

---

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

---

**FORM 10-Q**

---

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the Quarterly Period Ended September 30, 2005

OR

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 0-24612

---

**ADTRAN, INC.**

*(Exact name of Registrant as specified in its charter)*

---

**Delaware**  
*(State of Incorporation)*

**63-0918200**  
*(I.R.S. Employer  
Identification No.)*

**901 Explorer Boulevard, Huntsville, Alabama 35806-2807**  
*(Address of principal executive offices, including zip code)*

**(256) 963-8000**  
*(Registrant's telephone number, including area code)*

---

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

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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

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

---

Class	Outstanding at October 31, 2005
Common Stock, \$.01 Par Value	76,098,933 shares

---

---

**Table of Contents**

**ADTRAN, INC.**  
**Quarterly Report on Form 10-Q**  
**For the Quarter Ended September 30, 2005**

**Table of Contents**

<b><u>Item Number</u></b>		<b><u>Page Number</u></b>
<b>PART I. FINANCIAL INFORMATION</b>		
1	Financial Statements:	
	Consolidated Balance Sheets as of September 30, 2005 (Unaudited) and December 31, 2004	3
	Consolidated Statements of Income for the three and nine months ended September 30, 2005 and 2004 – (Unaudited)	4
	Consolidated Statements of Cash Flows for the nine months ended September 30, 2005 and 2004 – (Unaudited)	5
	Notes to Consolidated Financial Statements – (Unaudited)	6
2	Management’s Discussion and Analysis of Financial Condition and Results of Operations	14
3	Quantitative and Qualitative Disclosures About Market Risk	25
4	Controls and Procedures	25
<b>PART II. OTHER INFORMATION</b>		
2	Unregistered Sales of Equity Securities and Use of Proceeds	25
6	Exhibits	26
	<b>SIGNATURES</b>	27
	<b>EXHIBIT INDEX</b>	28

## Table of Contents

### PART I. FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS

**ADTRAN, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
(In thousands, except per share amounts)

	September 30, 2005	December 31, 2004
	(Unaudited)	
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 70,585	\$ 57,602
Short-term investments	180,758	124,831
Accounts receivable, less allowance for doubtful accounts of \$349 and \$361 at September 30, 2005 and December 31, 2004, respectively	71,554	63,729
Other receivables	7,260	4,335
Income tax receivable	—	2,442
Inventory, net	53,629	42,316
Prepaid expenses	3,391	2,643
Deferred tax assets	6,091	4,488
<b>Total current assets</b>	<b>393,268</b>	<b>302,386</b>
Property, plant and equipment, net	86,532	89,361
Other assets	1,346	586
Long-term investments	148,620	167,609
<b>Total assets</b>	<b>\$ 629,766</b>	<b>\$ 559,942</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 36,224	\$ 22,856
Unearned revenue	3,728	2,468
Accrued expenses	3,884	2,344
Accrued payroll	8,176	8,347
Income tax payable	11,126	—
<b>Total current liabilities</b>	<b>63,138</b>	<b>36,015</b>
Deferred tax liabilities	3,978	4,825
Other non-current liabilities	5,161	2,465
Bonds payable	50,000	50,000
<b>Total liabilities</b>	<b>122,277</b>	<b>93,305</b>
Commitments and contingencies (see Note 11)		
<b>Stockholders' equity</b>		
Common stock, par value \$0.01 per share; 200,000 shares authorized; 79,652 shares issued at September 30, 2005 and December 31, 2004	797	797
Additional paid-in capital	138,264	142,243
Accumulated other comprehensive income	4,788	5,235
Retained earnings	447,219	397,228
Less treasury stock at cost: 3,673 shares at September 30, 2005 and 3,238 shares at December 31, 2004	(83,579)	(78,866)
<b>Total stockholders' equity</b>	<b>507,489</b>	<b>466,637</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 629,766</b>	<b>\$ 559,942</b>

See notes to consolidated financial statements



**ADTRAN, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**(Unaudited)**  
**(In thousands, except per share amounts)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Sales	\$149,170	\$115,251	\$372,620	\$349,892
Cost of sales (see Note 1)	59,856	48,869	153,532	149,100
<b>Gross profit</b>	<b>89,314</b>	<b>66,382</b>	<b>219,088</b>	<b>200,792</b>
Selling, general and administrative expenses (see Note 1)	25,011	21,765	72,257	67,150
Research and development expenses	15,087	18,859	47,797	49,572
<b>Operating income</b>	<b>49,216</b>	<b>25,758</b>	<b>99,034</b>	<b>84,070</b>
Interest income	2,505	1,524	6,853	5,585
Interest expense	(693)	(644)	(1,901)	(1,932)
Net realized investment gain	535	646	1,275	590
Other income (expense), net	67	(33)	822	858
<b>Income before provision for income taxes</b>	<b>51,630</b>	<b>27,251</b>	<b>106,083</b>	<b>89,171</b>
Provision for income taxes	(18,615)	(8,500)	(37,129)	(28,624)
<b>Net income</b>	<b>\$ 33,015</b>	<b>\$ 18,751</b>	<b>\$ 68,954</b>	<b>\$ 60,547</b>
Weighted average shares outstanding - basic	75,710	77,778	75,602	78,858
Weighted average shares outstanding - diluted (1)	78,213	80,437	77,675	81,828
Earnings per common share – basic	\$ 0.44	\$ 0.24	\$ 0.91	\$ 0.77
Earnings per common share – diluted (1)	\$ 0.42	\$ 0.23	\$ 0.89	\$ 0.74
Dividends per share (2)	\$ 0.09	\$ 0.08	\$ 0.25	\$ 0.24

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

(2) During the three and nine months ended September 30, 2005 ADTRAN declared and paid dividends of \$0.09 and \$0.25 per common share, respectively. During the three and nine months ended September 30, 2004 ADTRAN declared and paid dividends of \$0.08 and \$0.24 per common share, respectively.

See notes to consolidated financial statements

**ADTRAN, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(In thousands)**

	Nine Months Ended September 30,	
	2005	2004
<b>Cash flows from operating activities:</b>		
Net income	\$ 68,954	\$ 60,547
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	10,202	11,089
Gain on sale of long-term investments	(1,275)	(590)
(Gain) loss on sale of property, plant and equipment	(2)	7
Stock-based compensation expense	409	—
Deferred income taxes	(3,103)	(5,152)
Income tax benefit from exercise of non-qualified stock options	4,371	2,683
Changes in operating assets and liabilities:		
Accounts receivable, net	(7,825)	(11,990)
Other receivables	(2,925)	2,333
Income tax receivable	2,442	8,907
Inventory, net	(11,313)	(3,654)
Prepaid expenses and other assets	(746)	(1,122)
Accounts payable	13,368	(1,599)
Accrued expenses and other liabilities	5,325	(2,913)
Income tax payable	11,126	(145)
<b>Net cash provided by operating activities</b>	<b>89,008</b>	<b>58,401</b>
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment	(7,373)	(5,066)
Proceeds from disposition of property, plant and equipment	2	34
Proceeds from maturities of held-to-maturity investments	—	2,305
Proceeds from sales of available-for-sale investments	126,606	103,875
Purchases of available-for-sale investments	(162,765)	(106,813)
<b>Net cash used in investing activities</b>	<b>(43,530)</b>	<b>(5,665)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from stock option exercises	10,602	5,046
Purchases of treasury stock	(24,074)	(70,209)
Dividend payments	(18,963)	(18,964)
<b>Net cash used in financing activities</b>	<b>(32,435)</b>	<b>(84,127)</b>
Net increase in cash and cash equivalents	13,043	(31,391)
Effect of exchange rate changes	(60)	(25)
<b>Cash and cash equivalents, beginning of period</b>	<b>57,602</b>	<b>94,048</b>
<b>Cash and cash equivalents, end of period</b>	<b>\$ 70,585</b>	<b>\$ 62,632</b>

