ADTRAN INC

FORM 10-K
(Annual Report)

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Industry	Communications Equipment
Sector	Technology
Fiscal Year	12/31

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 1996

[ ] 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 Number)

901 EXPLORER BOULEVARD, HUNTSVILLE, ALABAMA 35806-2807
(Address of principal executive offices, including zip code)

(205) 971-8000
(Registrant's telephone number, including area code)

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock,
$.01 par value

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

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

The aggregate market value of the Registrant's outstanding Common Stock held by non-affiliates of the Registrant on January 31, 1997 was $776,223,057. There were 38,920,914 shares of Common Stock outstanding as of January 31, 1997.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the 1996 Annual Report for the fiscal year ended December 31, 1996 are incorporated herein by reference in Part II and portions of the Proxy Statement for the Annual Meeting of Stockholders to be held on April 23, 1997 are incorporated herein by reference in Part III.

ADTRAN, Inc.
Annual Report on Form 10-K

For the Fiscal Year Ended December 31, 1996

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PART I

ITEM 1. BUSINESS

OVERVIEW

ADTRAN, Inc. (the "Company") designs, develops, manufactures, markets and services a broad range of high speed digital transmission products utilized by telephone companies ("Telcos") and corporate end-users to implement advanced digital data services over existing telephone networks. The Company also customizes many of its products for private label distribution and for original equipment manufacturers ("OEMs") to incorporate into their own products. Most of the Company's Telco and customer premises equipment ("CPE") products are connected to the local loop ("Local Loop"). The Local Loop is the large existing infrastructure of the telephone network connecting end-users to a Telco's central office, the facility that provides the local switching and distribution functions ("Central Office"). The balance of the Company's products are used in the Telcos' Central Offices.

The Company's product lines, which are comprised of over 400 principal products, are built around a core technology developed by the Company to address the Local Loop and Central Office digital communications marketplace. These products include a comprehensive line of transmission, repeater, extension and termination products such as dataports, channel and data service units, and digital repeaters and extenders. The Company also offers a broad line of T-1 multiplexers providing modular flexibility to the CPE marketplace. A separate T- 1 product line is sold to Telcos for use within their Central Offices. The Company recently has addressed the wireless marketplace with the introduction of a wireless spread spectrum microwave transceiver.

The Company's products address three market segments: (i) Telco products for use in the Local Loop or in Central Offices; (ii) CPE products for end- users; and (iii) OEM products. In 1996, sales of Telco, CPE and OEM products accounted for 60.1%, 27.8% and 12.1%, respectively, of the Company's sales. The Company's Telco products deliver cost-effective digital services such as 56/64 Kbit/sec Digital Data Service ("DDS"), 128 Kbit/sec Integrated Services Digital Network ("ISDN") 64 Kbit/sec or 1.544 Mbit/sec Frame Relay service ("Frame Relay") and 1.544 Mbit/sec T-1 (24 Channel) service. In addition, the Company's High bit-rate Digital Subscriber Line ("HDSL") products permit T-1 transmission on up to 12,000 feet of unconditioned copper wireline while reducing the need for costly mid-span repeaters. The Company's CPE products provide end-users access to Telco digital services and often include additional features for specific end-user applications. The Company customizes many of its Telco and CPE products and supplies them as OEM products to substantially all significant manufacturers of T-1 multiplexers used in Telcos' Central Offices. The Company has introduced and shipped a number of HDSL, ISDN and other products which comply with international standards to increase its penetration of overseas markets. See "Business -Products."

The rapidly expanding requirements for digital transmission in the Local Loop are being driven by Internet access, small office/home office ("SOHO") users, video delivery and on-line data services, among other applications, all of which require and benefit from the speed, reliability and low cost of digital transmission. While the Telcos have, to a large extent, replaced their wireline data transmission network between Central Offices with fiber-optic and digital microwave links which allow for high speed digital transmission, the Local Loop remains predominantly characterized by low speed analog transmission over copper wirelines. As a result, there has been considerable impetus for Telcos to upgrade the Local Loop in the most cost effective manner available. Widespread replacement of the copper wireline Local Loop remains prohibitively expensive, so the Telcos have turned to manufacturers such as the Company for technologies that expand Local Loop capabilities to handle digital transmission without necessitating this costly replacement. Existing digital delivery technologies, including Frame Relay, ISDN and HDSL, are all experiencing rapid compound growth. Numerous higher speed digital technologies are under development or in the trial stage, including Asymmetric Digital Subscriber Line ("ADSL"), Switched Multi-megabit Data Services ("SMDS"), Asynchronous Transfer Mode ("ATM"), wireless transmission, hybrid fiber coax and cable modems.

The Company's core technologies expand the digital transmission capabilities of the Local Loop by enabling increased transmission speed and/or increased transmission distance. Ongoing research and product development activities are designed to enhance the distances covered by existing services as well as to develop new higher speed technologies. For example, during the first quarter of 1996, the Company demonstrated to the Telcos its new "Total Reach" delivery technology which increases the distance covered by ISDN services in the Local Loop from 18,000 feet to 30,500 feet. The same technology is being incorporated into 64Kbit/sec digital products for use in Frame Relay and DDS services. In addition, the Company is engaged in research, performance simulation, and design of higher speed digital technologies for the transport of data. Current issues for future higher speed digital technologies, including costs, power consumption and distances reachable, must be resolved for widespread acceptance and deployment of these technologies.

In developing its product families, the Company has continuously improved its design, purchasing and production processes to lower product costs and has consistently offered improved products at lower prices to customers. As a result, management believes that the Company is a leading provider of Local Loop and Central Office digital transmission products to Telcos. See "Company Strategy." The Company's customers include all seven Regional Bell Operating Companies ("RBOCs"), GTE Corporation, the three largest interexchange carriers, many of the 1,300 independent telephone companies as well as a number of worldwide electronics, communications and industrial companies. See "Business- Customers."

The Company was incorporated under the laws of Delaware in November 1985 and commenced operations in January 1986.

Recent Developments

In August 1994, the Company completed an initial public offering of Common Stock which resulted in net proceeds to the Company of $37,867,963. The Company's Common Stock now trades on the Nasdaq National Market under the symbol "ADTN."

On June 29, 1995, the Company and certain stockholders of the Company sold a total of 3,125,100 shares of Common Stock in a second public offering. The Company received net proceeds of $15,705,362 from the sale of 500,000 shares of Common Stock at the public offering price of $33 per share. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in the Company's 1996 Annual Report to Shareholders.

The Company is continuing a project to expand its facilities in Huntsville, Alabama in several phases over the next three years at a cost of approximately $131,000,000 of which $36,255,906 had been incurred at December 31, 1996. The debt associated with $50,000,000 of this project has been approved for participation in an incentive program offered by the Alabama State Industrial Development Authority (the "Authority"). That program enables participating companies such as the Company to generate Alabama corporate income tax credits that can be used to reduce the amount of Alabama corporate income taxes that would otherwise be paid. In January 1995, the Authority issued $20,000,000 of its taxable revenue bonds (the "Original Bond"), pursuant to such program and loaned the proceeds from the sale of the bonds to the Company. The Original Bond was purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"), pursuant to a financing agreement dated January 1, 1995, (the "Original Financing Agreement") and bears interest, payable monthly, at the rate of 87.5 basis points over the 30 day London inter-bank offered rate and mature on January 1, 2020. First Union National Bank of Tennessee, Nashville, Tennessee (the "Bondholder") has agreed to purchase the Original Bond from AmSouth and to make further advances to the Authority with the total amount not to exceed $50,000,000. Upon approval by the Authority, an Amended and Restated Taxable Revenue Bond (Adtran, Inc. Project) Series 1995, (the "Amended and Restated Bond") will be issued and the Original Financing Agreement will be amended. The Company anticipates that the Amended and Restated Bond and associated documents will be completed during the second quarter of 1997. The Amended and Restated Bond will bear interest, payable monthly, at the rate of 45 basis points over the money market rate of the Bondholder and will mature on January 1, 2020. The Company has agreed to make payments to the Authority in amounts necessary to pay the principal of and interest on the Amended and Restated Bond. Construction on the project began in March 1995 and certain phases were completed by December 31, 1996. There can be no assurance that the State of Alabama will continue to make these corporate income tax credits available in the future, and the Company therefore may not realize the full benefit of these incentives. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in the Company's 1996 Annual Report to Shareholders.

Company Strategy

The Company's growth strategy includes the following elements:

Focus on Local Loop and Central Office Digital Transmission Products. Upon commencing operations in 1986, the Company focused its product strategy upon capturing a significant market share for sales of Local Loop and Central Office digital transmission products to Telcos. This focus was the result of the recognition by the Company's founders of the significant opportunity created by the elimination of American Telephone & Telegraph Co.'s ("AT&T") monopoly position in the manufacture of telecommunications equipment. Having achieved a leading market share of Local Loop and Central Office digital transmission products, the Company intends to consolidate its position through an integrated program of new product development, customer service and product excellence.

Capitalize on Existing Leadership Position in the Telco Market. As a leader in the Telco market it serves, the Company intends to apply its sales and customer service resources to new market opportunities that arise as expanded services are provided by the Telcos in response to increasing subscriber demand. In this regard, the Company expects that its in-depth understanding of and experience with Local Loop and Central Office technology will provide it a competitive advantage. The Company is committed to replace most of its products with succeeding generations of products with lower costs, additional product features and improved serviceability.

Adapt Product Technology and Sales Force to CPE Market. Over the past five years, the Company has adapted product technology developed for Telco Central Offices for use in the Company's CPE product lines. As many of the technologies that are critical to success in the CPE market are identical to those already developed and refined for the Company's Telco products, the Company has realized a competitive advantage through leveraging these product development efforts and expertise in all of its markets. To sell its CPE products to the large number of end-users which comprise the market, the Company has built a dedicated sales force and an extensive nationwide network of resellers over the past five years. The Company intends to develop new distribution channels to address the worldwide market for its CPE products.

Expand Presence in OEM Market. Sales of private label and OEM versions of the Company's standard products to manufacturers of Telco and CPE equipment have contributed significantly to the Company's growth and profitability. As standard products move to volume production, the Company will continue adapting them to other manufacturers' equipment. Since OEM products bear the nameplate of the manufacturer for whom they are produced, the manufacturers to whom OEM products are sold insist upon the highest quality and reliability in such products. Accordingly, management believes that the low cost, high quality and reliability of the Company's product technology will be increasingly attractive to manufacturers of a wide variety of Telco and CPE products that connect to the Local Loop. During 1996, sales of the Company's more mature 64 Kbit/sec DDS products met increasing cost competition and resulted in lower sales by its OEM customers. To address this new competitive threat, the Company reached agreements with its OEM customers allowing the Company to sell directly to certain large accounts (primarily GTE Corporation) and thus avoid the higher distribution costs associated with the OEM sales channel.

Expand into International Markets. While international sales are not currently substantial, international customers have begun to order, and the Company has shipped, international versions of the Company's Telco and CPE products. The Company has formed, and will continue to pursue, international distribution arrangements built upon core products and technology developed by the Company in an effort to further its penetration into international markets. The Company has also focused on developing E-1 technology, the predominant standard for data transmission outside of North America. In the future, the Company plans to add appropriate support capabilities and introduce new versions of its products that incorporate E-1 technology and that otherwise comply with relevant international standards. The Company's development process currently is conducted in accordance with ISO 9001, the international standard for quality management systems for design, manufacturing and service.

Invest in Engineering and Product Development. The Company expects to continue its relatively high levels of investment in developing innovative new products, and redesigning existing products, in order to reduce product costs and production cycle times, and in so doing will continue its efforts to be a low cost provider in the industry. New products are generally targeted at opportunities that promise rapid growth as product costs are reduced and feature sets are optimized. The Company will also continue to develop and expand its broad product line serving each of the Telco, CPE and OEM markets. The Company continuously monitors developing technologies and introduces products as defined standards and markets emerge. This diversification in products and markets will continue to be a key to the Company's business strategy.

Adapt to New Local Loop Media. New Local Loop connections continue to be implemented primarily with copper wirelines, although the Company anticipates an increased use of fiber-optic, coaxial and wireless communications in new installations over the next decade and more. To the extent such alternative connection methods become economically advantageous, and as such markets develop and grow, the Company intends to extend its technical and marketing experience to develop products meeting the demands of such markets.

Commit to Constant Improvements in Quality and Service. The Company believes its success to date has been due in large measure to its commitment to constantly improve product quality and customer service. This commitment has been formally recognized in awards received from several of its largest customers. In the future, product quality is expected to contribute significantly to the Company's efforts to reduce production cycle times and product costs.

Products

Core Product Technology. The Company's product lines, comprised of over 400 principal products, are built around core technologies developed by the Company to address the Central Office and Local Loop digital communications marketplaces. Central Office facilities, approximately 30,000 of which are located throughout North America, provide subscribers with access to a discrete portion of the network's bandwidth on a switched basis ("switched access") or on an exclusive basis ("private line"). Typically, access is available in unit multiples of 56 Kbit/sec (64 Kbit/sec in some locations) increments, although Telco multiplexing equipment can efficiently aggregate these basic increments into high speed channels up to T-1 rates (1.544 Mbit/sec), T-3 (45 Mbit/sec) or faster rates. Individual channels can also be subdivided to speeds as low as 2.4 Kbit/sec.

Each individual Local Loop circuit is served by a circuit assembly (consisting of a channel unit, U-Basic Rate Transmission Extender, or "U-BR1TE" or other similar products manufactured by the Company) that plugs into a Central Office channel bank or shelf. The speed and functionality of the circuit is determined by the type of circuit assembly deployed by the Telco. For each such circuit, Central Office facilities generally make available a corresponding physical mounting position in a channel bank or shelf, and plug-in circuit assemblies are installed in accordance with the service ordered by the subscriber. Other special plug-in circuit assemblies, such as those manufactured by the Company, are commonly employed to connect or bridge circuits within the Central Office. Individual communication channels (multiplexer time slots) are interconnected and switched as appropriate within the Central Office, and the resultant communications payload is then directed toward the proper destination. If the communications traffic needs to be delivered to another Central Office, it is directed toward the inter-office network, usually through a long distance carrier such as AT&T, MCI or Sprint. At the far-end connection, the process is reversed. Voice is converted into digital form by circuit assemblies within the RBOC's Central Office and treated like any other digital information until delivered to the far-end serving Central Office where it is returned to analog form in the Local Loop. However, when products such as those sold by the Company are utilized, data communications traffic remains in digital form end to end.

In recent years, the need for higher volume data communications has led to the development of "remote huts." Like the Central Office, remote huts provide subscriber access through plug-in circuit assemblies such as those manufactured by the Company, but they can take advantage of high capacity fiber- optic links to bring service to the local area economically. Remote huts are then connected by the Local Loop to end-users with products such as those sold by the Company. The Company also manufactures optional mid-span repeaters that extend the service range of the Local Loop, as well as optional termination units that are deployed to monitor and maintain service to the subscriber.

At the customer's premises, terminating equipment receives the transmitted signal from the Central Office and converts it to a form useful to end-user products such as LAN interconnection gear, video conferencing equipment, PBXs, personal computers and related equipment. In general, the Local Loop and related CPE products support bi-directional communications traffic.

Today, the Company's product lines consist of three groups of inter- related products, all evolving from the core product technology developed for the Local Loop:

* Telco Central Office and Local Loop digital transmission products.

* CPE products.

* OEM products

Telco Central Office and Local Loop Digital Transmission Products. Several hundred to several thousand circuit assemblies, such as those manufactured by the Company, are required at each Central Office, since each Local Loop generally requires a unit of this type to provide service to each subscriber. In 1996, the Company delivered more than 735,680 units of this product group, accounting for 60.1% of the Company's sales. Telco products accounted for 58.1% and 52.5% of the Company's sales in 1995 and 1994, respectively.

Typical of the different versions of Central Office channel assemblies manufactured by the Company are the various OCU dataports and related products, the fundamental building blocks for delivering DDS and Frame Relay services at 56/64 Kbit/sec rates to subscribers. The Company is also a leading industry supplier of mid-span DDS repeaters. In response to the Telco's need for a method to monitor transmission conditions and to detect problems for each individual circuit, the Company pioneered development of the Digital Data Station Termination ("DDST") product family. Both the OCU dataports and DDSTs are produced in relatively high volumes directly related to the increased demand for DDS and Frame Relay services.

The Company is one of the industry's primary suppliers of U-BR1TEs, which are required to extend ISDN service from an ISDN capable switch at a hub Central Office to a serving Central Office or to remote Channel Banks. The Company also supplies a substantial portion of the industry's ISDN mid-span repeaters. Other ISDN products include a BR1TE Bank to mount multiple U-BR1TES, T-BR1TES, NT-1 interface units, and outside plant housings for the repeaters.

Late in 1993, the Company commenced deliveries of its HDSL product family. The Company has chosen to develop its own custom integrated circuits so HDSL product performance, availability and cost can be carefully managed. Management believes that demand for this product family will increase steadily as more affordable versions increasingly become available to the Telcos.

