees who are in great demand. Stock option grants are designed to reward employees for their long-term contributions and to provide incentives for them to remain with us. The provisions of Statement of Financial Accounting Standards No. 123R require us to record significantly increased compensation costs as compared to prior accounting rules, which may cause us to restrict the availability and amount of equity incentives provided to employees. Changes to our overall compensation program, including our stock option incentive program, may also adversely affect our ability to retain key employees. Properly managing our continued growth, avoiding the problems often resulting from such growth and expansion, and continuing to operate in the manner which has proven successful to us to date will be critical to the future success of our business.

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

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

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

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

## *ITEM 1B. UNRESOLVED STAFF COMMENTS*

None.

## *ITEM 2. PROPERTIES*

Our headquarters and principal administrative, engineering and manufacturing facilities are located on an 80-acre campus in Cummings Research Park in Huntsville, Alabama. Two office buildings contain 440,000 and 600,000 square feet, respectively, and serve both our Carrier Networks and Enterprise Networks Divisions. These facilities can accommodate up to 3,000 employees. We lease a 15,500 square foot engineering facility in Phoenix, Arizona and a 13,400 square foot engineering facility in Mountain View, California that are used to develop products sold by our Carrier Networks Division.

In addition to our facilities listed above, we lease additional office space in the United States and abroad, providing sales and service support for both of our divisions. The leased offices in the United States are located in Chesterfield, MO; Kansas City, MO; Littleton, CO; Irving, TX; and Milford, MI. We also lease one office in each of the following locations: Melbourne and Sydney, Australia; Montreal and Toronto, Canada; Mexico, D.F., Mexico; Hong Kong and Beijing, China; Singapore; Bangkok, Thailand; and Bramley, United Kingdom. These cancelable and non-cancelable leases expire at various times through 2013. For more information, see Note 10 of the Notes to Consolidated Financial Statements included in this report.

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

### *ITEM 3. LEGAL PROCEEDINGS*

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

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

No matter was submitted by ADTRAN to a vote of security holders during the fiscal quarter ended December 31, 2008.

### *ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT*

Set forth below, in accordance with General Instruction G (3) of Form 10-K and Instruction 3 of Item 401(b) of Regulation S-K, is certain information regarding the executive officers of ADTRAN. Unless otherwise indicated, the information set forth is as of December 31, 2008.

| | |
|---|---|
| **Thomas R. Stanton** | Age 44 |
| 2007 to present | Chief Executive Officer and Chairman of the Board |
| 2005 – 2007 | Chief Executive Officer and Director |
| 2001 – 2005 | Senior Vice President and General Manager, Carrier Networks |
| 1999 – 2001 | Vice President and General Manager, Carrier Networks |
| 1995 – 1999 | Vice President, Carrier Networks Marketing |
| 1995 | Vice President, Marketing & Engineering – Transcrypt International, Inc. |
| 1994 – 1995 | Senior Director, Marketing – E.F. Johnson Company |
| 1993 – 1994 | Director, Marketing – E.F. Johnson Company |
| **James E. Matthews** | Age 52 |
| 2007 to present | Senior Vice President – Finance, Chief Financial Officer, Treasurer, Secretary and Director |
| 2001 – 2007 | Senior Vice President – Finance, Chief Financial Officer and Treasurer |
| 1999 – 2001 | Chief Financial Officer – Home Wireless Networks, Inc. |
| 1998 – 1999 | Chief Executive Officer – Miltope Group, Inc. |
| 1995 – 1998 | Vice President, Finance and Chief Financial Officer – Miltope Group, Inc. |
| 1992 – 1995 | Controller – Hughes Training, Inc. |
| **Michael K. Foliano** | Age 48 |
| 2006 to present | Senior Vice President – Global Operations |
| 2005 – 2006 | Senior Vice President, Sales, Services and Supply Chain – Somera Communications Inc. |
| 2004 – 2005 | Senior Vice President, Global Operations – Somera Communications, Inc. |
| 2002 – 2004 | Senior Director, Global Logistics and Customer Operations – Lucent Technologies |
| 2001 – 2002 | Executive General Manager, Mobility Supply Chain – Lucent Technologies |
| 2000 – 2001 | Stanford University Sloan Fellow – Lucent Technologies |
| 1997 – 2000 | Vice President, Global Provisioning Center – Lucent Technologies |
| 1995 – 1997 | Manufacturing Operations Plant Manager – Lucent Technologies/AT&T Network Systems |
| **Raymond R. Schansman** | Age 52 |
| 2006 to present | Senior Vice President and General Manager, Enterprise Networks |
| 2001 – 2006 | Vice President, Carrier Networks Engineering |
| 1998 – 2001 | Engineering Director, Carrier Networks Systems |
| 1996 – 1998 | Engineering Manager, Enterprise Networks Systems |
| 1989 – 1996 | Program Manager – SCI Systems, Inc. |
| 1986 – 1989 | Vice President, System and Product Engineering – General Digital Industries |
| 1983 – 1986 | Senior Design Engineer – General Digital Industries |

| | |
|---|---|
| **James D. Wilson, Jr.** | Age 38 |
| 2006 to present | Senior Vice President and General Manager, Carrier Networks |
| 2005 – 2006 | Vice President, Product Marketing, Carrier Networks |
| 2002 – 2005 | Director, Product Management, Carrier Networks |
| 1998 – 2002 | Director, Product Management, Loop Technologies, Carrier Networks |
| 1996 – 1998 | Manager, Engineering Operations – Wyle Laboratories, Inc. |
| 1992 – 1996 | Manager, Program Development – Wyle Laboratories, Inc. |
| **Robert A. Fredrickson** | Age 58 |
| 1996 to present | Vice President – Carrier Networks Sales |
| 1996 | Vice President, Broadband Business Development – DSC Communications Corporation |
| 1991 – 1996 | Senior Director, Access Products – DSC Communications Corporation |
| **P. Steven Locke** | Age 60 |
| 2005 to present | Vice President – Service Provider Sales |
| 2000 – 2005 | Vice President, Marketing, Carrier Networks |
| 1999 – 2000 | Vice President – Sprint Local Division Sales for Lucent Technologies |
| 1997 – 1999 | Senior Director of Sales, ADTRAN, Inc. |
| 1993 – 1997 | Vice President and General Manager, Business Network Group, Sprint North Supply |
| **Kevin W. Schneider** | Age 45 |
| 2003 to present | Vice President – Chief Technology Officer |
| 1999 – 2003 | Vice President – Technology |
| 1996 – 1999 | Chief Scientist |
| 1992 – 1996 | Staff Scientist |

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

## PART II

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

ADTRAN's common stock is traded on the NASDAQ Global Select Market under the symbol ADTN. As of February 6, 2009, ADTRAN had 285 stockholders of record and approximately 35,575 beneficial owners of shares held in street name. The following table shows the high and low closing prices per share for our common stock as reported by NASDAQ for the periods indicated.

**Common Stock Prices**

| | High | Low |
|---|---|---|
| **2008** | | |
| First Quarter | $21.17 | $17.32 |
| Second Quarter | $25.68 | $18.86 |
| Third Quarter | $26.06 | $19.04 |
| Fourth Quarter | $19.58 | $12.31 |
| **2007** | | |
| First Quarter | $25.28 | $22.11 |
| Second Quarter | $27.09 | $24.25 |
| Third Quarter | $28.26 | $22.30 |
| Fourth Quarter | $24.82 | $20.50 |

The following table shows the dividends paid in each quarter of 2008 and 2007. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

**Dividends per Common Share**

| | 2008 | 2007 |
|---|---|---|
| First Quarter | $0.09 | $0.09 |
| Second Quarter | $0.09 | $0.09 |
| Third Quarter | $0.09 | $0.09 |
| Fourth Quarter | $0.09 | $0.09 |

**Stock Repurchases**

The following table sets forth ADTRAN's repurchases of its common stock for the months indicated.

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| October 1, 2008 – October 31, 2008 | 299,234 | $ 14.21 | 299,234 | 3,553,571 |
| November 1, 2008 – November 30, 2008 | 100,000 | $ 13.93 | 100,000 | 3,453,571 |
| December 1, 2008 – December 31, 2008 | — | — | — | 3,453,571 |
| **Total** | 399,234 | $ 14.14 | 399,234 | |

*(1)* On April 14, 2008, ADTRAN's Board of Directors approved the repurchase of up to 5,000,000 shares of its common stock. This plan is being implemented through open market purchases from time to time as conditions warrant.

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## *ITEM 6. SELECTED FINANCIAL DATA*

***Income Statement Data (1)***
***(In thousands, except per share amounts)***

| *Year Ended December 31,* | *2008* | *2007* | *2006* | *2005* | *2004* |
|---|---|---|---|---|---|
| Sales | | | | | |
| Carrier Networks Division | $392,219 | $358,023 | $356,606 | $386,051 | $323,333 |
| Enterprise Networks Division | 108,457 | 118,755 | 116,102 | 127,164 | 131,184 |
| **Total sales** | **500,676** | **476,778** | **472,708** | **513,215** | **454,517** |
| Cost of sales | 201,771 | 193,792 | 193,747 | 209,895 | 195,182 |
| **Gross profit** | **298,905** | **282,986** | **278,961** | **303,320** | **259,335** |
| Selling, general and administrative expenses | 103,286 | 103,329 | 102,646 | 96,411 | 90,190 |
| Research and development expenses | 81,819 | 75,367 | 70,700 | 62,654 | 67,384 |
| **Operating income** | **113,800** | **104,290** | **105,615** | **144,255** | **101,761** |
| Interest and dividend income | 8,708 | 11,521 | 13,493 | 10,001 | 7,671 |
| Interest expense | (2,514) | (2,502) | (2,532) | (2,535) | (2,542) |
| Other income (expense), net | 688 | 764 | 570 | (59) | 1,353 |
| Net realized investment gain (loss) | (2,409) | 498 | 1,379 | 1,712 | 1,773 |
| Life insurance proceeds | — | 1,000 | — | — | — |
| **Income before provision for income taxes** | **118,273** | **115,571** | **118,525** | **153,374** | **110,016** |
| Provision for income taxes | 39,692 | 39,236 | 40,192 | 52,224 | 34,875 |
| **Net income** | **$ 78,581** | **$ 76,335** | **$ 78,333** | **$101,150** | **$ 75,141** |

| *Year Ended December 31,* | *2008* | *2007* | *2006* | *2005* | *2004* |
|---|---|---|---|---|---|
| Weighted average shares outstanding-basic | 63,549 | 67,848 | 73,451 | 75,775 | 78,235 |
| Weighted average shares outstanding-assuming dilution ( **2** ) | 64,408 | 69,212 | 75,197 | 77,966 | 80,985 |
| Earnings per common share-basic | $ 1.24 | $ 1.13 | $ 1.07 | $ 1.33 | $ 0.96 |
| Earnings per common share-assuming dilution ( **2** ) | $ 1.22 | $ 1.10 | $ 1.04 | $ 1.30 | $ 0.93 |
| Dividends declared and paid per common share | $ 0.36 | $ 0.36 | $ 0.36 | $ 0.34 | $ 0.32 |

***Balance Sheet Data (In thousands)***

| *At December 31,* | *2008* | *2007* | *2006* | *2005* | *2004* |
|---|---|---|---|---|---|
| Working capital (3) | $212,740 | $251,261 | $219,636 | $344,305 | $266,371 |
| Total assets | $473,615 | $479,220 | $539,658 | $651,720 | $559,942 |
| Total debt | $ 48,750 | $ 49,000 | $ 49,500 | $ 50,000 | $ 50,000 |
| Stockholders’ equity | $375,819 | $378,431 | $435,956 | $542,171 | $466,637 |

*(1) Net income for 2008, 2007 and 2006 includes stock-based compensation expense under Statement of Financial Accounting Standards No. 123R of $6.7 million, $7.1 million and $7.2 million, respectively, net of tax, related to stock option awards. See Note 2 of Notes to the Consolidated Financial Statements.*

*(2) Assumes exercise of dilutive stock options calculated under the treasury method. See Notes 1 and 11 of Notes to Consolidated Financial Statements.*

*(3) ADTRAN’s working capital consists of current assets less current liabilities.*

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

### Overview

ADTRAN, Inc. designs, manufactures, markets and services network access solutions for communications networks. Our solutions are widely deployed by providers of telecommunications services (serviced by our Carrier Networks Division), and small and mid-sized businesses and enterprises (serviced 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. 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.

**Loop Access** products are used by carrier and enterprise customers for access to copper-based telecommunications network. 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.

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 us 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.

Sales were $500.7 million in 2008 compared to $476.8 million in 2007 and $472.7 million in 2006. Sales increased in each of our primary growth areas, Broadband Access, Optical Access and Internetworking. Total sales of products in these three growth areas increased 23.0% in 2008 compared to 2007 and 18.2% in 2007 compared to 2006. Our gross profit margin improved in 2008 to 59.7% from 59.4% in 2007 and 59.0% in 2006, and our operating income margin increased to 22.7% in 2008 compared to 21.9% in 2007 and 22.3% in 2006. Net income was $78.6 million in 2008 compared to $76.3 million in 2007 and $78.3 million in 2006. Earnings per share, assuming dilution, were $1.22 in 2008 compared to $1.10 in 2007 and $1.04 in 2006. Earnings per share in 2008, 2007 and 2006 reflect the repurchase of 3.1 million, 5.8 million and 7.4 million shares of our stock, respectively.

Our operating results have fluctuated on a quarterly basis in the past, and may vary significantly in future periods due to a number of factors. 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 fourth quarter of 2008, 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, coupled with the fact that our sales in the fourth quarter of each year have typically been lower than our sales in the preceding third quarter due to seasonality. Our sales in the first quarter of each year have also typically been lower than our sales in the second and third quarters of the previous year due to seasonality.

Our operating results may also fluctuate as a result of a number of other factors, including a decline in general economic and market conditions, increased competition, customer order patterns, changes in product 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 this inventory may have an adverse effect on our business and operating results. Also, not maintaining sufficient inventory levels to assure prompt delivery of our products may cause us to incur expediting costs to meet customer delivery requirements, which may impact our operating results in a given quarter.

Accordingly, our historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that our financial results may vary from period to period. See Note 12 of Notes to Consolidated Financial Statements. *For a discussion of risks associated with our operating results, see Item 1A of this report.*

**Critical Accounting Policies and Estimates**

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

- We review customer contracts to determine if all of the requirements for revenue recognition have been met prior to recording revenues from sales transactions. We generally record sales revenue upon shipment of our products, net of any rebates or discounts, since: (i) we generally do not have significant post-delivery obligations, (ii) the product price is fixed or determinable, (iii) collection of the resulting receivable is probable, and (iv) product returns are reasonably estimable. We generally ship products upon receipt of a purchase order from a customer. We evaluate shipping terms and we record revenue on products shipped in accordance with the terms of each respective contract where applicable, or under our standard shipping terms for purchase orders accepted without a contract, generally FOB shipping point. In the case of consigned inventory, revenue is recognized when the customer assumes the risks and rewards of ownership of the product. When contracts contain multiple elements, contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple element contract should be treated as separate units of accounting for revenue recognition purposes, and, if so, how the price should be allocated among the elements and when to recognize revenue for each element. We record revenue associated with installation services when the installation and all contractual obligations are complete. When contracts include both installation and product sales, the installation is considered as a separate deliverable item. Either the purchaser, ADTRAN, or a third party can perform installation of our products. Revenues related to maintenance services are recognized on a straight line basis over the contract term.
- Sales returns are accrued based on historical sales return experience, which we believe provides a reasonable estimate of future returns. The majority of Enterprise Networks products are sold in the United States through a non-exclusive distribution network of major technology distributors. These organizations then distribute to an extensive network of value-added resellers and system integrators. Value-added resellers and system integrators may be affiliated with us as a channel

partner, or they may purchase from the distributor in an unaffiliated fashion. Additionally, with certain limitations, our distributors may return unused and unopened product for stock-balancing purposes when these returns are accompanied by offsetting orders for products of equal or greater value.

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

Prior to issuing payment terms to a new customer, we perform a detailed credit review of the customer. Credit limits are established for each new customer based on the results of this credit review. Payment terms are established for each new customer, and collection experience is reviewed periodically in order to determine if the customer's payment terms and credit limits need to be revised. We maintain allowances for doubtful accounts for losses resulting from the inability of our customers to make required payments. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, we may be required to make additional allowances. If circumstances change with regard to individual receivable balances that have previously been determined to be uncollectible (and for which a specific reserve has been established), a reduction in our allowance for doubtful accounts may be required. Our allowance for doubtful accounts was $38,000 at December 31, 2008 and $109,000 at December 31, 2007.

- We carry our inventory at the lower of cost or market, with cost being determined using the first-in, first-out method. We use standard costs for material, labor, and manufacturing overhead to value our inventory. Our standard costs are updated on at least a quarterly basis and any variances are expensed in the current period; therefore, our inventory costs approximate actual costs at the end of each reporting period. We write down our inventory for estimated obsolescence or unmarketable inventory by an amount equal to the difference between the cost of inventory and the estimated fair value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, we may be required to make additional inventory write-downs. Our reserve for excess and obsolete inventory was $7.7 million and $6.4 million at December 31, 2008 and 2007, respectively. Inventory write-downs charged to the reserve were $1.0 million, $1.6 million and $2.5 million for the years ended December 31, 2008, 2007 and 2006, respectively.

- The objective of our short-term investment policy is to preserve principal and maintain adequate liquidity with appropriate diversification, while emphasizing market returns on our monetary assets. The objective of our long-term investment policy is principal preservation and total return; that is, the aggregate return from capital appreciation, dividend income, and interest income. These objectives are achieved through investments with appropriate diversification in fixed and variable rate income securities, public equity, and private equity portfolios. We have experienced significant volatility in the market prices of our publicly traded equity investments. These investments are recorded on the consolidated balance sheets at fair value with unrealized gains and losses reported as a component of accumulated other comprehensive income, net of tax. The ultimate realized value on these equity investments is subject to market price volatility until they are sold.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* , we have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1 - Values based on unadjusted quoted prices for identical assets or liabilities in an active market; Level 2 - Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability; Level 3 - Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs include information supplied by investees. At December 31, 2008, we categorized $171.6 million and $15.0 million of our available-for-sale investments as Level 2 and Level 1, respectively, and $25.4 million of our cash equivalents as Level 1.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by more than 25% for more than six 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 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 duration of the historical decline. We then evaluated the individual security to determine the amount of write-down, if any. As a result, we recorded an other-than-temporary impairment charge of $1.8 million during the fourth quarter of 2008 related to 96 marketable equity securities. 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 years ended December 31, 2008, 2007 and 2006, we recorded charges of $2.4 million, $0.1 million and $0.1 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities. Actual losses, if any, could ultimately differ from these estimates. Future adverse changes in market conditions or poor operating results of underlying investments could result in additional losses that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future. See Note 3 of Notes to the Consolidated Financial Statements in this report for more information about our investments.

We also invest in privately held entities and private equity funds and record these investments at cost. We review these investments periodically in order to determine if circumstances (both financial and non-financial) exist that indicate that we will not recover our initial investment. Impairment charges are recorded on investments having a cost basis that is greater than the value that we would reasonably expect to receive in an arm's length sale of the investment. We have not been required to record any losses relating to these investments in 2008, 2007 or 2006.

- For purposes of determining the estimated fair value of our stock option awards on the date of grant under SFAS No. 123 (revised 2004) , *Share-Based Payments* , (SFAS 123R), we use the Black-Scholes Model. This model requires the input of certain assumptions that require subjective judgment. These assumptions include, but are not limited to, expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors. Because our stock option awards have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, the existing model may not provide a reliable single measure of the fair value of our stock option awards. For purposes of determining the estimated fair value of our performance-based restricted stock unit awards on the date of grant, we use the Monte Carlo Simulation valuation technique. Management will continue to assess the assumptions and methodologies used to calculate the estimated fair value of stock-based compensation. Circumstances may change and additional data may become available over time, which could result in changes to these assumptions and methodologies and thereby materially impact our fair value determination. If factors change and we use different assumptions in the application of SFAS 123R in future periods, the compensation expense that we record under SFAS 123R may differ significantly from what we have recorded in the current period.
- We estimate our income tax provision or benefit in each of the jurisdictions in which we operate, including estimating exposures related to examinations by taxing authorities. We also make judgments regarding the realization of deferred tax assets. The carrying value of our net deferred tax assets is based on our belief that it is more likely than not that we will generate sufficient future taxable income in certain jurisdictions to realize these deferred tax assets. A valuation allowance has been established for deferred tax assets which we do not believe meet the more-likely-than-not criteria established by SFAS No. 109, *Accounting for Income Taxes.* Our estimates regarding future taxable income and income tax provision or benefit may vary due to changes in market conditions, changes in tax laws, or other factors. If our assumptions, and consequently our estimates, change in the future, the valuation allowances we have established may be increased or decreased, impacting future income tax expense. For 2008 and 2007 respectively, the valuation allowance was $1.6 million and $1.2 million. As of December 31, 2008, we have state research tax credit carry-forwards of $1.6 million, which will expire between 2015 and 2023. These carry-forwards were caused by tax credits in excess of our annual tax liabilities to an individual state where we no longer generate sufficient state income. In accordance with SFAS No. 109, we believe it is more likely than not that we will not realize the benefits of our deferred tax asset arising from these credits, and accordingly, have provided a valuation allowance. This valuation allowance is included in non-current deferred tax liabilities in the accompanying balance sheets.
- 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, will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if

unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty returns totaled $2.8 million and $2.9 million at December 31, 2008 and 2007, respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets.

**Results of Operations**

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

| *Year Ended December 31,* | *2008* | *2007* | *2006* |
|---|---|---|---|
| **Sales** | | | |
| Carrier Networks Division | 78.3% | 75.1% | 75.4% |
| Enterprise Networks Division | 21.7 | 24.9 | 24.6 |
| **Total sales** | **100.0%** | **100.0%** | **100.0%** |
| Cost of sales | 40.3 | 40.6 | 41.0 |
| **Gross profit** | **59.7** | **59.4** | **59.0** |
| Selling, general and administrative expenses | 20.6 | 21.7 | 21.7 |
| Research and development expenses | 16.4 | 15.8 | 15.0 |
| **Operating income** | **22.7** | **21.9** | **22.3** |
| Interest and dividend income | 1.7 | 2.4 | 2.9 |
| Interest expense | (0.5) | (0.5) | (0.5) |
| Net realized investment gain (loss) | (0.5) | 0.1 | 0.3 |
| Other income, net | 0.2 | 0.1 | 0.1 |
| Life insurance proceeds | — | 0.2 | — |
| **Income before provision for income taxes** | **23.6** | **24.2** | **25.1** |
| Provision for income taxes | 7.9 | 8.2 | 8.5 |
| **Net income** | **15.7%** | **16.0%** | **16.6%** |

**2008 Compared to 2007**

**Sales**

ADTRAN's sales increased 5.0% from $476.8 million in 2007 to $500.7 million in 2008. This increase in sales is primarily attributable to an $18.4 million increase in sales of our Broadband Access products, a $10.7 million increase in sales of our Optical Access products and a $12.4 million increase in sales of our Internetworking products. HDSL product revenues increased 3.6% or $6.3 million and other traditional product revenues decreased 19.5% or $23.9 million.