See notes to consolidated financial statements

**ADTRAN, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**  
**(In thousands, except per share amounts)**

**1. BASIS OF PRESENTATION**

The accompanying unaudited consolidated financial statements of ADTRAN, Inc. and its subsidiaries (“ADTRAN”) have been prepared pursuant to the rules and regulations for reporting on Quarterly Reports on Form 10-Q. Accordingly, certain information and notes required by generally accepted accounting principles for complete financial statements are not included herein. In the opinion of management, all adjustments necessary for a fair statement of these interim statements have been included and are of a normal and recurring nature. Certain reclassifications, as discussed below, have been made to the 2004 consolidated financial statements in order to conform to the 2005 presentation. These reclassifications had no effect on previously reported net income, cash flows from operations, cash flows from financing activities, or total stockholders’ equity.

Operating results for the three and nine months ended September 30, 2005 are not necessarily indicative of the results that may be expected to occur for the year ending December 31, 2005. The interim statements should be read in conjunction with the financial statements and notes thereto included in ADTRAN’s Annual Report on Form 10-K for the year ended December 31, 2004.

In the fourth quarter of 2004, ADTRAN concluded it was appropriate to classify our auction rate municipal bonds and variable rate municipal demand notes as current investments. Previously, such investments had been classified as cash and cash equivalents. Accordingly, we revised the classification to report these securities as short-term investments in our consolidated balance sheet as of December 31, 2004. We also made corresponding adjustments to our consolidated statements of cash flows for the year ended December 31, 2004 to reflect the gross purchases and sales of these securities as investing activities rather than as a component of cash and cash equivalents. This change in classification did not affect previously reported cash flows from operations or from financing activities in our previously reported consolidated statement of cash flows, or our previously reported consolidated statement of income for the period. The table below presents the reclassified balances for the nine-month period ended September 30, 2004.

	<b>Nine Months Ended September 30, 2004</b>		
	<b>Previously Reported</b>	<b>Reclass Amount</b>	<b>As Reclassified</b>
Purchase of available-for-sale investments	\$ (63,230)	\$(43,583)	\$(106,813)
Net cash provided by (used in) investing activities	\$ 37,918	\$(43,583)	\$ (5,665)
Net increase (decrease) in cash and cash equivalents	\$ 12,192	\$(43,583)	\$ (31,391)
Cash and cash equivalents, beginning of period	\$132,072	\$(38,024)	\$ 94,048
Cash and cash equivalents, end of period	\$144,239	\$(81,607)	\$ 62,632

In the first quarter of 2005, ADTRAN reclassified certain purchasing costs related to procurement of materials from selling, general and administrative expenses (SG&A) to cost of sales. The table below presents the reclassified cost of sales, gross profit, SG&A expenses and the related adjustment for the three and nine months ended September 30, 2004.

## Table of Contents

	Three Months Ended September 30, 2004		Nine Months Ended September 30, 2004	
	Previously Reported	As Reclassified	Previously Reported	As Reclassified
Cost of sales	\$ 48,439	\$ 48,869	\$ 147,800	\$ 149,100
Gross profit	\$ 66,812	\$ 66,382	\$ 202,092	\$ 200,792
SG&A expenses	\$ 22,195	\$ 21,765	\$ 68,450	\$ 67,150

## 2. INVENTORY

At September 30, 2005 and December 31, 2004, inventory consisted of the following:

	September 30,	December 31,
	2005	2004
Raw materials	\$ 28,331	\$ 24,051
Work in progress	6,671	4,526
Finished goods	23,561	18,558
Inventory reserve	(4,934)	(4,819)
Inventory, net	\$ 53,629	\$ 42,316

## 3. COMPREHENSIVE INCOME

Comprehensive income consists of net income, unrealized foreign currency translation adjustments (net of deferred taxes) and unrealized gains and losses on marketable securities (net of deferred taxes).

	Nine Months Ended September 30,	
	2005	2004
Net income	\$68,954	\$60,547
Foreign currency translation loss, net of deferred taxes	(60)	(25)
Change in unrealized gain on available-for-sale securities, net of deferred taxes	(387)	(3,256)
Total comprehensive income	\$68,507	\$57,266

## 4. EARNINGS PER SHARE

A summary of the calculation of basic and diluted earnings per share (EPS) for the three and nine months ended September 30, 2005 and 2004 is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Numerator</b>				
Net Income	\$33,015	\$18,751	\$68,954	\$60,547
<b>Denominator</b>				
Weighted average number of shares - basic	75,710	77,778	75,602	78,858
Effect of dilutive securities – stock options	2,503	2,659	2,073	2,970
Weighted average number of shares - diluted	78,213	80,437	77,675	81,828
Net income per share - basic	\$ 0.44	\$ 0.24	\$ 0.91	\$ 0.77
Net income per share - diluted	\$ 0.42	\$ 0.23	\$ 0.89	\$ 0.74

## Table of Contents

Anti-dilutive options to purchase common stock outstanding were excluded from the above calculations. Anti-dilutive options totaled 727 and 739 for the three and nine months ended September 30, 2005, respectively. For the three and nine months ended September 30, 2004, anti-dilutive options totaled 739 and 717, respectively.

### 5. SEGMENT INFORMATION

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

The following table presents information about the sales and gross profit of our reportable segments for the three and nine months ended September 30, 2005 and 2004. Asset information by reportable segment is not reported, since ADTRAN does not produce such information internally.

	Three Months Ended			
	September 30, 2005		September 30, 2004	
	Sales	Gross Profit	Sales	Gross Profit
Carrier Networks	\$113,500	\$ 66,541	\$ 82,456	\$46,490
Enterprise Networks	35,670	22,773	32,795	19,892
	<b>\$149,170</b>	<b>89,314</b>	<b>\$115,251</b>	<b>66,382</b>
Selling, general and administrative expenses		25,011		21,765
Research and development expenses		15,087		18,859
<b>Operating income</b>		<b>49,216</b>		<b>25,758</b>
Interest expense		(693)		(644)
Other income, net		3,107		2,137
<b>Income before provision for income taxes</b>		<b>51,630</b>		<b>27,251</b>
Provision for income taxes		(18,615)		(8,500)
<b>Net income</b>		<b>\$ 33,015</b>		<b>\$18,751</b>

	Nine Months Ended			
	September 30, 2005		September 30, 2004	
	Sales	Gross Profit	Sales	Gross Profit
Carrier Networks	\$279,201	\$162,068	\$247,243	\$138,325
Enterprise Networks	93,419	57,020	102,649	62,467
	<b>\$372,620</b>	<b>219,088</b>	<b>\$349,892</b>	<b>200,792</b>
Selling, general and administrative expenses		72,257		67,150
Research and development expenses		47,797		49,572
<b>Operating income</b>		<b>99,034</b>		<b>84,070</b>
Interest expense		(1,901)		(1,932)
Other income, net		8,950		7,033
<b>Income before provision for income taxes</b>		<b>106,083</b>		<b>89,171</b>
Provision for income taxes		(37,129)		(28,624)
<b>Net income</b>		<b>\$ 68,954</b>		<b>\$ 60,547</b>

## Table of Contents

### Sales by Geographic Region

The table below presents sales information by geographic region for the three and nine months ended September 30, 2005 and 2004.