The list price for the Company's Telco product family generally ranges from $100 to $1,000 per unit. The following table illustrates the breadth of the Company's Telco products and their applications:

Representative Telco Products

Product or Product Family	Description	Application	Current Product Generation
DDST	Digital Data Station Terminations	Terminates DDS (up to 64 Kbit/sec); monitors and tests DDS lines	4th
DSO-DP	Digital Signal Zero Data Ports	Interconnects 2 channels in the Telco Central Office	5th
HDSL	High bit-rate Digital Subscriber Line	Delivers repeaterless	3rd

	Units	T-1 (1.544 Mbit/sec up to 12,000 ft.	
LR 56/72	DDS Loop Repeaters	Extends DDS Circuit Range	4th
OCU-DP	Office Channel Units - Data Ports	Provides DDS (up to 64 Kbit/sec)	8th
U-BR1TE	U-Basic Rate Transmission Extenders	Extends ISDN (up to 128 Kbit/sec) to Central Offices/remote huts without ISDN Switch	3rd
U-Repeater	ISDN Loop Repeaters	Extends ISDN Circuit Range	3rd

CPE Products. The Company's CPE products have evolved from technology developed for its Telco product line. As many of the technologies which are critical to success in the CPE market are identical to those already developed and refined for the Company's Telco products, the Company has realized a competitive advantage through leveraging these product development efforts and expertise in all of its markets. Since initial product deliveries in 1991, CPE product sales have accounted for 20.3%, 28.3% and 27.8% of the Company's sales in 1994, 1995 and 1996, respectively.

In most cases, a CPE product is purchased and installed by end-user customers in conjunction with a Telco's digital data transmission service. For example, a DSU is normally installed with each DDS loop. The Company's DSU product line was completely upgraded and revamped in 1993 with five new models that can terminate any standard DDS or Switched 56 digital service available in North America. In 1994, the product line was expanded to include lower cost versions as well as a family of shelf mount units. In 1995, products supporting synchronous data compression and versions supporting the simple network management protocol were added to the family. In 1996, the flagship products were once again redesigned to become more modular and flexible. These design changes have substantially reduced the associated manufacturing costs while increasing the utility of the product to the marketplace. Customer acceptance of this product family has significantly increased the Company's DSU market share, and management believes that further gains are possible with the Company's recent enhancements of this product line.

Over the past two years, Frame Relay Services have met with increasing customer acceptance. As a result, the Company has recently readied for introduction a family of Frame Relay Service units (FSU). These products are built from the core technologies utilized in the existing DSU and TSU product families.

The Company believes that its ISDN Service Unit (ISU) with sustained data transmission rates up to 128 Kbit/sec was the first product of its type when introduced in 1993. New versions of the product introduced by the Company have followed, including a model that automatically senses and adapts to virtually any far-end communications device, including modems, 2 wire or 4 wire DSUs, or another ISDN terminal adapter. The ISU product family was later extended to include the ISU 512, a device that allows multiple ISDN lines to be combined for use by high speed video conferencing equipment. Recently, ADTRAN has solved one of the biggest obstacles in successful installation of new ISDN circuits with the introduction of its "Expert ISDN" technology. Expert ISDN allows CPE devices to automatically determine key parameters, such as Telco switch type and Service Profile Identifiers ("SPIDS"). Previously, these parameters were passed manually from the Telco to the user, who manually entered the information into the CPE device. ADTRAN's new ISDN terminal adapters, the Express XR and XRT, utilize this technology. Additionally, these products have been recognized by Computer Telephony Magazine as "Products of the Year" and received the "97 Design and Engineering" award at the Winter Consumer Electronics Show (CES).

Late in 1993, initial installations of the Company's T-1 Service Unit ("TSU") were successfully completed. Offering full or fractional T-1 access, the product line is designed for sophisticated users needing higher speed interconnection of LANs, remote offices, video delivery systems, graphic workstations and related equipment. Common plug-in modules are available for several of the Company's models, tailoring the units for multi-channel data communications. TSU order rates have increased steadily since the 1993 introduction and now comprise a significant portion of CPE sales. The TSU product line augments the Company's mature line of ACT Channel Banks that accommodate most commercially available channel units, including those offered by the Company's competitors.

The list price for the CPE product family generally ranges from $500 to $2,000 per unit. The following table illustrates the breadth of the Company's CPE products and their applications:

Representative CPE Products

Product or Product Family	Description	Application	Current Product Generation
Act Channel Bank	T-1 (1.544 Mbit/sec) Channel Banks; compatible with D-4 Channel Units	Provides user access to each of 24 channels in T-1 service	3rd
DSU	Data Service Units/ Channel Service Units	Connects data terminal equipment to DDS (up to 64 Kbit/sec); standard interface for data processing equipment	4th
SMART 16	Shelf-Mount Systems	Provides means for end-users to plug in multiple DSU, TSU and ISU circuit assemblies	2nd
ISU	ISDN Service Units	Connects data terminal equipment to ISDN (up to 128 Kbit/sec) network	3rd
TSU	T-1 Data Service Units/ Channel Service Units	Connects data terminal equipment to T-1 (1.544 Mbit/sec) network	2nd
T1-CSU	T-1 Channel Service Units	Provides T-1 termination	2nd
NT-1	Network Termination	Provides ISDN termination	3rd
FSU	Frame Relay Service Unit	Provides Frame Relay circuit termination	1st

OEM Products. The Company supplies OEM products to essentially all significant manufacturers of T-1 multiplexers used in either Central Offices or remote huts, and has become a major OEM supplier of dataports, U-BR1TEs and other channel units for Central Office multiplexer systems sold to the Telcos. In 1994, 1995 and 1996, OEM products accounted for 27.2%, 13.6% and 12.1%, respectively, of the Company's sales. This decrease was attributable primarily to reduced demand related to mature programs combined with the low volume normally encountered on new programs. In addition, the Company converted numerous products originally developed under OEM contract status to ADTRAN standard product status. This conversion was accomplished with permission from the OEM contract holders and was done to allow the Company to directly pursue markets that will no longer support a two tier distribution structure. The Company has shipped new OEM versions of its HDSL products which comply with international standards. OEM versions of HDSL products that were sold internationally amounted to 12.4% of total international sales.

Generally, the Company's OEM supply contracts call for customer funded modification of standard products followed by joint testing and refinement of resultant designs. Minimum production volumes are usually, but not always, specified in such contracts. While the bulk of OEM sales has involved tailored versions of dataports and related products, DSUs and other CPE products have also become important sources of OEM sales. Such products are being supplied to manufacturers of video delivery equipment, LAN interconnect equipment and information services providers. OEM products are generally customized versions of the Company's Telco and CPE products. The selling price for the OEM product family generally ranges from $100 to $500 per unit.

International Markets

The Company serves its international markets through a combination of direct sales and distribution agreements. The Company has formed, and will continue to pursue, international distribution arrangements built upon core products and technology developed by the Company in an effort to further its penetration into international markets. In addition, the Company has focused on developing E-1 technology which, though similar to T-1 technology, has a transmission rate of 2.048 Mbit/sec and is the predominant standard for data transmission outside of North America. The Company has tested, received orders for and shipped HDSL products incorporating E-1 technology. The Company anticipates that it will develop additional products incorporating E-1 technology. ISDN development work is underway to incorporate compatibility with European ISDN standards and specific in-country network interface requirements. Although the Company has not yet fully developed its potential in its international markets and related sales have been modest (7.4% of total sales in 1996), the Company believes that international markets present a significant opportunity for growth.

Research and Product Development

The markets for the Company's products are characterized by rapidly changing technology, evolving industry standards and continuing improvements in telecommunications service offerings of common carriers. If technologies or standards applicable to the Company's products, or common carrier service offerings based on the Company's products, become obsolete or fail to gain widespread commercial acceptance, the Company's business may be adversely affected. Moreover, the introduction of products embodying new technology, the emergence of new industry standards or changes in common carrier service offerings could adversely affect the Company's ability to sell its products. For instance, a large number of the Company's products have, to date, been designed to apply primarily to the delivery of digital communications over copper wireline in the Local Loop. While the Company has competed favorably by developing a high performance line of products, it expects that the increasing deployment of fiber-optic cable, coaxial cable and wireless transmission in the Local Loop (each of which uses a significantly different process of delivery) will require that it develop new products to meet the demands of these markets when such markets are sufficiently established. The Company's sales and profitability in the past have resulted to a significant extent from its ability to anticipate changes in technology, industry standards and common carrier service offerings, and to develop and introduce new and enhanced products. The Company's continued ability to adapt will be a significant factor in maintaining or improving its competitive position and its prospects for growth. Therefore, the Company will continue to make significant investments in product development, although there can be no assurance that the Company will have the resources necessary to continue this strategy successfully or to otherwise respond appropriately to changing technology, industry standards and common carrier service offerings. See "Management's Discussion and Analysis of Financial Condition and Results of Operations" in the Company's 1996 Annual Report to Stockholders.

As of December 31, 1996, the Company's product development programs were carried out by 194 engineers and engineering support personnel, comprising approximately 21.7% of the Company's employees. To date, all product development expenses have been charged to operations as incurred. From time to time, development programs are conducted by other firms under contract with the Company, and related costs are also charged to operations as incurred. During 1994, 1995 and 1996, product development expenditures totaled $13,774,038, $19,131,457 and $24,647,425 respectively. Because the Company's product development activities are an important part of its strategy and because of rapidly changing technology and evolving industry standards, the Company expects to spend more in product development activities in 1997 than it did in 1996.

The Company's product development personnel are organized into teams, each of which is effectively dedicated to a specific product line or lines. However, because the Company services each of the Telco, CPE and OEM markets, and because all of the products in each of these markets share certain similarities, the benefits of the Company's product development efforts generally are not confined to a particular market, but can be leveraged to the Company's advantage in all of its markets. As of December 31, 1996, product development teams were assigned to the following product lines: Loop products, Network products, HDSL products, DSU and Frame Relay products, T-1 multiplexer products, ISDN Telco products, ISDN CPE products, strategic products and extended range products. In addition, engineering services and advanced technology groups provide support for all the product development teams. Each product development team is generally responsible for sustaining technical support of existing products, improving the cost or manufacturing of products, conceiving new products in cooperation with other groups within the Company and adapting standard products or technology under supply contracts to other firms. In particular, each product development team is charged with implementing the Company's engineering strategy of reducing product costs for each succeeding generation of the Company's products in an effort to be a low cost, high quality provider in the industry, without compromising functionality or serviceability. This strategy has involved setting a price point for the next generation of any given product with the aim of meeting that price point through innovative engineering. The key to this strategy is choosing an initial architecture for each product that enables engineering innovations to result in future cost reductions. Successful execution of this strategy also requires that the Company continue to attract and recruit outstanding engineers, and the continued success of the Company's recruiting program at Southeastern universities is critical to this effort.

The product development teams are supported by a research group that provides guidance in applicable digital signal processing technologies, computer simulation and modeling, CAD/CAM tool sets, custom semiconductor design and technological forecasting. As product and market opportunities arise, the organizational structure may be adjusted accordingly. The Company's development process is conducted in accordance with ISO 9001, which is the international standard for quality management systems for design, manufacturing and service.

The Company believes that its success in the past has been dependent upon the ability of its engineering team to establish and maintain a position of product and technological leadership, and its success in the future will be equally dependent upon the evolution of new forms of existing products and the development of new products fulfilling the needs of current and future customers. Therefore, the Company will continue to make significant investments in product development.

Customers

The Company's customer base includes each of the seven RBOCs and most of the major independent domestic Telcos. The major customers of the Company include:

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Alcatel                             Hong Kong Telecom
Alltel Corporation                  Nordata  dba Datatech
Ameritech Corp.                     Northern Telcom Inc.
AT&T                                NYNEX Corp.
Bell Atlantic Network Services      Pacific Bell
BellSouth Corp.                     R Tech.
Bloomberg L.P.                      Siemens Corp.
Charles Industries, Ltd.            Southwestern Bell Corp.
Desert Palms International Co.      Sprint Corp.
GTE Corp.                           US West, Inc.
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Historically, a large percentage of the Company's sales have been to the seven RBOCs (36.0% in 1996) and other Telcos (24.0% in 1996). GTE and Sprint accounted for 16.3% and 10.2%, respectively, of the Company's total sales in 1996. No other customer accounted for 10% or more of the Company's sales in 1996.

A supplier such as the Company must first obtain product approvals from an RBOC or other Telco to sell its products to such RBOC or Telco. The Company, therefore, is involved in a constant process of submitting for approval succeeding generations of products as well as products that deploy new technology or respond to a new technology demand from an RBOC or other Telco. While the Company has been successful in the past in obtaining such approvals, there can be no assurance that such approvals or that ensuing sales of such products will continue to occur. Further, any attempt by an RBOC or other Telco to seek out additional or alternative suppliers or to undertake, as permitted under applicable regulations, the production of such products internally could have a material adverse effect on the Company's operating results. See "Government Regulation."

Marketing, Sales and Distribution

As of December 31, 1996, the Company's marketing, sales and distribution programs were conducted by 160 employees. The Company sells its Telco products in the United States directly to the Telcos through a field sales organization based in 19 locations in the United States and Canada, and it sells its Telco products internationally under various distribution arrangements with a geographically dispersed set of distributors. The Company sells its CPE products, both domestically and internationally, through a network of resellers. OEM products are sold directly to other firms, both domestically and internationally, through various supply and product support arrangements. The

Company has formed, and will continue to pursue, international distribution arrangements built upon core products and technology developed by the Company in an effort to further its penetration into international markets. Although the international market channel has not yet been fully developed and related revenue has been modest, the Company believes that international markets present a significant opportunity for growth, and the Company continues to focus effort on positioning itself to take advantage of such opportunity.

Sales to Telcos involve protracted product qualification and standardization processes that can extend for several months or years. Subsequent orders, if any, are generally placed under single or multi-year supply agreements that are generally not subject to minimum volume commitments. Telcos generally prefer having two or more suppliers of most products, so individual orders are generally subject to competition based on some combination of price, delivery and other terms. OEM products are generally sold to other manufacturers under contracts negotiated prior to commencement of required engineering activities. CPE products are sold under both exclusive and non- exclusive distribution agreements.

The Company's field sales organizations and distributors receive support from headquarters-based marketing, sales and customer support groups. Under certain circumstances, other headquarters personnel may become involved in sales and other activities. The Company believes that its success in the past has been dependent to a significant degree upon the ability of its sales and distribution teams to compete effectively in a highly competitive environment that includes firms with greater financial resources and more experience than the Company. The Company's success in the future will depend in part upon its ability to attract and retain qualified sales and marketing personnel who can compete and succeed in this environment.

Customer Service and Support

The Company maintains 24-hour, 7 day a week telephone support for all of its customers as customers often demand an immediate response to problems with installed products or with plans for new installations. The Company provides on- site support in those circumstances in which problems cannot otherwise be resolved. It has generally been the Company's policy to follow through with problem resolutions even after it is established that the Company's products are not the source of the difficulty. The Company provides direct installation and service of its products in North America utilizing its own resources or resources available under a nationwide services contract with TSS (formerly General Electric) for installation and service. International Business Machines Corporation ("IBM") purchased General Electric's service division in 1995 and General Electric assigned the Company's service contract to IBM under the terms of their sale agreement. The Company has approved the assignment. The Company also provides training to its customers (on both a paid and complimentary basis) relative to installation, operation and maintenance of the Company's products.

Substantially all of the Company's products carry a full ten year return-to-factory warranty. Warranty returns to date have been relatively insignificant (1.1%). The Company believes that its low return rate is the direct result of its commitment to a rigorous product quality program that has garnered it special recognition by several key customers. The Company also offers annual maintenance agreements to its customers which provide that, in exchange for an annual fee, the Company will provide on-site service, within a specified time, in response to any reported difficulties in the use or performance of the Company's products.

Manufacturing

The principal steps in the manufacturing process are the purchase and management of materials, assembly, testing, final inspection, packing and shipping. The Company purchases parts and components for assembly of all its products from a large number of suppliers through a worldwide sourcing program. However, certain key components used in the Company's products are currently available from only one source, and other key components are available from only a limited number of sources. In the past, the Company has experienced delays in the receipt of certain of its key components, which have resulted in delays in related product deliveries. The Company attempts to manage such risks through developing alternative sources, through engineering efforts designed to obviate the necessity of certain components, and by maintaining quality relationships and close personal contact with each of its suppliers. However, there can be no assurance that delays in deliveries of key components (including particularly integrated circuits as discussed in greater detail below) and consequent delays in product deliveries will not occur in the future. The inability to obtain sufficient key components as required, or to develop alternative sources if and as required in the future, could result in delays or reductions in product shipments which, in turn, could have a material adverse effect on the Company's customer relationships and operating results.

The Company relies on subcontractors in the United States, Mexico and Taiwan for assembly of printed circuit board assemblies, subassemblies, chassis, enclosures and equipment shelves. The Company subcontracts the assembly of a significant portion of its lower priced products to a company in Mexico. Such assembly typically can be done by subcontractors at a lower cost than if the Company assembled such items internally, which furthers the Company's goal of being a low cost, high quality provider in the industry. Subcontract assembly operations do, however, contribute significantly to production cycle times, but the Company believes it can respond more rapidly to uncertainties in incoming order rates by selecting assembly subcontractors having significant reserve capacity. This reliance on third-party subcontractors for the assembly of its products involves several risks, including the unavailability of or interruptions in access to certain process technologies and reduced control over product quality, delivery schedules, manufacturing yields and costs. These risks may be exacerbated by economic or political uncertainties or by natural disasters in foreign countries in which the Company's subcontractors may be located. The Company currently does not undertake any foreign exchange risks as it conducts all transactions with foreign vendors or customers in U.S. dollars.