Carrier Systems product sales increased $26.5 million in 2008 compared to 2007 primarily due to an $18.4 million increase in Broadband Access product sales, primarily attributable to increased shipments of our 1100 series fiber-to-the-node products and our Total Access ® 5000 products, and a $10.7 million increase in Optical Access product sales, resulting from continuing market share gains across numerous customers including the top three U.S. carriers. Partially offsetting these increases in Carrier System product sales were decreases in TDM and other traditional product sales as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Broadband Access and Optical Access product areas.

Business Networking product sales increased $1.2 million in 2008 compared to 2007 due to a $12.4 million increase in Internetworking product sales, primarily as a result of market share gains due to our efforts to improve our focus on addressing traditional enterprise channels and leveraging our carrier distribution channels. Largely offsetting this increase in Internetworking product sales was a decline in sales of traditional IAD products as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales decreased $3.8 million in 2008 compared to 2007 primarily due to declines in Enterprise T1 product sales and DDS product sales, partially offset by a 3.6% or $6.3 million increase in HDSL product revenues.

Carrier Networks sales increased 9.6% from $358.0 million in 2007 to $392.2 million in 2008. The increase is primarily attributable to increases in Broadband Access and Optical Access products sales, and to a lesser extent an increase in HDSL product sales.

Enterprise Networks sales decreased 8.7% from $118.8 million in 2007 to $108.5 million in 2008. The decrease is primarily attributable to declines in sales of traditional IAD products, Enterprise T1 products and DDS products, partially offset by an increase in sales of Internetworking products. Internetworking product sales were 58.3% of Enterprise Network sales in 2008 compared with 44.5% in 2007. Traditional products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales decreased from 24.9% in 2007 to 21.7% in 2008.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, decreased 24.0% from $39.6 million in 2007 to $30.1 million in 2008. International sales, as a percentage of total sales, decreased from 8.3% in 2007 to 6.0% in 2008. International sales in 2007 reflected increased activity relating to an initial deployment of our products by a large Latin American carrier. International sales in 2008 decreased primarily due to a decline in sales to this Latin American carrier as well as a decline in sales in other regions.

**Cost of Sales**

As a percentage of sales, cost of sales decreased from 40.6% in 2007 to 40.3% in 2008. The decrease in cost of sales as a percentage of sales is primarily related to lower product costs.

Carrier Networks cost of sales, as a percent of division sales, decreased from 40.6% in 2007 to 39.8% in 2008. The decrease was primarily related to lower product costs noted above, and the impact of higher sales volume on allocated cost of sales elements to the division. Enterprise Networks cost of sales, as a percent of division sales, increased from 40.9% in 2007 to 42.2% in 2008. The increase was primarily related to a higher cost product mix plus the impact of allocated manufacturing costs to the division.

An important part of our strategy is to reduce the product cost of each succeeding product generation and then to lower the product’s price based on the cost savings achieved. This strategy sometimes results in variations in our gross profit margin due to timing differences between the recognition of cost reductions and the lowering of product selling prices. In view of the rapid pace of new product introductions by our company, this strategy may result in variations in gross profit margins that, for any particular financial period, can be difficult to predict.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses were $103.3 million in 2008 and 2007, and represented 20.6% of sales for 2008 and 21.7% of sales for 2007. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, gains or losses on the disposal of property, plant, and equipment occurring in the normal course of business, trade show expenses, and related travel costs.

Selling, general and administrative expenses as a percent of sales will generally fluctuate whenever there is significant fluctuation in revenues during the periods being compared.

**Research and Development Expenses**

Research and development expenses increased 8.5% from $75.4 million, or 15.8% as a percentage of sales, in 2007 to $81.8 million, or 16.3% as a percentage of sales, in 2008. The increase in research and development expenses primarily reflects increased staffing expense 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. Research and development expenses as a percentage of sales will fluctuate whenever there is a significant fluctuation in revenues during the periods being compared.

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 provides for new product development, enhancement of existing products and product cost reductions. 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 24.3% from $11.5 million in 2007 to $8.7 million in 2008. This decrease is primarily driven by a 14% reduction in our average investment balances in 2008 as compared to 2007, primarily as a result of our share repurchase activity, and a 25% reduction in the average rate of return on these investments, primarily as a result of lower interest rates.

**Interest Expense**

Interest expense remained constant at $2.5 million in 2008 and 2007, as we had no substantial change in our fixed rate borrowing. See "Liquidity and Capital Resources" below for additional information.

**Net Realized Investment Gain (Loss)**

Net realized investment gain (loss) decreased from a $0.5 million gain in 2007 to a $2.4 million loss in 2008. The change is primarily a result of the other-than-temporary impairment of certain securities in our equity portfolio. See "Investing Activities" in "Liquidity and Capital Resources" below for additional information.

**Other Income, net**

Other income, net, comprised primarily of miscellaneous income, gains and losses on foreign currency translations, investment account management fees and scrap raw material sales, decreased from $0.8 million in 2007 to $0.7 million in 2008.

**Life Insurance Proceeds**

We realized a gain on life insurance proceeds of $1.0 million during the first quarter of 2007 as a result of the death of our co-founder and then Chairman of the Board, Mark Smith.

**Income Taxes**

Our effective tax rate decreased from 34.0% in 2007 to 33.6% in 2008, primarily due to increased benefits relating to the deduction for manufacturer's domestic production activities under Internal Revenue Code Section 199 and an increase in our federal research and development credits.

**Net Income**

As a result of the above factors, net income increased from $76.3 million in 2007 to $78.6 million in 2008. As a percentage of sales, net income decreased from 16.0% in 2007 to 15.7% in 2008.

**2007 Compared to 2006**

**Sales**

ADTRAN's sales increased 0.9% from $472.7 million in 2006 to $476.8 million in 2007. This increase in sales is primarily attributable to a $4.5 million increase in sales of our Carrier Systems products. Carrier Systems product sales increased primarily due to a $6.6 million increase in Optical Access product sales, resulting from market share gains across a broad range of customers, and also due to a $3.8 million increase in Broadband Access product sales, primarily attributable to new business with a Tier 1 Latin American carrier and continuing bandwidth upgrades domestically. Partially offsetting these increases in Carrier System product sales were decreases in TDM and other traditional product sales as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Broadband Access and Optical Access product areas.

Business Networking product sales increased $0.4 million in 2007 compared to 2006 due to a $17.3 million increase in Internetworking product sales, driven by the strong performance of the NetVanta ® and IP business gateway product categories and as a result of our efforts to improve our focus on addressing traditional enterprise channels and leveraging our carrier distribution channels. Largely offsetting this increase in Internetworking product sales was a decline in traditional IAD product sales as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales decreased $0.8 million in 2007 compared to 2006 primarily due to a decline in Enterprise T1 product sales.

Carrier Networks sales increased 0.4% from $356.6 million in 2006 to $358.0 million in 2007. The increase is primarily attributable to the aforementioned increases in Optical Access and Broadband Access product sales, partially offset by declines in TDM product sales.

Enterprise Networks sales increased 2.3% from $116.1 million in 2006 to $118.8 million in 2007. The increase is primarily attributable to the aforementioned increase in Internetworking product sales, partially offset by a decrease in traditional IAD and Enterprise T1 product sales.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 23.8% from $32.0 million in 2006 to $39.6 million in 2007. International sales, as a percentage of total sales, increased from 6.8% in 2006 to 8.3% in 2007. International sales increased primarily due to new business with a Tier 1 Latin American carrier as well as improved sales to our European and Australian customer base.

**Cost of Sales**

Cost of sales, as a percentage of sales, was 40.6% in 2007 compared to 41.0% in 2006 on slightly higher sales volume. Carrier Networks cost of sales, as a percent of division sales, was 40.6% in 2007 compared to 41.5% in 2006. Enterprise Networks cost of sales, as a percent of division sales, was 39.4% in 2006 compared to 40.9% in 2007.

An important part of our strategy is to reduce the product cost of each succeeding product generation and then to lower the product's price based on the cost savings achieved. This strategy sometimes results in variations in our gross profit margin due to timing differences between the recognition of cost reductions and the lowering of product selling prices. In view of the rapid pace of new product introductions by our company, this strategy may result in variations in gross profit margins that, for any particular financial period, can be difficult to predict.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased 0.7% from $102.6 million in 2006 to $103.3 million in 2007, and represented 21.7% of sales for both periods. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, gains or losses on the disposal of property, plant, and equipment occurring in the normal course of business, trade show expenses, and related travel costs.

Selling, general and administrative expenses as a percent of sales will generally fluctuate whenever there is significant fluctuation in revenues during the periods being compared.

**Research and Development Expenses**

Research and development expenses increased 6.6% from $70.7 million, or 15.0% as a percentage of sales, in 2006 to $75.4 million, or 15.8% as a percentage of sales, in 2007. The increase in research and development expenses reflects increased staffing, engineering and testing expense primarily related to customer specific product development activities. Research and development expenses as a percentage of sales will fluctuate whenever there is a significant fluctuation in revenues during the periods being compared.

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 provides 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 14.8% from $13.5 million in 2006 to $11.5 million in 2007. This decrease is primarily related to a reduction in our cash and marketable securities balances, as a result of stock repurchases.

**Interest Expense**

Interest expense remained constant at $2.5 million in 2007 and 2006. See "Liquidity and Capital Resources" below for additional information.

**Net Realized Investment Gain**

Net realized investment gain decreased from $1.4 million in 2006 to $0.5 million in 2007. The change is primarily a result of the sale of securities associated with the realignment of our investment portfolios, which took place in 2006.

### Other Income, net

Other income, net, comprised primarily of miscellaneous income, gains and losses on foreign currency translations, investment account management fees and scrap raw material sales, increased from $0.6 million in 2006 to $0.8 million in 2007.

### Life Insurance Proceeds

We realized a gain on life insurance proceeds of $1.0 million during the first quarter of 2007 as a result of the death of our co-founder and then Chairman of the Board, Mark Smith.

### Income Taxes

Our effective tax rate increased slightly from 33.9% in 2006 to 34.0% in 2007, primarily reflecting the expiration of the tax benefit associated with the extra-territorial income exclusion after 2006, offset by an increase in benefits relating to the deduction for manufacturer's domestic production activities under Internal Revenue Code Section 199 in 2007.

### Net Income

As a result of the above factors, net income decreased from $78.3 million in 2006 to $76.3 million in 2007. As a percentage of sales, net income decreased from 16.6% in 2006 to 16.0% in 2007.

### Liquidity and Capital Resources

*Liquidity*

At December 31, 2008, cash on hand was $41.9 million and short-term investments were $96.3 million, which placed our short-term liquidity at $138.2 million. At December 31, 2007, our cash on hand of $13.9 million and short-term investments of $148.4 million placed our short-term liquidity at $162.3 million. The decrease in liquidity from 2007 to 2008 reflects a realignment of our investment portfolio whereby long-term investments increased $33.9 million in 2008 compared to 2007.

*Operating Activities*

Our working capital, which consists of current assets less current liabilities, decreased 15.4% from $251.3 million as of December 31, 2007 to $212.7 million as of December 31, 2008. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 5.41 as of December 31, 2007 to 4.76 as of December 31, 2008. The current ratio, defined as current assets divided by current liabilities, decreased from 6.83 as of December 31, 2007 to 6.30 as of December 31, 2008. The quick ratio and the current ratio decreased from 2007 to 2008 mainly due to a $17.9 million reduction in accounts receivable and a $24.1 million decrease in short-term liquidity as we realigned our investment portfolio and increased long-term investments by $33.9 million.

Net accounts receivable decreased 25.5% from $70.7 million at December 31, 2007 to $52.7 million at December 31, 2008. Our allowance for doubtful accounts has declined from $109,000 at December 31, 2007 to $38,000 at December 31, 2008. Quarterly accounts receivable days sales outstanding (DSO) decreased from 55 days as of December 31, 2007 to 43 days as of December 31, 2008. Net accounts receivable and DSO decreased for the year ended December 31, 2008 primarily because sales were recognized more evenly throughout the fourth quarter compared to the quarter ended December 31, 2007.

Quarterly inventory turnover decreased from 4.1 turns as of December 31, 2007 to 3.8 turns as of December 31, 2008. Inventory decreased 2.3% from December 31, 2007 to December 31, 2008. 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 decreased 8.6% from $22.2 million at December 31, 2007 to $20.3 million at December 31, 2008. 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 $9.5 million, $6.5 million and $6.1 million for the years ended December 31, 2008, 2007 and 2006, respectively. These expenditures were primarily used to purchase computer hardware, software and manufacturing and test equipment.

Our combined short-term and long-term investments decreased $18.2 million from $255.7 million at December 31, 2007 to $237.5 million at December 31, 2008. This decrease reflects the impact of net funds available for investment provided by our operating activities, reduced by our cash needs for equipment acquisitions, stock repurchases and dividends, as well as net realized and unrealized losses and amortization of net premiums on our combined investments.

We invest all available cash not required for immediate use in operations primarily in securities that we believe bear minimal risk of loss. At December 31, 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. At December 31, 2007, these investments included municipal variable rate demand notes of $47.5 million, municipal auction rate securities of $9.0 million and municipal fixed-rate bonds of $122.1 million.

Our municipal variable rate demand notes are classified as available-for-sale short-term investments and had a credit rating of A-1+ or VMIG-1 at December 31, 2008. 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 or auction rate securities, and we have held no municipal auction rate securities since February 7, 2008.

At December 31, 2008, approximately 54% of our municipal fixed-rate bond portfolio had a credit rating of AAA and 46% had a credit rating of AA. These bonds are classified as available-for-sale investments and had an average duration of 1.0 years at December 31, 2008. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

Our long-term investments increased 31.6% from $107.3 million at December 31, 2007 to $141.2 million at December 31, 2008. Municipal fixed-rate bonds classified as long-term investments increased $45.1 million from $30.2 million at December 31, 2007 to $75.3 million at December 31, 2008. The primary reason for the increase in our long-term municipal fixed rate bonds was to increase the yield on our fixed rate portfolio. Long-term investments at December 31, 2008 and 2007 include an investment in a certificate of deposit of $48.8 million and $49.0 million, respectively, 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 $12.0 million and $14.9 million, and with a fair value of $11.6 million and $21.7 million, at December 31, 2008 and 2007, respectively, including a single equity security, of which we held 2.5 million shares, carried at $2.5 million and $6.7 million of fair value at December 31, 2008 and 2007, respectively. The single security traded approximately 59,000 shares per day in 2008, in an active market on a European stock exchange. This single security carried $1.6 million and $5.8 million of the gross unrealized gains included in the fair value of our marketable securities at December 31, 2008 and 2007, respectively. The remaining $0.1 million of unrealized gains and $2.1 million in gross unrealized losses at December 31, 2008 were spread amongst more than 350 equity securities. Long-term investments at December 31, 2008 and 2007 also include $2.5 million and $3.1 million, respectively, related to our deferred compensation plan; $2.2 million and $2.1 million, respectively, of other investments carried at cost, consisting of two private equity funds and a direct investment in a privately held telecommunications equipment manufacturer; and $0.9 million and $1.2 million, respectively, of a fixed income bond fund. This bond fund had unrealized losses of $0.4 million and $25,000 at December 31, 2008 and 2007, respectively.

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 decline 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 more than 25% for more than six 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 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 duration of the historical decline. We then evaluated the individual securities to determine the amount of the write-down, if any. As a result, we recorded an other-than-temporary impairment charge of $1.8 million during the fourth quarter of 2008 related to 96 marketable equity securities. 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 each of the years ended December 31, 2008, 2007 and 2006 we recorded a charge of $2.4 million, $0.1 million and $0.1 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities.

*Financing Activities*

Fifty million dollars of the expansion of Phase III of our corporate headquarters was approved for participation in an incentive program offered by the Alabama State Industrial Development Authority (the Authority). Pursuant to the program, on January 13, 1995, the Authority issued $20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama, (the Bank). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee, Nashville, Tennessee) (the Bondholder), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to $50.0 million. The incentive program enables participating companies to generate Alabama corporate income tax credits that can be used to reduce the amount of Alabama corporate income taxes that would otherwise be payable, in exchange for investing capital and creating jobs in Alabama. We cannot be certain that the state of Alabama will continue to make these corporate income tax credits available; therefore, we may not realize the full benefit of these incentives. Through December 31, 2008, the Authority had issued $50.0 million of its taxable revenue bonds pursuant to the incentive program and loaned the proceeds from the sale of the bonds to ADTRAN. We are required to make payments to the Authority in the amounts necessary to pay the principal of, and interest on, the Authority's Taxable Revenue Bond, Series 1995, as amended, currently outstanding in the aggregate principal amount of $48.8 million. The bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. Included in long-term investments are $48.8 million of restricted funds, which is a collateral deposit against the principal amount of this 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. In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program.

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 up to $0.5 million in addition to the interest amounts that are due. In connection with this decision, $0.5 million of the bond debt has been reclassified to a current liability in the Consolidated Balance Sheets.

The following table shows dividends paid in each quarter of 2008, 2007 and 2006. During 2008, 2007 and 2006, ADTRAN paid dividends totaling $22.9 million, $24.6 million and $26.8 million. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

**Dividends per Common Share**

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| First Quarter | $0.09 | $0.09 | $0.09 |
| Second Quarter | $0.09 | $0.09 | $0.09 |
| Third Quarter | $0.09 | $0.09 | $0.09 |
| Fourth Quarter | $0.09 | $0.09 | $0.09 |

*Stock Repurchase Program*

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions. As of December 31, 2008, the Board of Directors has authorized cumulative repurchases of up to 30 million shares of our common stock. We currently have the authority to purchase an additional 3.5 million shares of our common stock under the plan approved by the Board of Directors on April 14, 2008. For the years 2008, 2007 and 2006, we repurchased 3.1 million shares, 5.8 million shares and 7.4 million shares, respectively, for a cost of $63.6 million, $138.6 million and $170.5 million, respectively, at an average price of $20.65, $24.08 and $22.96 per share, respectively.

To accommodate employee stock option exercises, we issued 0.3 million shares of treasury stock for $3.7 million during the year ended December 31, 2008, 1.2 million shares of treasury stock for $15.3 million during the year ended December 31, 2007, and 0.4 million shares of treasury stock for $4.4 million during the year ended December 31, 2006.

*Off-Balance Sheet Arrangements and Contractual Obligations*

We have various contractual obligations and commercial commitments. The following table sets forth, in millions, the annual payments we are required to make under contractual cash obligations and other commercial commitments at December 31, 2008.

**Contractual Obligations**

| *(In millions)* | Total | 2009 | 2010 | 2011 | 2012 | After 2012 |
|---|---|---|---|---|---|---|
| Long-term debt | $ 48.8 | $ — | $— | $— | $— | $ 48.8 |
| Interest on long-term debt | 26.8 | 2.4 | 2.4 | 2.4 | 2.4 | 17.2 |
| Investment commitments | 0.5 | — | 0.2 | — | 0.3 | — |
| Operating lease obligations | 2.8 | 1.2 | 1.0 | 0.5 | 0.1 | — |
| Purchase obligations | 29.6 | 29.3 | 0.3 | — | — | — |
| **Totals** | **$108.5** | **$32.9** | **$ 3.9** | **$ 2.9** | **$ 2.8** | **$ 66.0** |

We are required to make payments necessary to pay the interest on the Taxable Revenue Bond, Series 1995, as amended, currently outstanding in the aggregate principal amount of $48.8 million. The bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. Included in long-term investments are $48.8 million of restricted funds, which is a collateral deposit against the principal amount of this bond.

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. See Notes 6 and 10 of Notes to Consolidated Financial Statements for additional information on our revenue bond and operating lease obligations, respectively.

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 December 31, 2008, of which $7.4 million has been applied to these commitments. See Note 3 of Notes to 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.

**Effect of Recent Accounting Pronouncements**

During the first quarter of 2008, we adopted the following accounting standards, neither of which had a material effect on our consolidated results of operations or financial condition:

- Financial Accounting Standards Board (FASB) Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115* (SFAS 159), provides entities the option to measure certain financial assets and financial liabilities at fair value, with changes in fair value recognized in earnings each period. SFAS 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. We adopted SFAS 159 as of January 1, 2008. We elected not to apply the provisions of SFAS 159 to our eligible financial assets and financial liabilities on the date of adoption. Accordingly, the initial application of SFAS 159 had no effect on our consolidated results of operations and financial condition.
- FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), establishes a definition of fair value and a framework for measuring fair value, and expands disclosures about fair value measurements. The definition of fair value focuses on the price

that would be received upon the sale of an asset or the amount paid to transfer a liability. Under SFAS 157, the fair value measurement should reflect all of the assumptions that market participants would use in pricing the asset or liability. SFAS 157 establishes a three-level hierarchy to prioritize the inputs used in valuation techniques for fair value, consisting of: 1) observable inputs that reflect quoted prices in active markets; 2) inputs other than quoted prices with observable market data; and 3) unobservable data. SFAS 157 requires disclosures detailing the extent to which we measure assets and liabilities at fair value, the methods and assumptions used to measure fair value and the effect of fair value measurements on earnings. We adopted SFAS 157 in its entirety, including fair value measurements for nonfinancial assets and nonfinancial liabilities, and the initial application of SFAS 157 had no effect on our consolidated results of operations and financial condition. See Note 3 of Notes to Consolidated Financial Statements for more information.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* , (SFAS 141R) which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any non-controlling 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. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. We do not expect the adoption of SFAS 141R to have a material impact on our consolidated results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of ARB No. 51* (SFAS 160), which 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. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We do not expect the adoption of SFAS 160 to have a material impact on our consolidated results of operations or financial condition.

**Subsequent Events**

On January 20, 2009, the Board declared a quarterly cash dividend of $0.09 per common share to be paid to stockholders of record at the close of business on February 5, 2009. The quarterly dividend payment was $5.6 million and was paid on February 19, 2009.

During the first quarter of 2009 and as of February 25, 2009, ADTRAN repurchased 0.1 million shares of its common stock through open market purchases at an average cost of $14.51 per share and has the authority to repurchase an additional 3.4 million shares under the plan approved by the Board of Directors on April 14, 2008.

## *ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Details regarding the fair value of our available-for-sale investments as of December 31, 2008 are discussed in Note 3 of Notes to Consolidated Financial Statements included in this report.

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 December 31, 2008, our municipal variable rate demand notes had a credit rating of A-1+ or VMIG-1. Approximately 54% of our municipal fixed-rate bonds had a credit rating of AAA and 46% had a credit rating of AA.