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2005	2004	2005	2004
United States	\$ 129,739	\$ 108,370	\$ 329,608	\$ 328,588
Foreign	19,431	6,881	43,012	21,304
Total	<b>\$ 149,170</b>	<b>\$ 115,251</b>	<b>\$ 372,620</b>	<b>\$ 349,892</b>

### Sales by Product

The Digital Business Transport, "DBT/Total Reach<sup>®</sup>" category is comprised of revenue from ISDN and DDS transport and connectivity products sold to carrier and enterprise customers. The High-bit-rate Digital Subscriber Line, "HDSL/T1" category is comprised of revenue from HDSL related carrier products and T1 CSU/DSU enterprise products. The Systems category includes revenue from Total Access narrow band products, M-13 multiplexers, integrated access devices, Digital Subscriber Lines Access Multiplexer (DSLAM) products, optical access products and NetVanta products comprised of access routers, ethernet switches, Virtual Private Network (VPN) products and other access products.

The table below presents sales information by product for the three and nine months ended September 30, 2005 and 2004.

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2005	2004	2005	2004
DBT/Total Reach <sup>®</sup>	\$ 3,342	\$ 5,339	\$ 8,956	\$ 17,747
HDSL/T1	65,525	56,390	164,292	164,083
Systems	80,303	53,522	199,372	168,062
Total	<b>\$ 149,170</b>	<b>\$ 115,251</b>	<b>\$ 372,620</b>	<b>\$ 349,892</b>

## 6. LIABILITY FOR WARRANTY RETURNS

ADTRAN's products generally include warranties of one to ten years for product defects. ADTRAN accrues for warranty returns at the cost to repair or replace the defective products at the time revenue is recognized. ADTRAN engages in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our warranty obligation is affected by product failure rates, material usage, field service obligations and other rework costs incurred in correcting product failures. The liability for warranty returns totaled \$2,522 and \$1,560 at September 30, 2005 and December 31, 2004, respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets.

	Balance at	Charged to Costs	Deductions	Balance at
	December 31,			September 30,
	2004	and Expenses		2005
Warranty liability	\$ 1,560	\$ 2,372	\$ (1,410)	\$ 2,522

## Table of Contents

### 7. STOCK-BASED COMPENSATION

ADTRAN applies Accounting Principles Board (“APB”) Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its stock option plans. Had compensation cost for ADTRAN’s stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method prescribed in Statement of Financial Accounting Standards (“SFAS”) No. 123, *Accounting for Stock-Based Compensation*, net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Net income</b> – as reported	\$33,015	\$18,751	\$68,954	\$ 60,547
<b>Plus</b> : stock-based compensation expense included in reported net income, net of tax	266	—	266	—
<b>Less</b> : stock-based compensation expense, net of tax	(1,425)	(3,404)	(5,695)	(10,215)
Net income – pro forma	<b>\$31,856</b>	<b>\$15,347</b>	<b>\$63,525</b>	<b>\$ 50,332</b>
Earnings per share:				
Basic-as reported	\$ 0.44	\$ 0.24	\$ 0.91	\$ 0.77
Basic-pro forma	\$ 0.42	\$ 0.20	\$ 0.84	\$ 0.64
Diluted-as reported	\$ 0.42	\$ 0.23	\$ 0.89	\$ 0.74
Diluted-pro forma	\$ 0.41	\$ 0.19	\$ 0.82	\$ 0.62

The pro forma amounts reflected above are not representative of the effects on reported net income in future years because, in general, the options granted typically do not vest for several years, additional awards are made each year, and forfeiture rates and other inputs used to calculate compensation expense for stock option grants may vary on future grant dates. The fair value of each option grant is estimated on the grant date using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Expected dividend yield	1.34%	1.08%	1.53%	1.11%
Expected life (years)	5.00	5.00	5.00	5.00
Expected volatility	56.0%	55.9%	56.4%	55.9%
Risk-free interest rate	4.18%	3.62%	4.06%	3.25%

On July 18, 2005, the Compensation Committee of the Board of Directors approved the acceleration of the vesting of options held by Mr. Howard Thrailkill exercisable for 27,500 shares of ADTRAN’s common stock. In accordance with APB No. 25, ADTRAN recognized compensation expense equal to the difference in the option price on the date of accelerated vesting over the option price on the date of original grant. ADTRAN recorded a charge of \$409,000 (\$266,000 net of tax) in the three-month period ended September 30, 2005 for these modified option awards.

## Table of Contents

### 8. STOCKHOLDERS' EQUITY

A summary of the changes in stockholders' equity for the nine months ended September 30, 2005 is as follows:

	<u>Stockholders' Equity</u>
<b>Balance, December 31, 2004</b>	<b>\$ 466,637</b>
Net income	68,954
Dividend payments	(18,963)
Change in unrealized gain on marketable securities (net of deferred taxes)	(387)
Unrealized foreign currency translation (net of deferred taxes)	(60)
Exercise of stock options	10,602
Income tax benefit from exercise of non-qualified stock options	4,371
Stock-based compensation expense	409
Purchases of treasury stock	(24,074)
<b>Balance, September 30, 2005</b>	<b>\$ 507,489</b>

During 2005, ADTRAN has paid cash dividends as follows:

<u>Record Date</u>	<u>Payment Date</u>	<u>Per Share Amount</u>	<u>Total Dividend Paid</u>
February 4, 2005	February 16, 2005	\$ 0.08	\$ 6,114
May 5, 2005	May 19, 2005	\$ 0.08	\$ 6,026
August 5, 2005	August 19, 2005	\$ 0.09	\$ 6,823

ADTRAN issued 852 shares of treasury stock to fulfill stock option exercises during the nine months ended September 30, 2005. The stock options had exercise prices ranging from \$16.302 to \$32.000. ADTRAN received proceeds totaling \$10,602 from the exercise of these stock options during the nine months ended September 30, 2005.

ADTRAN repurchased 1,287 shares of its common stock through open market purchases at a total cost of \$24,074 during the nine months ended September 30, 2005 and has the authority to purchase an additional 4,713 shares.

### 9. RECENTLY ISSUED ACCOUNTING STANDARDS

On October 22, 2004, the American Jobs Creation Act of 2004 was signed into law. This legislation repeals export tax benefits, which have historically reduced our effective tax rate. This legislation transitions the repeal by allowing 100 percent of 2004, 80 percent of 2005 and 60 percent of 2006 export benefits. The legislation also transitions in a new tax deduction for a portion of domestic manufacturing expenditures, which will benefit ADTRAN. The legislation did not have a material effect on our 2004 tax expense. ADTRAN expects the net effect of the phase out of the extra-territorial income (ETI) and phase in of this new deduction to result in a decrease of approximately 0.20% to 0.50% in its effective tax rate for 2005.