The Company is heavily dependent on five subcontractors. In 1996, one of these subcontractors, Comptronix Corporation filed for protection under Chapter 11 bankruptcy laws and its assets were subsequently acquired by Sanmina Corporation. To date, the Company believes that it has successfully managed the risks of such dependence on these subcontractors through a variety of efforts, which include seeking and developing alternative subcontractors while maintaining existing relationships. However, there can be no assurance that delays in product deliveries may not occur in the future because of shortages resulting from this limited number of subcontractors or from the financial or other difficulties of such parties (including Sanmina). The inability to develop alternative subcontractors if and as required in the future could result in delays or reductions in product shipments which, in turn, could have a material adverse effect on the Company's customer relationships and operating results. While the Company believes that alternative sources of supply or alternative subcontractors could be developed if necessary, material delays or interruption of supply might, nevertheless, arise as a consequence of required retraining and other activities related to establishing and developing a new supply or subcontractor relationship and such material delays may have a material adverse effect on the Company's business and operating results.

Basically, final testing and shipment of products to customers occurs in the Company's Huntsville, Alabama facilities. The Company's facilities are certified pursuant to ISO 9001 and certain other telephone company standards, including those relating to emission of electromagnetic energy and safety specifications.

Backlog and Inventory

A substantial portion of the Company's shipments in any fiscal period relate to orders received in that period and firm purchase orders released in that fiscal period by customers under agreements containing non-binding purchase commitments. Further, a significant percentage of orders require delivery within 48 hours. These factors result in very little order backlog. The Company believes that because a substantial portion of customer orders are filled within the fiscal quarter of receipt, the Company's backlog is not a meaningful indicator of actual sales for any succeeding period. To meet this demand, the Company maintains a substantial finished goods inventory. The Company's inventory represented an acceptable range of 29% to 41% of working capital during 1996. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in the Company's 1996 Annual Report of Shareholders.

The Company's practice of maintaining sufficient inventory levels to assure prompt delivery of the Company's products increases the amount of inventory which may become obsolete. The provision for inventory losses as a percentage of sales was 1.5% in 1996. The obsolescence of such inventory may have an adverse effect on the Company's business and operating results.

Competition

The markets for the Company's products are intensely competitive. With the development of the worldwide communications market and the growing demand for related equipment, additional manufacturers have entered the markets in recent years to offer products in competition with the Company. Additionally, certain companies have, in recent years, developed the ability to deliver fiber- optic cable, coaxial cable and wireless transmission to certain office centers and other end-users. Competition would further increase if new companies enter the market or existing competitors expand their product lines. For instance, legislation has been enacted that lifts the restrictions which previously prevented the RBOCs from manufacturing telecommunications equipment. The RBOCs, which in the aggregate are the Company's largest customers, may increasingly become competitors of the Company in the markets served by the Company. See "Government Regulation" below.

The Company competes for customers on the basis of performance in relation to price, product features, adherence to standards, quality, reliability, development capabilities, availability and support. Some of the Company's competitors and potential competitors have greater financial, technological, manufacturing, marketing, and personnel resources than the Company.

With respect to Telco sales, product quality and availability and an established reputation for customer service are important competitive factors that can affect the Company's ability to have its products accepted and approved by the individual Telcos. The Company's Telco competitors include large established firms such as ADC Telecommunications, Inc., Lucent Technologies, Inc., PairGain Technologies, Inc., Pulse Communications, Inc. (a subsidiary of Hubbell Incorporated), Tellabs, Inc. and Teltrend, Inc., as well as smaller, specialized firms such as Conklin Instrument Corporation and Integrated Network Corporation.

With the introduction of its CPE product lines, the Company entered a market segment with entrenched competitors. Among the significant competitors for standard rate DSU market share are Motorola, Inc., Paradyne Corporation and Racal-Datacom, Incorporated. Market segment leaders for TSU products include ADC KENTROX, a subsidiary of ADC Telecommunications, Inc., Paradyne Corp., Digital Link Corporation and Verilink Corporation. The Company's T-1 multiplexer product line's key competitors include Newbridge Networks Corporation, Pulse Communications, Inc. and TELCO Systems, Inc. The Company generally competes with the same firms in sales of its OEM products as it does in sales of Telco and CPE products. An increase in competition could reduce the Company's gross profit margins, may require increased spending by the Company on product development and sales and marketing, and may otherwise adversely affect the Company's business.

Government Regulation

The telecommunications industry is subject to regulation in the United States and other countries. Federal and state regulatory agencies, including the Federal Communications Commission (the "FCC") and the various state public utility commissions and public service commissions, regulate most of the Company's domestic Telco customers. While such regulation does not typically affect the Company directly, the effects of such regulation on the Company's customers may, in turn, adversely impact the Company's business and operating results. For instance, the sale of the Company's products may be affected by the imposition upon certain of the Company's customers of common carrier tariffs and the taxation of telecommunications services. In addition, regulatory policies affecting the availability of common carrier services (such as high speed digital transmission lines) and other terms on which common carriers conduct their business may impede the Company's penetration of certain markets. These policies are under continuous review and are subject to change. Governmental authorities also have promulgated regulations which, among other things, set installation and equipment standards for private telecommunications systems and require that all newly installed hardware be registered and meet certain governmental standards.

Other governmental authorities, such as federal and state courts and the United States Department of Justice, have been in the past, and will likely continue in the future to be, a major force in shaping the manner in which the telecommunications business is conducted and telecommunication services are provided. For instance, the United States telecommunications industry was also significantly impacted by the landmark Modification of Final Judgment (the "MFJ"), which governed the structure of the 1984 divestiture by AT&T of its local operating telephone company subsidiaries (the Divestiture"). The Divestiture increased competition in the U.S. telecommunications industry by (i) eliminating the monopoly power which AT&T had enjoyed for years in most U.S. local and long distance telephone service and equipment markets, and (ii) prohibiting the RBOCs which emerged from the Divestiture from engaging in certain lines of business, including the provision of long distance services and the manufacture of telecommunications equipment. The terms of the Divestiture provide, however, for the removal of the line of business prohibitions if the rationale therefor becomes outmoded by technical developments or changes in competitive conditions.

The Telecommunications Act of 1996 covers a broad range of topics that will dramatically affect the telecommunications industry. RBOCs now will be allowed to manufacture equipment three years after they are eligible to enter the long distance business. The RBOCs, which are among the Company's largest customers, may increasingly become competitors of the Company in the markets it serves. The Telecommunications Act of 1996 also provides for RBOCs to enter long distance markets under certain conditions and long distance carriers may now provide local service.

The Company's business and operating results may also be adversely affected by the imposition of certain tariffs, duties and other import restrictions on components which the Company obtains from non-domestic suppliers, or by the imposition of export restrictions on products which the Company sells internationally.

Proprietary Rights

The name "ADTRAN" and the Company's corporate logo are registered trademarks of the Company. A number of the Company's product identifiers and names are also registered. The Company also claims rights to a number of unregistered trademarks. The Company has obtained patents on thirteen inventions relating to its products and has several patent applications pending. The Company will seek additional patents from time to time related to its research and development activities. The Company protects its trademarks, patents, inventions, trade secrets, and other proprietary rights by contract, trademark, copyright and patent registration, and internal security. Management believes, however, that the Company's competitive success will not depend on the ownership of intellectual property rights, but primarily on the innovative skills, technical competence and marketing abilities of the Company's personnel. The telecommunications industry, nevertheless, is characterized by the existence of an ever increasing number of patents and frequent litigation based on allegations of patent infringement. From time to time, third parties may assert exclusive patent, copyright and other intellectual property rights to technologies that are important to the Company. While there are no outstanding infringement lawsuits pending by or against the Company, there can be no assurance that third parties will not assert litigation claims against the Company in the future, that assertions by such parties will not result in costly litigation, or that the Company would prevail in any such litigation or be able to license any valid and infringed patents from third parties on commercially reasonable terms. Any infringement claim or other litigation against or by the Company could have a material adverse effect on the Company's business and operating results.

Employees

As of December 31, 1996, the Company had 894 full-time employees in the United States and two in Canada. Of the Company's total employees, 212 were in sales, marketing, distribution and service, 194 were in research and development, 379 were in manufacturing, and 111 were in administration. None of the Company's employees is represented by a collective bargaining agreement nor has the Company ever experienced any work stoppage. Management believes the Company's relationship with its employees is good.

ITEM 2. PROPERTIES

The Company's headquarters and principal administrative, engineering and manufacturing facilities are located in an office building containing 440,000 square feet located on approximately 22 acres of land in Huntsville, Alabama. The Company also temporarily leases 65,480 additional square feet to accommodate manufacturing and engineering activities. Plans are being made to expand its facilities in Huntsville by approximately 600,000 square feet (to accommodate a projected total of 3,000 employees) over the next three years at a cost of up to $131,000,000 of which $36,255,906 had been incurred at December 31, 1996. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in the Companay's 1996 Annual Report to Stockholders and Note 6 of Notes to Financial Statements.

The Company also maintains 19 sales and service facilities, 17 located within the United States and two in Canada, in the following locations: Huntsville, AL, Irvine, CA, San Francisco, CA, Denver, CO, Hartford, CT, Atlanta, GA, Chicago, IL, Bativia, IL, Darien, IL, Orland Park, IL, Leakwood, KS, Trenton, NJ, New York, NY, Cleveland, OH, Philadelphia, PA, Irving, TX, Washington, DC and Ontario and Quebec, Canada. In addition to the leases in Huntsville, AL, the facilities in Leakwood, KS, Irvine, CA, Denver, CO, Atlanta, GA, Irving, TX and Philadelphia, PA are leased under leases which expire at various times between 1995 and 2000. See Note 9 of Notes to Financial Statements.

ITEM 3. LEGAL PROCEEDINGS

The Company has been involved from time to time in litigation in the normal course of its business. The Company is not aware of any pending or threatened litigation matters which could have a material adverse effect on the Company.

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

No matter was submitted by the Company to vote of security holders during the fiscal quarter ended December 31, 1996.

Item 4(A). Executive Officers of the Registrant

Set forth below, in accordance with General Instruction G(3) of Form 10- K and Instruction 3 of Item 401(b) of Regulation S-K, is certain information regarding the executive officers of the Company. Unless otherwise indicated, the information set forth is as of March 14, 1997.

MARK C. SMITH - AGE 56

Mr. Smith is one of the co-founders of the Company.

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1995 to present      Chairman of the Board and Chief Executive Officer

1986 - 1995          Chairman of the Board, Chief Executive Officer
                     and President
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LONNIE S. McMILLIAN - AGE 68

Mr. McMillian is one of the co-founders of the Company.

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         1996 to present      Senior Vice President, Secretary and Director

         1986 - 1996          Vice President - Engineering, Secretary,
                              Treasurer and Director

HOWARD A. THRAILKILL - AGE 58

         1995 to present      President, Chief Operating Officer and Director

         October 1995         Executive Vice President, Chief Operating Officer
                              and Director

         1992 - 1995          Executive Vice President, Chief Operating Officer

         1988 - 1991          President and Chief Operating Officer of
                              Floating Point Systems, Inc.

JOHN R. COOPER - AGE 49

         1996 to present      Vice President - Finance and Chief Financial
                              Officer

         1995 - 1996          President, Sauty Group

         1991 - 1995          Partner, Coopers & Lybrand L.L.P.

DANNY J. WINDHAM - AGE 37

         1995 to present      Vice President - CPE Marketing

         1994 - 1995          Director of Marketing

         1989 - 1994          Manager of Product Management
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Mr. Windham, a co-founder of Processing Telecom Technologies (PTT), a subsidiary of ADTRAN, joined the Company in October 1989, and assumed responsibility for marketing activities for ADTRAN and PTT.

THOMAS R. STANTON - AGE 32

1995 to present	Vice President - Telco Marketing
1994 - 1995	Sr. Director, Marketing, E.F. Johnson Company
1993-1994	Director, Marketing, E.F. Johnson Company
1990-1992	Director, Systems Programs, E.F. Johnson Company

IRWIN O. GOLDSTEIN - AGE 63

1996 to present	Vice President - Admimistration
1989 - 1996	Vice President - Finance and Administration and Chief Financial Officer

PETER O. BRACKETT - AGE 55

1996 to present	Vice President - Techmology
1992 - 1996	Research Manager, Advanced Data Networking, Bellsouth
1986 - 1992	Division Vice President, Product Line, Racal-Datacom

M. MELVIN BRUCE - AGE 56

1996 to present	Vice President - Engineering
1989 - 1996	Vice President, Research and Design, TCI,

ROBERT A. FREDRICKSON

1996 to present	Vice President - Telco Sales
1996	Vice President, Broadband Business Development, DSC Communications Corp.
1991 - 1996	Senior Director, Access Products, DSC Communications Corp.

STEVEN L. HARVEY - AGE 36

1996 to present	Vice President - CPE Sales
1995 - 1996	Executive Vice President, Data Processing Sciences
1991 - 1995	Vice President, Data Processing Sciences

JUDE T. PANETTA - AGE 37

1994 to present	Vice President - Manufacturing
1989 - 1994	Director of Manufacturing, Exide Electronics

GREGORY A. PETERS - AGE 36

1996 to present	Vice President - International Sales
1993 - 1996	Executive Vice President and Chief Operating Officer, Connell Communications
1991 - 1992	Managing Director, Action Consulting International

There are no family relationships among the directors or executive officers.

All officers are elected annually by and serve at the pleasure of the Board of Directors of the Company.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Information relating to the market for holders of and dividends on the Company's Common Stock is set forth under the caption "Market for the Registrant's Common Stock and Related Stockholder Matters" on page 17 of the Company's 1996 Annual Report to Stockholders. Such information is incorporated herein by reference. Portions of the 1996 Annual Report to Stockholders are filed as Exhibit 13 to this report.

ITEM 6. SELECTED FINANCIAL DATA

Selected financial data for the Company for each year of the five-year period ended December 31, 1996 are set forth under the caption "Selected Financial Data" on page 18 of the Company's 1996 Annual Report to Stockholders referred to in Item 5 above. Such five-year selected financial data are incorporated herein by reference.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

A discussion of the Company's results of operations and financial condition is set forth under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" on pages 19 through 24 of the Company's 1996 Annual Report to Stockholders referred to in Item 5 above. Such discussion is incorporated herein by reference.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements of the Company, which are set forth on pages 25 through 39 of the Company's 1996 Annual Report to Stockholders referred to in Item 5 above, are incorporated herein by reference:

Balance Sheets as of December 31, 1995 and 1996.

Statements of Income for the years ended December 31, 1994, 1995 and 1996.

Statements of Changes in Stockholders' Equity for the years ended December 31, 1994, 1995 and 1996.

Statement of Cash Flows for the years ended December 31, 1994, 1995 and 1996.

Notes to Financial Statements.

Independent Auditor's Report.

The Supplementary financial information required by Item 302 of Regulation S-K is set forth in Note 13 of Notes to Financial Statements in the Company's 1996 Annual Report to Stockholders.

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

None

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information relating to nominees for director of the Company is set forth under the caption "Election of Directors-Information Regarding Nominees for Director" in the Proxy Statement for the Annual Meeting of Stockholders to be held on April 23, 1997. Such information is incorporated herein by reference. The definitive Proxy Statement will be filed with the Securities and Exchange Commission within 120 days after the Company's fiscal year end. Information relating to the executive officers of the Company, pursuant to Instruction 3 of Item 401(b) of Regulation S-K and General Instruction G(3) of Form 10-K, is set forth at Part I, Item 4(A) of this report under the caption "Executive Officers of the Registrant." Such information is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information relating to executive compensation is set forth under the caption "Executive Compensation" in the Proxy Statement referred to in Item 10 above. Such information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information relating to ownership of Common Stock of the Company by certain persons is set forth under the caption "Share Ownership of Principal Stockholders and Management" in the Proxy Statement referred to in Item 10 above. Such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information relating to existing or proposed relationships or transactions between the Company and any affiliate of the Company is set forth under the caption "Compensation Committee Interlocks and Insider Participation" in the Proxy Statement referred to in Item 10 above. Such information is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) Documents Filed as Part of This Report.

1. Financial Statements

The consolidated financial statements of the Company and the related report of Independent Auditors thereon which are required to be filed as part of this report are included in the Company's 1996 Annual Report and are incorporated by reference in Item 8 hereof.

2. Financial Statement Schedules

Schedule II

3. Exhibits

The following exhibits are filed with or incorporated by reference in this report. Where such filing is made by incorporation by reference to a previously filed registration statement or report, such registration statement or report is identified in parentheses. The Company will furnish any exhibit upon request to Irwin O. Goldstein, Vice President - Administration, ADTRAN, Inc., P.O. Box 140000, 901 Explorer Boulevard, Huntsville, Alabama 35814-4000. There is a charge of $.50 perpage to cover expenses for copying and mailing.

Exhibit Number	Description
3.1	Certificate of Incorporation, as amended (Exhibit 3.1 to the Company's Registration Statement on Form S-1, No. 33-81062 (the "Form S-1 Registration Statement")).
3.2	Bylaws, as amended (Exhibit 3.2 to the Form S-1 Registration Statement).
10.1	Documents relative to the $50,000,000 Taxable Revenue Bond, Series 1995 (ADTRAN, Inc.Project) issued by the State Industrial Development Authority, consisting of the following (Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994 (the "1994 Form 10-K")):
	(a) Financing Agreement dated January 1, 1995, among the State Industrial Development Authority, a public corporation organized under the laws of the State of Alabama (the "Issuer"), the Company and AmSouth Bank of

Alabama, a state banking corporation under the laws of the State of Alabama;

(b) Loan Agreement dated January 1, 1995 (the "Loan Agreement"), between the Issuer and the Company;

(c) Resolution of the Issuer authorizing the issuance of the $50,000,000 Taxable Revenue Bond, Series 1995 (ADTRAN, Inc. Project);

(d) Specimen Taxable Revenue Bond, Series 1995 (ADTRAN, Inc. Project);

(e) Resolution of the Company authorizing the Financing Agreement, the Loan Agreement and the Note;

(f) Specimen Note from the Company to AmSouth Bank of Alabama, dated January 13, 1995;

(g) Pledge Agreement dated January 13, 1995 between AmSouth Bank of Alabama and the Company;

*(h) Eighth Amended and Restated Closing Agreement between the Company and AmSouth Bank of Alabama dated March 24, 1997 and effective January 13, 1995; and

(i) Preliminary Agreement dated November 16, 1994 between the Issuer and the Company.