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these applicable financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of December 31, 2008, $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 December 31, 2008, approximately $208.2 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 December 31, 2008, we held $89.2 million of money market instruments and municipal variable rate demand notes. Hypothetical 50 bps, 100 bps and 150 bps declines in interest rates as of December 31, 2008 would reduce annualized interest income on our money market instruments and municipal variable rate demand notes by approximately $0.4 million, $0.9 million and $1.3 million, respectively. In addition, we held $118.9 million of fixed-rate municipal bonds whose fair value may be directly affected by a change in interest rates. Hypothetical 50 bps, 100 bps and 150 bps increases in interest rates as of December 31, 2008 would reduce the fair value of our municipal fixed-rate bonds by approximately $0.6 million, $1.1 million and $1.7 million, respectively.

As of December 31, 2007, interest income on approximately $67.5 million of our cash and investments was subject to being directly affected by changes in interest rates. We performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 bps, 100 bps and 150 bps for the entire year, while all other variables remain constant. Hypothetical 50 bps, 100 bps and 150 bps declines in interest rates as of December 31, 2007 would have reduced annualized interest income on our money market instruments, municipal variable rate demand notes and municipal auction rate securities by approximately $0.3 million, $0.7 million and $1.0 million, respectively. In addition, hypothetical 50 bps, 100 bps and 150 bps increases in interest rates as of December 31, 2007 would have reduced the fair value of our municipal fixed-rate bonds by approximately $0.4 million, $0.8 million and $1.1 million, respectively.

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

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## *ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

The following consolidated financial statements are contained in this report.

## MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

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

Management assessed the effectiveness of ADTRAN's internal control over financial reporting as of December 31, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework.*

Based on our assessment and those criteria, management has concluded that ADTRAN maintained effective internal control over financial reporting as of December 31, 2008.

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

## Report of Independent Registered Public Accounting Firm

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

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of ADTRAN, Inc. and its subsidiaries at December 31, 2008 and December 31, 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying *Management's Report On Internal Control Over Financial Reporting.* Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 7 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertain tax positions in fiscal 2007.

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

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

/s/ PricewaterhouseCoopers LLP
Birmingham, Alabama
February 26, 2009

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**Financial Statements**

***ADTRAN, INC.***
***Consolidated Balance Sheets (In thousands, except per share amounts)***
***December 31, 2008 and 2007***

| | 2008 | 2007 |
|---|---|---|
| ***ASSETS*** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 41,909 | $ 13,941 |
| Short-term investments | 96,277 | 148,416 |
| Accounts receivable, less allowance for doubtful accounts of $38 and $109 at December 31, 2008 and 2007, respectively | 52,749 | 70,667 |
| Other receivables | 2,896 | 3,085 |
| Inventory | 47,406 | 48,546 |
| Prepaid expenses | 2,974 | 2,023 |
| Deferred tax assets, net | 8,653 | 7,659 |
| **Total current assets** | **252,864** | **294,337** |
| Property, plant and equipment, net | 75,487 | 75,969 |
| Deferred tax assets, net | 3,920 | 1,113 |
| Other assets | 103 | 505 |
| Long-term investments | 141,241 | 107,296 |
| **Total assets** | **$ 473,615** | **$ 479,220** |
| ***LIABILITIES AND STOCKHOLDERS' EQUITY*** | | |
| **Current liabilities** | | |
| Accounts payable | $ 20,313 | $ 22,200 |
| Unearned revenue | 6,141 | 5,361 |
| Accrued expenses | 3,536 | 3,801 |
| Accrued wages and benefits | 9,868 | 10,497 |
| Income tax payable, net | 266 | 1,217 |
| **Total current liabilities** | **40,124** | **43,076** |
| Other non-current liabilities | 9,422 | 9,213 |
| Bonds payable | 48,250 | 48,500 |
| **Total liabilities** | **97,796** | **100,789** |
| Commitments and contingencies (see Note 10) | | |
| **Stockholders' equity** | | |
| Common stock, par value $0.01 per share; 200,000 shares authorized; 79,652 issued in 2008 and 2007 | 797 | 797 |
| Additional paid-in capital | 172,704 | 164,385 |
| Accumulated other comprehensive income (loss) | (1,009) | 5,704 |
| Retained earnings | 603,600 | 551,764 |
| Less treasury stock at cost: 17,493 shares at December 31, 2008 and 14,739 shares at December 31, 2007 | (400,273) | (344,219) |
| **Total stockholders' equity** | **375,819** | **378,431** |
| **Total liabilities and stockholders' equity** | **$ 473,615** | **$ 479,220** |

*The accompanying notes are an integral part of these consolidated financial statements.*

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***ADTRAN, INC.***
***Consolidated Statements of Income (In thousands, except per share amounts)***
***Years ended December 31, 2008, 2007 and 2006***

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Sales | $500,676 | $476,778 | $472,708 |
| Cost of sales | 201,771 | 193,792 | 193,747 |
| **Gross profit** | **298,905** | **282,986** | **278,961** |
| Selling, general and administrative expenses | 103,286 | 103,329 | 102,646 |
| Research and development expenses | 81,819 | 75,367 | 70,700 |
| **Operating income** | **113,800** | **104,290** | **105,615** |
| Interest and dividend income | 8,708 | 11,521 | 13,493 |
| Interest expense | (2,514) | (2,502) | (2,532) |
| Net realized investment gain (loss) | (2,409) | 498 | 1,379 |
| Other income, net | 688 | 764 | 570 |
| Life insurance proceeds | — | 1,000 | — |
| **Income before provision for income taxes** | **118,273** | **115,571** | **118,525** |
| Provision for income taxes | 39,692 | 39,236 | 40,192 |
| **Net income** | **$ 78,581** | **$ 76,335** | **$ 78,333** |
| Weighted average shares outstanding – basic | 63,549 | 67,848 | 73,451 |
| Weighted average shares outstanding – diluted (1) | 64,408 | 69,212 | 75,197 |
| Earnings per common share – basic | $ 1.24 | $ 1.13 | $ 1.07 |
| Earnings per common share – diluted (1) | $ 1.22 | $ 1.10 | $ 1.04 |

(1) Assumes exercise of dilutive stock options calculated under the treasury method. See Notes 1 and 11 of the Notes to Consolidated Financial Statements.

*The accompanying notes are an integral part of these consolidated financial statements.*

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Index to Financial Statements

***ADTRAN, INC.***
***Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income (In thousands)***
***Years ended December 31, 2008, 2007 and 2006***

| | Common Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2005** | **79,652** | **$ 797** | **$142,441** | **$465,699** | **$ (70,938)** | **$ 4,172** | **$ 542,171** |
| Net income | | | | 78,333 | | | **78,333** |
| Change in unrealized loss on marketable securities (net of deferred tax of $891) | | | | | | (1,404) | **(1,404)** |
| Reclassification adjustment for amounts included in net income (net of income tax of $470) | | | | | | (814) | **(814)** |
| Foreign currency translation adjustment | | | | | | 742 | **742** |
| Comprehensive income | | | | | | | **76,857** |
| Dividend payments | | | | (26,755) | | | **(26,755)** |
| Stock options exercised: Various prices per share | | | | (3,762) | 8,203 | | **4,441** |
| Purchase of treasury stock: 7,425 shares | | | | | (170,479) | | **(170,479)** |
| Income tax benefit from exercise of stock options | | | 1,583 | | | | **1,583** |
| Stock-based compensation expense | | | 8,138 | | | | **8,138** |
| **Balance, December 31, 2006** | **79,652** | **$ 797** | **$152,162** | **$513,515** | **$(233,214)** | **$ 2,696** | **$ 435,956** |
| Net income | | | | 76,335 | | | **76,335** |
| Change in unrealized gain on marketable securities (net of deferred tax of $1,409) | | | | | | 2,375 | **2,375** |
| Reclassification adjustment for amounts included in net income (net of income tax of $31) | | | | | | 52 | **52** |
| Foreign currency translation adjustment | | | | | | 581 | **581** |
| Comprehensive income | | | | | | | **79,343** |
| Dividend payments | | | | (24,600) | | | **(24,600)** |
| Adoption of FIN 48 | | | | (1,190) | | | **(1,190)** |
| Stock options exercised: Various prices per share | | | | (12,296) | 27,584 | | **15,288** |
| Purchase of treasury stock: 5,756 shares | | | | | (138,589) | | **(138,589)** |
| Income tax benefit from exercise of stock options | | | 4,408 | | | | **4,408** |
| Stock-based compensation expense | | | 7,815 | | | | **7,815** |
| **Balance, December 31, 2007** | **79,652** | **$ 797** | **$164,385** | **$551,764** | **$(344,219)** | **$ 5,704** | **$ 378,431** |
| Net income | | | | 78,581 | | | **78,581** |
| Change in unrealized loss on marketable securities (net of deferred tax of $3,638) | | | | | | (6,127) | **(6,127)** |
| Reclassification adjustment for amounts included in net income (net of income tax of $740) | | | | | | 1,238 | **1,238** |
| Foreign currency translation adjustment | | | | | | (1,824) | **(1,824)** |
| Comprehensive income | | | | | | | **71,868** |
| Dividend payments | | | | (22,919) | | | **(22,919)** |
| Dividends accrued for unvested restricted stock units | | | | (2) | | | **(2)** |
| Stock options exercised: Various prices per share | | | | (3,824) | 7,515 | | **3,691** |
| Purchase of treasury stock: 3,078 shares | | | | | (63,569) | | **(63,569)** |
| Income tax benefit from exercise of stock options | | | 981 | | | | **981** |
| Stock-based compensation expense | | | 7,338 | | | | **7,338** |
| **Balance, December 31, 2008** | **79,652** | **$ 797** | **$172,704** | **$603,600** | **$(400,273)** | **$ (1,009)** | **$ 375,819** |

ADTRAN issued 325 shares, 1,197 shares and 357 shares of treasury stock to accommodate employee stock option exercises during 2008, 2007 and 2006, respectively. In 2008, 2007 and 2006, ADTRAN received 9 shares, 2 shares and 7 shares, respectively, previously held by employees for at least six months as payment of the exercise price for employee stock options. None of the transactions with respect to these shares were made in the open market. The average price paid per share with respect to these transactions was based on the closing price of the common stock on the NASDAQ Global Select Market on the date of the transaction.

*The accompanying notes are an integral part of these consolidated financial statements.*

***ADTRAN, INC.***
***Consolidated Statements of Cash Flows (In thousands)***
***Years ended December 31, 2008, 2007 and 2006***

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net income | **$ 78,581** | **$ 76,335** | **$ 78,333** |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 9,891 | 10,695 | 10,827 |
| Amortization of net premium on available-for-sale investments | 2,101 | 2,094 | 3,137 |
| Net realized loss (gain) on long-term investments | 2,409 | (498) | (1,379) |
| Loss on disposal of property, plant and equipment | 83 | 65 | 73 |
| Stock-based compensation expense | 7,338 | 7,815 | 8,138 |
| Deferred income taxes | (903) | (2,990) | (4,332) |
| Tax benefit from stock option exercises | 981 | 4,408 | 1,583 |
| Excess tax benefits from stock-based compensation arrangements | (619) | (3,249) | (973) |
| Change in operating assets and liabilities: | | | |
| Accounts receivable, net | 17,918 | (13,898) | 9,477 |
| Other receivables | 189 | 4,396 | (4,267) |
| Income tax receivable, net | — | 1,446 | (1,446) |
| Inventory | 1,140 | 4,571 | (2,185) |
| Prepaid expenses and other assets | (549) | 596 | 167 |
| Accounts payable | (1,887) | (7,933) | 4,932 |
| Accrued expenses and other liabilities | 93 | 3,517 | (2,256) |
| Income taxes payable, net | (951) | 1,507 | (4,551) |
| **Net cash provided by operating activities** | **115,815** | **88,877** | **95,278** |
| **Cash flows from investing activities** | | | |
| Purchases of property, plant and equipment | (9,492) | (6,535) | (6,061) |
| Proceeds from sales and maturities of available-for-sale investments | 248,688 | 253,339 | 323,211 |
| Purchases of available-for-sale investments | (242,791) | (217,316) | (293,098) |
| Acquisition of business | — | — | (400) |
| **Net cash (used in) provided by investing activities** | **(3,595)** | **29,488** | **23,652** |
| **Cash flows from financing activities** | | | |
| Proceeds from stock option exercises | 3,691 | 15,288 | 4,441 |
| Purchases of treasury stock | (63,569) | (138,589) | (170,479) |
| Dividend payments | (22,919) | (24,600) | (26,755) |
| Payments on long-term debt | (250) | (500) | (500) |
| Excess tax benefits from stock-based compensation arrangements | 619 | 3,249 | 973 |
| **Net cash used in financing activities** | **(82,428)** | **(145,152)** | **(192,320)** |
| Net increase (decrease) in cash and cash equivalents | 29,792 | (26,787) | (73,390) |
| Effect of exchange rate changes | (1,824) | 581 | 743 |
| **Cash and cash equivalents, beginning of year** | **13,941** | **40,147** | **112,794** |
| **Cash and cash equivalents, end of year** | **$ 41,909** | **$ 13,941** | **$ 40,147** |
| Supplemental disclosure of cash flow information | | | |
| Cash paid during the year for interest | $ 2,447 | $ 2,469 | $ 2,493 |
| Cash paid during the year for income taxes | $ 42,267 | $ 35,099 | $ 49,918 |

*The accompanying notes are an integral part of these consolidated financial statements.*

***Notes to Consolidated Financial Statements***

**Note 1—Nature of Business and Summary of Significant Accounting Policies**

ADTRAN, Inc. designs, manufactures, markets and services network access solutions for communications networks. Our solutions are widely deployed by providers of telecommunications services (serviced by our Carrier Networks Division), and small and mid-sized businesses and enterprises (serviced 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.

**Principles of Consolidation**

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

**Cash and Cash Equivalents**

Cash and cash equivalents represent demand deposits, money market funds, and short-term investments classified as available for sale with original maturities of three months or less. We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these applicable financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of December 31, 2008, $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.

**Financial Instruments**

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the immediate or short-term maturity of these financial instruments. The carrying amount reported for bonds payable was $48.8 million compared to an estimated fair value of $44.4 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor’s credit rating of AA.

Investments with maturities beyond one year may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. These investments consist of municipal variable rate demand notes and municipal auction rate securities. We have held no municipal auction rate securities since February 7, 2008. Variable rate demand notes are designed to be marketed as money market instruments. These instruments’ interest rates reset on a seven, 28 or 35 day basis to maintain the price of the instruments at par. At December 31, 2008, our municipal variable rate demand notes had a credit rating of A-1+ or VMIG-1 and contained put options of seven days, which allows ADTRAN to sell the security before its stated maturity date to a remarketing agent, tender agent or issuer in the event we decide to liquidate our investment in a particular variable rate demand note. Approximately 75% of our variable rate demand notes are supported by letters of credit from banks that we believe are in good financial condition.

Long-term investments represent a restricted certificate of deposit, municipal fixed-rate bonds, a fixed income bond fund, marketable equity securities, and other equity investments. Marketable equity securities are reported at fair value as determined by the most recently traded price of the securities at the balance sheet date, although the securities may not be readily marketable due to the size of the available market. Unrealized gains and losses, net of tax, are reported as a separate component of stockholders’ equity. Realized gains and losses on sales of securities are computed under the specific identification method and are included in current income. We periodically review our investment portfolio for investments considered to have sustained an other-than-temporary decline in value. Impairment charges for other-than-temporary declines in value are recorded as realized losses in the accompanying consolidated statements of income. All of our investments at December 31, 2008 and 2007 are classified as available-for-sale (see Note 3).

**Accounts Receivable**

We record accounts receivable at net realizable value. Prior to issuing payment terms to a new customer, we perform a detailed credit review of the customer. Credit limits are established for each new customer based on the results of this credit review. Payment terms are established for each new customer, and collection experience is reviewed periodically in order to determine if the customer’s payment terms and credit limits need to be revised.

We maintain allowances for doubtful accounts for losses resulting from the inability of our customers to make required payments. We regularly review the allowance for doubtful accounts and consider factors such as the age of accounts receivable balances, the current economic conditions that may affect a customer’s ability to pay, significant one-time events and our historical experience. If the financial condition of a customer deteriorates, resulting in an impairment of their ability to make payments, we may be required to make additional allowances. If circumstances change with regard to individual receivable balances that have previously been determined to be uncollectible (and for which a specific reserve has been established), a reduction in our allowance for doubtful accounts may be required. Our allowance for doubtful accounts was $38,000 at December 31, 2008 and $109,000 at December 31, 2007.

### Other Receivables

Other receivables are comprised primarily of amounts due from subcontract manufacturers for product component transfers and accrued interest.

### Inventory

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

### Property, Plant and Equipment

Property, plant and equipment, which are stated at cost, are depreciated using methods which approximate straight-line depreciation over the estimated useful lives of the assets. We depreciate building and land improvements from five to 39 years, office machinery and equipment from three to seven years, engineering machinery and equipment from three to seven years and computer software from three to five years. Expenditures for repairs and maintenance are charged to expense as incurred. Betterments that materially prolong the lives of the assets are capitalized. The cost of assets retired or otherwise disposed of and the related accumulated depreciation are removed from the accounts, and the gain or loss on such disposition is included in selling, general and administrative expenses in the accompanying consolidated statements of income.

### Liability for Warranty

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, will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled $2.8 million and $2.9 million at December 31, 2008 and 2007 respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets.

| **Year Ended December 31,** *(In thousands)* | **2008** | **2007** |
|---|---|---|
| Balance at beginning of period | $ 2,944 | $ 3,045 |
| Plus: amounts acquired or charged to cost and expenses | 2,261 | 1,822 |
| Less: deductions | (2,393) | (1,923) |
| **Balance at end of period** | **$ 2,812** | **$ 2,944** |

### Stock-Based Compensation

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

In 2008 and under the provisions of our approved plans, we made an initial grant of performance-based restricted stock units to five of our executive officers. The restricted stock units are earned based on the relative total shareholder return of ADTRAN against a peer group of companies and vest at the end of a three-year performance period. The restricted stock units are converted into shares of common stock upon vesting. Depending on the relative total shareholder return over the performance period, the executive officers may earn from 0% to 150% of the number of restricted stock units granted. The fair value of the award is based on the market price of our common stock on the date of grant, adjusted for the expected outcome of the impact of market conditions using a Monte Carlo Simulation valuation technique. The recipients of the restricted stock units also earn dividend credits during the performance period, which will be paid in cash upon the issuance of common stock for the restricted stock units.

Stock-based compensation expense recognized under SFAS 123R in 2008, 2007 and 2006 was approximately $7.3 million, $7.8 million and $8.1 million, respectively. As of December 31, 2008, total compensation cost related to non-vested stock options and restricted stock units not yet recognized was approximately $15.2 million, which is expected to be recognized over an average remaining recognition period of 2.8 years. See Note 2 of Notes to Consolidated Financial Statements for additional information.

### Impairment of Long-Lived Assets

We review long-lived assets for impairment under the guidance prescribed by Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* . We evaluate long-lived assets used in operations for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and the undiscounted cash flows estimated to be generated by the asset are less than the asset’s carrying value. An impairment loss would be recognized in the amount by which the recorded value of the asset exceeds the fair value of the asset, measured by the quoted market price of an asset or an estimate based on the best information available in the circumstances. There were no such impairment losses recognized during 2008, 2007 and 2006.

### Research and Development Costs

Research and development costs include compensation for engineers and support personnel, outside contracted services, depreciation and material costs associated with new product development, the enhancement of current products, and product cost reductions. We continually evaluate new product opportunities and engage in intensive research and product development efforts. Research and development costs totaled $81.8 million, $75.4 million and $70.7 million for the years ended December 31, 2008, 2007 and 2006, respectively.

### Comprehensive Income

Comprehensive income consists of all changes in equity (net assets) during a period from non-owner sources. Items included in comprehensive income include net income, changes in unrealized gains and losses on marketable securities and foreign currency translation adjustments. Comprehensive income is presented in the Consolidated Statements of Changes in Stockholders’ Equity and Comprehensive Income. The components of accumulated comprehensive income (loss) are as follows:

| *(In thousands)* | Unrealized Gain (Loss) on Marketable Securities, Net of Tax | Foreign Currency Translation Adjustment | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|
| **Balance at December 31, 2005** | **$ 4,437** | **$ (265)** | **$ 4,172** |
| Activity in 2006 | (1,404) | 742 | (662) |
| Reclassification adjustment for amounts included in net income | (814) | — | (814) |
| **Balance at December 31, 2006** | **2,219** | **477** | **2,696** |
| Activity in 2007 | 2,375 | 581 | 2,956 |
| Reclassification adjustment for amounts included in net income | 52 | — | 52 |
| **Balance at December 31, 2007** | **4,646** | **1,058** | **5,704** |
| Activity in 2008 | (6,127) | (1,824) | (7,951) |
| Reclassification adjustment for amounts included in net income | 1,238 | — | 1,238 |
| **Balance at December 31, 2008** | **$ (243)** | **$ (766)** | **$ (1,009)** |

### Income Taxes

The provision for income taxes has been determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from the difference between financial and tax bases of our assets and liabilities and are adjusted for changes in tax rates and tax laws when such changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

### Foreign Currency

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

### Revenue Recognition

Revenue is generally recognized upon shipment of the product to the customer in accordance with the terms of the sales agreement, generally FOB shipping point. In the case of consigned inventory, revenue is recognized when the customer assumes the risks and rewards of ownership of the product. When contracts contain multiple elements, contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple element contract should be treated as separate units of accounting for revenue recognition purposes, and, if so, how the price should be allocated among the elements and when to recognize the revenue for each element. We record revenue associated with installation services when the installation and all contractual obligations are complete. When contracts include both installation and product sales, the installation is considered as a separate deliverable item. Either the purchaser, ADTRAN, or a third party can perform the installation of our products. Shipping fees are recorded as revenue and the related cost is included in cost of sales. Revenue is recorded net of discounts. Also, revenue is recorded when the product price is fixed and determinable, collection of the resulting receivable is probable, and product returns are reasonably estimable. Sales returns are accrued based on historical sales return experience, which we believe provides a reasonable estimate of future returns.

The majority of Enterprise Networks products are sold in the United States through a non-exclusive distribution network of major technology distributors. These large organizations then distribute to an extensive network of value-added resellers and system integrators. Value-added resellers and system integrators may be affiliated with us as a channel partner, or they may purchase from the distributor in an unaffiliated fashion. Additionally, with certain limitations our distributors may return unused and unopened product for stock-balancing purposes when such returns are accompanied by offsetting orders for products of equal or greater value.

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

### Unearned Revenue

Unearned revenue primarily represents customer billings on our maintenance service programs and deferred revenues relating to multiple element contracts where we still have contractual obligations to our customers. We currently offer maintenance contracts ranging from one to five years, primarily on Enterprise Networks Division products sold through distribution channels. Revenue attributable to maintenance contracts is recognized on a straight-line basis over the related contract term. In addition, we provide software maintenance and a variety of hardware maintenance services to Carrier Network Division customers under contracts with terms up to ten years. Non-current unearned revenue is included in other non-current liabilities in the accompanying consolidated balance sheets. At December 31, 2008 and 2007, unearned revenue was as follows:

| *(In thousands)* | 2008 | 2007 |
|---|---|---|
| Current unearned revenue | $6,141 | $5,361 |
| Non-current unearned revenue | 3,235 | 2,223 |
| **Total** | **$9,376** | **$7,584** |

### Other Income, net

Other income, net, is comprised primarily of miscellaneous income and expense, gains and losses on foreign currency transactions, investment account management fees, scrap raw material sales, and litigation costs.