In November 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 151, *Inventory Costs – An Amendment of ARB No. 43, Chapter 4*. SFAS No. 151 amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and rehandling costs be recognized as current-period charges regardless of whether they meet the criterion

---

## Table of Contents

of “so abnormal” as stated in ARB No. 43. Additionally, SFAS No. 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005, and is required to be adopted by ADTRAN effective January 1, 2006. We do not expect SFAS No. 151 to have a material impact on our consolidated results of operations or financial condition.

In December 2004, the FASB issued SFAS No. 123R, *Accounting for Stock Based Compensation*. SFAS No. 123R revises the guidance in SFAS No. 123 and supersedes APB No. 25 and its related implementation guidance. SFAS No. 123R focuses primarily on the accounting for share-based payments to employees in exchange for services, and it requires a public entity to measure and recognize compensation cost for these payments. SFAS No. 123R is effective for the first fiscal year beginning after June 15, 2005, and is required to be adopted by ADTRAN effective January 1, 2006. SFAS No. 123R requires ADTRAN to recognize the cost of employee services received in exchange for its equity instruments. Currently, in accordance with APB No. 25, we record the intrinsic value of stock-based compensation as expense. Accordingly, no compensation expense is currently recognized for fixed stock option plans, as the exercise price equals the stock price on the date of grant. Under SFAS No. 123R, ADTRAN will be required to measure compensation expense over the options’ requisite service period based on the stock options’ fair value at the date the options are granted. SFAS No. 123R allows for the use of the Black-Scholes or a lattice option-pricing model to value such options.

ADTRAN has determined that it will use the Black-Scholes option-pricing model to calculate the fair value of its options. As allowed by SFAS No. 123R, ADTRAN will elect to use the Modified Prospective Application method, which applies the Statement to new awards and modified awards after the effective date, and to any unvested awards as service is rendered on or after the effective date. For a discussion of our stock-based compensation plans and agreements, see Note 7 in ADTRAN’s Annual Report on Form 10-K for the year ended December 31, 2004. ADTRAN is continuing to evaluate this guidance and the impact it will have on its consolidated results of operations or financial condition.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Non-monetary Assets – An Amendment of APB Opinion No. 29*. SFAS No. 153 eliminates the exception from fair value measurement for non-monetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Non-monetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. SFAS No. 153 specifies that a non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for periods beginning after June 15, 2005, and was adopted by ADTRAN on July 1, 2005. Adoption of SFAS No. 153 did not have a material impact on our consolidated results of operations or financial condition.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. SFAS 154 replaces APB No. 20 and SFAS No. 3. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. SFAS No. 154 provides guidance for determining whether retrospective application of a change in accounting principle is impractical and for reporting a change when retrospective application is impractical. SFAS No. 154 also addresses the reporting of an error by restating previously issued financial statements. SFAS No. 154 becomes effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. ADTRAN will adopt this pronouncement effective January 1, 2006.

On June 8, 2005, the FASB issued FASB Staff Position No. FAS 143-1, *Accounting for Electronic Waste Obligations (“FSP FAS 143-1”)*. This position provides guidance on accounting for electronic equipment waste obligations associated with Directive 2002/96/EC on Waste Electrical and Electronic Equipment (the “Directive”) adopted by the European Union. In particular, the new guidance specifies the appropriate accounting for obligations to dispose of “historical” waste, defined as electronic waste obligations relating

---

## Table of Contents

to equipment put on the market prior to August 13, 2005. Under the Directive, when historical waste equipment is replaced, the waste management obligation for that equipment may be transferred to the producer of the replacement equipment depending upon the law adopted by the applicable European Union country. In this case, the producer of the new asset should recognize revenue for the total amount received reduced by the fair value of the obligation required for disposal of the replaced asset. The producer of the new asset should derecognize the liability when the obligation is settled. FSP FAS 143-1 is effective for reporting periods ending after June 8, 2005 and was adopted by ADTRAN on July 1, 2005. Adoption of FSP FAS 143-1 did not have a material impact on our consolidated results of operations or financial conditions.

On July 14, 2005 the FASB issued a proposed Interpretation, *Accounting for Uncertain Tax Provisions, an Interpretation of FASB Statement 109*. This proposed Interpretation would clarify the accounting for uncertain tax positions as described in SFAS No. 109, *Accounting for Income Taxes*, and would require a company to recognize, in its financial statements, the best estimate of the impact of a tax position only if that position is probable of being sustained on an audit basis solely on the technical merit of the position. On October 10, 2005, the FASB confirmed that the guidance in this proposed Interpretation has been delayed and will not be finalized before the first quarter of 2006. ADTRAN will continue to monitor this guidance and the impact it might have on its consolidated results of operations or financial condition.

### 10. RELATED PARTY TRANSACTIONS

We employ the law firm of our director emeritus for legal services. All bills for services rendered by this firm are reviewed and approved by our chief financial officer. We believe that the fees for such services are comparable to those charged by other firms for services rendered to us. We paid \$91 during each of the nine months ended September 30, 2005 and 2004, respectively, for legal services rendered.

One of our non-employee directors is the Vice Chairman – Planning and Administration, of one of our significant customers who is also a vendor. In the normal course of business, we receive payments from and make payments to this customer. For the nine months ended September 30, 2005 and 2004, we received payments, directly and indirectly, from this customer in the amount of approximately \$14,242 and \$18,234, respectively, for products supplied to this customer. In addition, for the nine months ended September 30, 2005 and 2004, we paid to this customer \$367 and \$571, respectively, for services provided to us.

### 11. COMMITMENTS AND CONTINGENCIES

We have certain contingent liabilities from time to time from litigation for employment or other matters arising in the normal course of business. Although the outcome of any litigation can never be certain, it is our opinion that the outcome of such contingencies will not materially affect our business, operations, financial condition or cash flows.

We have committed to invest up to an aggregate of \$7,850 in two private equity funds, of which \$3,837 has been invested to date. The duration of each of these commitments is five years with \$1,010 expiring in 2005 and \$3,003 expiring in 2007.

### 12. SUBSEQUENT EVENT

On October 17, 2005, ADTRAN announced that its board of directors declared a quarterly cash dividend of \$0.09 per common share to be paid to stockholders of record at the close of business on November 4, 2005. The payment date will be November 17, 2005. The quarterly dividend payment will be approximately \$6,838. 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.

---

## Table of Contents

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

#### **FORWARD LOOKING STATEMENTS**

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by or on behalf of ADTRAN. ADTRAN and its representatives may from time to time make written or oral forward-looking statements, including statements contained in this report, our other filings with the Securities and Exchange Commission (SEC) and in our reports to 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 us or on our behalf are subject to uncertainties and other factors that could cause such statements to be wrong. Some of these uncertainties and other factors are listed below. They have been discussed in our most recent Form 10-K filed on March 11, 2005 with the SEC. Though we have attempted to list comprehensively these important factors, we caution investors that other factors may prove to be important in the future in affecting our operating results. New factors emerge from time to time, and it is not possible for us to predict all of these factors, nor can we assess the impact each factor or combination of factors may have on our business.