*10.2 Master Note for Business and Commercial Loans, dated June 1, 1996 and in the original principal amount of $10,000,000 by and between the Company and AmSouth Bank of Alabama.

10.3 Tax Indemnification Agreement dated July 1, 1994 by and among the Company and the stockholders of the Company prior to the Company's initial public offering of Common Stock (Exhibit 10.5 to the 1994 Form 10-K).

10.4 Management Contracts and Compensation Plans:

(a) 1996 Employees Stock Incentive Plan (Exhibit 10.4 to 1995 Form 10-K).

(b) 1995 Directors Stock Incentive Plan (Exhibit 10.4 to 1995 Form 10-K).

*11 Statement regarding Computation of Per Share Earnings.

***13 1996 Annual Report to Security Holders on Form 10-K.**

***23 Consent of Coopers & Lybrand L.L.P.**

***24 Powers of Attorney**

***27 Article 5 Financial Data Schedule**

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*Filed herewith

(b) Reports on Form 8-K. The following Current Reports on Form 8-K were filed by the Company during the year ended December 31, 1996:

Date of Report Filed	Form 8-K Item No.	Description	Financial Statements
9/11/96	7(c)	Press release dated August 12, 1996 announcing the appointment of John R. Cooper as Vice President and Chief Financial Officer of Adtran, Inc.	None
		Press release dated August 29, 1996 announcing the appointment of Dr. Melvin Bruce as Vice President of Engineering of Adtran, Inc.	None
		Press release dated September 9, 1996 announcing the appointment of Dr. Peter O. Brackett as Vice President of Technology of Adtran, Inc.	None

(c) See Item 14(a)(3) above.

(d) See Item 14(a)(2) above.

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*Filed herewith

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 26, 1997.

ADTRAN, Inc.
(Registrant)

By: /s/ John R. Cooper
John R. Cooper
Vice President - Finance and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on March 26, 1997

Signature	Title
/s/ Mark C. Smith Mark C. Smith	Chairman of the Board, Chief Executive Officer and Director
Howard A. Thrailkill* Howard A. Thrailkill	President, Chief Operating Officer and Director
Lonnie S. McMillian* Lonnie S. McMillian	Sr. Vice President, Secretary, and Director
O. Gene Gabbard* O. Gene Gabbard	Director
William L. Marks* William L. Marks	Director
Roy J. Nichols* Roy J. Nichols	Director
James L. North* James L. North	Director
/s/ John R. Cooper John R. Cooper	Vice President-Finance and Chief Financial Officer

By: /s/Mark C. Smith
Mark C. Smith
as Attorney-in-Fact

[LETTERHEAD OF COOPERS & LYBRAND APPEARS HERE]

REPORT OF INDEPENDENT ACCOUNTANTS

Our report on the financial statement of ADTRAN, Inc. has been incorporated by reference in this Form 10-K from the 1996 Annual Report to Shareholders of ADTRAN, Inc. In connection with our audits of such financial statements, we have also audited the related financial statement schedule listed in the index in Item 14 of this Form 10-K.

In our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information required to be included therein.

/s/ Coopers & Lybrand L.L.P.

Coopers & Lybrand L.L.P.

Birmingham, Alabama
January 14, 1997

SCHEDULE II
ADTRAN, INC.
VALUATION AND QUALIFYING ACCOUNTS
DECEMBER 31, 1996

	BALANCE AT BEGINNING OF PERIOD	ADDITIONS	DEDUCTIONS	BALANCE AT END OF PERIOD
YEAR ENDED DECEMBER 31, 1996				
Allowance for Doubtful Accounts	$544,526	$430,789	$102,591	$ 872,724
Inventory Reserve	$660,151	$222,881		$ 883,032
Warranty Liability	$523,027	$503,129		$1,026,156
YEAR ENDED DECEMBER 31, 1995				
Allowance for Doubtful Accounts	$450,000	$178,952	$ 84,426	$ 544,526
Inventory Reserve	$497,825	$162,326		$ 660,151
Warranty Liability	$280,806	$242,221		$ 523,027
YEAR ENDED DECEMBER 31, 1994				
Allowance for Doubtful Accounts	$150,000	$300,000		$ 450,000
Inventory Reserve	$ 90,000	$407,825		$ 497,825
Warranty Liability	$ 24,519	$256,287		$ 280,806

ADTRAN, INC.

INDEX OF EXHIBITS

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3.1	Certificate of Incorporation, as amended (Exhibit 3.1 to the Company's Registration Statement on Form S-1, No. 33-81062 (the "Form S-1 Registration Statement")).	
3.2	Bylaws, as amended (Exhibit 3.2 to the Form S-1 Registration Statement).	
10.1	Documents relative to the $50,000,000 Taxable Revenue Bond, Series 1995 (ADTRAN, Inc. Project) issued by the State Industrial Development Authority, consisting of the following (Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended December 31, 1994 (the "1994 Form 10-K")):	
	(a) Financing Agreement dated January 1, 1995, among the State Industrial Development Authority, a public corporation organized under the laws of the State of Alabama (the "Issuer"), the Company and AmSouth Bank of Alabama, a state banking corporation under the laws of the State of Alabama;	
	(b) Loan Agreement dated January 1, 1995 (the "Loan Agreement"), between the Issuer and the Company;	
	(c) Resolution of the Issuer authorizing the issuance of the $50,000,000 Taxable Revenue Bond, Series 1995 (ADTRAN, Inc. Project);	
	(d) Specimen Taxable Revenue Bond, Series 1995 (ADTRAN, Inc. Project);	
	(e) Resolution of the Company authorizing the Financing Agreement, the Loan Agreement and the Note;	
	(f) Specimen Note from the Company to AmSouth Bank of Alabama, dated January 13, 1995;	
	(g) Pledge Agreement dated January 13, 1995 between Amsouth Bank of Alabama and the Company;	

	*(h)	Eighth Amended and Restated Closing Agreement between the Company and AmSouth Bank of Alabama dated March 24, 1997 and effective January 13, 1995; and
	(i)	Preliminary Agreement dated November 16, 1994 between the Issuer and the Company.
*10.2	Master Note for Business and Commercial Loans, dated June 1, 1996 and in the original principal amount of $10,000,000 by and between the Company and AmSouth Bank of Alabama.	
10.3	Tax Indemnification Agreement dated July 1, 1994 by and among the Company and the stockholders of the Company prior to the Company's initial public offering of Common Stock (Exhibit 10.5 to the 1994 Form 10-K).	
10.4	Management Contracts and Compensation Plans:	
	(a)	1996 Employees Incentive Plan (Exhibit 10.4 to 1995 Form 10-K).
	(b)	1995 Directors Stock Incentive Plan (Exhibit 10.4 to 1995 Form 10-K).
*11	Statement regarding Computation of Per Share Earnings.	
*13	1996 Annual Report to Security Holders on Form 10-K.	
*23	Consent of Coopers & Lybrand L.L.P.	
*24	Powers of Attorney.	
*27	Financial Data Schedule.	

*Filed herewith

EIGHTH AMENDED AND RESTATED CLOSING AGREEMENT

This Agreement is made as of January 13, 1995 by ADTRAN, INC. ("ADTRAN") and AMSOUTH BANK OF ALABAMA ("AmSouth") in connection with the execution and delivery of that certain Financing Agreement dated January 1, 1995, (the "Financing Agreement") between the State Industrial Development Authority (the "Authority"), ADTRAN and AmSouth, as Bondholder. Capitalized terms not otherwise defined in this Agreement shall have the meaning assigned in the Financing Agreement.

RECITALS

On January 13, 1995 ADTRAN and AmSouth entered into a Closing Agreement in connection with the execution and delivery of the Financing Agreement and the consummation of the transactions contemplated therein. On February 13, 1995, May 15, 1995, August 11, 1995, December 9, 1995, March 8, 1996, November 12, 1996 and February 4, 1997, the parties amended the period of time for satisfaction of the conditions of the Closing Agreement and entered into the First Amended and Restated Closing Agreement, the Second Amended and Restated Closing Agreement, the Third Amended and Restated Closing Agreement, the Fourth Amended and Restated Closing Agreement, the Fifth Amended and Restated Closing Agreement, the Sixth Amended and Restated Closing Agreement, and the Seventh Amended and Restated Closing Agreement, respectively, for such purpose. The parties wish to further amend the period of time for satisfaction of the conditions of the Closing Agreement and have now entered into this Eighth Amended and Restated Closing Agreement for such purpose. Accordingly, the Closing Agreement is hereby amended and restated as follows:

1. ADTRAN has requested that AmSouth purchase the Bond on this date and make an initial Advance of $20,000,000 without selling a 100% participation interest to Madison County Investment Company, Inc. ("Madison"), as contemplated by the Financing Agreement and that certain Participation Agreement dated January 1, 1995, (the "Participation Agreement") to be executed by AmSouth and Madison. A copy of the Participation Agreement is attached as Exhibit A.

2. AmSouth shall purchase and hold the Bond for 868 days (that is, until May 30, 1997) without selling such a participation interest to Madison, provided, however, that:

(a) no additional Advances shall be made during such 868-day period,

(b) the proceeds of such Advance shall be pledge to AmSouth as security for payment of the Bond pursuant to a pledge agreement (the "Pledge Agreement") to be executed by ADTRAN in favor of AmSouth.

(c) Madison must enter into the Participation Agreement within such 868-day period;

(d) ADTRAN must execute and deliver the letter agreement attached as Exhibit B simultaneously with the delivery of the Participation Agreement by Madison: and

(e) all other conditions of the Financing Agreement to the initial Advance must be satisfied within such 868-day period.

3. If all the conditions of paragraph 2 are not satisfied within 868 days, then

(a) ADTRAN shall purchase the Bond from AmSouth upon 30 days' written demand therefor by AmSouth for an amount equal to the principal amount of the Bond plus accrued interest to the purchase date; and

(b) AmSouth shall have no further obligation to make Advances under the Financing Agreement, and ADTRAN shall execute (and shall cause the Authority to execute) an amendment to the Financing Agreement confirming such agreement.

4. If ADTRAN fails to purchase the Bond from AmSouth as provided in paragraph 3 above, then AmSouth may in its discretion, notify the Authority and ADTRAN that a default exists under this Agreement, and such notice shall also constitute an Event of Default under the Financing Agreement and the Loan Agreement, and AmSouth may pursue all remedies available to it under the Financing Documents and the Pledge Agreement or under applicable law.

5. ADTRAN has applied to AmSouth for credit approval for a loan or loans in an amount not to exceed $20,000,000, which may be in the form of Advances pursuant to the Financing Agreement or a loan pursuant to a separate agreement. AmSouth has given preliminary approval to such application, subject to documentation acceptable to AmSouth in its sole discretion. If such loan is funded prior to the date that ADTRAN is required to purchase the Bond pursuant to this Agreement and if the parties agree that the proceeds of such loan will be in the form of Advances pursuant to the Financing Agreement, then ADTRAN shall not be required to purchase the Bond and Madison shall not be required to enter into the Participation Agreement, but AmSouth shall not be required to make any further Advances under the Financing Agreement.

IN WITNESS WHEREOF, ADTRAN and AmSouth have caused this Agreement to be executed by their duly authorized officers as of March 24, 1997, although this Agreement is effective as of January 13, 1995 (the date of original execution).

ADTRAN, INC.

By: /s/ Mark C. Smith

Mark C. Smith

Its: Chairman

AMSOUTH BANK OF ALABAMA

By: /s/ Randall E. Phillips

Randall E. Phillips

Its: Vice President

[AMSOUTH BANK OF ALABAMA LOGO APPEARS HERE]

MASTER NOTE FOR BUSINESS AND COMMERCIAL LOANS

$10,000,000.00 Huntsville, Alabama

June 1, 1996

FOR VALUE RECEIVED, the undersigned (hereinafter called, whether one or more the "Borrower"), jointly and severally (if more than one) promises to pay to the order of AmSouth Bank of Alabama, its successors and assigns (hereinafter sometimes called the "Bank" and sometimes, together with any other holder of this note, called "Holder"), at any office of Holder or at such other place as Holder may from time to time designate, the sum of TEN MILLION AND 00/1000******
****
($10,000,000.00**********), or so much thereof as the Bank has advanced to the Borrower hereunder (the "Loan"), plus interest from the date hereof until maturity (whether by acceleration or otherwise) on the outstanding unpaid principal balance of the Loan, at the rate of [check (1), (2) or (3)]:

[ ] (1)__________% per annum

[ ] (2)__________% per annum in excess of the prime rate of the Bank in effect from time to time as designated by the Bank (the "Prime Rate"), with changes in the interest rate on this note caused by changes in the Prime Rate to take effect on the date the Prime Rate changes without notice to the Borrower or any other action by Holder:

[X] (3)30 day LIBOR RATE + 87.5 basis points as listed in the Wall Street Journal

Interest will be computed on the basis of the actual number of days elapsed over (check one) [X] an assumed 360-day year, [ ] a 365-(or 366-, if leap year) day year.

If none of the foregoing provisions for a rate of interest is checked, the rate of interest payable on the Loan until maturity (whether by acceleration or otherwise) shall be the Prime Rate of the Bank in effect from time to time, or such lesser rate as shall be the maximum permitted by law, computed on the basis of the actual number of days elapsed over an assumed 360-day year.

Notwithstanding anything to the contrary contained in this note, the amount paid or agreed to be paid as interest on the principal amount of the Loan shall never exceed the highest lawful rate allowed under applicable law. If at any time, interest is due to be paid in an amount that exceeds the highest lawful rate, then the obligation to pay interest hereunder shall be reduced to the highest lawful rate. If at any time, interest is paid in an amount that is greater then the highest lawful rate, then the amount that exceeds the highest lawful rate shall be deemed to have been a prepayment of principal of the Loan and applied to principal in the manner hereinafter provided, or if the excessive amount of interest exceeds the unpaid principal balance, the excess shall be refunded to the Borrower.

The Borrower hereby agrees to repay principal and interest as follows:

The Borrower will pay the principal amount of the Loan (check one and complete if applicable):

[ ] on demand, [X] 365 days after date, or

[ ] ____

and will pay the interest on the Loan (check one and complete if applicable):

[ ] at maturity, [X] in monthly installments on the 1st day of each month, and at maturity

[ ] In quarterly installments on the _____ day of each _________________ ______________________, and ____ and at maturity or

[ ] ____

For purposes of sending periodic billing statements in advance of each interest payment date, at the Holder's option, the Prime Rate in effect 15 days prior to each interest payment date shall be deemed to be the Prime Rate that continues in effect until the date prior to such interest payment date for purposes of computing the amount of interest payable on such interest payment date. If the Prime Rate changes during such 15-day period, the difference between the amount of interest that in fact accrues during such period and the amount of interest actually paid will be added to or subtracted from, as the case may be, the interest otherwise payable in preparing the periodic billing statement for the next succeeding interest payment date. In determining the amount of interest payable at the final maturity or upon full prepayment of this Master Note, all changes in the Prime Rate occurring on or prior to the day before the final maturity date or the date of such full prepayment shall be taken into account.

If none of the foregoing provisions for the repayment of principal and/or interest is checked, the principal, if not checked, and interest, if not checked, due hereunder shall be payable on demand of Holder.

If permitted under applicable law, the Borrower agrees to pay to Holder, on demand, a late charge. This late charge will be 5% of any installment that is not paid within 12 days after it is due and will be 5% of the interest portion of the payment due upon the final maturity date of this note if that payment is not paid within 12 days after it is due. This late charge will never be less than $10 nor more than $250 on each payment. This provision shall not be deemed to excuse a late payment or be deemed a waiver of any other right Holder may have, including, without limitation, the right to declare the entire unpaid principal and interest immediately due and payable.

All payments coming due on this Master Note shall be made in cash or immediately available funds at the Holder's office at which the payment is made. At its option, the Holder may elect to give the Borrower credit for any payment made by check or other instrument in accordance with the Holder's availability schedule in effect from time to time for such items and instruments, which the Holder will make available to the Borrower on request. Each payment on the indebtedness evidenced hereby will first reduce charges owed by the Borrower that are neither principal nor interest. The remainder of each payment will be applied first to accrued but unpaid interest and then to unpaid principal. Any partial prepayments of principal will be applied to installments due in the inverse order of their maturity and no such partial prepayment of principal will have the effect of postponing, satisfying, reducing, or otherwise affecting any scheduled installment before the principal of and interest on the Loan is, and all other charges due hereunder are, paid in full.

This note is a master note, and it is contemplated that the proceeds of the Loan evidenced hereby will be advanced from time to time to the Borrower by Holder in installments as requested by the Borrower and agreed to by Holder. It is further contemplated that any amounts advanced under this note may be prepaid from time to time by the Borrower and subsequently re-advanced by Holder, so long as the principal amount outstanding does not exceed the face amount of this note. By reason of prepayments hereon there may be times when no indebtedness is owing hereunder, and notwithstanding any such occurrence, this note shall remain valid and shall be in full force and effect as to each subsequent principal advance made hereunder. The Holder shall maintain a record (by computer or otherwise) of all principal advances and repayments under this Master Note and that record shall be presumed to be correct in the absence of clear and convincing evidence to the contrary.