### Earnings Per Share

Earnings per common share, and earnings per common share assuming dilution, are based on the weighted average number of common shares and, when dilutive, common equivalent shares outstanding during the year (see Note 11).

### Dividends

The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the current tax treatment of dividends exists and adequate levels of liquidity are maintained. During the years ended December 31, 2008, 2007 and 2006, ADTRAN paid $22.9 million, $24.6 million and $26.8 million, respectively, in dividend payments. On January 20, 2009, the Board of Directors declared a quarterly cash dividend of $0.09 per common share to be paid to holders of record at the close of business on February 5, 2009. The ex-dividend date was February 3, 2009 and the payment date was February 19, 2009. The quarterly dividend payment was $5.6 million.

### 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.

### Recently Issued Accounting Standards

During the first quarter of 2008, we adopted the following accounting standards, neither of which had a material effect on our consolidated results of operations or financial condition:

- Financial Accounting Standards Board (FASB) Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115* (SFAS 159), provides entities the option to measure certain financial assets and financial liabilities at fair value, with changes in fair value recognized in earnings each period. SFAS 159 permits the fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. We adopted SFAS 159 as of January 1, 2008. We elected not to apply the provisions of SFAS 159 to our eligible financial assets and financial liabilities on the date of adoption. Accordingly, the initial application of SFAS 159 had no effect on our consolidated results of operations and financial condition.
- FASB Statement No. 157, *Fair Value Measurements* (SFAS 157), establishes a definition of fair value and a framework for measuring fair value, and expands disclosures about fair value measurements. The definition of fair value focuses on the price that would be received upon the sale of an asset or the amount paid to transfer a liability. Under SFAS 157, the fair value measurement should reflect all of the assumptions that market participants would use in pricing the asset or liability. SFAS 157 establishes a three-level hierarchy to prioritize the inputs used in valuation techniques for fair value, consisting of: 1) observable inputs that reflect quoted prices in active markets; 2) inputs other than quoted prices with observable market data; and 3) unobservable data. SFAS 157 requires disclosures detailing the extent to which we measure assets and liabilities at fair value, the methods and assumptions used to measure fair value and the effect of fair value measurements on earnings. We adopted SFAS 157 in its entirety, including fair value measurements for nonfinancial assets and nonfinancial liabilities, and the initial application of SFAS 157 had no effect on our consolidated results of operations and financial condition. See Note 3 of Notes to Consolidated Financial Statements for more information.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* , (SFAS 141R) which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any non-controlling 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. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. We do not expect the adoption of SFAS 141R to have a material impact on our consolidated results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an Amendment of ARB No. 51* (SFAS 160), which 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. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We do not expect the adoption of SFAS 160 to have a material impact on our consolidated results of operations or financial condition.

**Note 2—Stock Incentive Plans**

*Stock Incentive Program Descriptions*

Our Board of Directors adopted the 1996 Employee Incentive Stock Option Plan (1996 Plan) effective February 14, 1996, as amended, under which 17.0 million shares of common stock were authorized for issuance to certain employees and officers through incentive stock options and non-qualified stock options. Options granted under the 1996 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four or five-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. The 1996 Plan expired February 14, 2006, and expiration dates of options outstanding at December 31, 2008 under the 1996 Plan range from 2009 to 2016.

On January 23, 2006, the Board of Directors adopted the 2006 Employee Stock Incentive Plan (2006 Plan), which authorizes 13.0 million shares of common stock for issuance to certain employees and officers through incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. The 2006 Plan was adopted by stockholder approval at our annual meeting of stockholders held on May 9, 2006. Options granted under the 2006 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. Expiration dates of options outstanding at December 31, 2008 under the 2006 Plan range from 2016 to 2018.

Our stockholders approved the 2005 Directors Stock Option Plan (Directors Plan) on May 18, 2005, under which 0.4 million shares of common stock have been reserved. The Directors Plan is a formula plan to provide options to our non-employee directors. Options granted under the Directors Plan normally become exercisable in full on the first anniversary of the grant date, and have a ten-year contractual term. We currently also have options outstanding under the 1995 Directors Stock Option Plan, as amended, which expired October 31, 2005. Expiration dates of options outstanding under both plans at December 31, 2008 range from 2010 to 2018.

The following table is a summary of our stock options outstanding as of December 31, 2007 and 2008 and the changes that occurred during 2008:

| *(In thousands, except per share amounts)* | Number of Options | Weighted Average Exercise Price | Weighted Avg. Remaining Contractual Life in Years | Aggregate Intrinsic Value |
|---|---|---|---|---|
| **Options outstanding, December 31, 2007** | **6,375** | **$ 19.79** | **5.94** | **$ 24,737** |
| Options granted | 969 | $ 15.49 | | |
| Options cancelled/forfeited | (184) | $ 25.32 | | |
| Options exercised | (334) | $ 11.69 | | |
| **Options outstanding, December 31, 2008** | **6,826** | **$ 19.43** | **5.79** | **$ 6,889** |
| **Options exercisable, December 31, 2008** | **4,665** | **$ 19.12** | **4.32** | **$ 6,889** |

The following table further describes our stock options outstanding as of December 31, 2008:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Options Outstanding at 12/31/08 | Weighted Avg. Remaining Contractual Life in Years | Weighted Average Exercise Price | Options Exercisable at 12/31/08 | Weighted Average Exercise Price |
| $ 8.69 - $10.65 | 1,097 | 3.33 | $10.12 | 1,097 | $10.12 |
| $10.66 - $18.02 | 1,805 | 6.40 | $14.21 | 867 | $13.04 |
| $18.03 - $22.52 | 1,817 | 5.09 | $21.00 | 1,449 | $20.66 |
| $22.53 - $30.03 | 1,597 | 7.93 | $25.80 | 744 | $27.46 |
| $30.04 - $37.18 | 510 | 4.80 | $32.37 | 508 | $32.37 |
| | **6,826** | | | **4,665** | |

All of the options above were issued at exercise prices that approximate fair market value at the date of grant. At December 31, 2008, 10.7 million options were available for grant under the shareholder approved plans.

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic value (the difference between ADTRAN's closing stock price on the last trading day of 2008 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2008. The amount of aggregate intrinsic value will change based on the fair market value of ADTRAN's stock.

The total pre-tax intrinsic value of options exercised during 2008, 2007 and 2006 was $3.7 million, $14.5 million and $5.1 million, respectively. The fair value of options fully vesting during 2008, 2007 and 2006 was $7.4 million, $11.2 million and $4.7 million, respectively.

*Restricted Stock Program Description*

On November 6, 2008, the Compensation Committee of the Board of Directors approved the Performance Shares Agreement under the 2006 Plan which sets forth the terms and conditions of awards of performance-based restricted stock units (RSUs). Of the 13.0 million shares of common stock authorized for issuance under the 2006 Plan, ADTRAN may grant up to 5.0 million shares of common stock for issuance to certain employees and officers for awards other than stock options, which would include RSUs. For the grants made in 2008, the number of shares of common stock earned by a recipient pursuant to the RSUs is based on ADTRAN's relative total shareholder return against a peer group at the end of a three-year performance period. Depending on the relative total shareholder return over the performance period, the recipient may earn from 0% to 150% of the shares underlying the RSUs, with the shares earned distributed upon the vesting of the RSUs at the end of the three-year performance period. The fair value of the award is based on the market price of our common stock on the date of grant, adjusted for the expected outcome of the impact of market conditions using a Monte Carlo Simulation valuation technique. A portion of the granted RSUs also vest and the underlying shares become deliverable upon the death or disability of the recipient or upon a change of control of ADTRAN, as defined by the 2006 Plan. The recipients of the RSUs receive dividend credits based on the shares of common stock underlying the RSUs. The dividend credits are vested, earned and distributed in the same manner as the RSUs. On November 6, 2008, the Compensation Committee granted 26,100 RSUs with a fair value at the date of grant of $17.05 per unit, to certain executive officers. As of December 31, 2008, there was approximately $0.4 million of total unamortized compensation cost related to the non-vested portion of this grant which will be recognized on a straight-line basis over the remainder of the three-year performance period.

*Stock-Based Compensation*

On January 1, 2006, ADTRAN adopted SFAS 123R, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including grants of stock options and RSUs, based on estimated fair values. SFAS 123R supersedes APB No. 25, which we previously applied, for periods beginning in fiscal 2006.

ADTRAN adopted SFAS 123R using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our fiscal 2006 year. Our Consolidated Statements of Income for the 12 months ended December 31, 2008, 2007 and 2006 reflect the impact of SFAS 123R. In accordance with the modified prospective transition method, our Consolidated Statements of Income for prior periods have not been restated to reflect the impact of SFAS 123R. New awards are valued and accounted for prospectively upon adoption. Prior outstanding stock option awards that were not fully vested as of December 31, 2005 are being recognized as compensation expense in our Consolidated Statements of Income over their remaining requisite service periods based on their previously established fair values.

Prior to the adoption of SFAS 123R, ADTRAN recorded the intrinsic value of stock-based compensation as expense, in accordance with APB No. 25, as allowed under SFAS 123. Under the intrinsic value method, no material amounts of stock-based compensation expense had been recorded in our Consolidated Statements of Income prior to January 1, 2006, other than as related to accelerated vesting at retirement, because the exercise price of the majority of our stock options granted equaled the fair market value of the underlying stock at the date of grant. In our pro forma disclosures required under SFAS 123, we accounted for forfeitures as they occurred.

SFAS 123R requires companies to estimate the fair value of stock option awards on the date of grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest will be recognized as expense over the requisite service periods in our Consolidated Statements of Income. Stock-based compensation expense recognized in our Consolidated Statements of Income for the years ended December 31, 2008, 2007 and 2006 includes compensation expense for stock-based payment awards granted prior to, but not yet vested as of, December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for the stock-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Compensation expense for all stock option awards is recognized using the ratable single-option approach. Stock-based compensation expense recognized in our Consolidated Statements of Income for the years ended December 31, 2008, 2007 and 2006 is based on awards ultimately expected to vest; therefore, it has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. As such, we evaluated the need to record a cumulative effect adjustment for estimated forfeitures upon the adoption of SFAS 123R. Because this adjustment only applies to the extent that compensation cost was previously recognized for the unvested awards, no cumulative effect adjustment was recorded upon adoption of SFAS 123R.

ADTRAN uses the Black-Scholes option pricing model (Black-Scholes Model) for the purpose of determining the estimated fair value of stock option awards on the date of grant under SFAS 123R. The Black-Scholes Model requires the input of certain assumptions that involve judgment. Because our stock options have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, existing models may not provide reliable measures of fair value of our stock options. ADTRAN uses the Monte Carlo Simulation valuation technique to value its performance-based RSUs. We will continue to assess the assumptions and methodologies used to calculate the estimated fair value of stock-based compensation. If circumstances change, and additional data becomes available over time, we may change our assumptions and methodologies, which may materially impact our fair value determination.

ADTRAN elected to adopt the alternative transition method, as permitted by FASB Staff Position No. FAS 123R-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards* , to calculate the tax effects of stock-based compensation pursuant to SFAS 123R for those awards that were outstanding upon adoption of SFAS 123R. The alternative transition method allows the use of simplified methods to calculate the beginning capital-in-excess-of-par pool related to the tax effects of stock-based compensation and to determine the subsequent impact of the tax effects of stock-based compensation awards on the capital-in-excess-of-par pool and the Consolidated Statements of Cash Flows. Prior to the adoption of SFAS 123R, we reported all tax benefits resulting from the exercise of stock options as operating cash flows in the Consolidated Statements of Cash Flows. SFAS 123R requires cash flows resulting from the tax deductions in excess of the related compensation cost recognized in the financial statements (“excess tax benefits”) to be classified as financing cash flows. In accordance with SFAS 123R, excess tax benefits recognized in periods after the adoption date have been classified as financing cash flows. Excess tax benefits recognized in periods prior to the adoption date are classified as operating cash flows.

*Valuation and Expense Information*

The following table summarizes stock-based compensation expense related to stock options and RSUs under SFAS 123R for the years ended December 31, 2008, 2007 and 2006, which was recognized as follows:

| *(In thousands)* | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Stock-based compensation expense included in cost of sales** | **$ 253** | **$ 268** | **$ 399** |
| Selling, general and administrative expense | 3,263 | 3,495 | 3,945 |
| Research and development expense | 3,822 | 4,052 | 3,794 |
| **Stock-based compensation expense included in operating expenses** | **7,085** | **7,547** | **7,739** |
| **Total stock-based compensation expense** | **7,338** | **7,815** | **8,138** |
| Tax benefit for expense associated with non-qualified options | (669) | (680) | (971) |
| **Total stock-based compensation expense, net of tax** | **$6,669** | **$7,135** | **$7,167** |

At December 31, 2008, total compensation cost related to non-vested stock options and RSUs not yet recognized was approximately $15.2 million, which is expected to be recognized over an average remaining recognition period of 2.8 years.

The stock option pricing model requires the use of several significant assumptions that impact the fair value estimate. These variables include, but are not limited to, the volatility of our stock price and employee exercise behaviors. The assumptions and variables used for the current period grants were developed based on SFAS 123R and SEC guidance contained in Staff Accounting Bulletin 107. There were no material changes made during 2008 to the methodology used to determine our assumptions.

The weighted-average estimated fair value of stock options granted to employees and directors during the twelve months ended December 31, 2008, 2007 and 2006 was $4.96 per share, $8.76 per share and $9.33 per share, respectively, with the following weighted-average assumptions:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Expected volatility | 41.70% | 43.42% | 47.40% |
| Risk-free interest rate | 2.43% | 4.02% | 4.58% |
| Expected dividend yield | 2.33% | 1.56% | 1.58% |
| Expected life (in years) | 4.97 | 4.98 | 4.90 |

We based our estimate of expected volatility for the 12 months ended December 31, 2008, 2007 and 2006 on the sequential historical daily trading data of our common stock for a period equal to the expected life of the options granted. The selection of the historical volatility method was based on available data indicating our historical volatility is as equally representative of ADTRAN's future stock price trends as is implied volatility. We have no reason to believe the future volatility of our stock price is likely to differ from its past volatility.

The risk-free interest rate assumption is based upon implied yields of U.S. Treasury zero-coupon bonds on the date of grant having a remaining term equal to the expected life of the options granted. The dividend yield is based on our historical and expected dividend payouts.

The expected life of our stock options is based upon historical exercise and cancellation activity of our previous stock-based grants with a ten-year contractual term.

The RSU pricing model also requires the use of several significant assumptions that impact the fair value estimate. The estimated fair value of the RSUs granted to employees on November 6, 2008 was $17.05, with the following assumptions:

| | 2008 |
|---|---|
| Expected volatility | 38.61% |
| Risk-free interest rate | 1.63% |
| Expected dividend yield | 2.35% |
| Fair value of future dividend payments | $ 1.06 |

Stock-based compensation expense recognized in our Consolidated Statements of Income for the 12 months ended December 31, 2008, 2007 and 2006 is based on RSUs and options ultimately expected to vest, and has been reduced for estimated forfeitures. Estimates for forfeiture rates are based upon historical experience and are evaluated quarterly. We expect our forfeiture rate for stock option awards to be approximately 5.0% 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.

**Note 3—Investments**

We classify our investments as available-for-sale. At December 31, 2008, we held the following securities and investments, recorded at either fair value or cost.

| *(In thousands)* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value / Carrying Value |
|---|---|---|---|---|
| Deferred compensation plan assets | $ 3,137 | $ — | $ (680) | $ 2,457 |
| Government agency security | 1,995 | 4 | — | 1,999 |
| Municipal fixed-rate bonds | 115,792 | 1,152 | (1) | 116,943 |
| Municipal variable rate demand notes | 52,633 | — | — | 52,633 |
| Fixed income bond fund | 1,279 | — | (395) | 884 |
| Marketable equity securities | 12,014 | 1,740 | (2,110) | 11,644 |
| **Available-for-sale securities held at fair value** | **$186,850** | **$2,896** | **$(3,186)** | **$ 186,560** |
| **Restricted investments held at cost** | | | | **48,750** |
| **Other investments held at cost** | | | | **2,208** |
| **Total carrying value of available-for-sale securities and investments** | | | | **$ 237,518** |

At December 31, 2007, we held the following securities and investments, recorded at either fair value or cost.

| *(In thousands)* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value / Carrying Value |
|---|---|---|---|---|
| Deferred compensation plan assets | $ 2,953 | $ 205 | $ (2) | $ 3,156 |
| Municipal fixed-rate bonds | 121,800 | 333 | (24) | 122,109 |
| Municipal variable rate demand notes | 47,475 | — | — | 47,475 |
| Municipal auction rate securities | 8,970 | — | — | 8,970 |
| Fixed income bond fund | 1,194 | — | (25) | 1,169 |
| Marketable equity securities | 14,904 | 7,825 | (994) | 21,735 |
| **Available-for-sale securities held at fair value** | **$197,296** | **$8,363** | **$(1,045)** | **$ 204,614** |
| **Restricted investments held at cost** | | | | **49,000** |
| **Other investments held at cost** | | | | **2,098** |
| **Total carrying value of available-for-sale securities and investments** | | | | **$ 255,712** |

At December 31, 2008 and 2007, we held $2.5 million and $3.2 million, respectively, of deferred compensation plan assets, carried at fair value.

At December 31, 2008, we held $2.0 million in securities issued by a single government agency, with a maturity of February 2009.

At December 31, 2008 and 2007, we held $116.9 million and $122.1 million of municipal fixed-rate bonds. At December 31, 2008, approximately 54% of our municipal fixed-rate bond portfolio had a credit rating of AAA and 46% had a credit rating of AA. These bonds are classified as available-for-sale investments and had an average duration of 1.0 years at December 31, 2008. 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. As of December 31, 2008, municipal fixed-rate bonds had the following contractual maturities:

| *(In thousands)* | 2008 |
|---|---|
| **Maturity** | |
| Less than one year | **$ 41,645** |
| One year to three years | 75,298 |
| Total | $116,943 |

At December 31, 2008 and 2007, we held $52.6 million and $47.5 million of municipal variable rate demand notes, all of which were classified as available-for-sale short-term investments. At December 31, 2008, these municipal variable rate demand notes had a credit rating of A-1+ or VMIG-1 and 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 in the event we decide to liquidate our investment in a particular variable rate demand note. Approximately 75% of our variable rate demand notes are supported by letters of credit from banks that we believe are in good financial condition. 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 or municipal auction rate securities, and we have held no municipal auction rate securities since February 7, 2008.

At December 31, 2008, we held $11.6 million of marketable equity securities, including a single security, of which we held 2.5 million shares, carried at a fair value of $2.5 million. The single security traded approximately 59,000 shares per day in 2008, in an active market on a European stock exchange. This single security carried $1.6 million of the gross unrealized gains included in the fair value of our marketable equity securities at December 31, 2008. The remaining $0.1 million of unrealized gains and $2.1 million of gross unrealized losses at December 31, 2008 were spread amongst more than 350 equity securities. At December 31, 2007, we held $21.7 million of marketable equity securities, including the single security mentioned above, of which we held 2.5 million shares, carried at a fair value of $6.7 million. This single security carried $5.8 million of the gross unrealized gains included in the fair value of our marketable equity securities at December 31, 2007. The remaining $2.0 million of unrealized gains and $1.0 million of gross unrealized losses at December 31, 2007 were spread amongst more than 300 securities.

At December 31, 2008 and 2007, we held $0.9 million and $1.2 million of a fixed income bond fund. This bond fund had unrealized losses of $0.4 million and $25,000 at December 31, 2008 and 2007, respectively.

At December 31, 2008 and 2007, we held a $48.8 million and $49.0 million, respectively, 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). 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 Note 6 of Notes to Consolidated Financial Statements.

At December 31, 2008 and 2007, we held $2.2 million and $2.1 million, respectively, of other investments carried at cost, consisting of two private equity funds and a direct investment in a privately held telecommunications equipment manufacturer. The fair value of these investments was estimated to be approximately $10.9 million at December 31, 2008, based on unobservable inputs including information supplied by the investees. 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 December 31, 2008, of which $7.4 million has been applied toward these commitments. As of December 31, 2008, 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 these commitments 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 more than 25% for more than six 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 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 $1.8 million during the fourth quarter of 2008 related to 96 marketable equity securities. 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 each of the years ended December 31, 2008, 2007 and 2006 we recorded a charge of $2.4 million, $0.1 million and $0.1 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities. Although we believe our marketable equity security portfolio is diversified, if the market conditions experienced at and subsequent to December 31, 2008 prove to be other-than-temporary, we may be required to record additional impairments.

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

| **Year Ended December 31,** *(In thousands)* | **2008** | **2007** | **2006** |
|---|---|---|---|
| Gross realized gains | $ 1,884 | $1,075 | $2,158 |
| Gross realized losses | $(4,293) | $ (577) | $ (779) |

The following table presents the breakdown of investments with unrealized losses at December 31, 2008.

| | **Continuous Unrealized Loss Position for Less than 12 Months** | | **Continuous Unrealized Loss Position for 12 Months or Greater** | | **Total** | |
|---|---|---|---|---|---|---|
| *(In thousands)* | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** |
| Deferred compensation plan assets | $ 2,435 | $ (658) | $ 22 | $ (22) | $ 2,457 | $ (680) |
| Municipal fixed-rate bonds | 1,573 | (1) | — | — | 1,573 | (1) |
| Fixed income bond fund | — | — | 884 | (395) | 884 | (395) |
| Marketable equity securities | 5,627 | (1,848) | 554 | (262) | 6,181 | (2,110) |
| Total | $ 9,635 | $ (2,507) | $ 1,460 | $ (679) | $ 11,095 | $ (3,186) |

The following table presents the breakdown of investments with unrealized losses at December 31, 2007.

| | **Continuous Unrealized Loss Position for Less than 12 Months** | | **Continuous Unrealized Loss Position for 12 Months or Greater** | | **Total** | |
|---|---|---|---|---|---|---|
| *(In thousands)* | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** |
| Deferred compensation plan assets | $ 94 | $ (2) | $ — | $ — | $ 94 | $ (2) |
| Municipal fixed-rate bonds | 1,320 | (2) | 16,320 | (22) | 17,640 | (24) |
| Fixed income bond fund | 1,169 | (25) | — | — | 1,169 | (25) |
| Marketable equity securities | 4,270 | (827) | 407 | (167) | 4,677 | (994) |
| Total | $ 6,853 | $ (856) | $ 16,727 | $ (189) | $ 23,580 | $ (1,045) |

The increase in unrealized losses during 2008, as reflected in the tables above, primarily occurred during the fourth quarter of 2008 due to the impact of strained credit markets and deteriorating equity market conditions on the value of these investments. At December 31, 2008, a total of 216 of our marketable equity securities were in an unrealized loss position.