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

#### **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:**

- 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.
- We do not engage in long-term research and development processes, and as a consequence may miss certain market opportunities enjoyed by larger companies with substantially greater research and development efforts.
- 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.
- Our dependence on subcontractors located in Asia may result in reduced control over product quality, delayed delivery of products, increased material cost from excess/obsolete material, and/or increased manufacturing costs, each of which could negatively affect customer relations and operating results.
- The decision of foreign countries to no longer base their currency value on the U.S. Dollar could cause material cost to increase in cost over time and negatively affect operating results.
- We compete in markets that have become increasingly competitive, which may result in reduced gross profit margins and market share.
- We depend heavily on sales to certain customers; the loss of any of these customers would significantly reduce our revenues and net income.
- The lengthy approval process required by Incumbent Local Exchange Carriers (ILECs) and other carriers could result in fluctuations in our revenues.
- Consolidation and deterioration in the competitive service provider market could result in a significant decrease in our revenue.
- Increased sales volume in international markets could result in increased costs or loss of revenue due to factors inherent in these markets.
- Our success depends on our ability to reduce the selling prices of succeeding generations of our products.
- Our failure to maintain rights to intellectual property used in our business could adversely affect the development, functionality and commercial value of our products.
- Our success depends on attracting and retaining key personnel.
- The price of our common stock has been volatile and may continue to fluctuate significantly.

---

## Table of Contents

- 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 returns may be increased or decreased, impacting future cost of goods sold.

The foregoing list of risks is not exclusive.

### OVERVIEW

ADTRAN designs, develops, manufactures, markets, and services a broad range of high-speed network access products utilized by providers of telecommunications services and enterprise end-users. We currently sell our products to a large number of carriers, including the four largest U.S. telecommunications providers, and to private and public enterprises worldwide.

An important part of ADTRAN's strategy is to reduce the cost of each succeeding product generation and then to lower the product's selling price based on the cost savings achieved. As a part of this strategy, we seek to be a high-quality, low-cost provider of products in our markets. ADTRAN's 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 ADTRAN to sell succeeding generations of products to existing customers, while increasing our market share by selling these enhanced products to new customers.

ADTRAN's sales and earnings for the third quarter and nine months ended September 30, 2005 increased from those for the third quarter and nine months ended September 30, 2004. The increase in sales and earnings for the three and nine month periods ended September 30, 2005 is primarily attributable to an increase in sales of our System products, particularly DSLAM, Optical Access, M13 multiplexer and Integrated Access Device products. These increases are a result of ADTRAN's strategy of leveraging its engineering capabilities, distribution channels and customer base to enter new markets and grow market share. Revenue growth in the third quarter of 2005 was broad based across product categories and customer categories alike. The increase in gross profit for the three and nine month periods ended September 30, 2005, as a percentage of sales, is primarily related to continuing improvements in manufacturing efficiencies, the timing differences between the recognition of cost reductions and the lowering of product selling cost, and the sales of higher margin products.

Our operating results have fluctuated on a quarterly basis in the past, and operating results 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. Furthermore, a majority of customers typically 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 ADTRAN's 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 ADTRAN's financial results in a given quarter. Further, maintaining sufficient inventory levels to assure prompt delivery of our products increases the amount of inventory that may become obsolete and increases the risk that the obsolescence of such inventory may have an adverse effect on our business and operating results.

ADTRAN's operating results may also fluctuate as a result of a number of other factors, including increased competition, customer order patterns, changes in product mix, timing differences between price decreases and product cost reductions, product warranty returns, and announcements of new products by ADTRAN or our competitors. Accordingly, ADTRAN's historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that ADTRAN's financial results may vary from period to period.

---

## Table of Contents

### CRITICAL ACCOUNTING POLICIES

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 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 applicable terms of each respective 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. 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.

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 and system integrators. These large distribution organizations then sell 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. Our distributors may return products to us that are damaged or defective upon receipt for replacement. Additionally, 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 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 accepting 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 \$0.3 million and \$0.4 million at September 30, 2005 and December 31, 2004, respectively.

---

## Table of Contents

- 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 a monthly 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 market 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 \$4.9 million and \$4.8 million at September 30, 2005 and December 31, 2004, 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 (loss), net of tax. The ultimate realized value on these equity investments is subject to market price volatility until they are sold.  

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 a wide range of objective and subjective 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 market value that has declined from its original or adjusted cost basis by 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. 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.

We also invest in privately held entities and record our investments in these entities at cost. We review our investments in these entities 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 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.

---

## Table of Contents

- We estimate our cost to repair or replace defective products at the time revenue is recognized and include this cost in cost of goods sold in our consolidated statements of income. Our products generally include warranties of one to ten years for product defects. The liability for warranty returns totaled \$2.5 million and \$1.6 million at September 30, 2005 and December 31, 2004, respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets. 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 returns may be increased or decreased, impacting future cost of goods sold.

### **RESULTS OF OPERATIONS – THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005 COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004**

#### **SALES**

ADTRAN's sales increased 29.4% from \$115.3 million in the three months ended September 30, 2004 to \$149.2 million in the three months ended September 30, 2005. Sales increased 6.5% from \$349.9 million in the nine months ended September 30, 2004 to \$372.6 million in the nine months ended September 30, 2005. The increase in overall sales is primarily attributable to increases in sales of our HDSL/T1 and Systems products partially offset by decreases in DBT/Total Reach products. Systems revenue was \$80.3 million in the third quarter of 2005, compared to \$53.5 million in the third quarter of 2004, primarily due to an increase in DSLAM, Optical Access, and NetVanta product revenues. HDSL/T1 product category revenues were \$65.5 million in the three months ended September 30, 2005, up 16.1% from revenues of \$56.4 million in the three months ended September 30, 2004. Systems revenue, as a percentage of total sales, increased from 48.0% for the nine months ended September 30, 2004 to 53.5% for the nine months ended September 30, 2005.

Carrier Networks sales increased 37.6% from \$82.5 million in the three months ended September 30, 2004 to \$113.5 million in the three months ended September 30, 2005, and increased 12.9% from \$247.2 million in the nine months ended September 30, 2004 to \$279.2 million in the nine months ended September 30, 2005. The quarter-over-quarter increase in Carrier Networks sales is primarily attributable to continued increases in HDSL/T1 and Systems revenue, partially offset by declines in DBT/Total Reach product revenues. Carrier Networks sales as a percentage of total sales increased from 71.5% in the three months ended September 30, 2004 to 76.1% in the three months ended September 30, 2005, and increased from 70.7% in the nine months ended September 30, 2004 to 74.9% in the nine months ended September 30, 2005.

Enterprise Networks sales increased 8.8% from \$32.8 million in the three months ended September 30, 2004 to \$35.7 million in the three months ended September 30, 2005, and decreased 9.0% from \$102.6 million in the nine months ended September 30, 2004 to \$93.4 million in the nine months ended September 30, 2005. The quarter-over-quarter increase in Enterprise Networks sales is primarily attributable to an increase in sales of T1 and System products. The year-over-year decrease in Enterprise Networks sales is primarily due to an Integrated Access Device customer who declared bankruptcy in the second quarter of 2004. Enterprise Networks sales as a percentage of total sales decreased from 28.5% for the three months ended September 30, 2004 to 23.9% for the three months ended September 30, 2005, and decreased from 29.3% for the nine months ended September 30, 2004 to 25.1% for the nine months ended September 30, 2005.