Unless the Holder has otherwise agreed in writing, the Holder is not obligated to make any advances or re-advances hereunder, and all advances and re-advances shall be made at the option of Holder. This note shall be valid and enforceable as to the aggregate amount advanced at any time hereunder, whether or not the full face amount hereof is advanced.

If the Loan is payable on demand, this paragraph is inoperative and is not applicable otherwise, this paragraph is operative and applies to the Loan in accordance with its terms. In the event of default in the payment of any one or more installments of principal or interest which may become due hereunder, when and as the same fall due, or in the payment of all of principal and interest due hereunder at maturity, or the failure of any maker, endorser, surety or guarantor hereof (hereinafter called the "Obligors") to pay when due or perform any of the Obligations (meaning thereby this note and any and all renewals and extensions thereof and all other liabilities and indebtedness of the Borrower to Holder, now existing or hereafter incurred or arising, direct or indirect, and however incurred) or any part thereof or the failure of any Obligor to pay when due any other liability to Holder, in the event a default occurs under the terms of any loan agreement or other instrument (other than this note), document or paper evidencing, securing, guaranteeing, or executed in connection with all or any part of the Obligations (hereinafter, together with this note, collectively called the "Loan Documents"), or in the event Holder shall in good faith deem itself insecure for any reason, or on the happening of any one or more of said events. Holder shall have the right at its election and without notice to any Obligor to declare the Obligations immediately due and payable with interest to date. No delay in making such election shall be construed to waive the right to make such election. Holder may note the fact of acceleration hereon without stating the ground therefor, and whether or not noted hereon such election to accelerate shall be effective.

In the event of death of, insolvency of, general assignment by, judgment against, filing of petition in bankruptcy by or against, filing a petition for the reorganization of, filing of application in any court for receiver for or issuance of a writ of garnishment or attachment in a suit or action against any Obligor or against any of the assets of any Obligor, or on the happening of any one or more of said events, the Obligations shall, without notice to or demand upon any Obligor, immediately become due and payable with interest to date unless Holder shall on notice of such event elect to waive such acceleration by written notation hereon.

Each of the Obligors hereby severally (a) waives as to this debt or any renewal or extension thereof all rights of exemption under the Constitution or laws of Alabama or any other state as to personal property; (b) waives demand (unless this notes is payable on demand), presentment, protest, notice of protest, notice of dishonor, suit against any party and all other requirements necessary to hold any Obligor liable; (c) agrees that time of payment may be extended one or more times for any period of time (whether such period is shorter or longer than the initial term of this note) or renewal notes taken or other indulgence granted without notice of or consent to such action and without release of liability as to any Obligor; (d) as to all or any part of the Obligations, consents to Holder's releasing, agreeing not to sue, suspending the right to enforce this instrument against or otherwise discharging or compromising any Obligation of any Obligor or other person against whom any Obligor has to the knowledge of Holder a right of recourse, all without notice to or further reservations of rights against any Obligor, and all without in any way affecting or releasing the liability of any Obligor; (e) consents to Holder's releasing, exchanging or otherwise dealing in any manner with all or any portion of any collateral, lien, or right of set-off which may now or hereafter secure this note, all without notice to or further reservations of rights against any Obligor, and all without in any way affecting or releasing the liability of any Obligor, even though such release, exchange or other dealing may in any manner and to any extent impair any such collateral, lien or right to set-off; (f) agrees to pay all costs of collecting or securing or attempting to collect or secure this note or defending any unsuccessful claim asserted against the Holder in connection with this note, including reasonable attorneys' fees; and (g) warrants that this Loan is for business, commercial or agricultural purposes.

In addition to all liens upon, and rights of set-off against, any monies, securities, or other property of any of the Obligors given to Holder by law, Holder shall have a lien upon and a right of set-off against all monies, securities and other property of any of the Obligors now or hereafter in the possession of, or on deposit with, Holder, whether held in a general or special account or deposit, for safekeeping, or otherwise; and every such lien and right of set-off may be exercised without demand upon or notice to any Obligor, and the Bank shall have no liability with respect to any of Obligor's checks or other items which may be returned or other funds transfers which may not be made due to insufficient funds thereafter.

The Borrower understands that the Bank may from time to time enter into a participation agreement or agreements with one or more participants pursuant to which such participant or participants shall be given participation in the Loan and that such participants may from time to time similarly grant to other participants sub-participations to the Loan. The Borrower agrees that any participant may exercise any and all rights of banker's lien or set-off, whether arising by operation of law or given to Holder by the provisions of this note, with respect to the Borrower as fully as if such participant had made the Loan directly to the Borrower. For the purposes of this Paragraph only, the Borrower shall be deemed to be directly obligated to each participant or subparticipant in the amount of its participating interest in the principal of, and interest on, the Loan.

Neither any failure nor any delay on the part of Holder in exercising any right, power or privilege under this note shall operate as a waiver thereof, nor shall a single or partial exercise thereof preclude any other or further exercise or the exercise of any other right, power or privilege. No modification, amendment or waiver of any provisions of this note shall be effective unless in writing and signed by a duly authorized officer of Holder, and then the same shall be effective only in the specific instance and for the purpose for which given. No notice to or demand on any Obligor in any case shall entitle any Obligor to any other or further notice or demand in the same, similar or other circumstances.

Any provision of this note which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof or affecting the validity or enforceability of such provision in any other jurisdiction.

The provisions of this note shall inure to the benefit of the Holder, its successors and assigns and shall be binding upon the heirs, successors and assigns of each Obligor, except that no Obligor may assign or transfer his, her or its obligation hereunder without the written consent of Holder.

All rights, powers and remedies of Holder under this note and now or hereafter existing at law, in equity or otherwise shall be cumulative and may be exercised successively or concurrently.

The Loan Documents contain the entire understanding and agreement between the Borrower and the Holder with respect to the Loan and supersede any and all prior agreements, understandings, promises, and statements with respect to the Loan. This Master Note may not be modified, amended, or supplemented in any manner except by a written agreement executed by both the Borrower and the Holder.

This note shall be construed in accordance with and governed by the laws of the State of Alabama.

This agreement is executed under seal by the Borrower or each of them.

CAUTION--IT IS IMPORTANT THAT YOU THOROUGHLY READ THIS CONTRACT BEFORE YOU SIGN IT

NO. 0000387224-0000212522 XEP01

Due May 31, 1997

901 Explorer Blvd.
Huntsville, Alabama 35806

Adtran, Inc. [SEAL]

By:/s/ MARK C. SMITH [SEAL]

Mark C. Smith
[SEAL]

[SEAL]

EXHIBIT 11

ADTRAN, INC.

STATEMENT REGARDING COMPUTATION OF PER SHARE EARNINGS
FOR THE YEARS ENDED DECEMBER 31, 1994, 1995 AND 1996

	1994	1995	1996
Weighted average common shares outstanding	33,213,678	36,984,156	38,603,289
Net weighted average common stock options outstanding under the treasury stock method	2,918,262	2,305,351	962,801
Weighted average common and common equivalent shares outstanding	36,131,940	39,289,507	39,566,090
Net income (pro forma)	$18,608,605	$29,457,727	$39,819,904
Net income per common and common equivalent share (pro forma)	$ 0.52	$ 0.75	$ 1.01

NET INCOME* NET SALES STOCKHOLDERS' EQUITY
(in $ Millions) (in $ Millions) (in $ Millions)
* Pro forma for years prior to 1995

1991 -- $ 6.5m	1991 -- $ 42.6	1991 -- $ 16.7m
1992 -- $ 8.7m	1992 -- $ 57.0	1992 -- $ 22.0m
1993 -- $ 8.5m	1993 -- $ 72.4	1993 -- $ 29.8m
1994 -- $18.6m	1994 -- $123.4	1994 -- $ 85.2m
1995 -- $29.5m	1995 -- $181.5	1995 -- $130.7m
1996 -- $39.8m	1996 -- $250.1	1996 -- $172.9m

Report to Stockholders

ADTRAN achieved record sales and earnings for 1996. The Company's sales increased 38 percent to $250,120,836, while earnings increased from $.75 per share to $1.01 per share. Revenue growth across our major product lines of DDS/Frame Relay Access, ISDN, and HDSL/T1 was 11 percent, 41 percent, and 72 percent, respectively. Revenue growth across our major markets of Telco, Customer Premises Equipment (CPE), Original Equipment Manufacturing (OEM), and International was 43 percent, 37 percent, 22 percent, and 70 percent, respectively.

The Company's investment in engineering and technology resulted in 125 new products being released during the year.

In the Telco market, revenue in all product lines grew and benefited from new product introductions. DDS/Frame Relay Access product introductions included a new generation of Channel Units approved by our OEM customer base for direct sales to our Telco customers. New and expanded local loop performance monitoring and enhanced deployment platforms continued to differentiate ADTRAN 64 kilobit products from those of our competitors.

We further enhanced our dominant position during 1996 in the supply of ISDN extension products to the Telco marketplace. A new platform, the BR1/10, allows deployment of 20 ISDN lines in only 2-3/4 inches of chassis height. New generations of reduced cost, improved performance U-BR1TES and Repeaters allowed us to retain our leadership position in this fast growing market.

During the year, we introduced a new technological concept called "Total Reach." Currently, a major and almost prohibitive cost results when ISDN is installed at distances over 15,000-18,000 feet. Our "Total Reach" technology allows for economical ISDN installation for distances of up to 30,000 feet, without the use of repeaters. Field trials have been successfully installed and production initiated.

The use of HDSL in the installation of T1 service expanded during the year at a much faster rate than anticipated. A new line of low voltage (-135 volt) HDSL products was introduced, allowing for both a remote unit and a mid-span repeater to be line powered. Major engineering and technology investments were initiated, with the goal of driving HDSL market share to levels consistent with those of our DDS & ISDN Telco products.

In the Customer Premises Equipment market, new product introductions fueled growth across all product areas. DDS/Frame Relay Access products were enhanced with the addition of SNMP performance monitoring and expanded by the addition of a new Frame Relay Access Device (FRAD) product line being readied for introduction early in the first quarter. Installation of ISDN Terminal Adapters (modems) was greatly simplified with the introduction of the Express XR and XRT ISDN terminal adapters. ADTRAN's new Expert ISDN technology solved the major problems associated with setting up and optioning ISDN devices. Expert ISDN removes human error by automatically programming the ISDN modem with the necessary phone company information, including switch type and service profile

identifiers. The T1 market for our products exceeded expectations as new and expanded products were introduced. The TSU line of multiplexers continued to gain market share because of the introduction of new modules that support numerous new applications. The inclusion of SNMP throughout the T1 line will serve to further expand the market for these products in the coming year.
Both our OEM and International markets experienced growth as each of the new Telco and CPE products became available to those customers.

The breadth and depth of the Company's management staff were significantly increased during the year. Bob Fredrickson joined the Company as Vice President Telco Sales, and Tom Stanton was promoted to Vice President Telco Marketing. These two seasoned professionals will now lead our sales and marketing expansion in our largest market area of Telco customers. Steve Harvey joined the Company as Vice President of CPE Sales. He joined Danny Windham, our Vice President of CPE Marketing, and this team has the goal of growing CPE revenue to that of our established Telco levels. Also added to the management staff in 1996 was Greg Peters, Vice President-International, who will lead in expanding our international presence. Melvin Bruce joined the Company as Vice President of Engineering, and Peter Bracket joined the Company as Vice President of Technology. Both of these seasoned executives bring years of experience to these roles and will enhance our expansion in these core areas. John Cooper joined the Company as Vice President Finance and Chief Financial Officer, while Irwin Goldstein retains the position of Vice President of Administration. Charles O'Donnell joined the Company as Vice President Quality and Customer Services and is charged with enhancing this area, viewed by many as best in class.
During the year, both John Jurenko, our founding Vice President of Sales and Marketing, and Jerry Moore, our Vice President of Technology, reached retirement. Both of these executives will remain as consultants and continue providing access to their expertise. Lonnie McMillian, a founder, original Board Member, and Vice President of Engineering, will now head our Center of New Technology and Innovation. Mr. McMillian, with one of the most creative minds of any of our employees, is now hard at work defining and initiating new product market segments for our future.
The Company's efforts and achievements during the year have been extensive and will provide an even stronger base for future growth. All of us at ADTRAN are excited by the growth of our industry and the leadership role we play in our respective markets.

/s/Mark C. Smith	*/s/Howard A. Thrailkill*
Mark C. Smith *Chairman and CEO*	*Howard A. Thrailkill* *President and COO*

PHOTO OF CONNECTING WALKWAY BETWEEN NORTH TOWER AND SOUTH TOWER

CORPORATE PROFILE

ADTRAN, Inc. designs, develops, and manufactures ADvanced TRANsmission products for high-speed digital communications. Incorporated in 1985, ADTRAN began operations in 1986, following AT&T's divestiture of the Regional Bell Operating Companies (RBOCs) with restrictions that effectively barred their manufacturing of equipment. These events created an opportunity for companies such as ADTRAN to supply network equipment to the seven RBOCs as well as more than 1,300 independent telephone companies in the United States. At the same time, sophisticated users were demanding the flexibility, reliability, and economy afforded by emerging digital transmission technology. ADTRAN's founders recognized the importance of the transition from analog to digital loop technology using the existing copper wire network.

Today, ADTRAN supplies equipment for both ends of the local loop, that portion of the network which connects homes and businesses to telephone company network equipment, typically housed in a facility referred to as a Central Office. The majority of this local loop infrastructure consists of twisted pair copper wire. Today, more than 700 million such copper wire local loops are installed worldwide, with 160 million in place in the United States. Industry projections call for the installation of new copper local loops to outpace that of any other transmission medium for several years to come.

Telephone companies' (Telcos) huge investment in copper wire infrastructure mandates adapting existing local loops to meet growing data communication needs.

THROUGH THE APPLICATION OF INNOVATIVE ENGINEERING AND TECHNOLOGY, ADTRAN HAS PROSPERED AS A LEADING SUPPLIER OF TELCO PRODUCTS WHICH TRANSFORM COPPER WIRE LOCAL LOOPS INTO HIGH-SPEED DIGITAL NETWORKS.

Having firmly established a leading position with our Telco products, we subsequently adapted that technology for use by end-users and earned a growing share of the

Customer Premises Equipment (CPE) market. Both our Telco and CPE product lines have produced rapid, profitable growth, resulting in our being selected as a Nasdaq 100 Index stock by the Nasdaq Stock Market in 1996.
With over a million ADTRAN-based local loops operating worldwide, we have become a leading supplier of Digital Data Service (DDS), Integrated Services Digital Network (ISDN), and T1/High-bit-rate Digital Subscriber Line (HDSL) digital loop products. These products are sold to all the RBOCs, most of the domestic independent Telcos, a large number of corporate end-users, and a growing number of international customers. In addition, we provide custom-designed products for many well-known original equipment manufacturers (OEMs).
ADTRAN is headquartered in Huntsville, Alabama, with sales offices strategically located throughout the United States. We also sell our products through a network of more than two hundred domestic and international value added resellers and distributors, and we are aggressively augmenting those world-wide resources.

BUSINESS PHILOSOPHY
Supporting customers beyond their expectations is the primary philosophy guiding business decisions at ADTRAN. Our success has been built upon a commitment to total customer satisfaction, which requires continually developing and improving products to meet changing needs while maintaining the highest level of quality and customer support.

AN ISO 9001 COMPANY, ADTRAN EMPLOYS CONSISTENT QUALITY PROCESSES FROM INITIAL PRODUCT DESIGN AND DEVELOPMENT TO THE COMPREHENSIVE TESTING OF EVERY UNIT DELIVERED. ADTRAN QUALITY ACHIEVEMENTS HAVE BEEN RECOGNIZED ON MANY OCCASIONS, INCLUDING BY BEING SELECTED AS A PACIFIC BELL QUALITY PARTNER EACH YEAR SINCE 1991.

Our product programs follow a process that has proven consistently successful and placed ADTRAN in a leading position in the industry. First, we seek early identification of appropriate local loop market segments offering the potential for future high unit volume demand. Once established in a market, we drive for market share by constantly reducing costs and leveraging the benefits associated with manufacturing economies of scale. Finally, we strive to develop a full complement of products, consolidating and protecting our position in the selected market segment.
ADTRAN maintains a strong commitment to developing products that extend the performance of the existing copper network to its full potential. Most recently, ADTRAN has participated in the early stages of development of Digital Subscriber Line (DSL) products that have quickly established an important presence in the market. This promising technology allows the current Telco infrastructure to support demand for innovative new services such as remote access to corporate networks, distance learning, and high speed Internet access.

ADTRAN implements extensive Product Qualification procedures, which ensure consistent performance over specified temperature, humidity, line length, and supply voltage conditions.

**PHOTO OF PRODUCT QUALIFICATION
LAB TEMPERATURE AND SUPPLY
VOLTAGE TESTING EQUIPMENT.**

PHOTO OF SEVERAL TYPES OF END-USER DIGITAL COMMUNICATIONS EQUIPMENT DESIGNED AND MANUFACTURED BY ADTRAN.

ADTRAN provides for a broad range of products for telcos and end-users of telco services, including DDS/Frame Relay, ISDN, T1/HDSL, and other emerging technologies.

MARKETS SERVED

ADTRAN products are targeted at two primary markets: Network equipment for Telcos and network access equipment for end-users of Telco services. ADTRAN is a major supplier to these two markets in the United States and is making advances in the international market, enhancing our position as a worldwide leader in the telecommunications industry.