In accordance with SFAS 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.

| (In thousands) | Fair Value | Fair Value Measurements at December 31, 2008 Using: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| **Cash equivalents** | | | | |
| Money market funds | $ 25,389 | $ 25,389 | $ — | $ — |
| **Available-for-sale securities held at fair value** | | | | |
| 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 | — | — |
| **Available-for-sale securities held at fair value** | **186,560** | **14,985** | **171,575** | **—** |
| **Total** | **$211,949** | **$ 40,374** | **$ 171,575** | **$ —** |

**Note 4—Inventory**

At December 31, 2008 and 2007, inventory was comprised of the following:

| (In thousands) | 2008 | 2007 |
|---|---|---|
| Raw materials | $32,591 | $30,519 |
| Work in process | 1,552 | 2,552 |
| Finished goods | 20,991 | 21,899 |
| Inventory reserve | (7,728) | (6,424) |
| **Total** | **$47,406** | **$48,546** |

**Note 5—Property, Plant and Equipment**

At December 31, 2008 and 2007, property, plant and equipment were comprised of the following:

| (In thousands) | 2008 | 2007 |
|---|---|---|
| Land | $ 4,263 | $ 4,263 |
| Building and land improvements | 13,508 | 11,856 |
| Building | 68,495 | 68,554 |
| Furniture and fixtures | 15,690 | 15,735 |
| Computer hardware and software | 55,125 | 52,734 |
| Engineering and other equipment | 74,864 | 70,007 |
| **Total Property, Plant and Equipment** | **231,945** | **223,149** |
| Less accumulated depreciation | (156,458) | (147,180) |
| **Total Property, Plant and Equipment (net)** | **$ 75,487** | **$ 75,969** |

Depreciation expense was $9.9 million, $10.7 million and $10.8 million in 2008, 2007 and 2006, respectively.

**Note 6—Alabama State Industrial Development Authority Financing and Economic Incentives**

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the “Authority”). Pursuant to the program, on January 13, 1995, the Authority issued $20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the “Bank”). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the “Bondholder”), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to $50.0 million. An Amended and Restated Taxable Revenue Bond (“Amended and Restated Bond”) was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 5%. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond at December 31, 2008 was approximately $44.4 million, based on a debt security with a comparable interest rate and maturity and a Standard &

Poor's credit rating of AA. We are required to make payments to the Authority in amounts necessary to pay the principal of and interest on the Amended and Restated Bond. Included in long-term investments at December 31, 2008 is $48.8 million which is invested in a restricted certificate of deposit. These funds serve as a collateral deposit against the principal of this bond, and 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. In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. We realized $1.4 million in economic incentives for each of the years ended December 31, 2008, 2007 and 2006.

Due to continued positive cash flow from operating activities, ADTRAN made a business decision to begin an early partial redemption of the bond as evidenced by a $0.2 million principal payment in the third quarter of 2008 and a $0.5 million principal payment in the third quarters of 2006 and 2007. It is our intent to make annual principal payments of between $0.5 million and $5.0 million per year in addition to the interest amounts that are due. In connection with this decision, $0.5 million of the bond debt has been reclassified to a current liability in the Consolidated Balance Sheet.

**Note 7—Income Taxes**

A summary of the components of the provision for income taxes as of December 31, 2008, 2007 and 2006 is as follows:

| *(In thousands)* | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Current** | | | |
| Federal | $37,245 | $38,956 | $40,121 |
| State | 3,350 | 3,270 | 4,403 |
| **Total current** | **40,595** | **42,226** | **44,524** |
| Deferred tax benefit | (903) | (2,990) | (4,332) |
| **Total provision for income taxes** | **$39,692** | **$39,236** | **$40,192** |

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

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Tax provision computed at the federal statutory rate | 35.00% | 35.00% | 35.00% |
| State income tax provision, net of federal benefit | 2.95% | 2.95% | 3.58% |
| Federal research credits | (1.86)% | (1.64)% | (1.39)% |
| Tax-exempt income | (1.59)% | (2.43)% | (2.79)% |
| State tax incentives | (1.15)% | (1.19)% | (1.14)% |
| Stock-based compensation | 1.59% | 1.71% | 1.58% |
| Extra-territorial income | 0.0% | 0.0% | (0.43)% |
| Domestic production activity deduction | (1.62)% | (0.95)% | (0.53)% |
| Life insurance | 0.0% | (0.28)% | 0.0% |
| Other, net | 0.24% | 0.78% | 0.03% |
| **Effective tax rate** | **33.56%** | **33.95%** | **33.91%** |

Deferred income taxes on the balance sheet result from temporary differences between the amount of assets and liabilities recognized for financial reporting and tax purposes. The principal components of our current and non-current deferred taxes are as follows:

| *(In thousands)* | 2008 | 2007 |
|---|---|---|
| Current deferred tax assets | | |
| Accounts receivable | $ 14 | $ 41 |
| Inventory | 4,656 | 4,028 |
| Accrued expenses | 3,959 | 3,590 |
| State tax and interest expense | 24 | — |
| **Total current deferred tax assets** | **8,653** | **7,659** |
| Non-current deferred tax assets | | |
| Accrued expenses | 55 | 87 |
| Deferred compensation | 1,249 | 1,184 |
| Stock-based compensation | 2,248 | 1,552 |
| State tax and interest expense | 900 | 843 |
| Investments | 2,220 | — |
| Other | 107 | 222 |
| State research credits | 1,581 | 1,236 |
| Valuation allowance | (1,581) | (1,236) |
| **Total non-current deferred tax assets** | **6,779** | **3,888** |
| **Total deferred tax assets** | **$15,432** | **$11,547** |

| Non-current deferred tax liabilities | 2008 | 2007 |
|---|---|---|
| Accumulated depreciation | $ (2,859) | $ (1,644) |
| Investments | — | (1,131) |
| **Total non-current deferred tax liabilities** | **$ (2,859)** | **$ (2,775)** |
| **Net deferred tax assets** | **$12,573** | **$ 8,772** |

At December 31, 2008 and 2007, non-current deferred tax liabilities related to investments reflect amounts provided for changes in unrealized gains and losses on available-for-sale investments. The net change in non-current deferred taxes associated with these investments, a deferred tax benefit of $2.9 million in 2008 and a deferred tax provision of $1.4 million in 2007, is recorded as an adjustment to other comprehensive income, presented in the Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income.

We have state research tax credit carry-forwards of $1.6 million which will expire between 2015 and 2023. These carry-forwards were caused by tax credits in excess of our annual tax liabilities to an individual state where we no longer generate sufficient state income. In accordance with SFAS No. 109, *Accounting for Income Taxes* , we believe it is more likely than not that we will not realize the benefits of our deferred tax asset arising from these credits, and accordingly, have provided a valuation allowance. We do not provide for U.S. income tax on undistributed earnings of our foreign operations, whose earnings are intended to be permanently reinvested. For years ended December 31, 2008, 2007 and 2006, foreign profits before income taxes were not material.

During 2008, 2007 and 2006, we recorded an income tax deduction of $1.0 million, $4.4 million and $1.6 million, respectively, as an adjustment to equity in accordance with SFAS 123R. This deduction is calculated on the difference between the exercise price of stock option exercises and the market price of the underlying common stock upon exercise. For the years ended December 31, 2008, 2007 and 2006, approximately 64%, 52% and 86%, respectively, of the income tax deduction related to disqualifying dispositions of shares acquired upon exercise of incentive stock options and 36%, 48% and 14%, respectively, related to non-qualified stock options.

On January 1, 2007, ADTRAN adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement 109* (FIN 48), which requires a company to recognize the benefit of a tax position in its financial statements only if that position is "more likely than not" of being sustained on an audit basis solely on the technical merit of the position. The adoption of FIN 48 resulted in a decrease to stockholders' equity of $1.2 million on January 1, 2007 for unrecognized tax expense, of which $0.5 million was related to estimated interest and penalties. The change in the unrecognized income tax benefits for 2008 and 2007 is reconciled below:

| *(In thousands)* | 2008 Gross Unrecognized Income Tax Benefit | 2007 Gross Unrecognized Income Tax Benefit |
|---|---|---|
| **Unrecognized income tax benefit as of December 31, 2007 and January 1, 2007, respectively** | $ 3,772 | $ 2,877 |
| Increases for tax positions related to: | | |
| Prior years | 473 | 1,060 |
| Current year | 864 | 563 |
| Decreases for tax positions related to: | | |
| Prior years | (134) | (106) |
| Current year | — | — |
| Settlements with taxing authorities | (69) | (502) |
| Expiration of applicable statute of limitations | (939) | (120) |
| **Unrecognized income tax benefits as of December 31,** | **$ 3,967** | **$ 3,772** |

As of December 31, 2008 and 2007, our total liability for unrecognized tax benefits was $4.0 million and $3.8 million, respectively, of which $2.9 million and $2.7 million, respectively, would reduce our effective tax rate if we were successful in upholding all of the uncertain positions and recognized the amounts recorded. We classify interest and penalties recognized on the liability for unrecognized tax benefits as income tax expense. The balances of accrued interest and penalties were $1.2 million and $1.1 million as of December 31, 2008 and 2007, respectively, and are included in the table above.

We do not anticipate a single tax position generating a significant increase or decrease in our liability for unrecognized tax benefits within 12 months of this reporting date. We file income tax returns in the U.S. federal and various state jurisdictions and several foreign jurisdictions. We have been audited by the Internal Revenue Service through the 2004 tax year and by the State of Alabama through the 2006 tax year. Generally, we are not subject to changes in income taxes by any taxing jurisdiction for the years prior to 2004.

**Note 8—Employee Benefit Plans**

*401(k) Savings Plan*

We maintain the ADTRAN, Inc. 401(k) Retirement Plan (Savings Plan) for the benefit of our eligible employees. The Savings Plan is intended to qualify under Sections 401(a) and 401(k) of the Internal Revenue Code of 1986, as amended (Code), and is intended to be a "safe harbor" 401 (k) plan under Code Section 401(k)(12). The Savings Plan allows employees to save for retirement by contributing part of their compensation to the plan on a tax-deferred basis. The Savings Plan also requires us to contribute a "safe harbor" amount each year. In 2007 and 2006, we contributed an amount equal to 3% of compensation for eligible employees who had completed a year of service by the end of the year. Beginning January 1, 2008, we changed our contribution such that we matched up to 4% of employee contributions (100% of an employee's first 3% of contributions and 50% of his or her next 2% of contributions). In calculating our matching contribution, we only use compensation up to the statutory maximum under the Code ($230,000 for 2008). All contributions under the Savings Plan are 100% vested. Expenses recorded for employer contributions and plan administration costs for the Savings Plan amounted to approximately $3.9 million, $3.1 million and $3.0 million in 2008, 2007 and 2006, respectively.

*Deferred Compensation Plan*

We maintain the ADTRAN, Inc. Deferred Compensation Plan (Deferred Compensation Plan). This plan is offered as a supplement to our tax-qualified 401(k) plan and is available to our management and highly compensated employees who have been designated by our Board of Directors. The deferred compensation plan allows participants to defer all or a portion of certain specified bonuses and up to 25% of remaining cash compensation, and permits us to make matching contributions on a discretionary basis, without the limitations that apply to the 401(k) plan. To date, we have not made any matching contributions under this plan. We have set aside the plan assets in a rabbi trust (Trust) and all contributions are credited to bookkeeping accounts for the participants. The Trust assets are subject to the claims of our creditors in the event of bankruptcy or insolvency. The assets of the Trust are deemed to be invested in pre-approved mutual funds as directed by each participant, and the participant's bookkeeping account is credited with the earnings and losses attributable to those investments. None of the Trust assets are invested in shares of ADTRAN common stock. Benefits are usually distributed six months after termination of employment in a single lump sum cash payment. We account for the Deferred Compensation Plan in accordance with EITF Abstract 97-14, *Accounting for Deferred Compensation Arrangements Where Amounts Earned are Held in a Rabbi Trust and Invested* .

Assets of the Trust are deemed invested in mutual funds that cover an investment spectrum ranging from equities to money market instruments. These mutual funds are publicly quoted and reported at fair value. We account for these investments in accordance with SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities* . The fair value of the assets held by the Trust and the amounts payable to the plan participants are as follows:

| *(In thousands)* | 2008 | 2007 |
|---|---|---|
| **Fair Value of Plan Assets** | | |
| Short-term Investments | $ — | $ 92 |
| Long-term Investments | 2,457 | 3,064 |
| **Total Fair Value of Plan Assets** | **$2,457** | **$3,156** |
| **Amounts Payable to Plan Participants** | | |
| Current Liabilities | $ — | $ 92 |
| Non-current Liabilities | 2,457 | 3,064 |
| **Total Amounts Payable to Plan Participants** | **$2,457** | **$3,156** |

In accordance with EITF 97-14, changes in the fair value of the plan assets held by the Trust have been included as other income in the accompanying 2008 and 2007 Consolidated Statements of Income and in other comprehensive income in the accompanying 2008 and 2007 Consolidated Balance Sheets. Changes in the fair value of the deferred compensation liability are included as selling, general and administrative expense in the accompanying 2008, 2007 and 2006 Consolidated Statements of Income. Based on the changes in the total fair value of the Trust's assets, we recorded deferred compensation adjustments in 2008, 2007 and 2006 of $(0.9) million, $0.3 million and $0.3 million, respectively.

*Retiree Medical Coverage*

We provide medical, dental and prescription drug coverage to one retired former officer and his spouse, for his life, on the same terms as provided to our active officers, and to the spouse of a former deceased officer for up to 30 years. This liability totaled $0.2 million at December 31, 2008 and 2007.

**Note 9—Segment Information and Major Customers**

ADTRAN operates two reportable segments: (1) the Carrier Networks Division and (2) the Enterprise Networks Division. The accounting policies of the segments are the same as those described in the “Nature of Business and Summary of Significant Accounting Policies” (see Note 1) to the extent that such policies affect the reported segment information. We evaluate the performance of our segments based on gross profit; therefore, selling, general and administrative expense, as well as research and development expenses, interest income/expense, net realized investment gains/loss, other income/expense and provision for taxes are reported on an entity-wide basis only. There are no inter-segment revenues.

The following table presents information about the reported sales and gross profit of our reportable segments for each of the years ended December 31, 2008, 2007 and 2006. Asset information by reportable segment is not reported, since ADTRAN does not produce such information internally.

**Sales and Gross Profit by Market Segment**

| | 2008 | | 2007 | | 2006 | |
|---|---|---|---|---|---|---|
| *(In thousands)* | Sales | Gross Profit | Sales | Gross Profit | Sales | Gross Profit |
| Carrier Networks | $392,219 | $ 236,168 | $358,023 | $ 212,818 | $356,606 | $ 208,549 |
| Enterprise Networks | 108,457 | 62,737 | 118,755 | 70,168 | 116,102 | 70,412 |
| | **$500,676** | **$ 298,905** | **$476,778** | **$ 282,986** | **$472,708** | **$ 278,961** |

**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.

**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 years ended December 31, 2008, 2007 and 2006:

| *(In thousands)* | 2008 | 2007 | 2006 |
|---|---|---|---|
| Carrier Systems | $206,225 | $179,769 | $175,283 |
| Business Networking | 89,577 | 88,329 | 87,934 |
| Loop Access | 204,874 | 208,680 | 209,491 |
| **Total** | **$500,676** | **$476,778** | **$472,708** |

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.

The table below presents subcategory revenues for the years ended December 31, 2008, 2007 and 2006:

| *(In thousands)* | 2008 | 2007 | 2006 |
|---|---|---|---|
| Broadband Access (included in Carrier Systems) | $102,335 | $ 83,951 | $ 80,124 |
| Optical Access (included in Carrier Systems) | 53,844 | 43,109 | 36,481 |
| Internetworking (NetVanta ® & Multi-service Access Gateways) (included in Business Networking) | 65,791 | 53,381 | 36,102 |
| **Growth Products** | **$221,970** | **$180,441** | **$152,707** |
| HDSL (does not include T1) (included in Loop Access) | 179,814 | 173,550 | 173,994 |
| Other products (included in the above table) | 98,892 | 122,787 | 146,007 |
| **Traditional Products** | **$278,706** | **$296,337** | **$320,001** |
| **Total** | **$500,676** | **$476,778** | **$472,708** |

### Sales by Geographic Region

The following is sales information by geographic area for the years ended December 31, 2008, 2007 and 2006:

| *(In thousands)* | 2008 | 2007 | 2006 |
|---|---|---|---|
| United States | $470,563 | $437,159 | $440,757 |
| International | 30,113 | 39,619 | 31,951 |
| **Total** | **$500,676** | **$476,778** | **$472,708** |

Single customers comprising more than 10% of our revenue in 2008 include AT&T Inc. at 24%, Qwest Communications International at 16%, Verizon Communications, Inc. at 12%, and Embarq Corporation (formerly Sprint Corporation) at 10%. Single customers comprising more than 10% of our revenue in 2007 include AT&T Inc. at 23%, Qwest Communications International at 13%, Embarq Corporation at 12%, and Verizon Communications, Inc. at 12%. Single customers comprising more than 10% of our revenue in 2006 included AT&T Inc. at 24%, Embarq Corporation at 13% and Verizon Communications, Inc. at 13%. No other customer accounted for 10% or more of our sales in 2008, 2007, or 2006.

Sales to domestic incumbent local exchange carriers (ILECs) amounted to approximately 62%, 60% and 56% of total sales during the years ended December 31, 2008, 2007 and 2006, respectively. In addition, a significant portion of our products are sold directly to distributors and certain value-added resellers, which accounted for approximately 26%, 26% and 31% of our revenue for each of the years ended December 31, 2008, 2007 and 2006, respectively.

As of December 31, 2008, long-lived assets, net totaled $75.5 million, which includes $75.3 million held in the United States and $0.2 million held outside the United States. As of December 31, 2007, long-lived assets, net, totaled $76.0 million, which includes $75.7 million held in the United States and $0.3 million held outside the United States.

### Note 10—Commitments and Contingencies

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

We lease office space and equipment under operating leases which expire at various dates through 2013. As of December 31, 2008, future minimum rental payments under non-cancelable operating leases with original maturities of greater than 12 months are approximately as follows:

| *(In thousands)* | |
|---|---|
| 2009 | $1,196 |
| 2010 | 1,010 |
| 2011 | 490 |
| 2012 | 110 |
| After 2012 | 16 |
| **Total** | **$2,822** |

Rental expense was approximately $1.5 million in 2008 and 2007 and $1.3 million in 2006.

### Note 11—Earnings Per Share

A summary of the calculation of basic and diluted earnings per share (EPS) for the years ended December 31, 2008, 2007 and 2006 is as follows:

| | Year Ended | | |
|---|---|---|---|
| *(In thousands, except for per share amounts)* | 2008 | 2007 | 2006 |
| **Numerator** | | | |
| Net Income | $78,581 | $76,335 | $78,333 |
| **Denominator** | | | |
| Weighted average number of shares—basic | 63,549 | 67,848 | 73,451 |
| Effect of dilutive securities—stock options | 859 | 1,364 | 1,746 |
| Weighted average number of shares—diluted | **64,408** | **69,212** | **75,197** |
| Net income per share – basic | $ 1.24 | $ 1.13 | $ 1.07 |
| Net income per share – diluted | $ 1.22 | $ 1.10 | $ 1.04 |

For the years ended December 31, 2008, 2007 and 2006, 3.5 million, 3.5 million and 1.5 million stock options were outstanding but were not included in the computation of that year's diluted EPS because the options' exercise prices were greater than the average market price of the common shares, therefore making them anti-dilutive under the treasury stock method.

### Note 12—Summarized Quarterly Financial Data (Unaudited)

The following table presents unaudited quarterly operating results for each of our last eight fiscal quarters. This information has been prepared on a basis consistent with our audited financial statements and includes all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation of the data.

**Unaudited Quarterly Operating Results**

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

| Three Months Ended | March 31, 2008 | June 30, 2008 | September 30, 2008 | December 31, 2008 |
|---|---|---|---|---|
| Net sales | $ 119,885 | $ 131,183 | $ 137,195 | $ 112,413 |
| Gross profit | $ 70,240 | $ 79,394 | $ 81,683 | $ 67,588 |
| Operating income | $ 25,140 | $ 33,470 | $ 33,678 | $ 21,512 |
| Net income | $ 17,047 | $ 22,414 | $ 22,411 | $ 16,709 |
| Earnings per common share assuming dilution (1) | $ 0.26 | $ 0.34 | $ 0.35 | $ 0.27 |
| Earnings per common share | $ 0.26 | $ 0.35 | $ 0.36 | $ 0.27 |

| Three Months Ended | March 31, 2007 | June 30, 2007 | September 30, 2007 | December 31, 2007 |
|---|---|---|---|---|
| Net sales | $ 110,312 | $ 123,674 | $ 123,821 | $ 118,971 |
| Gross profit | $ 65,790 | $ 73,559 | $ 74,118 | $ 69,519 |
| Operating income | $ 20,956 | $ 27,858 | $ 30,048 | $ 25,428 |
| Net income | $ 16,928 | $ 19,843 | $ 21,453 | $ 18,111 |
| Earnings per common share assuming dilution (1) | $ 0.24 | $ 0.28 | $ 0.31 | $ 0.27 |
| Earnings per common share | $ 0.24 | $ 0.29 | $ 0.32 | $ 0.28 |

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

**Note 13—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 reasonable and comparable to those charged by other firms for services rendered to us. We paid $0.1 million during each of the years ended December 31, 2008, 2007 and 2006 for these legal services.

**Note 14—Subsequent Events**

On January 20, 2009, the Board declared a quarterly cash dividend of $0.09 per common share to be paid to stockholders of record at the close of business on February 5, 2009. The quarterly dividend payment was $5.6 million and was paid on February 19, 2009.

During the first quarter of 2009 and as of February 25, 2009, ADTRAN repurchased 0.1 million shares of its common stock through open market purchases at an average cost of $14.51 per share and has the authority to repurchase an additional 3.4 million shares under the plan approved by the Board of Directors on April 14, 2008.

## *ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE*

None.

## *ITEM 9A. CONTROLS AND PROCEDURES*

(a) *Internal control over financial reporting.* Section 404 of the Sarbanes-Oxley Act of 2002 requires management to include in this Annual Report on Form 10-K a report on management's assessment of the effectiveness of our internal control over financial reporting, as well as a report from our independent registered public accounting firm on the effectiveness of internal control over financial reporting. Management's report on internal control over financial reporting and the related report from our independent registered public accounting firm are located in Item 8. "Financial Statements and Supplementary Data" of this report.

(b) *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 the company. 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 annual report, have concluded that our disclosure controls and procedures are effective.

(c) *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.

## *ITEM 9B. OTHER INFORMATION*

None.