---

## Table of Contents

Foreign sales increased 181.2% from \$6.9 million in the three months ended September 30, 2004 to \$19.4 million in the three months ended September 30, 2005, and increased 101.9% from \$21.3 million in the nine months ended September 30, 2004 to \$43.0 million in the nine months ended September 30, 2005. Foreign sales, as a percentage of total sales, increased from 6.0% for the three months ended September 30, 2004 to 13.0% for the three months ended September 30, 2005, and increased from 6.1% for the nine months ended September 30, 2004 to 11.5% for the nine months ended September 30, 2005. The increase in foreign sales is primarily attributable to an overall increase in demand for Systems products in Australia and Canada.

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

As a percentage of sales, cost of sales decreased from 42.4% in the three months ended September 30, 2004 to 40.2% in the three months ended September 30, 2005, and decreased from 42.6% in the nine months ended September 30, 2004 to 41.2% in the nine months ended September 30, 2005. The decrease in cost of sales as a percentage of sales is primarily related to manufacturing efficiencies, the timing differences between the recognition of cost reductions and the lowering of product selling prices, and sales of higher margin products. The decrease was partially offset by an increase in warranty provision for a component failure in a Systems product.

Carrier Networks cost of sales, as a percent of division sales, decreased from 43.6% in the three months ended September 30, 2004 to 41.4% in the three months ended September 30, 2005 and decreased from 44.1% in the nine months ended September 30, 2004 to 41.9% in the nine months ended September 30, 2005. The decreases in Carrier Network cost of sales as a percentage of division sales are primarily related to manufacturing efficiencies, the timing differences between the recognition of cost reductions and the lowering of product selling prices, and the sales of higher margin new products. Enterprise Networks cost of sales, as a percent of division sales, decreased from 39.3% in the three months ended September 30, 2004 to 36.1% in the three months ended September 30, 2005 and decreased from 39.2% in the nine months ended September 30, 2004 to 39.0% in the nine months ended September 30, 2005. The decrease in Enterprise Networks cost of sales, as a percentage of division sales, is primarily related increased sales of higher margin products.

An important part of ADTRAN's 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, as described above, sometimes results in variations in ADTRAN's gross profit margin from quarter to quarter, 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 ADTRAN, it is difficult to predict the gross margin for any particular financial period.

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

Selling, general and administrative expenses increased 14.7% from \$21.8 million in the three months ended September 30, 2004 to \$25.0 million in the three months ended September 30, 2005 and increased 7.6% from \$67.2 million in the nine months ended September 30, 2004 to \$72.3 million in the nine months ended September 30, 2005. The increase in selling, general and administrative expenses is primarily related to increased selling expenses and insurance cost, and includes \$409,000 in compensation expense relating to the accelerated vesting of stock options for a retiring officer. In the nine months ended September 30, 2004, ADTRAN recorded \$977,000 of bad debt expense primarily related to financial difficulties at a former integrated access device customer who ceased business during 2004. No bad debt expense was recorded in this same period in 2005.

Selling, general and administrative expenses as a percentage of sales decreased from 18.9% in the three months ended September 30, 2004 to 16.8% in the three months ended September 30, 2005 and remained relatively flat from 19.2% in the nine months ended September 30, 2004 to 19.4% in the nine months ended September 30, 2005. Selling, general and administrative expenses as a percent of sales will fluctuate whenever there is a significant fluctuation in revenues during the periods being compared.

---

## Table of Contents

### **RESEARCH AND DEVELOPMENT EXPENSES**

Research and development expenses decreased 20.1% from \$18.9 million in the three months ended September 30, 2004 to \$15.1 million in the three months ended September 30, 2005 and decreased 3.6% from \$49.6 million in the nine months ended September 30, 2004 to \$47.8 million in the nine months ended September 30, 2005. The decrease in research and development expense is a result of higher product testing approval expenses incurred in 2004 related to Optical Access products and accelerated approvals for DSLAM products. As a percentage of sales, research and development expenses decreased from 16.4% in the three months ended September 30, 2004 to 10.1% in the three months ended September 30, 2005 and decreased from 14.2% in the nine months ended September 30, 2004 to 12.8% in the nine months ended September 30, 2005. Research and development expenses as a percent of sales will fluctuate whenever there is a significant fluctuation in revenues during the periods being compared.

ADTRAN will continue to incur research and development expenses in connection with its new products and its expansion into international markets. ADTRAN continually evaluates new product opportunities and engages in intensive research and product development efforts. 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.

### **INTEREST INCOME**

Interest income increased 66.7% from \$1.5 million in the three months ended September 30, 2004 to \$2.5 million in the three months ended September 30, 2005 and increased 23.2% from \$5.6 million in the nine months ended September 30, 2004 to \$6.9 million in the nine months ended September 30, 2005. This increase is primarily related to more cash at work in investing activities, increasing interest rates and the continuing realignment of our investment portfolio resulting in additional interest income.

### **INTEREST EXPENSE**

Interest expense remained relatively stable at \$693,000 and \$644,000 in the three months ended September 30, 2005 and 2004, respectively, and remained relatively stable at \$1.9 million in the nine months ended September 30, 2005 and September 30, 2004.

### **NET REALIZED INVESTMENT GAIN**

Net realized investment gain decreased from \$646,000 in the three months ended September 30, 2004 to \$535,000 in the three months ended September 30, 2005 and increased from \$590,000 in the nine months ended September 30, 2004 to \$1.3 million in the nine months ended September 30, 2005. These changes primarily resulted from the sale of public equity securities associated with the realignment of our investment portfolio.

### **OTHER INCOME, NET**

Other income, net, comprised primarily of miscellaneous income, gains and losses on foreign currency transactions and scrap raw material sales, increased from expense of \$33,000 in the three months ended September 30, 2004 to income of \$67,000 in the three months ended September 30, 2005 and decreased from \$858,000 in the nine months ended September 30, 2004 to \$822,000 in the nine months ended September 30, 2005. The nine-month period ended September 30, 2005 includes a one-time \$196,000 payment received from a customer as settlement for the cancellation of an order.

### **INCOME TAXES**

Our effective tax rate increased from 31.2% in the three months ended September 30, 2004 to 36.1% in the three months ended September 30, 2005 and increased from 32.1% in the nine months ended September 30, 2004 to 35.0% in the nine months ended September 30, 2005. This increase is primarily related to a higher mix of taxable income and lower research and development tax credits and economic incentive credits as a percent of taxable income.

---

## Table of Contents

### **NET INCOME**

As a result of the above factors, net income increased \$14.2 million from \$18.8 million in the three months ended September 30, 2004 to \$33.0 million in the three months ended September 30, 2005 and increased \$8.4 million from \$60.5 million in the nine months ended September 30, 2004 to \$68.9 million in the nine months ended September 30, 2005. As a percentage of sales, net income increased from 16.3% in the three months ended September 30, 2004 to 22.1% in the three months ended September 30, 2005 and increased from 17.3% in the nine months ended September 30, 2004 to 18.5% in the nine months ended September 30, 2005.