Both Telcos and their end-user customers utilize our products to deploy DDS/Frame Relay, ISDN, and T1/HDSL service. Today, ADTRAN offers more than 200 principal products supporting these services, differentiated by the transmission rate or capacity they provide, as well as features such as dedicated (leased) or switched (dial-up) access. End-users consider these factors, along with cost, when selecting the digital service that best fits their needs.

DDS is a widely deployed leased line (dedicated) digital service, that has provided reliable wide area network (WAN) connections in corporate networks for many years. DDS circuits, supporting data transmission rates from 2.4 to 64 kbps, are used most often by corporate customers who transfer information among multiple locations for several hours a day. For example, DDS service is frequently used to link ATM machines to banks. Frame Relay, a new technology deployed over an existing DDS or T1 network, is a digital packet service, providing the benefits of DDS but at a substantially lower cost. For digital circuits that require DDS data rates on a less frequent basis, a switched version of DDS service is often used.

ISDN is a switched access digital service; i.e., a user can dial other locations as required and hang up when the connection is no longer needed. ISDN subscribers can use Basic Rate ISDN circuits to carry two voice conversations at once, voice and data signals simultaneously, or data-only signals at rates up to 128,000 bits per second. This service is beneficial to customers who need to transfer large files periodically. ISDN is also becoming a preferred solution for remote access, Internet access, and telecommuting.

T1 is a leased line digital service transporting up to 24 individual voice or data channels. Operating at rates up to 1.544 Mbps, it is used to transmit large volumes of data or voice traffic that modern corporate networks demand. In recent years, HDSL technology, developed by ADTRAN and others, has made it possible to deliver T1 service much more quickly and economically.

In 1996, as in the past, Telco products provided the largest contribution to ADTRAN revenue, comprising 60 percent of total revenue. CPE and OEM product revenue made up 28 percent and 12 percent, respectively. Telco revenue grew 43 percent, while CPE revenue expanded by more than 35 percent. International sales have become increasingly important and now contribute more than 7 percent of total sales.

PHOTO OF ADTRAN PRODUCT INTEROPERABILITY LAB WITH ADTRAN EMPLOYEE SITTING AT TERMINAL.

TELCO OVERVIEW

ADTRAN supplies a full range of local loop and network equipment to Telcos, enabling economic, efficient deployment of digital services. We supply the circuit assemblies used by Telcos to provide digital services to their customers, the repeaters that allow increased deployment range, and the network termination devices that allow circuits to be tested up to the customer's facility.
Our Telco product revenue increased 43 percent, from $105 million in 1995 to more than $150 million in 1996. The Telco business base continues to grow steadily, fueled by the recent 1996 Telecommunications Act mandating deregulation of local exchange carriers. The Act allows new market entrants into the service provider business, significantly increasing the market for ADTRAN Telco products. Today our markets include all the RBOCs, major and smaller independent telephone companies as well as a growing number of the international service providers.

TO ADDRESS THESE MARKETS, WE CONSISTENTLY INTRODUCE NEW TECHNOLOGIES THAT INCREASE EFFICIENCY AND REDUCE COSTS, WHILE STEADFASTLY MAINTAINING A COMMITMENT TO QUALITY AND PERFORMANCE. FOR EXAMPLE, OUR INNOVATIVE TOTAL REACH PRODUCTS, BASED ON REPEATERLESS TECHNOLOGY, ARE REVOLUTIONIZING DIGITAL DATA SERVICE DEPLOYMENT BY ENABLING TELCOS TO DRAMATICALLY CUT DEPLOYMENT COSTS, INSTALLATION TIMES, AND MAINTENANCE REQUIREMENTS.

DDS
In the 1980s, ADTRAN DDS products established our reputation as a leader in digital transmission. Newer digital transmission services have since emerged, yet DDS continues to hold a strong position because of its large installed base, simplicity, and availability. In addition, new cost-effective service offerings such as Frame Relay are being deployed over existing digital networks. With market research predicting a compound annual growth rate for Frame Relay exceeding 30 percent through the year 2000, demand for DDS should continue to grow.
A noteworthy recent accomplishment within our DDS product line has been the addition of performance monitoring capability, which allows more efficient deployment and maintenance of the DDS circuits.

ISDN
The attractive pricing and widespread availability of ISDN, along with its ability to enhance major new applications such as Internet, work-at-home, and remote office/WAN connection, are increasing demand for the service.

FOUR-TO-EIGHT TIMES FASTER THAN ANALOG MODEMS USED FOR INTERNET ACCESS TODAY, ISDN PROVIDES TRANSMISSION OF BOTH VOICE AND DATA SIMULTANEOUSLY OVER A SINGLE LINE.

THE ISDN OPPORTUNITY

[LINE GRAPH APPEARS HERE]

1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
100,000	150,000	200,000	300,000	350,000	450,000	700,000	1.25m	1.75m	2.4m	3.15m	3.85m

Domestic BRI Circuits (000)
Source: Dataquest (February 1997)

ADTRAN's Total Reach range extension products allow Telco service providers to deploy ISDN and DDS services to remote locations without the use of costly repeaters.

[PHOTO OF TOTAL REACH(TM) ENCLOSURE AND HOUSING]

In 1996, we enhanced our ISDN product offerings by adding Performance Monitoring and introducing our new BR1/10 digital loop carrier (DLC) and Total Reach Range Extension Products. The BR1/10 is the most compact unit available today, yet provides the most economical method of delivering Basic Rate ISDN services over a T1 carrier system.

OUR TOTAL REACH TECHNOLOGY REVOLUTIONIZED ISDN BY EXTENDING THE BASIC RATE ISDN SERVICE DEPLOYMENT RANGE FAR BEYOND LIMITATIONS OF THE PAST, WITHOUT THE NEED FOR REPEATERS AND ENVIRONMENTAL ENCLOSURES.

Because of the reduction of equipment, installation, and maintenance costs, our Total Reach family of products significantly lowers the cost of ISDN deployment to remote locations, typically comprising 20% or more of total ISDN customers.

T1/HDSL

In the past, Telcos have delivered T1 using a series of repeaters to extend the service. Now, HDSL products from ADTRAN allow Telcos to deploy T1 circuits without using repeaters, allowing for quicker, easier, more economical installation. In addition, T1/HDSL accommodates newer network services such as Frame Relay, Fractional T1, and Primary Rate ISDN service in order to meet specific customer needs.
For services beyond normal range, we provide the HDSL Range.

THE HDSL OPPORTUNITY

[LINE GRAPH APPEARS HERE]

	1990	91	92	93	94	95	96	97	98
Fractional T1		N/A	N/A	220k	300k	450k	550k	800k	1.05m
HDSL T1		100k	150k	200k	300k	375k	550k	675k	750k
Fiber T1		100k	150k	175k	250k	300k	350k	370k	375k
Repeater T1		80k	100k	125k	200k	210k	208k	125k	110k

New Domestic T1/E1 Circuits (000)
Sources: TRA & Forward Concepts, IDC, Frost & Sullivan, & Company Estimates

[PHOTO OF ADTRAN ACT 2300 CHASSIE AND OCU DP MODULES]

The Act 2300 provides advanced provisioning and monitoring capabilities to new and existing special services networks.

Extender as an outside plant, range extension solution that doubles the range of deployment. These HDSL products carry on our commitment to improve performance, reduce cost, and serve the needs of our customers.

NETWORK PRODUCTS
ADTRAN markets a full range of intelligent channel bank products for special applications that meet service providers' needs for greater network management and control. Based on industry-standard technology, the products accept dataports from a variety of vendors. ADTRAN dataports add advanced capabilities such as performance monitoring, local and remote provisioning, and redundancy.
A promising 1996 product addition, the ACT 2300 channel bank, is the centerpiece of the ADTRAN intelligent channel bank family. The ACT 2300, along with the ADTRAN Site Manager (network management platform), intelligent channel units, and bank upgrade products, represent a system that allows Telcos to add intelligence into their special services networks for future growth, while protecting their investments in existing technologies.

WIRELESS
The ADTRAN TRACER is the first of a new product family designed to meet the wireless infrastructure needs of end-users, Telcos, and cellular/PCS service providers. It allows cellular service providers and local Telcos to expand their coverage areas with cost effective wireless links. The TRACER can also be used for the point-to-point, high speed connections demanded by voice, video, and data transfer applications in campus environments.

OUR COMMITMENT
The ADTRAN Telco products team moved decisively in 1996 to focus on new market opportunities. As 1997 begins, we pledge to remain a leader in local loop products and technology and to maintain our commitment to value and service for our customers.

Adtran Express XRT unit being used in a work-at-home environment.

CPE OVERVIEW

ADTRAN supplies the Customer Premises Equipment (CPE) market with a complete line of high-performance equipment for corporate end-users of digital services. Much of the equipment developed for this market utilizes technology from the Telco products ADTRAN develops. As a result, our CPE products hold a competitive advantage over other companies, since building equipment for both ends of the telecommunication network allows an increased degree of interoperability, higher unit volumes, and lower cost.

CPE MARKET GROWTH IS DRIVEN BY SEVERAL FORCES; PRIMARY AMONG THESE IS GROWTH OF THE INTERNET. TODAY, AN ESTIMATED 25 MILLION PEOPLE HAVE INTERNET CONNECTIONS; BY THE YEAR 2000 THAT NUMBER IS PROJECTED TO HAVE INCREASED TO 160 MILLION, ALL REQUIRING SOME TYPE OF INTERNET ACCESS.

Another CPE market driver is the increasing demand for remote access to corporate networks by employees working from home, whether full time telecommuting or traditional employees working during off hours. A third driver is enterprise connectivity, the need for businesses to connect multiple sites such as branch offices. Finally, electronic commerce, which is soon to become an important way of conducting business, requires Internet connection.

ADTRAN HAS DEVELOPED A COMPLETE LINE OF CPE PRODUCTS, DESIGNED TO OFFER CONNECTIVITY OPTIONS THAT ADDRESS A CUSTOMER'S SPEED, AVAILABILITY, AND COST CRITERIA IN THE AREAS OF DDS/FRAME RELAY, ISDN, AND T1/HDSL.

Like all ADTRAN products, our high-performance CPE equipment is reliable and user-friendly.

THE DDS/FRAME RELAY MARKET

ADTRAN's CPE market offerings began with a line of data service units (DSUs) first introduced in 1991. Now comprised of over 100 individual products, the DSU family has become one of the most comprehensive lines of DSUs available today.

New DSU products in 1996 included a broad fourth generation family of DSUs with embedded Simple Network Management Protocol (SNMP). ADTRAN has also introduced a line of Frame Relay products for 1997. Frame Relay is a digital packet service which provides a permanent virtual connection to the network and is deployed over an infrastructure similar to current DDS and T1 connections. Frame Relay provides all the benefits of DDS at a lower cost than multiple dedicated circuits allow. Popular in the IBM networking world and particularly in branch offices, applications and equipment for Frame Relay service are similar to those for DDS, making it easier for users to migrate to this service. Service providers have elected to promote Frame Relay by reducing its price relative to standard DDS.

THE DDS/FRAME RELAY OPPORTUNITY

	94	95	96	97	98	99
FRADS...............	$400k	$525k	$750k	$950k	$1.1m	$1.45m
MULTI RATE DSUs.....	$325k	$325k	$375k	$450k	$550k	$600k

Source: International Data Corporation

[PHOTO APPEARS HERE]

ADTRAN's FSU series of FRADs provide customers with a cost-effective means of transporting multiprotocol data and voice over frame relay networks. Through a series of ESP option cards, units can be configured to support a combination of data, voice, and dial backup applications.

ISDN MARKET
ISDN service has continued to grow as demand for high-speed connection for homes and remote offices increases. ISDN provides data transfer rates four to eight times faster than the analog modems widely used for Internet access today. ADTRAN products support basic rate ISDN, providing low-cost solutions for telecommuting, connecting the small office/home office (SOHO), accessing the Internet, and other applications.

IN 1996, ADTRAN MADE GREAT STRIDES IN MAKING ISDN PRACTICAL FOR THE NON-TECHNICAL CUSTOMER. WE INTRODUCED EXPERT ISDN, AN ADTRAN PATENT-PENDING TECHNOLOGY WHICH SIMPLIFIES SERVICE INSTALLATION, TRANSLATING A DIFFICULT AND FRUSTRATING TASK INTO AN EASY AND CONVENIENT ONE.

Two of seven new products added to our ISDN product family in 1996, the Express XR and the Express XRT, won an Innovations '97 Design and Engineering award at the International Winter Consumer Electronics Show (CES). The Express XR and XRT are ISDN modems equipped with Expert ISDN. The Express XRT was also named a 1996 Computer Telephony Product of the Year.

New additions to the family also included the ISU 512 S/T; the Express XL and Express XLT, a family of ISDN router products; and the third generation of the NT1 ACE. The ISDN CPE market now has a total of nearly 50 product offerings that contributed to a 41 percent increase in ISDN revenue in 1996.

[PHOTO OF ADTRAN FRAME RELAY PRODUCTS RECENTLY ANNOUNCED.]

The Adtran ISU 512 is one of the most popular inverse multiplexers for Basic Rate ISDN, providing connections of up to 512 kilobits per second. Its ease of use, features, and price make it attractive for many applications including corporate videoconferencing, medical imaging and remote broadcasting.

[PHOTO OF ADTRAN T1 END-USER EQUIPMENT]

ADTRAN offers an extensive line of T1 CSUs, T1 DSU/CSUs and T1 multiplexers for a variety of end-user applications. Providing support for T1 network termination, frame relay circuit termination, LAN to LAN connectivity, and voice/data multiplexing, the ADTRAN T1 CPE product family delivers value and flexibility.

T1/FT1

ADTRAN entered the T1 CPE market in 1994 with a small family of T1 Service Unit (TSU) products. Now our TSU family has expanded to include more than 50 products. The TSU products and available plug-in modules are designed to support various data and voice applications including LAN connectivity, digital and analog voice, and videoconferencing. Our application- specific plug-in modules can be combined in various ways to meet specific customer needs, making the T1/FT1 product line flexible and practical. ADTRAN's T1 CPE product line experienced an impressive overall 68 percent revenue increase over 1995.

THE FUTURE OF THE ADTRAN CPE MARKET

The CPE market faces a bright future as growing numbers of faster, more reliable networks are built. At ADTRAN, we are developing products that address the emerging T3 market, a service which is 28 times faster than a T1 line. In certain cases, customers requiring multiple T1s find it less expensive to purchase a T3 line. We are also developing host-site products for use at corporate networking centers to provide more efficient networking options. Currently, our products focus primarily on remote site needs. Development of host site products will allow us to sell a complete solution to the customer by providing the central connection point for all remote site products. As we expand into new markets, we will continue our commitment to fully support the markets addressed by our existing products.

THE T1 CPE OPPORTUNITY

[LINE GRAPH APPEARS HERE]

	94	95	96	97	98	99
T1/FT1 DSUs	$225m	$300m	$375m	$425m	$500m	$550m
T1/FTI CSUs	$ 75m	90m	$105m	$125m	$140m	$150m

[PLOT POINTS TO COME]

INTERNATIONAL MARKET OVERVIEW

In 1996, we strengthened our position in the international marketplace. Our revenue increased 70 percent, growing from less than $11 million in 1995 to over $18 million. International revenue now represents 7 percent of total sales.
We expanded our revenue base in the Asia-Pacific region, Latin America, and Europe by focusing on international network requirements, responding to specific customer needs, and diversifying our product families. In countries where telecom authorities faced national deregulation, the market opened up to competing service providers, resulting in increased demand for ADTRAN's HDSL products. In 1996, ISDN product sales also grew steadily because of accelerated demands for home office and Internet access and corporate requirements for increased bandwidth. Building on our HDSL and ISDN success, ADTRAN expanded product offerings and received certification and approval on multiple products.

TO STRENGTHEN OUR POSITION IN THE INTERNATIONAL MARKETPLACE, WE ARE DESIGNING NEW PRODUCTS WITH INTERNATIONAL SPECIFICATIONS AND STANDARDS IN MIND AND ADAPTING EXISTING PRODUCTS TO MEET THESE REQUIREMENTS.

We are currently adding resources to address promising international markets and expanding existing distribution alliances to service them. We are also forging important new relationships to meet market and product requirements unique to international customers.

[PHOTO OF BIG BEN IN LONDON]

Big Ben, Parliament and River Thames, London

Market for the Registrant's Common Stock and Related Stockholder Matters

The Company's Common Stock has been traded on the Nasdaq National Market (Nasdaq) under the symbol "ADTN" since the Company's initial public offering of Common Stock in August 1994. Prior to the initial public offering, there was no established trading market for the Company's Common Stock. As of January 31, 1997, the Company had 561 shareholders of record and approximately 10,500 beneficial owners of shares held in street name. The following table shows the high and low closing sale prices per share for the Common Stock as reported by Nasdaq for the periods indicated:

Fiscal 1995	High	Low
First Quarter	$30-3/8	$20
Second Quarter	$37-3/4	$26-7/8
Third Quarter	$38-1/4	$30
Fourth Quarter	$55-1/2	$33-1/4
Fiscal 1996	**High**	**Low**
First Quarter	$54-3/4	$26-1/2
Second Quarter	$73-1/2	$45
Third Quarter	$75-1/4	$47-1/2
Fourth Quarter	$52-1/4	$33-1/2

The prices per share for the common stock give retroactive effect to the 2- for-1 stock split effective May 12, 1995.