## PART III

### *ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE*

Information relating to nominees for director of ADTRAN and compliance with Section 16(a) of the Securities Exchange Act of 1934 is set forth under the captions "Proposal 1–Election of Directors," "Section 16(a) Beneficial Ownership Reporting Compliance" and "Corporate Governance," respectively, in the Proxy Statement for the Annual Meeting of Stockholders to be held on May 6, 2009. Such information is incorporated herein by reference. The definitive Proxy Statement will be filed with the Securities and Exchange Commission no later than 120 days after December 31, 2008. Information relating to the executive officers of ADTRAN, pursuant to Instruction 3 of Item 401(b) of Regulation S-K and General Instruction G(3) of Form 10-K, is set forth at Part I, Item 4A of this report under the caption "Executive Officers of the Registrant." This information is incorporated herein by reference.

**Code of Ethics**

We have adopted the ADTRAN, Inc. Code of Business Conduct and Ethics, which applies to all employees, officers and directors of ADTRAN. The Code of Business Conduct and Ethics meets the requirements of a "code of ethics" as defined by Item 406 of Regulation S-K, and applies to our Chief Executive Officer, Chief Financial Officer (who is both our principal financial and principal accounting officer), as well as all other employees, as indicated above. The Code of Business Conduct and Ethics also meets the requirements of a code of conduct under Nasdaq listing standards. The Code of Business Conduct and Ethics is posted on our website at www.adtran.com under the links "Investor Relations – Corporate Governance—ADTRAN Code of Business Conduct and Ethics." We intend to disclose any amendments to the Code of Business Conduct and Ethics, as well as any waivers for executive officers or directors, on our website at www.adtran.com.

### *ITEM 11. EXECUTIVE COMPENSATION*

Information required by this Item 11 relating to executive compensation and other matters is set forth under the captions "Executive Compensation," "Director Compensation" and "Corporate Governance" in the Proxy Statement referred to in Item 10. This information is incorporated herein by reference.

### *ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

Information relating to ownership of common stock of ADTRAN by certain persons is set forth under the caption "Share Ownership of Principal Stockholders and Management" in the Proxy Statement referred to in Item 10 above. Such information is incorporated herein by reference. Information regarding securities authorized for issuance under equity compensation plans of ADTRAN is set forth under the caption "Equity Compensation Plan Information" in the Proxy Statement referred to in Item 10. This information is incorporated herein by reference.

### *ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE*

Information relating to existing or proposed relationships or transactions between ADTRAN and any affiliate of ADTRAN is set forth under the captions "Certain Relationships and Related Transactions" and "Corporate Governance" in the Proxy Statement referred to in Item 10. This information is incorporated herein by reference.

### *ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES*

Information relating to ADTRAN's principal accountant's fees and services is set forth under the caption "Principal Accountant Fees and Services" in the Proxy Statement referred to in Item 10. This information is incorporated herein by reference.

## PART IV

### *ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

Documents Filed as Part of This Report.

1. Consolidated Financial Statements

   The consolidated financial statements of ADTRAN and the report of independent registered public accounting firm thereon are set forth under Part II, Item 8 of this report.

   Consolidated Balance Sheets as of December 31, 2008 and 2007

   Consolidated Statements of Income for the years ended December 31, 2008, 2007 and 2006

   Consolidated Statements of Changes in Stockholders' Equity and Other Comprehensive Income for the years ended December 31, 2008, 2007 and 2006

   Consolidated Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006

   Notes to Consolidated Financial Statements

2. Consolidated Financial Statement Schedule

   Schedule II—Valuation and Qualifying Accounts

3. Exhibits

The following exhibits are filed with or incorporated by reference in this report. Where such filing is made by incorporation by reference to a previously filed registration statement or report, such registration statement or report is identified in parentheses. We will furnish any exhibit upon request to: ADTRAN, Inc., Attn: Investor Relations, P.O. Box 140000, 901 Explorer Boulevard, Huntsville, Alabama 35806. There is a charge of $0.50 per page to cover expenses for copying and mailing.

| Exhibit Number | Description |
|---|---|
| 3.1 | Certificate of Incorporation, as amended (Exhibit 3.1 to ADTRAN's Registration Statement on Form S-1, No. 33-81062 (the "Form S-1 Registration Statement")). |
| 3.2 | Bylaws, as amended (Exhibit 3.1 to ADTRAN's Current Report on Form 8-K filed October 16, 2007). |
| 10.1 | Documents relative to the $50,000,000 Taxable Revenue Bond, Series 1995 (ADTRAN, Inc. Project) issued by the Alabama State Industrial Development Authority, consisting of the following: |
| | (a) First Amended and Restated Financing Agreement dated April 25, 1997, among the State Industrial Development Authority, a public corporation organized under the laws of the State of Alabama (the "Authority"), ADTRAN and First Union National Bank of Tennessee, a national banking corporation (the "Bondholder") (Exhibit 10.1(a) to ADTRAN's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997 (the "1997 Form 10-Q")). |
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| --- | --- |
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| *23 | Consent of PricewaterhouseCoopers LLP. |
| *24 | Powers of Attorney. |
| *31 | Rule 13a-14(a)/15d-14(a) Certifications. |
| *32 | Section 1350 Certifications. |

* Filed herewith

Table of Contents

Index to Financial Statements

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 on February 26, 2009.

**ADTRAN, Inc.**
**(Registrant)**

By: /s/ James E. Matthews
James E. Matthews
Senior Vice President – Finance,
Chief Financial Officer, Treasurer, Secretary and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on February 26, 2009.

| Signature | Title |
|---|---|
| /s/ Thomas R. Stanton<br>Thomas R. Stanton | Chief Executive Officer and Chairman of the Board |
| /s/ James E. Matthews<br>James E. Matthews | Senior Vice President-Finance,<br>Chief Financial Officer, Treasurer, Secretary and Director |
| /s/ Balan Nair*<br>Balan Nair | Director |
| /s/ William L. Marks*<br>William L. Marks | Director |
| /s/ Roy J. Nichols*<br>Roy J. Nichols | Director |
| /s/ H. Fenwick Huss *<br>H. Fenwick Huss | Director |
| /s/ Ross K. Ireland *<br>Ross K. Ireland | Director |

*By: /s/ James E. Matthews
James E. Matthews as Attorney in Fact

## ADTRAN, INC.

## SCHEDULE II
## VALUATION AND QUALIFYING ACCOUNTS

| Column A | Column B | Column C | Column D | Column E |
|---|---|---|---|---|
| *(In thousands)* | Balance at Beginning of Period | Charged to Costs & Expenses | Deductions | Balance at End of Period |
| ***Year ended December 31, 2008*** | | | | |
| Allowance for Doubtful Accounts | $ 109 | (18) | 53 | $ 38 |
| Inventory Reserve | $ 6,424 | 2,261 | 957 | $ 7,728 |
| Warranty Liability | $ 2,944 | 2,261 | 2,393 | $ 2,812 |
| Deferred Tax Asset Valuation Allowance | $ 1,236 | 345 | — | $ 1,581 |
| ***Year ended December 31, 2007*** | | | | |
| Allowance for Doubtful Accounts | $ 210 | 108 | 209 | $ 109 |
| Inventory Reserve | $ 7,042 | 939 | 1,557 | $ 6,424 |
| Warranty Liability | $ 3,045 | 1,822 | 1,923 | $ 2,944 |
| Deferred Tax Asset Valuation Allowance | $ 1,187 | 49 | — | $ 1,236 |
| ***Year ended December 31, 2006*** | | | | |
| Allowance for Doubtful Accounts | $ 349 | 6 | 145 | $ 210 |
| Inventory Reserve | $ 5,300 | 4,282 | 2,540 | $ 7,042 |
| Warranty Liability | $ 3,972 | 1,097 | 2,024 | $ 3,045 |
| Deferred Tax Asset Valuation Allowance | $ 734 | 453 | — | $ 1,187 |

**ADTRAN, INC.**
**INDEX OF EXHIBITS**

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| *31 | Rule 13a-14(a)/15d-14(a) Certifications. |
| *32 | Section 1350 Certifications. |

* Filed herewith

**Exhibit 10.3(d)**

**The CORPORATE *plan for Retirement* *SM***
**EXECUTIVE PLAN**

Adoption Agreement

***IMPORTANT NOTE***

**This document has not been approved by the Department of Labor, the Internal Revenue Service or any other governmental entity. An Employer must determine whether the plan is subject to the Federal securities laws and the securities laws of the various states. An Employer may not rely on this document to ensure any particular tax consequences or to ensure that the Plan is "unfunded and maintained primarily for the purpose of providing deferred compensation to a select group of management or highly compensated employees" under the Employee Retirement Income Security Act with respect to the Employer's particular situation. Fidelity Management Trust Company, its affiliates and employees cannot and do not provide legal or tax advice or opinions in connection with this document. This document does not constitute legal or tax advice or opinions and is not intended or written to be used, and it cannot be used by any taxpayer, for the purposes of avoiding penalties that may be imposed on the taxpayer. This document must be reviewed by the Employer's attorney prior to adoption.**

ADOPTION AGREEMENT
Article 1

1.01 PLAN INFORMATION

(a) Name of Plan:

This is the ADTRAN, Inc. Deferred Compensation Plan (the “Plan”).

(b) Plan Status ( *Check one* .):

(1) Adoption Agreement effective date: 1/1/2008 .

(2) The Adoption Agreement effective date is *(Check (A) or check and complete (B))* :

(A) ☐ A new Plan effective date .

(B) ☒ An amendment and restatement of the Plan. The original effective date of the Plan was: 9/1/2001

(c) Name of Administrator, if not the Employer:

______________________________

1.02 EMPLOYER

(a) Employer Name: ADTRAN, Inc.

(b) The term “Employer” includes the following Related Employer(s) (as defined in Section 2.01(a)(25)) participating in the Plan:

______________________________

______________________________

1.03 COVERAGE

*(Check (a) and/or (b).)*

(a) ☒ The following Employees are eligible to participate in the Plan *(Check (1) or (2)):*

(1) ☒ Only those Employees designated in writing by the Employer, which writing is hereby incorporated herein.

(2) ☐ Only those Employees in the eligible class described below:

________________________________________

________________________________________

(b) ☐ The following Directors are eligible to participate in the Plan *(Check (1) or (2)):*

(1) ☐ Only those Directors designated in writing by the Employer, which writing is hereby incorporated herein.

(2) ☐ All Directors, effective as of the later of the date in 1.01(b) or the date the Director becomes a Director.

(Note: A designation in Section 1.03(a)(1) or Section 1.03(b)(1) or a description in Section 1.03(a)(2) must include the effective date of such participation.)

1.04 COMPENSATION

*(If Section 1.03(a) is selected, select (a) or (b). If Section 1.03(b) is selected, complete (c))*

For purposes of determining all contributions under the Plan:

(a) ☐ Compensation shall be as defined, with respect to Employees, in the Plan maintained by the Employer:

(1) ☐ to the extent it is in excess of the limit imposed under Code section 401(a)(17).

(2) ☐ notwithstanding the limit imposed under Code section 401(a)(17).

(b) ☒ Compensation shall be as defined in Section 2.01(a)(9) with respect to Employees *(Check (1), and/or (2) below, if, and as, appropriate)* :

(1) ☐ but excluding the following:

________________________________________

(2) ☐ but excluding bonuses, except those bonuses listed in the table in Section 1.05(a)(2).

(c) ☐ Compensation shall be as defined in Section 2.01(a)(9)(c) with respect to Directors, but excluding the following:

________________________________________

1.05 CONTRIBUTIONS ON BEHALF OF EMPLOYEES

(a) Deferral Contributions *(Complete all that apply)* :

(1) ☒ Deferral Contributions. Subject to any minimum or maximum deferral amount provided below, the Employer shall make a Deferral Contribution in accordance with, and subject to, Section 4.01 on behalf of each Participant who has an executed salary reduction agreement in effect with the Employer for the applicable calendar year (or portion of the applicable calendar year).

| **Deferral Contributions** | **Dollar Amount** | | **% Amount** | |
|---|---|---|---|---|
| **Type of Compensation** | **Min** | **Max** | **Min** | **Max** |
| Non-Bonus Compensation | | | 0 | 25 |

(Note: With respect to each type of Compensation, list the minimum and maximum dollar amounts or percentages as whole dollar amounts or whole number percentages.)

(2) ☒ Deferral Contributions with respect to Bonus Compensation only. The Employer requires Participants to enter into a special salary reduction agreement to make Deferral Contributions with respect to one or more Bonuses, subject to minimum and maximum deferral limitations, as provided in the table below.

| **Deferral Contributions** | **Treated As** | | **Dollar Amount** | | **% Amount** | |
|---|---|---|---|---|---|---|
| **Type of Bonus** | **Performance Based** | **Non-Performance Based** | **Min** | **Max** | **Min** | **Max** |
| Bonus Compensation | | Yes | | | 0 | 100 |

(Note: With respect to each type of Bonus, list the minimum and maximum dollar amounts or percentages as whole dollar amounts or whole number percentages. In the event a bonus identified as a Performance-based Bonus above does not constitute a Performance-based Bonus with respect to any Participant, such Bonus will be treated as a Non-Performance-based Bonus with respect to such Participant.)

(b) Matching Contributions *(Choose (1) or (2) below, and (3) below, as applicable)* :

(1) ☒ The Employer shall make a Matching Contribution on behalf of each Employee Participant in an amount described below:

(A) ☐ % of the Employee Participant's Deferral Contributions for the calendar year.

(B) ☒ The amount, if any, declared by the Employer in writing, which writing is hereby incorporated herein.

(C) ☐ Other: ____________________

(2) ☐ Matching Contribution Offset. For each Employee Participant who has made elective contributions (as defined in 26 CFR section 1.401(k)-6 (“QP Deferrals”)) of the maximum permitted under Code section 402(g), or the maximum permitted under the terms of the                Plan (the “QP”), to the QP, the Employer shall make a Matching Contribution in an amount equal to (A) minus (B) below:

(A) The matching contributions (as defined in 26 CFR section 1.401(m)-1(a)(2) (“QP Match”)) that the Employee Participant would have received under the QP on the sum of the Deferral Contributions and the Participant’s QP Deferrals, determined as though—

- no limits otherwise imposed by the tax law applied to such QP match; and
- the Employee Participant’s Deferral Contributions had been made to the QP.

(B) The QP Match actually made to such Employee Participant under the QP for the applicable calendar year.

Provided, however, that the Matching Contributions made on behalf of any Employee Participant pursuant to this Section 1.05 (b)(2) shall be limited as provided in Section 4.02 hereof.

(3) ☐ Matching Contribution Limits *(Check the appropriate box(es)):*

(A) ☐ Deferral Contributions in excess of    % of the Employee Participant’s Compensation for the calendar year shall not be considered for Matching Contributions.

(B) ☐ Matching Contributions for each Employee Participant for each calendar year shall be limited to $          .

(c) Employer Contributions

(1) ☐ Fixed Employer Contributions. The Employer shall make an Employer Contribution on behalf of each Employee Participant in an amount determined as described below:

______________________________________________________________________

______________________________________________________________________

(2) ☐ Discretionary Employer Contributions. The Employer may make Employer Contributions to the accounts of Employee Participants in any amount (which amount may be zero), as determined by the Employer in its sole discretion from time to time in a writing, which is hereby incorporated herein.

1.06 CONTRIBUTIONS ON BEHALF OF DIRECTORS

(a) ☐ Director Deferral Contributions

The Employer shall make a Deferral Contribution in accordance with, and subject to, Section 4.01 on behalf of each Director Participant who has an executed deferral agreement in effect with the Employer for the applicable calendar year (or portion of the applicable calendar year), which deferral agreement shall be subject to any minimum and/or maximum deferral amounts provided in the table below.

| **Deferral Contributions Type of Compensation** | **Dollar Amount** | | **% Amount** | |
|---|---|---|---|---|
| | **Min** | **Max** | **Min** | **Max** |

(Note: With respect to each type of Compensation, list the minimum and maximum dollar amounts or percentages as whole dollar amounts or whole number percentages.)

(b) Matching and Employer Contributions:

(1) ☐ Matching Contributions. The Employer shall make a Matching Contribution on behalf of each Director Participant in an amount determined as described below:

______________________________________________________________________

______________________________________________________________________

(2) ☐ Fixed Employer Contributions. The Employer shall make an Employer Contribution on behalf of each Director Participant in an amount determined as described below:

____________________________________________________________

____________________________________________________________

(3) ☐ Discretionary Employer Contributions. The Employer may make Employer Contributions to the accounts of Director Participants in any amount (which amount may be zero), as determined by the Employer in its sole discretion from time to time, in a writing, which is hereby incorporated herein.

1.07 DISTRIBUTIONS

The form and timing of distributions from the Participant's vested Account shall be made consistent with the elections in this Section 1.07.

(a) (1) Distribution options to be provided to Participants

| | **(A) Specified Date** | **(B) Specified Age** | **(C) Separation From Service** | **(D) Earlier of Separation or Age** | **(E) Earlier of Separation or Specified Date** | **(F) Disability** | **(G) Change in Control** | **(H) Death** |
|---|---|---|---|---|---|---|---|---|
| Deferral Contribution | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum | ☐ Lump Sum<br>☐ Installments |
| Matching Contributions | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum | ☐ Lump Sum<br>☐ Installments |
| Employer Contributions | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum<br>☐ Installments | ☐ Lump Sum | ☐ Lump Sum<br>☐ Installments |

(Note: If the Employer elects (F), (G), or (H) above, the Employer must also elect (A), (B), (C), (D), or (E) above, and the Participant must also elect (A), (B), (C), (D), or (E) above. In the event the Employer elects only a single payment trigger and/or payment method above, then such single payment trigger and/or payment method shall automatically apply to the Participant. If the employer elects to provide for payment upon a specified date or age, and the employer applies a vesting schedule to amounts that may be subject to such payment trigger(s), the employer must apply a minimum deferral period, the number of years of which must be greater than the number of years required for 100% vesting in any such amounts. If the employer elects to provide for payment upon disability and/or death, and the employer applies a vesting schedule to amounts that may be subject to such payment trigger, the employer must also elect to apply 100% vesting in any such amounts upon disability and/or death.)

(2) ☐ A Participant incurs a Disability when the Participant *(Check at least one if Section 1.07(a)(1)(F) or if Section 1.08(e)(3) is elected):*

(A) ☐ is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months.

(B) ☐ is, by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering employees of the Employer.

(C) ☐ is determined to be totally disabled by the Social Security Administration or the Railroad Retirement Board.

(D) ☐ is determined to be disabled pursuant to the following disability insurance program: the definition of disability under which complies with the requirements in regulations under Code section 409A.

(Note: If more than one box above is checked, then the Participant will have a Disability if he satisfies at least one of the descriptions corresponding to one of such checked boxes.)

(3) ☒ Regardless of any payment trigger and, as applicable, payment method, to which the Participant would otherwise be subject pursuant to (1) above, the first to occur of the following Plan-level payment triggers will cause payment to the Participant commencing pursuant to Section 1.07(c)(1) below in a lump sum, provided such Plan-level payment trigger occurs prior to the payment trigger to which the Participant would otherwise be subject.

Payment Trigger

(A) ☐ Separation from Service prior to: ____________________

(B) ☒ Separation from Service

(C) ☐ Death

(D) ☐ Change in Control

(b) Distribution Election Change

A Participant

(1) ☐ shall

(2) ☒ shall not

be permitted to modify a scheduled distribution election in accordance with Section 8.01(b) hereof.

(c) Commencement of Distributions

(1) Each lump sum distribution and the first distribution in a series of installment payments (if applicable) shall commence as elected in (A), (B) or (C) below:

(A) ☒ Monthly on the 1 st day of the month which day next follows the applicable triggering event described in 1.07(a).

(B) ☐ Quarterly on the ___ day of the following months ___, ___, ___, or ___ (list one month in each calendar quarter) which day next follows the applicable triggering event described in 1.07(a).

(C) ☐ Annually on the ___ day of ___ (month) which day next follows the applicable triggering event described in 1.07(a).

(Note: Notwithstanding the above: a six-month delay shall be imposed with respect to certain distributions to Specified Employees; a Participant who chooses payment on a Specified Date will choose a month, year or quarter (as applicable) only, and payment will be made on the applicable date elected in (A), (B) or (C) above that falls within such month, year or quarter elected by the Participant.)

(2) The commencement of distributions pursuant to the events elected in Section 1.07(a)(1) and Section 1.07(a)(3) shall be modified by application of the following:

(A) ☒ Separation from Service Event Delay – Separation from Service will be treated as not having occurred for 6 months after the date of such event.

(B) ☐ Plan Level Delay – all distribution events (other than those based on Specified Date or Specified Age) will be treated as not having occurred for ___ days (insert number of days but not more than 30).

(d) Installment Frequency and Duration

If installments are available under the Plan pursuant to Section 1.07(a), a Participant shall be permitted to elect that the installments will be paid ( *Complete 1 and 2 below* ):

(1) at the following intervals:

(A) ☐ Monthly commencing on the day elected in Section 1.07(c)(1).

(B) ☐ Quarterly commencing on the day elected in Section 1.07(c)(1) (with payments made at three-month intervals thereafter).

(C) ☐ Annually commencing on the day elected in Section 1.07(c)(1).

(2) over the following term(s) ( *Complete either (A) or (B)* ):

(A) ☐ Any term of whole years between (minimum of 1) and (maximum of 30).

(B) ☐ Any of the whole year terms selected below.

| | | | | | |
|---|---|---|---|---|---|
| ☐ 1 | ☐ 2 | ☐ 3 | ☐ 4 | ☐ 5 | ☐ 6 |
| ☐ 7 | ☐ 8 | ☐ 9 | ☐ 10 | ☐ 11 | ☐ 12 |
| ☐ 13 | ☐ 14 | ☐ 15 | ☐ 16 | ☐ 17 | ☐ 18 |
| ☐ 19 | ☐ 20 | ☐ 21 | ☐ 22 | ☐ 23 | ☐ 24 |
| ☐ 25 | ☐ 26 | ☐ 27 | ☐ 28 | ☐ 29 | ☐ 30 |

(Note: Only elect a term of one year if Section 1.07(d)(1)(A) and/or Section 1.07(d)(1)(B) is elected above.)

(e) Conversion to Lump Sum

☐ Notwithstanding anything herein to the contrary, if the Participant’s vested Account at the time such Account becomes payable to him hereunder does not exceed $ distribution of the Participant’s vested Account shall automatically be made in the form of a single lump sum at the time prescribed in Section 1.07(c)(1).

(f) Distribution Rules Applicable to Pre-effective Date Accruals

☐ Benefits accrued under the Plan (subject to Code section 409A) prior to the date in Section 1.01(b)(1) above are subject to distribution rules not described in Section 1.07(a) through (e), and such rules are described in Attachment A Re: PRE EFFECTIVE DATE ACCRUAL DISTRIBUTION RULES.

1.08 VESTING SCHEDULE

(a) (1) The Participant’s vested percentage in Matching Contributions elected in Section 1.05(b) shall be based upon the following schedule and unless Section 1.08(a)(2) is checked below will be based on the elapsed time method as described in Section 7.03 (b).

| **Years of Service** | **Vesting %** |
|---|---|
| 0 | 0 |
| 1 | 0 |
| 2 | 0 |
| 3 | 0 |
| 4 | 0 |
| 5 | 0 |
| 6 | 0 |
| 7 | 100 |

(2) ☐ Vesting shall be based on the class year method as described in Section 7.03(c).