### **LIQUIDITY AND CAPITAL RESOURCES**

Fifty million dollars of the expansion of Phase III of our corporate headquarters was approved for participation in an incentive program offered by the Alabama State Industrial Development Authority (the "Authority"). 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") 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. We cannot be certain that the state of Alabama will continue to make these corporate income tax credits available in the future; and therefore, we may not realize the full benefit of these incentives. Through September 30, 2005, 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 \$50.0 million. The bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. Included in long-term investments are \$50.0 million of restricted funds, which is a collateral deposit against the principal amount of this bond. In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program.

In July 2003, our board of directors elected to begin declaring quarterly dividends on our common stock, and 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. During the nine months ended September 30, 2005, ADTRAN paid dividends totaling \$18,963.

Our working capital, which consists of current assets less current liabilities, increased 23.9% from \$266.4 million as of December 31, 2004 to \$330.1 million as of September 30, 2005. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 6.83 as of December 31, 2004 to 5.11 as of September 30, 2005. The current ratio, defined as current assets divided by current liabilities, decreased from 8.40 as of December 31, 2004 to 6.23 as of September 30, 2005. These liquidity ratios will fluctuate with increased business growth and as our inventory, accounts payable and income tax position change. As of December 31, 2004, we had an income tax receivable of \$2.4 million. This income tax receivable was primarily related to amended tax filings for additional federal research and development tax credits. These refunds were received during the first quarter of 2005. As a result of significantly more income, as of September 30, 2005, we had an income tax payable of \$11.1 million.

At September 30, 2005, our cash on hand of \$70.6 million and short-term investments of \$180.7 million placed our short-term liquidity in cash, cash equivalents, and short-term investments at \$251.3 million. At December 31, 2004, our cash on hand of \$57.6 million and short-term investments of \$124.8 million placed our short-term liquidity in cash, cash equivalents, and short-term investments at \$182.4 million.

---

## Table of Contents

We receive an income tax deduction for the difference between the exercise price and the market price of non-qualified stock options upon exercise by employees. We recorded \$4.4 million and \$2.7 million during the nine months ended September 30, 2005 and 2004, respectively, as an income tax deduction for the difference between the option exercise price and the market price of our stock for non-qualified stock option exercises on the date of exercise of each non-qualified stock option grant.

On July 18, 2005, the Compensation Committee of the Board of Directors approved the acceleration of the vesting of options held by Mr. Howard Thraikill exercisable for 27,500 shares of ADTRAN's common stock. In accordance with APB No. 25, ADTRAN recognized compensation expense equal to the difference in the option price on the date of accelerated vesting over the option price on the date of original grant. ADTRAN recorded a charge of \$409,000 (\$266,000 net of tax) in the three-month period ended September 30, 2005 for these modified awards.

At September 30, 2005, our long-term investments decreased by 11.3% to \$148.6 million from \$167.6 million at December 31, 2004. This decrease is primarily attributable to the sale of long-term investments, and the movement of bonds maturing within one year from long-term investments to short-term investments. Long-term investments at September 30, 2005 and December 31, 2004 include a restricted balance of \$50.0 million related to our revenue bonds, as discussed above. Long-term investments at September 30, 2005 also include \$2.3 million related to our deferred compensation plan. We intend to finance our operations and capital requirements in the future with cash flow from operations and, if necessary, use of our investment portfolio. We believe these available sources of funds to be adequate to meet our operating and capital needs for the foreseeable future.

Net accounts receivable increased 12.4% from December 31, 2004 to September 30, 2005, primarily due to the increase in overall sales. Our allowance for doubtful accounts remained relatively stable at \$349,000 and \$361,000 at September 30, 2005 and December 31, 2004, respectively. Quarterly accounts receivable days sales outstanding decreased 12 days from 56 days as of December 31, 2004 to 44 days as of September 30, 2005. Quarterly inventory turnover increased from 4.29 turns as of December 31, 2004 to 4.77 turns as of September 30, 2005. Inventory increased 26.7% from December 31, 2004 to September 30, 2005 due to the general overall increase in business and the need to carry the level of inventory necessary to meet current demand.

Accounts payable increased 58.5% from December 31, 2004 to September 30, 2005 due to a general overall increase in business. Accrued expenses increased 65.7% from December 31, 2004 to September 30, 2005. These increases are primarily related to the variations in the timing of payments. Capital expenditures totaled approximately \$7.4 million and \$5.1 million for the nine months ended September 30, 2005 and 2004, respectively. These expenditures were primarily used to purchase computer hardware, computer software, manufacturing equipment, and test equipment.

During February 2005, with the purchase of 1,000,700 common shares at an average price of \$17.96, we completed our April 29, 2004 stock repurchase plan. On February 11, 2005, ADTRAN announced that its board of directors approved the repurchase of up to an additional 5,000,000 shares of its common stock. This plan will be implemented through open market purchases from time to time as conditions warrant. As of September 30, 2005, we had repurchased a total of 1,287,263 shares of our common stock in the first nine months of 2005 at a total cost of \$24.1 million and had the authority to purchase an additional 4,713,437 shares.

We issued 851,751 shares of treasury stock for \$10.6 million during the nine months ended September 30, 2005, to accommodate employee stock option exercises. During 2004, we issued 84,794 shares of treasury stock and 357,601 newly issued shares of common stock for an aggregate of \$5.6 million to accommodate employee stock option exercises.

---

## Table of Contents

We have used, and expect to continue to use, the cash generated from operations for working capital, 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.

During the nine months ended September 30, 2005, there have been no material changes in contractual obligations and commercial commitments from those discussed in our most recent Form 10-K filed on March 11, 2005. We do not have off-balance sheet financing arrangements and have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of or requirements for capital resources. We have committed to invest up to an aggregate of \$7.9 million in two private equity funds, of which \$3.8 million has been invested to date. The duration of each of these commitments is five years with \$1.0 million expiring in 2005 and \$3.0 million expiring in 2007.

### **EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS**

On October 22, 2004, the American Jobs Creation Act of 2004 was signed into law. This legislation repeals export tax benefits, which have historically reduced our effective tax rate. This legislation transitions the repeal by allowing 100 percent of 2004, 80 percent of 2005 and 60 percent of 2006 export benefits. The legislation also transitions in a new tax deduction for a portion of domestic manufacturing expenditures, which will benefit ADTRAN. The legislation did not have a material effect on our 2004 tax expense. ADTRAN expects the net effect of the phase out of the extra-territorial income (ETI) and phase in of this new deduction to result in a decrease of 0.20% to 0.50% in its effective tax rate for 2005.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs – An Amendment of ARB No. 43, Chapter 4*. SFAS No. 151 amends the guidance in Accounting Research Bulletin (ARB) No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Among other provisions, the new rule requires that items such as idle facility expense, excessive spoilage, double freight, and rehandling costs be recognized as current-period charges regardless of whether they meet the criterion of “so abnormal” as stated in ARB No. 43. Additionally, SFAS No. 151 requires that the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005, and is required to be adopted by ADTRAN effective January 1, 2006. We do not expect SFAS No. 151 to have a material impact on our consolidated results of operations or financial condition.