The Company has operated with a policy of retaining earnings, presently intends to retain all future earnings for use in the development of its business and does not anticipate paying any cash dividends in the foreseeable future.

The following selected financial data concerning the Company for and as of the end of each of the years in the five year period ended December 31, 1996 are derived from the financial statements of the Company, which financial statements have been audited by Coopers & Lybrand L.L.P., independent accountants. The selected financial data are qualified in their entirety by the more detailed information and financial statements, including the notes thereto, included elsewhere in this report. The financial statements of the Company as of December 31, 1995 and 1996 and for each of the years in the three year period ended December 31, 1996, and the report of Coopers & Lybrand L.L.P. thereon, are included elsewhere in this report.

Selected Financial Data

Year Ended December 31, (in thousands, except per share data)	1992	1993	1994	1995	1996
Income Statement Data:					
Sales:					
Telco(1)	$36,849	$42,795	$64,830	$105,400	$150,310
OEM(1)	16,428	19,841	33,568	24,739	30,288
CPE(1)	3,765	9,775	25,042	51,339	69,523
Total sales	57,042	72,411	123,440	181,478	250,121
Cost of sales	27,694	36,769	63,187	93,007	129,953
Gross profit	29,348	35,642	60,253	88,471	120,168
Selling, general and administrative expenses	8,472	11,898	17,347	27,260	34,308
Research and development expenses	7,188	10,033	13,774	19,131	24,647
Operating income	13,688	13,711	29,132	42,080	61,213
Interest income	25	7	440	3,205	2,542
Interest expense	(82)	(424)	(448)	(1,105)	(895)
Other income (expense)	102	(13)	(25)	111	642
Income before income taxes(2)	13,733	13,281	29,099	44,291	63,502
Provision for income taxes(2)	0	0	6,288	14,833	23,682
Historical net income(2)	13,733	13,281	22,811	29,458	39,820
Pro forma provision for income taxes(2)	5,041	4,825	4,202		
Pro forma net income(2)	8,692	8,456	18,609	29,458	39,820
Pro forma net income per share(2)(3)	.25	.25	.52	.75	1.01
Weighted average shares outstanding(3)	34,124	34,061	36,132	39,290	39,566
S corporation distributions(2)	$ 8,063	$ 5,494	$ 5,483		

At December 31, (in thousands except per share data)	1992	1993	1994	1995	1996
Balance Sheet Data:					
Working capital	$13,315	$19,795	$66,368	122,466	$140,510
Total assets	31,947	46,304	94,347	165,767	210,207
Total debt	6,500	10,100	0	20,000	20,000
Stockholders' equity	21,974	29,757	85,233	130,743	172,879

(1) Represents sales of the Company's Telco, OEM and CPE products. These amounts are not derived from the Company's audited financial statements.
(2) Effective July 1, 1994, the Company converted from an S corporation to a C corporation for income tax purposes. As an S corporation, the Company was not subject to income taxes but paid quarterly cash distributions to fund the income tax liabilities passed through to the stockholders. The Company also paid a cash distribution of $3,121,816 to its stockholders in December 1992 in an amount approximately equal to their original investment in the Company's Common Stock. As a C corporation, the Company is subject to income taxes at corporate tax rates. The pro forma income statement data herein presents the provision for income taxes, net income and netincome per share as if the Company had been subjec t to corporate income taxes for all periods presented.
(3) Reflects a 3-for-2 split of the Company's Common Stock which was effected on August 1, 1994, and a 2 for-1 split of the Common Stock which was effected on May 12, 1995. Also assumes exercise of dilutive stock options calculated under the treasury stock method. See Notes 1 and 10 of Notes to Financial Statements.

Overview

The Company designs, develops, manufactures, markets and services a broad range of high speed digital transmission products utilized by Telcos and corporate end-users to implement advanced digital data services over existing telephone networks. The Company currently sells its products to Telcos (including all of the RBOCs), OEMs and, since 1991, private end-users in the CPE market.

The Company's sales have increased in each year due primarily to increases in the number of units sold to both new and existing customers. These annual sales increases reflect the Company's strategy of increasing unit volume and market share through the introduction of succeeding generations of products having lower selling prices and increased functionality as compared both to the prior generation of a product and to the products of competitors. An important part of the Company's strategy is to engineer the reduction of the product cost of each succeeding product generation and then to lower the product's price based on the cost savings achieved. As a part of this strategy, the Company seeks in most instances to be a low cost, high quality provider of products in its markets. The Company's success to date is attributable in large measure to its ability to initially design its products with a view to their subsequent re-design, allowing efficient enhancements of the product in each succeeding product generation. This strategy has enabled the Company to sell succeeding generations of products to existing customers as well as to increase its market share by selling these enhanced products to new customers.

While the Company has experienced increased sales in each year, the Company's 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. The Company operates with very little order backlog. A substantial majority of its sales in each quarter results from orders booked in that quarter and firm purchase orders released in that quarter by customers under agreements containing nonbinding purchase commitments. Furthermore, most Telcos typically require prompt delivery of products; this results in a limited backlog of orders for these products and requires the Company to maintain sufficient inventory levels to satisfy anticipated customer demand. If near term demand for the Company's products declines or if significant potential sales in any quarter do not occur as anticipated, the Company's financial results will be adversely affected. The Company currently does not undertake any foreign exchange risks, as all transactions with foreign vendors or customers are conducted in currency of the United States. Operating expenses are relatively fixed in the short term; therefore, a shortfall in quarterly revenues could impact the Company's financial results significantly in a given quarter. Further, maintaining sufficient inventory levels to assure prompt delivery of the Company's products increases the amount of inventory which may become obsolete and increases the risk that the obsolescence of such inventory may have an adverse effect on the Company's business and operating results. The Company'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, product warranty returns and announcements of new products by the Company or its competitors. Accordingly, the Company's historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that the Company's financial results may vary from period to period. See Note 13 of Notes to Financial Statements.

On August 16, 1994, the Company completed an initial public offering of Common Stock, receiving net proceeds (after deduction of underwriting discounts and other offering expenses) of $37,867,963 from the sale of 2,300,000 shares of Common Stock (on a pre-split basis). The Company used the offering proceeds to repay the full amount of principal and interest owed on certain revenue bonds issued to construct and equip the Company's headquarters and manufacturing facility in Huntsville, Alabama and to repay all amounts outstanding under its bank line of credit and for general working capital purposes. On June 29, 1995, the Company and certain stockholders of the Company (the "Selling Stockholders") sold a total of 3,125,100 shares of Common Stock to the public. Of the 3,125,100 shares offered, 500,000 shares were offered by the Company and 2,625,100 shares were offered by the Selling Stockholders. The Company received net proceeds (after deduction of underwriting discounts and other offering expenses) of $15,705,362 from the sale of 500,000 shares of Common Stock at the public offering price of $33 per share. The Company did not receive any of the proceeds from the sale of shares by the Selling Stockholders. The Company has used and expects to continue to use the proceeds of the public offerings for working capital and other general corporate purposes, including product development activities to enhance its existing products and develop new products and expansion of sales and marketing activities.

The Company operated as an S corporation for tax purposes through June 30, 1994. Effective July 1, 1994, the Company converted from an S corporation to a C corporation and became subject to corporate income taxes. The Company intends to retain all earnings for use in the development of its business and does not anticipate paying any cash dividends in the foreseeable future.

Results of Operations

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

Years Ended December 31			
Percentage of Sales	1994	1995	1996
Sales:			
Telco	52.5%	58.1%	60.1%
CPE	20.3	28.3	27.8
OEM	27.2	13.6	12.1
Total sales	100.0	100.0	100.0
Cost of sales	51.2	51.3	51.9
Gross profit	48.8	48.7	48.1
Selling, general and administrative expenses	14.0	15.0	13.7
Research and development expenses	11.2	10.5	9.9
Operating income	23.6	23.2	24.5
Interest income	0.4	1.8	1.0
Interest expense	(0.4)	(0.6)	(0.4)
Other income (expense)	0.0	0.0	0.3
Income before provision for income taxes	23.6	24.4	25.4
Provision for income taxes (pro forma prior to July 1, 1994) (1)	8.5	8.2	9.5
Net income (pro forma prior to July 1, 1994)(1)	15.1%	16.2%	15.9%

(1)Prior to July 1, 1994, the Company was an S corporation for income tax purposes and passed its taxattributes through to its stockholders. Effective July 1, 1994, the Company converted from an S corporation to a C corporation and therefore became subject to corporate income taxes for the third and fourth quarters of 1994. The indicated amounts in the table reflect, for periods prior to July 1, 1994, the unaudited pro forma effects of income taxes on the Company's operations as if the Company had been subject to corporateincome taxes prior to July 1, 1994.

1996 Compared to 1995

Sales

The Company's sales increased 37.8% from $181,478,065 in 1995 to $250,120,836 in 1996. The increased sales resulted primarily from increased sales volume to existing customers and from increased market penetration. Sales to Telcos increased 42.6% from $105,399,953 in 1995 to $150,310,111 in 1996 due primarily to increased sales of Integrated Services Digital Network (ISDN) products and increased sales of High bit-rate Digital Subscriber Line (HDSL) products. Unit sales volume for Telco products increased by 52.7% from 1995 to 1996. Telco sales as a percentage of total sales increased from 58.1% in 1995 to 60.1% in 1996 primarily as a result of increased sales volume of ISDN and HDSL products during the 1996 period. Sales of CPE products increased 35.4% from $51,338,868 in 1995 to $69,523,067 in 1996. The increase in sales of CPE products is attributable to increased demand for ISDN products and T1 Service Unit (TSU) products. OEM sales increased 22.4% from $24,739,244 in 1995 to $30,287,658 in 1996. This increase was due to new contracts for customer funded modifications of standard DDS, ISDN and HDSL designs. OEM products are generally customized versions of the Company's Telco and CPE products. The financial effect of the increase in overall unit volume was offset somewhat by lower unit selling prices for many of the Company's products.

Cost of Sales

Cost of sales increased 39.7% from $93,006,672 in 1995 to $129,953,371 in 1996, primarily as a result of the increase in sales. As a percentage of sales, cost of sales increased from 51.3% in 1995 to 51.9% in 1996. An important part of the Company'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 sometimes results in variations in the Company's gross profit margin due to timing differences between the lowering of product selling prices and the full recognition of cost reductions. In view of the rapid pace of new product introductions by the Company, this strategy may result in variations in gross profit margins that, for any particular financial period, can be difficult to predict.

Provision for Losses On Inventory

A provision for losses on inventory of $3,862,396 in 1996 was comprised primarily of assorted assembled products and assorted raw material. The provision for inventory losses as a percentage of sales decreased from 1.6% in 1995 to 1.5% in 1996. The Company decreased its inventory levels in 1996 due to overall manufacturing efficiencies associated with production of the Company's products. The reduction in inventory was accomplished without any interruption in prompt delivery of the Company's products to its customers. Obsolescence of assembled products generally was caused by technological changes driven by an effort to provide total customer satisfaction.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 25.9% from $27,259,610 in 1995 to $34,308,436 in 1996 due to additional sales and support expenditures necessary as a result of the Company's expanded sales base. However, the larger sales base caused selling, general and administrative expenses as a percentage of sales to decrease from 15.0% in 1995 to 13.7% in 1996.

Research and Development Expenses

Research and development expenses increased 28.8% from $19,131,457 in 1995 to $24,647,425 in 1996. This increase was due to increased engineering costs associated with new product introductions and product cost and feature enhancement activities. As a percentage of sales, however, research and development expenses declined from 10.5% in 1995 to 9.9% in 1996. The Company continually evaluates new product opportunities and engages in intensive research and product development efforts. To date, the Company has expensed all product research and development costs as incurred. Additionally, the Company also frequently invests heavily in up-front market development efforts prior to the actual commencement of sales of a major new product. As a result, the Company may incur significant research and development expenses and selling, general and administrative expenses prior to the receipt of revenues from a major new product group. The Company is presently incurring both research and development expenses and selling, general and administrative expenses in connection with its new products and its expansion into international markets.

Interest Expense

Interest expense decreased 19.0% from $1,105,156 in 1995 to $894,657 in 1996. This decrease was due to capitalization of the interest cost as a part of the cost of acquiring certain assets. The Company currently pays interest on $20,000,000 of revenue bond proceeds loaned to the Company in January 1995, which proceeds are being used to expand the Company's facilities in Huntsville, Alabama. See "Liquidity and Capital Resources."

Net Income

As a result of the above factors, net income increased 35.2% from $29,457,727 in 1995 to $39,819,904 in 1996. As a percentage of sales, net income decreased from 16.2% in 1995 to 15.9% in 1996.

1995 Compared to 1994

Sales

The Company's sales increased 47.0% from $123,440,202 in 1994 to $181,478,065 in 1995. The increased sales resulted primarily from increased sales volume to existing customers and from increased market penetration. Sales to Telcos increased 62.6% from $64,829,910 in 1994 to $105,399,953 in 1995, due primarily to increased sales of ISDN products and increased sales of HDSL products. Unit sales volume for Telco products increased by 44.3% from 1994 to 1995. Telco sales as a percentage of total sales increased from 52.5% in 1994 to 58.1% in 1995, primarily as a result of increased sales volume of ISDN and HDSL products during the 1995 period. Sales of CPE products increased 105.0% from $25,042,299 in 1994 to $51,338,868 in 1995. The increase in sales of CPE products was attributed to increased demand for DDS, ISDN and TSU products. OEM sales decreased 26.3% from $33,567,993 in 1994 to $24,739,244 in 1995. This decrease was attributable primarily to reduced demand related to mature programs combined with the low volume normally encountered on new programs. In addition, the Company converted numerous products originally developed under OEM contract status to ADTRAN standard product status. This conversion was accomplished with permission from the OEM contract holders and was done to allow ADTRAN to pursue markets directly that will no longer support a two tier distribution structure. The financial effect of the increase in overall unit volume was offset somewhat by lower unit selling prices for many of the Company's products.

Cost of Sales

Cost of sales increased 47.2% from $63,187,366 in 1994 to $93,006,672 in 1995, primarily as a result of the increase in sales. As a percentage of sales, cost of sales increased only slightly from 51.2% in 1994 to 51.3% in 1995 as the Company continued to maintain manufacturing efficiencies associated with higher unit volume sales.

Provision for Losses On Inventory

A provision for losses on inventory of $2,887,877 in 1995 was comprised primarily of assorted assembled products and assorted raw material. The provision for inventory losses as a percentage of sales remained the same at 1.6% in 1994 and 1995. The Company increased its inventory levels in 1995 to assure prompt delivery of the Company's products, which in turn increased the amount of inventory which could become obsolete.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 57.1% from $17,346,759 in 1994 to $27,259,610 in 1995 due to additional sales and support expenditures necessary as a result of the Company's expanded sales base. Selling, general and administrative expenses as a percentage of sales increased from 14.0% in 1994 to 15.0% in 1995. The increase resulted primarily from increased dollar amounts of these expenses associated with the ongoing introduction of HDSL products, increased distribution activities associated with the CPE market, and general expansion into international markets.

Research and Development Expenses

Research and development expenses increased 38.9% from $13,774,038 in 1994 to $19,131,457 in 1995. This increase was due to increased engineering costs associated with new product introductions and product cost and feature enhancement activities. As a percentage of sales, however, research and development expenses declined from 11.2% in 1994 to 10.5% in 1995 due to the increased sales in 1995. The Company continually evaluates new product opportunities and engages in intensive research and product development efforts.

Interest Expense

Interest expense increased 146.9% from $447,547 in 1994 to $1,105,156 in 1995. This increase was the result of interest paid on $20,000,000 of revenue bond proceeds loaned to the Company in January 1995, which proceeds are being used to finance the expansion of the Company's facilities in Huntsville, Alabama. See "Liquidity and Capital Resources."

Provision for Income Taxes

The Company operated through June 30, 1994 as an S corporation under Subchapter S of the Internal Revenue Code and comparable state tax laws. The Company therefore was not subject to corporate income taxes, and its tax liabilities instead were passed through to its stockholders for all periods through June 30, 1994. Effective July 1, 1994, the Company converted from an S corporation to a C corporation for income tax purposes and therefore became subject to corporate income taxes for the third and fourth quarters of 1994. The Company's statements of income set forth elsewhere in this report include, for periods prior to July 1, 1994, a presentation of the pro forma effects of income taxes on the Company's operations as if the Company had been subject to corporate income taxes prior to July 1, 1994.

Net Income

As a result of the above factors, net income increased 58.3% from $18,608,605 in 1994 to $29,457,727 in 1995. As a percentage of sales, net income increased from 15.1% in 1994 to 16.2% in 1995.

Liquidity and Capital Resources

The Company's only long-term debt outstanding as of December 31, 1996 consisted of a loan in the amount of $20,000,000 related to the expansion of the Company's facilities in Huntsville, Alabama. The Company is continuing a project to expand its facilities in Huntsville in several phases over the next three years at a cost of approximately $131,000,000, of which $36,255,906 has been incurred at December 31, 1996. The debt associated with fifty million dollars of the project has been approved for participation in an incentive program offered by the Alabama State Industrial Development Authority (the "Authority"). That program enables participating companies such as the Company to generate Alabama corporate income tax credits that can be used to reduce the amount of Alabama corporate income taxes that would otherwise be paid. In January 1995, the Authority issued $20,000,000 of its taxable revenue bonds pursuant to such program and loaned the proceeds from the sale of the bonds to the Company. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank") and bear interest, payable monthly, at the rate of 87.5 basis points over the 30 day London inter-bank offered rate and mature on January 1, 2020. First Union National Bank of Tennessee, Nashville, Tennessee (the "Bondholder") has agreed to purchase the Original Bond from AmSouth and to make further advances to the Authority with the total amount not to exceed $50,000,000. Upon approval by the Authority, an Amended and Restated Taxable Revenue Bond (Adtran, Inc. Project) Series 1995 will be issued and the Original Financing Agreement will be amended. The Company anticipates that the Amended and Restated Bond and associated documents will be completed during the second quarter of 1997. The Amended and Restated Bond will bear interest, payable monthly, at the rate of 45 basis points over the money market rate of the Bondholder and will mature on January 1, 2020. The Company has agreed to make payments to the Authority in amounts necessary to pay the principal of and interest on the Amended and Restated Bond. Construction on the project began in March 1995 and certain phases were completed by December 31, 1996.