(b) (1) The Participant’s vested percentage in Employer Contributions elected in Section 1.05(c) shall be based upon the following schedule and unless Section 1.08(b)(2) is checked below will be based on the elapsed time method as described in Section 7.03 (b).

(2) ☐ Vesting shall be based on the class year method as described in Section 7.03(c).

(c) ☒ Years of Service shall exclude *(Check one.)* :

(1) ☐ for new plans, service prior to the Effective Date as defined in Section 1.01(b)(2)(A).

(2) ☒ for existing plans converting from another plan document, service prior to the original Effective Date as defined in Section 1.01(b)(2)(B).

(Note: Do not elect to apply this Section 1.08(c) if vesting is based only on the class year method.)

(d) ☒ Notwithstanding anything to the contrary herein, a Participant will forfeit his Matching Contributions and Employer Contributions (regardless of whether vested) upon the occurrence of the following event(s):

Criminal activity, theft, violation of non-compete agreement

(Note: Contributions with respect to Directors, which are 100% vested at all times, are subject to the rule in this subsection (d).)

(e) A Participant will be 100% vested in his Matching Contributions and Employer Contributions upon *(Check the appropriate box(es))* :

(1) ☐ Retirement eligibility is the date the Participant attains age 0 and completes 0 Years of Service, as defined in Section 7.03 (b).

(2) ☐ Death.

(3) ☐ The date on which the Participant becomes disabled, as determined under Section 1.07(a)(2).

(Note: Participants will automatically vest upon Change in Control if Section 1.07(a)(1)(G) is elected.)

(f) ☐ Years of Service in Section 1.08(a)(1) and Section 1.08(b)(1) shall include service with the following employers:

______________________________

______________________________

1.09 INVESTMENT DECISIONS

A Participant's Account shall be treated as invested in the Permissible Investments as directed by the Participant unless otherwise provided below:

______________________________

______________________________

1.10 ADDITIONAL PROVISIONS

The Employer may elect Option below and complete the Superseding Provisions Addendum to describe overriding provisions that are not otherwise reflected in this Adoption Agreement.

☐ The Employer has completed the Superseding Provisions Addendum to reflect the provisions of the Plan that supersede provisions of this Adoption Agreement and/or the Basic Plan Document.

EXECUTION PAGE
(Fidelity's Copy)

IN WITNESS WHEREOF, the Employer has caused this Adoption Agreement to be executed this day of , 20 .

Employer ________________________

By ________________________

Title ________________________

EXECUTION PAGE
(Employer's Copy)

IN WITNESS WHEREOF, the Employer has caused this Adoption Agreement to be executed this      day of           , 20      .

Employer ______________________

By ______________________

Title ______________________

AMENDMENT EXECUTION PAGE
(Fidelity's Copy)

Plan Name: ADTRAN, Inc. Deferred Compensation Plan (the "Plan")

Employer: ADTRAN, Inc.

(Note: These execution pages are to be completed in the event the Employer modifies any prior election(s) or makes a new election(s) in this Adoption Agreement. Attach the amended page(s) of the Adoption Agreement to these execution pages.)

The following section(s) of the Plan are hereby amended effective as of the date(s) set forth below:

| **Section Amended** | **Effective Date** |
|---|---|
| | |

IN WITNESS WHEREOF, the Employer has caused this Amendment to be executed on the date below.

Employer: ______________________

By: ______________________

Title: ______________________

Date: ______________________

AMENDMENT EXECUTION PAGE
(Employer's Copy)

Plan Name: ADTRAN, Inc. Deferred Compensation Plan (the "Plan")

Employer: ADTRAN, Inc.

(Note: These execution pages are to be completed in the event the Employer modifies any prior election(s) or makes a new election(s) in this Adoption Agreement. Attach the amended page(s) of the Adoption Agreement to these execution pages.)

| **Section Amended** | **Effective Date** |
|---|---|

IN WITNESS WHEREOF, the Employer has caused this Amendment to be executed on the date below.

Employer: ____________________

By: ____________________

Title: ____________________

Date: ____________________

ATTACHMENT A

Re: PRE EFFECTIVE DATE ACCRUAL DISTRIBUTION RULES

Plan Name: ADTRAN, Inc. Deferred Compensation Plan (the “Plan”)

ATTACHMENT B

Re: SUPERSEDING PROVISIONS
for

Plan Name: ADTRAN, Inc. Deferred Compensation Plan (the "Plan")

(a) Superseding Provision(s) – The following provisions supersede other provisions of this Adoption Agreement and/or the Basic Plan Document as described below:

**THE CORPORATE *PLAN FOR RETIREMENT* SM**
**EXECUTIVE PLAN**

**BASIC PLAN DOCUMENT**

**IMPORTANT NOTE**

This document has not been approved by the Department of Labor, the Internal Revenue Service or any other governmental entity. The Employer must determine whether the plan is subject to the Federal securities laws and the securities laws of the various states. The Employer may not rely on this document to ensure any particular tax consequences or to ensure that the Plan is “unfunded and maintained primarily for the purpose of providing deferred compensation to a select group of management or highly compensated employees” under the Employee Retirement Income Security Act with respect to the Employer’s particular situation. Fidelity Management Trust Company, its affiliates and employees cannot and do not provide legal or tax advice or opinions in connection with this document. This document does not constitute legal or tax advice or opinions and is not intended or written to be used, and it cannot be used by any taxpayer, for the purposes of avoiding penalties that may be imposed on the taxpayer. This document must be reviewed by the Employer’s attorney prior to adoption.

## TABLE OF CONTENTS

## PREAMBLE

**It is the intention of the Employer to establish herein an unfunded plan maintained solely for the purpose of providing deferred compensation for a select group of management or highly compensated employees as provided in ERISA. The Employer further intends that this Plan comply with Code section 409A, and the Plan is to be construed accordingly.**

**If the Employer has previously maintained the Plan described herein pursuant to a previously existing plan document or description, the Employer's adoption of this Plan document is an amendment and complete restatement of, and supersedes, such previously existing document or description with respect to benefits accrued or to be paid on or after the effective date of this document (except to the extent expressly provided otherwise herein).**

**Article 1 Adoption Agreement .**

**Article 2 Definitions .**

**2.01. Definitions .**

(a) Wherever used herein, the following terms have the meanings set forth below, unless a different meaning is clearly required by the context:

(1) "Account" means an account established on the books of the Employer for the purpose of recording amounts credited to a Participant and any income, expenses, gains, or losses attributable thereto.

(2) "Active Participant" means a Participant who is eligible to accrue benefits under a plan (other than earnings on amounts previously deferred) within the 24-month period ending on the date the Participant becomes a Participant under Section 3.01. Notwithstanding the above, however, a Participant is not an Active Participant if he has been paid all amounts deferred under the plan, provided that he was, on and before the date of the last payment, ineligible to continue or to elect to continue to participate in the plan for periods after such last payment (other than through an election of a different time and form of payment with respect to the amounts paid).

(A) For purposes of Section 4.01(d), as used in the first paragraph of the definition of "Active Participant" above, "plan" means an account balance plan (or portion thereof) of the Employer or a Related Employer subject to Code section 409A pursuant to which the Participant is eligible to accrue benefits only if the Participant elects to defer compensation thereunder, and the "date the Participant becomes a Participant hereunder" refers only to the date the Participant becomes a Participant with respect to Deferral Contributions.

(B) For purposes of Section 8.01(a)(2), as used in the first paragraph of the definition of "Active Participant" above, "plan" means an account balance plan (or portion thereof) of the Employer or a Related Employer subject to Code section 409A pursuant to which the Participant is eligible to accrue benefits without any election by the Participant to defer compensation thereunder, and the "date the Participant becomes a Participant hereunder" refers only to the date the Participant becomes a Participant with respect to Matching or Employer Contributions.

(3) "Administrator" means the Employer adopting this Plan (but excluding Related Employers) or other person designated by the Employer in Section 1.01(c).

(4) "Adoption Agreement" means Article 1, under which the Employer establishes and adopts or amends the Plan and selects certain provisions of the Plan. The provisions of the Adoption Agreement are an integral part of the Plan.

(5) "Beneficiary" means the person or persons entitled under Section 7.02 to receive benefits under the Plan upon the death of a Participant.

(6) "Bonus" means any Performance-based Bonus or any Non-performance-based Bonus as listed and identified in the table in Section 1.05(a)(2) hereof.

(7) "Change in Control" means a change in control with respect to the applicable corporation, as defined in 26 CFR section 1.409A-3(i)(5). For purposes of this definition "applicable corporation" means:

(A) The corporation for which the Participant is performing services at the time of the change in control event;

(B) The corporation(s) liable for payment hereunder (but only if either the accrued benefit hereunder is attributable to the performance of service by the Participant for such corporation(s) or there is a bona fide business purpose for such corporation(s) to be liable for such payment and, in either case, no significant purpose of making such corporation(s) liable for such benefit is the avoidance of Federal income tax); or

(C) A corporate majority shareholder of one of the corporations described in (A) or (B) above or any corporation in a chain of corporations in which each corporation is a majority shareholder of another corporation in the chain, ending in a corporation identified in (A) or (B) above.

(8) "Code" means the Internal Revenue Code of 1986, as amended from time to time.

(9) "Compensation" means for purposes of Article 4:

(A) If the Employer elects Section 1.04(a), such term as defined in such Section 1.04(a).

(B) If the Employer elects Section 1.04(b), wages as defined in Code section 3401(a) and all other payments of compensation to an Employee by the Employer (in the course of the Employer's trade or business) for which the Employer is required to furnish the Employee a written statement under Code sections 6041(d) and 6051(a)(3), excluding any items elected by the Employer in Section 1.04(b), reimbursements or other expense allowances, fringe benefits (cash and non-cash), moving expenses, deferred compensation and welfare benefits, but including amounts that are not includable in the gross income of the Employee under a salary reduction agreement by reason of the application of Code section 125, 132(f)(4), 402(e)(3), 402(h) or 403(b). Compensation shall be determined without regard to any rules under Code section 3401(a) that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in Code section 3401(a)(2)).

(C) If the Employer elects Section 1.04(c), any and all monetary remuneration paid to the Director by the Employer, including, but not limited to, meeting fees and annual retainers, and excluding items listed in Section 1.04(c).

For purposes of this Section 2.01(a)(9), Compensation shall also include amounts deferred pursuant to an election under Section 4.01.

(10) "Deferral Contribution" means a hypothetical contribution credited to a Participant's Account as the result of the Participant's election to reduce his Compensation in exchange for such credit, as described in Section 4.01.

(11) "Director" means a person, other than an Employee, who is elected or appointed as a member of the board of directors of the Employer, with respect to a corporation, or to an analogous position with respect to an entity that is not a corporation.

(12) "Disability" is described in Section 1.07(a)(2).

(13) "Employee" means any employee of the Employer.

(14) “Employer” means the employer named in Section 1.02(a) and any Related Employers listed in Section 1.02(b).

(15) “Employer Contribution” means a hypothetical contribution credited to a Participant’s Account under the Plan as a result of the Employer’s crediting of such amount, as described in Section 4.03.

(16) “Employment Commencement Date” means the date on which the Employee commences employment with the Employer.

(17) “ERISA” means the Employee Retirement Income Security Act of 1974, as from time to time amended.

(18) “Inactive Participant” means a Participant who is not an Employee or Director.

(19) “Matching Contribution” means a hypothetical contribution credited to a Participant’s Account under the Plan as a result of the Employer’s crediting of such amount, as described in Section 4.02.

(20) “Non-performance-based Bonus” means any Bonus listed under the column entitled “non-performance based” in Section 1.05 (a)(2).

(21) “Participant” means any Employee or Director who participates in the Plan in accordance with Article 3 (or formerly participated in the Plan and has an amount credited to his Account).

(22) “Performance-based Bonus” means any Bonus listed under the column entitled “performance based” in Section 1.05(a)(2), which constitutes compensation, the amount of, or entitlement to, which is contingent on the satisfaction of pre-established organizational or individual performance criteria relating to a performance period of at least 12 consecutive months and which is further defined in 26 CFR section 1.409A-1(e).

(23) “Permissible Investment” means the investments specified by the Employer as available for hypothetical investment of Accounts. The Permissible Investments under the Plan are listed in the Service Agreement, and the provisions of the Service Agreement listing the Permissible Investments are hereby incorporated herein.

(24) “Plan” means the plan established by the Employer as set forth herein as a new plan or as an amendment to an existing plan, such establishment to be evidenced by the Employer’s execution of the Adoption Agreement, together with any and all amendments hereto.

(25) “Related Employer” means any employer other than the Employer named in Section 1.02(a), if the Employer and such other employer are members of a controlled group of corporations (as defined in Code section 414(b)) or trades or businesses (whether or not incorporated) under common control (as defined in Code section 414(c)).

(26) "Separation from Service" means the date the Participant retires or otherwise has a termination of employment (or a termination of the contract pursuant to which the Participant has provided services as a Director, for a Director Participant) with the Employer and all Related Employers, as further defined in 26 CFR section 1.409A-1(h); provided, however, that

(A) For purposes of this paragraph (26), the definition of "Related Employer" shall be modified as follows:

(i) In applying Code section 1563(a)(1), (2) and (3) for purposes of determining a controlled group of corporations under Code section 414(b), the phrase "at least 50%" shall be used instead of "at least 80 percent" each place "at least 80 percent" appears in Code section 1563(a)(1), (2) and (3); and

(ii) In applying 26 CFR section 1.414(c)-2 for purposes of determining trades or business (whether or not incorporated) under common control for purposes of Code section 414(c), the phrase "at least 50%" shall be used instead of "at least 80 percent" each place "at least 80 percent" appears in 26 CFR section 1.414(c)-2.

(B) In the event a Participant provides services to the Employer or a Related Employer as an Employee and a Director,

(i) The Employee Participant's services as a Director are not taken into account in determining whether the Participant has a Separation from Service as an Employee; and

(ii) The Director Participant's services as an Employee are not taken into account in determining whether the Participant has a Separation from Service as a Director

provided that this Plan is not aggregated with a plan subject to Code section 409A in which the Director Participant participates as an employee of the Employer or a Related Employer or in which the Employee Participant participates as a director (or a similar position with respect to a non-corporate entity) of the Employer or a Related Employer, as applicable, pursuant to 26 CFR section 1.409A-1(c)(2)(ii).

(27) "Service Agreement" means the agreement between the Employer and Trustee regarding the arrangement between the parties for recordkeeping services with respect to the Plan.

(28) "Specified Employee," (unless defined by the Employer in a separate writing, in which case such writing is hereby incorporated herein) means a Participant who meets the requirements in 26 CFR section 1.409A-1(i) applying the default definition components provided in such regulation (those that would apply absent elections, as described in 26 CFR section 1.409A-1(i)(8)), including an identification date of December 31. In the event that such default definition components are applicable, the Employer has elected Section 1.01(b)(2) and, immediately prior to the date in Section 1.01(b)(2), the Plan applied an identification date (the "prior date") other than the December 31, the prior date shall continue to apply, and December 31 shall not apply, until the date that is 12 months after the date in Section 1.01 (b)(2)

(29) "Trust" means the trust created by the Employer, pursuant to the Trust agreement between the Employer and the Trustee, under which assets are held, administered, and managed, subject to the claims of the Employer's creditors in the event of the Employer's insolvency, until paid to Participants and their Beneficiaries as specified in the Plan.

(30) "Trust Fund" means the property held in the Trust by the Trustee.

(31) "Trustee" means the individual(s) or entity appointed by the Employer under the Trust agreement.

(32) "Unforeseeable Emergency" is as defined in 26 CFR section 1.409A-3(i)(3)(i).

(33) "Year of Service" is as defined in Section 7.03(b) for purposes of the elapsed time method and in Section 7.03(c) for purposes of the class year method.

(b) Pronouns used in the Plan are in the masculine gender but include the feminine gender unless the context clearly indicates otherwise.

**Article 3 Participation .**

**3.01. Date of Participation .** An Employee or Director becomes a Participant on the date such Employee's or Director's participation becomes effective (as described in Section 1.03).

**3.02. Participation following a Change in Status .**

(a) If a Participant ceases to be an Employee or Director and thereafter resumes the same status he had as a Participant during his immediately previous participation in the Plan (as an Employee if previously a Participant as an Employee and as a

Director if previously a Participant as a Director), he will again become a Participant immediately upon resumption of such status, provided, however, that if such Participant is a Director, he is an eligible Director upon resumption of such status (as defined in Section 1.03(b)), and provided, further, that if such Participant is an Employee, he is an eligible Employee upon resumption of such status (as defined in Section 1.03(a)). Deferral Contributions to such Participant's Account thereafter, if any, shall be subject to (1) or (2) below.

(1) If the Participant resumes such status during a period for which such Participant had previously made a valid deferral election pursuant to Section 4.01, he shall immediately resume such Deferral Contributions. Deferral Contributions applicable to periods thereafter shall be made pursuant to the election and other rules described in Section 4.01.

(2) If the Participant resumes such status after the period described in the first sentence of paragraph (1) of this Section 3.02, any Deferral Contributions with respect to such Participant shall be made pursuant to the election and other rules described in Section 4.01.

(b) When an individual who is a Participant due to his status as an eligible Employee (as defined in Section 1.03(a)) continues in the employ of the Employer or Related Employer but ceases to be an eligible Employee, the individual shall not receive an allocation of Matching or Employer Contributions for the period during which he is not an eligible Employee. Such Participant shall continue to make Deferral Contributions throughout the remainder of the applicable period (as described in Section 4.01) in which such change in status occurs, if, and as, applicable.

(c) When an individual who is a Participant due to his status as an eligible Director (as defined in Section 1.03(b)) continues his directorship with the Employer or a Related Employer but ceases to be an eligible Director, the individual shall not receive an allocation of Matching or Employer Contributions for the period during which he is not an eligible Director. Such Participant shall continue to make Deferral Contributions throughout the remainder of the applicable period (as described in Section 4.01) in which such change in status occurs, if, and as, applicable.

**Article 4 Contributions .**

**4.01. Deferral Contributions .** If elected by the Employer pursuant to Section 1.05(a) and/or 1.06(a), a Participant described in such applicable Section may elect to reduce his Compensation by a specified percentage or dollar amount. The Employer shall credit an amount to the Participant's Account equal to the amount of such reduction. Except as otherwise provided in this Section 4.01, such election shall be effective to defer Compensation relating to all services performed in the calendar year beginning after the calendar year in which the Participant executes the election. Under no circumstances may a salary reduction agreement be adopted retroactively. If the Employer has elected to apply Section 1.05 (a)(2), no amount will be deducted from Bonuses unless the Participant has made a separate deferral election applicable to such Bonuses. A Participant's election to defer Compensation may be changed at any time before the last permissible date for making such election, at which time such election becomes irrevocable. Notwithstanding anything herein to the contrary, the conditions under which a Participant may make a deferral election as provided in the applicable salary reduction agreement are hereby incorporated herein and supersede any otherwise inconsistent Plan provision.

(a) **Performance Based Bonus .** With respect to a Performance-based Bonus, a separate election made pursuant to Section 1.05(a)(2) will be effective to defer such Bonus if made no later than 6 months before the end of the period during which the services on which such Performance-based Bonus is based are performed.

(b) **Fiscal Year Bonus .** With respect to a Bonus relating to a period of service coextensive with one or more consecutive fiscal years of the Employer, of which no amount is paid or payable during the service period, a separate election pursuant to Section 1.05(a)(2) will be effective to defer such Bonus if made no later than the close of the Employer's fiscal year next preceding the first fiscal year in which the Participant performs any services for which such Bonus is payable.

(c) **Cancellation of Salary Reduction Agreement .**

(1) The Administrator may cancel a Participant's salary reduction agreement pursuant to the provisions of 26 CFR section 1.409A-3(j)(4)(viii) in connection with the Participant's Unforeseeable Emergency. To the extent required pursuant to the application of 26 CFR section 1.401(k)-1(d)(3) (or any successor thereto), a Participant's salary reduction agreement shall be automatically cancelled.

(2) The Administrator may cancel a Participant's salary reduction agreement pursuant to the provisions of 26 CFR section 1.409A-3(j)(4)(xii) in connection with the Participant's disability. Such cancellation must occur by the later of the end of the Participant's taxable year or the 15 th day of the third month following the date the Participant incurs a disability. For purposes of this paragraph (2), a disability is any medically determinable physical or mental impairment resulting in the Participant's inability to perform the duties of his or her position or any substantially similar position, where such impairment can be expected to result in death or can be expected to last for a continuous period of not less than six months.

In no event may the Participant, directly or indirectly, elect such a cancellation. A cancellation pursuant to this subsection (c) shall apply only to Compensation not yet earned.

(d) **Initial Deferral Election .** Notwithstanding the above, if the Participant is not an Active Participant, the Participant may make an election to defer Compensation within 30 days after the Participant becomes a Participant, which election shall be effective with respect to Compensation payable for services performed during the calendar year (or other deferral period described in (a) or (b) above, as applicable) and after the date of such election. For Compensation that is earned based upon a specified performance period (e.g., an annual bonus) an election pursuant to this subsection (d) will be effective to defer an amount equal to the total amount of the Compensation for the performance period multiplied by the ratio of the number of days remaining in the performance period after the election over the total number of days in the performance period.

**4.02. Matching Contributions .** If so provided by the Employer in Section 1.05(b) and/or 1.06(b)(1), the Employer shall credit a Matching Contribution to the Account of each Participant entitled to such Matching Contribution. The amount of the Matching Contribution shall be determined in accordance with Section 1.05(b) and/or 1.06(b)(1), as applicable, provided, however, that the Matching Contributions credited to the Account of a Participant pursuant to Section 1.05(b)(2) shall be limited pursuant to (a) and (b) below:

(a) The sum of Matching Contributions made on behalf of a Participant pursuant to Section 1.05(b)(2) for any calendar year and any other benefits the Participant accrues pursuant to another plan subject to Code section 409A as a result of such Participant's action or inaction under a qualified plan with respect to elective deferrals and other employee pre-tax contributions subject to the contribution restrictions under Code section 401(a)(30) or 402(g) shall not result in an increase in the amounts deferred under all plans subject to Code section 409A in which the Participant participates in excess of the limit with respect to elective deferrals under Code section 402(g)(1)(A), (B) and (C) in effect for the calendar year in which such action or inaction occurs; and

(b) The Matching Contributions made on behalf of a Participant pursuant to Section 1.05(b)(2) shall never exceed 100% of the matching amounts that would be provided under the qualified employer plan identified in Section 1.05(b)(2) absent any plan-based restrictions that reflect limits on qualified plan contributions under the Code.