In December 2004, the FASB issued SFAS No. 123R, *Accounting for Stock Based Compensation*. SFAS No. 123R revises the guidance in SFAS No. 123 and supersedes APB No. 25, and its related implementation guidance. SFAS No. 123R focuses primarily on the accounting for share-based payments to employees in exchange for services, and it requires a public entity to measure and recognize compensation cost for these payments. SFAS No. 123R is effective for fiscal years beginning after June 15, 2005, and is required to be adopted by ADTRAN effective January 1, 2006. SFAS No. 123R requires ADTRAN to recognize the cost of employee services received in exchange for its equity instruments. Currently, in accordance with APB No. 25, we record the intrinsic value of stock-based compensation as expense. Accordingly, no compensation expense is currently recognized for fixed stock option plans, as the exercise price equals the stock price on the date of grant. Under SFAS No. 123R, ADTRAN will be required to measure compensation expense over the options’ requisite service period based on the stock options’ fair value at the date the options are granted. SFAS No. 123R allows for the use of the Black-Scholes or a lattice option-pricing model to value such options.

---

## Table of Contents

ADTRAN has determined that it will use the Black-Scholes option-pricing model to calculate the fair value of its options. As allowed by SFAS No. 123R, ADTRAN will elect the Modified Prospective Application method, which applies the Statement to new awards and modified awards after the effective date, and to any unvested awards as service is rendered on or after the effective date. For a discussion of our stock-based compensation plans and agreements, see Note 7 in ADTRAN's Annual Report on Form 10-K for the year ended December 31, 2004. ADTRAN is continuing to evaluate this guidance and the impact it will have on its consolidated results of operations or financial condition.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Non-monetary Assets – An Amendment of APB Opinion No. 29*. SFAS No. 153 eliminates the exception from fair value measurement for non-monetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Non-monetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. SFAS No. 153 specifies that a non-monetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS No. 153 is effective for periods beginning after June 15, 2005 and was adopted by ADTRAN effective July 1, 2005. Adoption of SFAS No. 153 did not have a material impact on our consolidated results of operations or financial condition.

In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*. SFAS 154 replaces APB No. 20 and SFAS No. 3. SFAS No. 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. SFAS No. 154 provides guidance for determining whether retrospective application of a change in accounting principle is impractical and for reporting a change when retrospective application is impractical. SFAS No. 154 also addresses the reporting of an error by restating previously issued financial statements. SFAS No. 154 becomes effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. ADTRAN will adopt this pronouncement effective January 1, 2006.

On June 8, 2005, the FASB issued FASB Staff Position No. FAS 143-1, *Accounting for Electronic Waste Obligations (“FSP FAS 143-1”)*. This position provides guidance on accounting for electronic equipment waste obligations associated with Directive 2002/96/EC on Waste Electrical and Electronic Equipment (the “Directive”) adopted by the European Union. In particular, the new guidance specifies the appropriate accounting for obligations to dispose of “historical” waste, defined as electronic waste obligations relating to equipment put on the market prior to August 13, 2005. Under the Directive, when historical waste equipment is replaced, the waste management obligation for that equipment may be transferred to the producer of the replacement equipment depending upon the law adopted by the applicable European Union country. In this case, the producer of the new asset should recognize revenue for the total amount received reduced by the fair value of the obligation required for disposal of the replaced asset. The producer of the new asset should derecognize the liability when the obligation is settled. FSP FAS 143-1 is effective for reporting periods ending after June 8, 2005 and was adopted by ADTRAN on July 1, 2005. Adoption of FSP FAS 143-1 did not have a material impact on our consolidated results of operations or financial conditions.

On July 14, 2005 the FASB issued a proposed Interpretation, *Accounting for Uncertain Tax Provisions, an Interpretation of FASB Statement 109*. This proposed Interpretation would clarify the accounting for uncertain tax positions as described in SFAS No. 109, *Accounting for Income Taxes*, and would require a company to recognize, in its financial statements, the best estimate of the impact of a tax position only if that position is probable of being sustained on an audit basis solely on the technical merit of the position. On October 10, 2005, the FASB confirmed that the guidance in this proposed Interpretation has been delayed and will not be finalized before the first quarter of 2006. ADTRAN will continue to monitor this guidance and the impact it might have on its consolidated results of operations or financial condition.

## Table of Contents

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

ADTRAN has not conducted transactions, established commitments or entered into relationships requiring disclosures beyond those provided elsewhere in this Form 10-Q.

### **ITEM 4. CONTROLS AND PROCEDURES**

(a) *Evaluation of disclosure controls and procedures.* Our chief executive officer and chief financial officer are responsible for establishing and maintaining “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) for 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 quarterly report, have concluded that our disclosure controls and procedures are effective.

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

## **PART II. OTHER INFORMATION**

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Item 2(a) and (b) are inapplicable.

#### (c) Stock Repurchases

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

<u>Period</u>	<u>(a) Total Number of Shares Purchased</u>	<u>(b) Average Price Paid per Share</u>	<u>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)</u>	<u>(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</u>
July 1 - July 31, 2005	—	—	—	4,846,649
August 1 - August 31, 2005	134,112(2)	\$ 25.059(2)	133,212	4,713,437
September 1 - September 30, 2005	—	—	—	4,713,437
<u>Total</u>	<u>134,112</u>	<u>\$ 25.059</u>	<u>133,212</u>	

- (1) On February 11, 2005, ADTRAN announced that its board of directors approved the repurchase of up to 5,000,000 shares of its common stock. This plan will be implemented through open market purchases from time to time as conditions warrant. 133,212 shares of common stock were repurchased under this share repurchase plan for the periods indicated.
- (2) Includes 900 mature shares received by ADTRAN as payment of the exercise price for employee stock options. None of the transactions with respect to these 900 shares were made in the open market. The average price paid per share with respect to these transactions is based on the closing price of the common stock on the NASDAQ National Market on the date of the transactions.

---

## Table of Contents

### **ITEM 6. EXHIBITS**

Exhibits.

**Exhibit No.**

**Description**

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

---

**Table of Contents**

**SIGNATURE**

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

**ADTRAN, INC.**  
*(Registrant)*

Date: November 4, 2005

/s/ James E. Matthews

---

James E. Matthews  
Senior Vice President - Finance and Chief Financial Officer

---

**Table of Contents****EXHIBIT INDEX**

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

CERTIFICATIONS

I, Thomas R. Stanton, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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(s) 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 (or persons performing the equivalent functions):

(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: November 4, 2005

/s/ Thomas R. Stanton

---

Thomas R. Stanton  
Chief Executive Officer

I, James E. Matthews, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q 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(s) 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 (or persons performing the equivalent functions):

(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: November 4, 2005

/s/ James E. Matthews

---

James E. Matthews  
Senior Vice President –  
Finance and Chief Financial Officer

**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 Quarterly Report of ADTRAN, Inc. (the "Company") on Form 10-Q for the quarter ending September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Thomas R. Stanton, Chief Executive Officer 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  
November 4, 2005

---

**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 Quarterly Report of ADTRAN, Inc. (the "Company") on Form 10-Q for the quarter ending September 30, 2005 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 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 and Chief Financial Officer  
November 4, 2005