**4.03. Employer Contributions .** If so provided by the Employer in Section 1.05(c)(1) and/or 1.06(b)(2), the Employer shall make an Employer Contribution to be credited to the Account of each Participant entitled thereto in the amount provided in such Section(s). If so provided by the Employer in Section 1.05(c)(2) and/or 1.06(b)(3), the Employer may make an Employer Contribution to be credited to the Account maintained on behalf of any Participant in such an amount as the Employer, in its sole discretion, shall determine, subject to the provisions of the applicable Section.

**4.04. Election Forms .** Notwithstanding anything herein to the contrary, the terms of an election form with respect to the conditions under which a Participant may make any election hereunder, as provided in such form (whether electronic or otherwise) are hereby incorporated herein and supersede any otherwise inconsistent Plan provision.

**Article 5 Participants' Accounts .** The Administrator will maintain an Account for each Participant, reflecting hypothetical contributions credited to the Participant, along with hypothetical earnings, expenses, gains and losses, pursuant to the terms hereof. A hypothetical contribution shall be credited to the Account of a Participant on the date determined by the Employer and accepted by the Plan recordkeeper. The Administrator will maintain such other accounts and records as it deems appropriate to the discharge of its duties under the Plan.

**Article 6 Investment of Accounts .**

**6.01. Manner of Investment .** All amounts credited to the Accounts of Participants shall be treated as though invested and reinvested only in Permissible Investments.

**6.02. Investment Decisions, Earnings and Expenses .** Investments in which the Accounts of Participants shall be treated as invested and reinvested shall be directed by the Employer or by each Participant, or both, in accordance with Section 1.09. All dividends, interest, gains, and distributions of any nature that would be earned on a Permissible Investment will be credited to the Account as though reinvested in additional shares of that Permissible Investment. Expenses that would be attributable to such investments shall be charged to the Account of the Participant.

**Article 7 Right to Benefits .**

**7.01. Retirement .** If provided by the Employer in Section 1.08(e)(1), the Account of a Participant or an Inactive Participant who attains retirement eligibility prior to a Separation from Service will be 100% vested.

**7.02. Death .** If provided by the Employer in Section 1.08(e)(2), the Account of a Participant or former Participant who dies before the distribution of his entire Account will be 100% vested, provided that at the time of his death he is earning Years of Service.

A Participant may designate a Beneficiary or Beneficiaries, or change any prior designation of Beneficiary or Beneficiaries, by giving notice to the Administrator on a form designated by the Administrator. If more than one person is designated as the Beneficiary, their respective interests shall be as indicated on the designation form.

A copy of the death certificate or other sufficient documentation must be filed with and approved by the Administrator. If upon the death of the Participant there is, in the opinion of the Administrator, no designated Beneficiary for part or all of the Participant's Account, such amount will be paid to his surviving spouse or, if none, to his estate (such spouse or estate shall be deemed to be the Beneficiary for purposes of the Plan). If a Beneficiary dies after benefits to such Beneficiary have commenced, but before they have been completed, and, in the opinion of the Administrator, no person has been designated to receive such remaining benefits, then such benefits shall be paid to the deceased Beneficiary's estate.

A distribution to a Beneficiary of a Specified Employee is not considered to be a payment to a Specified Employee for purposes of Sections 1.07 and 8.01(e).

**7.03. Separation from Service .**

(a) **General .** If provided by the Employer in Section 1.08, and subject to Section 1.08(e)(2), if a Participant has a Separation from Service, he will be entitled to a benefit equal to (i) the vested percentage(s) of the value of the Matching and Employer Contributions credited to his Account, as adjusted for income, expense, gain, or loss, such percentage(s) determined in accordance with the vesting schedule(s) and methodology selected by the Employer in Section 1.08, and (ii) the value of the Deferral Contributions to his Account as adjusted for income, expense, gain, or loss. The amount payable under this Section 7.03 will be distributed in accordance with Article 8.

(b) **Elapsed Time Vesting .** Unless otherwise provided by the Employer in Section 1.08, vesting shall be determined based on the elapsed time method. For purposes of the elapsed time method, "Years of Service" means, with respect to any Participant or Inactive Participant, the number of whole years of his periods of service with the Employer and any Related Employers (as defined in Section 2.01(a)(26)(A)), subject to any exclusion elected by the Employer in Section 1.08(c). A Participant or Inactive Participant will receive credit for the aggregate of all time period(s) commencing with his Employment Commencement Date and ending on the date a break in service begins, unless any such years are excluded by Section 1.08(c). A Participant or Inactive Participant will also receive credit for any period of severance of less than 12 consecutive months. Fractional periods of a year will be expressed in terms of days.

A break in service is a period of severance of at least 12 consecutive months. A "period of severance" is a continuous period of time beginning on the date the Participant or Inactive Participant incurs a Separation from Service, or if earlier, the 12-month anniversary of the date on which the Participant or Inactive Participant was otherwise first absent from service.

Notwithstanding the above, the Employer shall comply with any service crediting rules to the extent required by applicable law.

(c) **Class Year Vesting .** If provided by the Employer in Section 1.08, a Participant's or Inactive Participant's vested percentage in the Matching Contributions and/or Employer Contributions portion(s) of his Account shall be determined pursuant to the class year method. Pursuant to such method, amounts attributable to the applicable contribution types are assigned to "class years" established in the records of the Plan. Such class years are years (calendar or non-calendar) to which the contribution is assigned by the Administrator, as described in the Service Agreement between the Trustee and the Employer. The Participant's or Inactive Participant's vested percentage in amounts attributable to a particular contribution is determined from the beginning of the applicable class year to the date the Participant or Inactive Participant incurs a Separation from Service. For purposes of the class year method, a Participant or Inactive Participant is credited with a Year of Service on the first day of each such class year.

**7.04. Vesting after Partial Distribution .** If a distribution from a Participant's Account has been made to him at a time when his Account is less than 100% vested, the vesting schedule in Section 1.08 will thereafter apply only to amounts in his Account attributable to Matching and Employer Contributions credited after such distribution. The balance of his Account immediately after such distribution will be subject to the following for the purpose of determining his interest therein.

At any relevant time prior to a forfeiture of any portion thereof under Section 7.05, a Participant's nonforfeitable interest in the portion of his Account described in the sentence immediately above will be equal to P(AB + (RxD))-(RxD), where P is the nonforfeitable percentage at the relevant time determined under Section 7.05; AB is the account balance of such portion at the relevant time; D is the amount of the distribution; and R is the ratio of the account balance at the relevant time to the account balance after distribution. Following a forfeiture of any portion of such portion under Section 7.05 below, any balance with respect to such portion will remain fully vested and nonforfeitable.

**7.05. Forfeitures .** If a Participant has a Separation from Service, any portion of his Account (including any amounts credited after his Separation from Service) not payable to him under Section 7.03 will be forfeited by him.

**7.06. Change in Control .** If the Employer has elected to apply Section 1.07(a)(3)(D), then, upon a Change in Control, notwithstanding any other provision of the Plan to the contrary, all Participant Accounts shall be 100% vested.

**7.07. Disability .** If the Employer has elected to apply Section 1.08(e)(3), then, upon the date a Participant incurs a Disability, as defined in Section 1.07(a)(2), notwithstanding any other provision of the Plan to the contrary, all Accounts of such Participant shall be 100% vested.

**7.08. Directors .** Notwithstanding any other provision of the Plan to the contrary, all Accounts of a Participant who is a Director shall be 100% vested at all times, including Accounts attributable to the Participant's service as an Employee, if any.

## Article 8 Distribution of Benefits .

**8.01. Events Triggering, and Form of, Distributions .**

(a) Events triggering the distribution of benefits and the form of such distributions are described in Section 1.07(a), pursuant to the Employer's election and/or the Participant's election, as applicable.

(1) With respect to the form and time of distribution of amounts attributable to a Deferral Contribution, a Participant election must be made no later than the time by which the Participant must elect to make a Deferral Contribution, as described in Section 4.01.

(2) With respect to the form and time of distribution of amounts attributable to Matching or Employer Contributions, a Participant election must be made

no later than the time by which a Participant would be required to make a Deferral Contribution as described in Section 4.01 with respect to the calendar year for which the Matching and/or Employer Contributions are credited. For purposes of applying Section 4.01(d) "Active Participant" shall have the meaning assigned in Section 2.01(a)(2)(B).

(3) Notwithstanding anything herein to the contrary, an election choosing a distribution trigger and payment method pursuant to Section 1.07(a)(1) will only be effective with respect to amounts attributable to contributions credited to the Participant's Account for the calendar year (or other deferral period described in 4.01(a) or (b)) to which such election relates. Amounts attributable to contributions credited to a Participant's account prior to the effective date of any new election will not be affected and will be paid in accordance with the otherwise applicable election.

(b) If the Employer elects to permit a distribution election change pursuant to Section 1.07(b), then any such distribution election change must satisfy (1) through (3) below:

(1) Such election may not take effect until at least 12 months after the date on which such election is made.

(2) In the case of an election related to a payment not on account of Disability, death or the occurrence of an Unforeseeable Emergency, the payment with respect to which such election is made must be deferred for a period of not less than five years from the date such payment would otherwise have been paid (or in the case of installment payments, five years from the date the first amount was scheduled to be paid).

(3) Any election related to a payment at a specified time or pursuant to a fixed schedule may not be made less than 12 months prior to the date the payment is scheduled to be paid (or in the case of installment payments, 12 months prior to the date the first amount was scheduled to be paid).

With respect to any initial distribution election, a Participant shall in no event be permitted to make more than one distribution election change.

(c) A Participant's entitlement to installments will not be treated as an entitlement to a series of separate payments.

(d) If the Plan does not provide for Plan-level payment triggers pursuant to Section 1.07(a)(3), and the Participant does not designate in the manner prescribed by the Administrator the method of distribution, and/or the distribution trigger (if and as required), such method of distribution shall be a lump sum at Separation from Service.

(e) Notwithstanding anything herein to the contrary, with respect to any Specified Employee, if the applicable payment trigger is Separation from Service, then payment shall not commence before the date that is six months after the date of Separation from Service (or, if earlier, the date of death of the Specified Employee, pursuant to Section 7.02). Payments to which a Specified Employee would otherwise be entitled during the first six months following the date of Separation from Service are delayed by six months.

(f) Notwithstanding anything herein to the contrary, the Administrator may, in its discretion, automatically pay out a Participant's vested Account in a lump sum, provided that such payment satisfies the requirements in (1) through (3) below:

(1) Such payment results in the termination and liquidation of the entirety of the Participant's interest under the Plan, including all agreements, methods, programs, or other arrangements with respect to which deferrals of compensation are treated as having been deferred under a single nonqualified deferred compensation plan under 26 CFR section 1.409A-1(c)(2);

(2) Such payment is not greater than the applicable dollar amount under Code section 402(g)(1)(B); and

(3) Such exercise of Administrator discretion is evidenced in writing no later than the date of such payment.

(g) Notwithstanding anything herein to the contrary, the Administrator may, in its discretion, delay a payment otherwise required hereunder to a date after the designated payment date due to any of the circumstances described in (1) through (4) below, provided that the Administrator treats all payments to similarly situated Participants on a reasonably consistent basis.

(1) In the event the Administrator reasonably anticipates that, if the payment were made as scheduled, the Employer's deduction with respect to such payment would not be permitted due to the application of Code section 162(m), provided the delay complies with the conditions in 26 CFR section 1.409A-2(b)(7)(i).

(2) In the event the Administrator reasonably anticipates that the making of such payment will violate Federal securities laws or other applicable law, provided the delay complies with the conditions in 26 CFR section 1.409A-2(b)(7)(ii).

(3) Upon such other events and conditions as the Commissioner of the Internal Revenue Service may prescribe in generally applicable guidance published in the Internal Revenue Bulletin.

(4) Upon a change in control event, provided the delay complies with conditions in 26 CFR section 1.409A-3(i)(5)(iv).

(h) Notwithstanding anything herein to the contrary, the Administrator may provide an election to change the time or form of a payment hereunder to satisfy the requirements of the Uniformed Services Employment and Reemployment Rights Act of 1994, as amended, 38 USC sections 4301 through 4344.

**8.02. Notice to Trustee .** The Administrator will provide direction to the Trustee, as provided in the Trust agreement, whenever any Participant or Beneficiary is entitled to receive benefits under the Plan. The Administrator's notice shall indicate the form, amount and frequency of benefits that such Participant or Beneficiary shall receive.

**8.03. Unforeseeable Emergency Withdrawals .** Notwithstanding anything herein to the contrary, a Participant may apply to the Administrator to withdraw some or all of his Account if such withdrawal is made on account of an Unforeseeable Emergency as determined by the Administrator in accordance with the requirements of and subject to the limitations provided in 26 CFR section 1.409A-3(i)(3).

## Article 9 Amendment and Termination .

**9.01. Amendment by Employer .** The Employer reserves the authority to amend the Plan in its discretion. Any such amendment notwithstanding, no Participant's Account shall be reduced by such amendment below the amount to which the Participant would have been entitled if he had voluntarily left the employ of the Employer immediately prior to the date of the change.

**9.02. Termination .** The Employer has no obligation or liability whatsoever to maintain the Plan for any length of time and may terminate the Plan at any time by written notice delivered to the Trustee without any liability hereunder for any such discontinuance or termination. Such termination shall comply with 26 CFR section 1.409A-3(j)(ix) and other applicable guidance.

## Article 10 Miscellaneous .

**10.01. Communication to Participants .** The Plan will be communicated to all Participants by the Employer promptly after the Plan is adopted.

**10.02. Limitation of Rights .** Neither the establishment of the Plan and the Trust, nor any amendment thereof, nor the creation of any fund or account, nor the payment of any benefits, will be construed as giving to any Participant or other person any legal or equitable right against the Employer, Administrator or Trustee, except as provided herein; in no event will the terms of employment or service of any individual be modified or in any way affected hereby.

**10.03. Nonalienability of Benefits .** The benefits provided hereunder will not be subject to alienation, assignment, garnishment, attachment, execution or levy of any kind, either voluntarily or involuntarily, and any attempt to cause such benefits to be so subjected will not be recognized, except to such extent as may be required by law and as provided pursuant to a domestic relations order (defined in Code section 414 (p)(1)(B)), as determined by the Administrator. Pursuant to a domestic relations order, payments may be accelerated to a time sooner, and pursuant to a schedule more rapid, than the time and schedule applicable in the absence of the domestic relations order, provided that such payment pursuant to such order is not made to the Participant and provided further that this provision shall not be construed to provide the Participant discretion regarding whether such payment time or schedule will be accelerated.

**10.04. Facility of Payment .** In the event the Administrator determines, on the basis of medical reports or other evidence satisfactory to the Administrator, that the recipient of any benefit payments under the Plan is incapable of handling his affairs by reason of minority, illness, infirmity or other incapacity, the Administrator may disburse such payments, or direct the Trustee to disburse such payments, as applicable, to a person or institution designated by a court which has jurisdiction over such recipient or a person or institution otherwise having the legal authority under State law for the care and control of such recipient. The receipt by such person or institution of any such payments shall be complete acquittance therefor, and any such payment to the extent thereof, shall discharge the liability of the Trust for the payment of benefits hereunder to such recipient.

**10.05. Plan Records .** The Administrator shall maintain the records of the Plan on a calendar-year basis.

**10.06. USERRA .** Notwithstanding anything herein to the contrary, the Administrator shall permit any Participant election and make any payments hereunder required by the Uniformed Services Employment and Reemployment Rights Act of 1994, as amended, 38 USC 4301-4334.

**10.07. Governing Law .** The Plan and the accompanying Adoption Agreement will be construed, administered and enforced according to ERISA, and to the extent not preempted thereby, the laws of the State in which the Employer has its principal place of business, without regard to the conflict of laws principles of such State.

## Article 11 Plan Administration .

**11.01. Powers and Responsibilities of the Administrator .** The Administrator has the full power and the full responsibility to administer the Plan in all of its details, subject, however, to the applicable requirements of ERISA. The Administrator's powers and responsibilities include, but are not limited to, the following:

(a) To make and enforce such rules and regulations as it deems necessary or proper for the efficient administration of the Plan;

(b) To interpret the Plan, its interpretation thereof in good faith to be final and conclusive on all persons claiming benefits under the Plan;

(c) To decide all questions concerning the Plan and the eligibility of any person to participate in the Plan;

(d) To administer the claims and review procedures specified in Section 11.02;

(e) To compute the amount of benefits which will be payable to any Participant, former Participant or Beneficiary in accordance with the provisions of the Plan;

(f) To determine the person or persons to whom such benefits will be paid;

(g) To authorize the payment of benefits;

(h) To appoint such agents, counsel, accountants, and consultants as may be required to assist in administering the Plan; and

(i) By written instrument, to allocate and delegate its responsibilities, including the formation of an administrative committee to administer the Plan.

**11.02. Claims and Review Procedures .**

(a) Claims Procedure . If any person believes he is being denied any rights or benefits under the Plan, such person may file a claim in writing with the Administrator. If any such claim is wholly or partially denied, the Administrator will notify such person of its decision in writing. Such notification will contain (i) specific reasons for the denial, (ii) specific reference to pertinent Plan provisions, (iii) a description of any additional material or information necessary for such person to perfect such claim and an explanation of why such material or information is necessary, and (iv) information as to the steps to be taken if the person wishes to submit a request for review, including a statement of the such person's right to bring a civil action under ERISA section 502(a) following as adverse determination upon review. Such notification will be given within 90 days after the claim is received by the Administrator (or within 180 days, if special circumstances require an extension of time for processing the claim, and if written notice of such extension and circumstances is given to such person within the initial 90-day period).

If the claim concerns disability benefits under the Plan, the Plan Administrator must notify the claimant in writing within 45 days after the claim has been filed in order to deny it. If special circumstances require an extension of time to process the claim, the Plan Administrator must notify the claimant before the end of the 45-day period that the claim may take up to 30 days longer to process. If special circumstances still prevent the resolution of the claim, the Plan Administrator may then only take up to another 30 days after giving the claimant notice before the end of the original 30-day extension. If the Plan Administrator gives the claimant notice that the claimant needs to provide additional information regarding the claim, the claimant must do so within 45 days of that notice.

(b) Review Procedure . Within 60 days after the date on which a person receives a written notice of a denied claim (or, if applicable, within 60 days after the date on which such denial is considered to have occurred), such person (or his duly authorized representative) may (i) file a written request with the Administrator for a review of his denied claim and of pertinent documents and (ii) submit written issues and comments to the Administrator. This written request may include comments, documents, records, and other information relating to the claim for benefits. The claimant shall be provided, upon the claimant's request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claim for benefits. The review will take into account all comments, documents, records, and other information submitted by the claimant relating to the claim, without regard to whether such information was submitted or considered in the initial benefit determination. The Administrator will notify such person of its decision in writing. Such notification will be written in a manner calculated to be understood by such person and will contain specific reasons for the decision as well as specific references to pertinent Plan provisions. The decision on review will be made within 60 days after the request for review is received by the Administrator (or within 120 days, if special circumstances require an extension of time for processing the request, such as an election by the Administrator to hold a hearing, and if written notice of such extension and circumstances is given to such person within the initial 60-day period). The extension notice shall indicate the special circumstances requiring an extension of time and the date by which the Plan expects to render the determination on review.

If the initial claim was for disability benefits under the Plan and has been denied by the Plan Administrator, the claimant will have 180 days from the date the claimant received notice of the claim's denial in which to appeal that decision. The review will be handled completely independently of the findings and decision made regarding the initial claim and will be processed by an individual who is not a subordinate of the individual who denied the initial claim. If the claim requires medical judgment, the individual handling the appeal will consult with a medical professional whom was not consulted regarding the initial claim and who is not a subordinate of anyone consulted regarding the initial claim and identify that medical professional to the claimant.

The Plan Administrator shall provide the claimant with written notification of a plan's benefit determination on review. In the case of an adverse benefit determination, the notification shall set forth, in a manner calculated to be understood by the claimant — the specific reason or reasons for the adverse determinations, reference to the specific plan provisions on which the benefit determination is based, a statement that the claimant is entitled to receive, upon the claimant's request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claim for benefits.

**Exhibit 21**

# SUBSIDIARIES OF ADTRAN, INC.

December 31, 2008

| Name of Subsidiary | Country or State of Incorporation |
|---|---|
| ADTRAN Networks, Pty. Ltd. | Australia |
| ADTRAN Asia-Pacific, Inc. | Delaware |
| ADTRAN Networks Hong Kong Limited | Hong Kong |
| ADTRAN Europe Limited | United Kingdom |
| ADTRAN Canada, Inc. | Canada |
| ADTRAN Networks S.A. de C.V. | Mexico |
| ADTRAN Singapore Pte. Ltd. | Singapore |

**Exhibit 23**

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-133927, 333-126734, 333-66000, 333-41458, 333-78417, 333-30375, 333-29899, 333-4808) of ADTRAN, Inc. of our report dated February 26, 2009 relating to the financial statements, financial statement schedule and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Birmingham, Alabama
February 26, 2009

**Exhibit 24**

## POWER OF ATTORNEY

**KNOW ALL MEN BY THESE PRESENTS,** that the undersigned constitutes and appoints Thomas R. Stanton and James E. Matthews, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution, for him and in his name, place and stead, in any and all capacities, to sign the Annual Report on Form 10-K of ADTRAN, Inc. for the fiscal year ended December 31, 2008 and any and all amendments thereto, and other documents in connection therewith and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission and the Nasdaq Global Select Market, Inc., granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

This 26th day of February 2009.

/s/ Balan Nair
Balan Nair
Director

/s/ H. Fenwick Huss
H. Fenwick Huss
Director

/s/ William L. Marks
William L. Marks
Director

/s/ Roy J. Nichols
Roy J. Nichols
Director

/s/ Ross K. Ireland
Ross K. Ireland
Director

**EXHIBIT 31**

**CERTIFICATIONS**

I, Thomas R. Stanton, certify that:

1. I have reviewed this Annual Report on Form 10-K of ADTRAN, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2009

/s/ Thomas R. Stanton
Thomas R. Stanton
Chief Executive Officer and Chairman of the Board

I, James E. Matthews, certify that:

1. I have reviewed this Annual Report on Form 10-K of ADTRAN, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors:

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 26, 2009

/s/ James E. Matthews
James E. Matthews
Senior Vice President – Finance,
Chief Financial Officer, Treasurer,
Secretary and Director

**EXHIBIT 32**

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of ADTRAN, Inc. (the “Company”) on Form 10-K for the period ended December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Thomas R. Stanton, Chief Executive Officer and Chairman of the Board of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Thomas R. Stanton
Thomas R. Stanton
Chief Executive Officer and Chairman of the Board
Date: February 26, 2009

**CERTIFICATION PURSUANT TO**
**18 U.S.C. SECTION 1350,**
**AS ADOPTED PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of ADTRAN, Inc. (the "Company") on Form 10-K for the period ended December 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, James E. Matthews, Senior Vice President – Finance and Chief Financial Officer, Treasurer, Secretary and Director of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ James E. Matthews
James E. Matthews
Senior Vice President – Finance,
Chief Financial Officer, Treasurer,
Secretary and Director
Date: February 26, 2009