The Company's working capital position improved from $122,465,725 as of December 31, 1995 to $140,509,802 in 1996. This improvement in the Company's working capital position was due primarily to increased earnings. The Company has used, and expects to continue to use, the remaining proceeds of its earlier public offerings for working capital and other general corporate purposes, including (i) product development activities to enhance its existing products and develop new products and (ii) expansion of sales and marketing activities. Inventory decreased 9.3% for the twelve months ended December 31, 1996 due to overall efficiencies in manufacturing operations.

Capital expenditures totaling $12,790,517 in 1995 and $29,661,438 in 1996 were used to expand the Company's headquarters and to purchase equipment.

At December 31, 1996, the Company's cash on hand of $44,839,131, short-term investments of $32,555,930 and $10,000,000 available under a bank line of credit placed the Company's potential cash availability at $87,395,061. The Company's $10,000,000 bank line of credit bears interest at the rate of 87.5 basis points over the 30 day London inter-bank offered rate and expires in May 1997. The Company anticipates renewing the $10,000,000 bank line of credit upon its expiration.

The Company intends to finance its operations in the future with cash flow from operations, the remaining net proceeds of its earlier public offerings, amounts available under the bank line of credit, borrowed revenue bond proceeds and possible additional public financings. These available sources of funds are expected to be adequate to meet the Company's operating and capital needs for the foreseeable future.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders
ADTRAN, Inc.

We have audited the accompanying balance sheets of ADTRAN, Inc. as of December 31, 1995 and 1996, and the related statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ADTRAN, Inc. as of December 31, 1995, and 1996, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

/s/ Cooper & Lybrand L.L.P.
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COOPERS & LYBRAND L.L.P.
Birmingham, Alabama
January 14, 1997

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying financial statements and related notes of ADTRAN, Inc. were prepared by management, which has the primary responsibility for the integrity of the financial information therein. The statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances and include amounts which are necessarily based on management's judgment. Financial information presented elsewhere in this report is consistent with that in the financial statements.

Management maintains a comprehensive system of internal accounting controls and relies on the system to discharge its responsibility for the integrity of the financial statements. This system provides reasonable assurance that corporate assets are safeguarded, and that transactions are recorded in such a manner as to permit the preparation of reliable financial information. Reasonable assurance recognizes that the cost of a system of internal accounting controls should not exceed the related benefits. This system of internal accounting controls is augmented by written policies and procedures and the careful selection and training of qualified personnel. As of December 31, 1996, management was aware of no material weaknesses in the ADTRAN system of internal accounting controls.

The financial statements have been audited by the Company's independent certified public accountants, whose opinion is expressed above. Their audit was conducted in accordance with generally accepted auditing standards, and as such, they obtained an understanding of the Company's systems of internal accounting controls and conducted such tests and related procedures as they deemed necessary to arrive at an opinion on the fairness of presentation of the financial statements.

/s/ Mark C. Smith	/s/ John R. Cooper
Mark C. Smith	John R. Cooper
Chairman and CEO	Vice President and CFO

December 31, 1995 and 1996

	1995	1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 35,027,609	$ 44,839,131
Short-term investments	24,652,689	32,555,930
Accounts receivable, less allowance for doubtful accounts of $544,526 and $872,724 in 1995 and 1996, respectively	29,234,803	33,825,560
Other receivables	857,303	362,578
Inventory	44,997,195	40,792,646
Prepaid expenses	683,594	2,261,338
Deferred income taxes	1,068,861	1,598,750
Total current assets	136,522,054	156,235,933
Property, plant, and equipment, net	29,245,252	53,971,213
Total assets	$165,767,306	$210,207,146
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 9,740,587	$ 9,350,266
Accrued salaries	1,332,141	2,454,194
Accrued income taxes	1,310,841	1,803,706
Accrued taxes other than income taxes	586,150	338,997
Accrued interest payable	74,305	59,594
Warranty liability	523,027	1,026,156
Compensated absences	489,278	693,218
Total current liabilities	14,056,329	15,726,131
Bonds payable	20,000,000	20,000,000
Deferred income taxes	967,666	1,602,116
Total liabilities	35,023,995	37,328,247
Stockholders' equity:		
Common stock, par value $.01 per share; 60,000,000 shares authorized; 37,462,275 shares issued and outstanding in 1995; 38,769,514 in 1996	374,623	387,695
Additional paid-in capital	89,404,177	90,172,863
Retained earnings	40,964,511	82,318,341
Total stockholders' equity	130,743,311	172,878,899
Total liabilities and stockholders' equity	$165,767,306	$210,207,146

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

Statements of Income

for the years ended December 31, 1994, 1995, and 1996

	1994	1995	1996
Sales	$123,440,202	$181,478,065	$250,120,836
Cost of sales	63,187,366	93,006,672	129,953,371
Gross profit	60,252,836	88,471,393	120,167,465
Selling, general, and administrative expenses	17,346,759	27,259,610	34,308,436
Research and development expenses	13,774,038	19,131,457	24,647,425
Income from operations	29,132,039	42,080,326	61,211,604
Other income (expenses):			
Interest income	440,151	3,204,902	2,542,417
Interest expense	(447,547)	(1,105,156)	(894,657)
Other	(25,144)	111,219	642,432
	(32,540)	2,210,965	2,290,192
Income before income taxes	29,099,499	44,291,291	63,501,796
Provision for income taxes	6,288,675	14,833,564	23,681,892
Net income (historical)	22,810,824	29,457,727	39,819,904
Pro forma provision for income taxes	4,202,219		
Net income (pro forma in 1994)	$ 18,608,605	$ 29,457,727	$39,819,904
Net income per common and common equivalent share (pro forma in 1994)	$0.52	$0.75	$1.01
Weighted average common and common equivalent shares oustanding	36,131,940	39,289,507	39,566,090

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

STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

for the years ended December 31, 1994, 1995, and 1996

	Common Stock						
	Number Of Shares	Price Per Share	Par Value ($.01 Per Share)	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Total Stockholders' Equity
BALANCE, DECEMBER 31, 1993	15,663,690		$156,637	$ 2,919,559	$27,091,267	$(410,000)	$ 29,757,463
Purchase of treasury stock: 750 shares		$6.67				(5,000)	(5,000)
Stock options exercised through issuance of treasury stock: 60,000 shares		$0.11		(393,332)		400,000	6,668
2,250 shares		$3.00		(8,250)		15,000	6,750
Stock options exercised through issuance of common stock: Various prices per share	109,908		1,099	125,270			126,369
Transfer in connection with conversion from an S corporation to a C Corporation (see Note 7)				33,057,603	(33,057,603)		
Issuance of common stock through initial public offering, net of offering costs	2,300,000	$16.46	23,000	37,844,963			37,867,963
Income tax benefit from exercise of nonqualified stock options					145,763		145,763
Distribution to stockholders					(5,483,467)		(5,483,467)
Net income					22,810,824		22,810,824
BALANCE, DECEMBER 31, 1994	18,073,598		180,736	73,545,813	11,506,784	0	85,233,333
Stock options exercised through issuance of common stock: Various prices per share	460,619		4,606	342,283			346,889
Issuance of common stock in June 1995 through a public offering of shares, net of offering costs	500,000	$31.41	5,000	15,700,362			15,705,362
Issuance of shares to effect stock split. (see Note 8)	18,428,058		184,281	(184,281)			
Net income					29,457,727		29,457,727
BALANCE, DECEMBER 31, 1995	37,462,275		374,623	89,404,177	40,964,511	0	130,743,311
Stock options exercised through issuance of common stock: Various prices per share	1,307,239		13,072	768,686			781,758
Income tax benefit from exercise of nonqualified stock options					1,533,926		1,533,926
Net income					38,819,904		39,819,904
BALANCE, DECEMBER 31, 1996	38,769,514		$387,695	$90,172,863	$82,318,341	$ 0	$172,878,899

The accompanying notes are an integral pert of these financial statements.

Statements of Cash Flows

for the years ended December 31, 1994, 1995, and 1996

	1994	1995	1996
Cash flows from operating activities:			
Net income	$ 22,810,824	$ 29,457,727	$ 39,819,904
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	2,252,549	3,052,798	4,890,303
Provision for losses on accounts receivable	300,000	172,621	430,637
Provision for losses on inventory	2,013,201	2,887,877	3,862,396
Provision for warranty claims	639,081	776,908	2,110,614
Loss on sale of property, plant, and equipment	82,644	8,842	40,572
Loss on sale of short-term investments classified as available-for-sale		169,766	405,789
Change in operating assets:			
Accounts receivable	(5,852,356)	(11,384,955)	(5,021,394)
Inventory	(13,939,944)	(20,360,721)	342,153
Other current assets	(1,149,441)	(302,634)	(978,458)
Change in operating liabilities:			
Accounts payable	1,292,104	3,245,924	(390,321)
Other liabilities	71,177	1,584,749	(50,491)
Net cash provided by operating activities	8,519,839	9,308,902	45,461,704
Cash flows from investing activities:			
Expenditures for property, plant, and equipment	(4,051,716)	(12,790,517)	(29,661,438)
Proceeds from the disposition of property, plant, and equipment	70,233	14,250	4,602
Purchase of short-term investments classified as available-for-sale	(8,500,000)	(16,322,455)	(8,309,030)
Net cash used in investing activities	(12,481,483)	(29,098,722)	(37,965,866)
Cash flows from financing activities:			
Change in borrowings under line of credit	(1,100,000)		
Proceeds from capital lease obligation	1,000,000		
Payment of capital lease obligation	(10,000,000)		
Proceeds from bond issuance		20,000,000	
Proceeds from public offering, net of expenditures	37,867,963	15,705,362	
Proceeds from issuance of common stock	139,787	346,889	781,758
Income tax benefit from exercise of nonqualified stock options	145,763		1,533,926
Purchase of treasury stock	(5,000)		
Distribution to stockholders	(5,483,467)		
Net cash provided by financing activities	22,565,046	36,052,251	2,315,684
Net increase in cash and cash equivalents	18,603,402	16,262,431	9,811,522
Cash and cash equivalents, beginning of year	161,776	18,765,178	35,027,609
Cash and cash equivalents, end of year	$ 18,765,178	$ 35,027,609	$ 44,839,131
Supplemental disclosure of cash flow information:			
Cash paid during the year for interest, net of capitalized interest of $235,928 in 1995 and $393,096 in 1996	$ 479,415	$ 1,030,851	$ 909,368
Cash paid during the year for income taxes	$ 6,824,070	$ 13,033,140	$ 22,151,925

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

Notes to Financial Statements

1. Summary of Significant Accounting Policies ADTRAN, Inc. (the "Company") designs, develops, manufactures, markets, and services a broad range of high-speed digital transmission products utilized by telephone companies ("Telcos") and corporate end-users to implement advanced digital data services over existing telephone networks. The Company also customizes many of its products for private label distribution and for original equipment manufacturers to incorporate into their own products. Most of the Company's Telco and customer premises equipment products are connected to the local loop, which is the large existing infrastructure of the telephone network, predominantly consisting of copper wireline, which connects end-users to a Telco's central office. The central office is the Telco facility that provides local switching and distribution functions. The balance of the Company's products are used in the Telcos' central offices.

Cash and Cash Equivalents
Cash and cash equivalents represent demand deposits, money market accounts, and short-term investments classified as held-to-maturity (see Note 2) with original maturities of three months or less.

Financial Instruments
The carrying amount reported in the balance sheets for cash and cash equivalents, accounts receivable, and accounts payable approximates fair value because of the immediate or short-term maturity of these financial instruments. The carrying amount reported for the bonds payable approximates fair value because the underlying instruments are at variable rates that reprice frequently.

Short-term investments represent remarketed preferred stocks and municipal bonds classified as available-for-sale securities under the provisions of Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities, (SFAS 115), which the Company adopted effective January 1, 1994. SFAS 115 requires that these investments be classified as either held-to-maturity, trading, or available-for-sale securities. Remarketed Preferred Stocks are designed to be marketed as money market instruments. These instruments' interest rates reset on a short-term basis to maintain the price of the instruments at par. These instruments may be redeemed on the date the interest rate resets. The fair value of short-term investments is estimated based on quoted market prices (see Note 2). Realized gains or losses are computed under the specific identification method.

Inventory
Inventory is carried at the lower of cost or market, with cost being determined using the first-in, first-out method.

Property, Plant, and Equipment
Property, plant, and equipment, which is stated at cost, is depreciated using methods which approximate straight-line depreciation over the estimated useful lives of the assets. Expenditures for repairs and maintenance are charged to expense as incurred; betterments which materially prolong the lives of the assets are capitalized. The cost of assets retired or otherwise disposed of and the related accumulated depreciation are removed from the accounts and the gain or loss on such disposition is included in income.

Long-Lived Assets
The Company recognizes impairment losses on long lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying values. There were no such losses recognized during 1994, 1995, and 1996.

Research and Development Costs
Research and development costs are expensed as incurred.

Use of Estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Income Taxes
Effective July 1, 1994, concurrent with the Company's conversion from an S corporation to a C corporation for income tax purposes (see Note 7), the Company adopted the asset and liability method of accounting for income taxes. This method requires the establishment of deferred tax liabilities and assets, as measured by enacted tax rates, for all temporary differences caused when the tax bases of assets and liabilities differ from those reported in the financial statements. The adoption of the asset and liability method did not have a material impact on the financial statements.

Net Income Per Share
Net income per common and common equivalent share (pro forma) is based on the weighted average number of shares of common stock outstanding during each period and the assumed exercise of dilutive stock options (less the number of treasury shares assumed to be purchased from the proceeds using the market price of the Company's common stock).

Reclassifications
Certain reclassifications have been made to the 1994 and 1995 financial statements and related footnotes to conform with the 1996 presentation. These reclassifications had no impact on retained earnings or net income.

2. Investments

At December 31, 1995 and 1996, the Company held the following securities as available-for-sale or held-to-maturity recorded at amortized cost which approximates fair value:

1995
Short term investments, available-for-sale:
Municipal Bonds $24,652,689

Cash equivalents, held-to-maturity:

General Motors Acceptance, zero coupon bonds mature January 17, 1996	$ 4,986,731
Ford Motor Credit, zero coupon bonds, mature January 17, 1996	4,986,731
Chevron Oil Company, zero coupon bonds, mature January 18, 1996	4,986,000
General Electric Credit, zero coupon bonds, mature January 18, 1996	4,986,000
	$19,945,462

1996	
Short-term investments, available-for-sale:	
Municipal Bonds	$10,055,930
Remarketed preferred stocks:	
GE Capital preferred asset corporation A series A	5,000,000
Merrill Lynch preferred series G	5,000,000
Muniyield Fund Auction preferred series A	5,000,000
VKM Investment Grade Municipal Trust preferred	5,000,000
Nuveen Premium preferred series A	2,500,000
	$32,555,930

Cash equivalents, held-to-maturity:	
Triple A One Plus, zero coupon bonds mature January 10, 1997	$ 4,992,889
Receivables Capital, zero coupon bonds, mature January 10, 1997	4,992,889
Barton Corporation, zero coupon bonds, mature January 15, 1997	4,989,248
Three Rivers Funding, zero coupon bonds, mature January 16, 1997	4,988,533
	$19,963,559

3. Inventory

At December 31, 1995 and 1996, inventory consisted of the following:

	1995	1996
Raw materials	$27,390,750	$24,454,251
Work in process	4,428,437	2,963,220
Finished goods	13,178,008	13,375,175
	$44,997,195	$40,792,646

4. Property, Plant, and Equipment

Property, plant, and equipment comprised the following at December 31, 1995 and 1996:

	1995	1996
Land	$ 2,149,469	$ 4,263,104
Building	12,642,588	26,230,470
Construction in progress	3,511,987	2,021,525
Land improvements	2,995,292	7,177,261
Office machinery and equipment	4,594,880	8,338,789
Engineering machinery and equipment	12,228,540	19,577,071
	38,122,756	67,608,220
Less accumulated depreciation	(8,877,504)	(13,637,007)
	$29,245,252	$ 53,971,213

5. Line of Credit The Company has a $10,000,000 line of credit at a bank, which bears interest at the rate of 87.5 basis points over the 30 day London inter-bank offered rate. At December 31, 1996, the Company had no borrowings against this line. The line of credit expires on May 1, 1997.

6. Alabama State Industrial Development Authority Financing In contemplation of an expansion of its Huntsville, Alabama facility, the Company was approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the "Authority"). Pursuant to such program, on January 13, 1995, the Authority issued $20 million of its taxable revenue bonds pursuant to such program and loaned the proceeds from the sale of the bonds to the Company. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"), and bear interest, payable monthly, at the rate of 87.5 basis points over the 30 day London inter-bank offered rate and mature on January 1, 2020. First Union National Bank of Tennessee, Nashville, Tennessee (the "Bondholder") has agreed to purchase the original bond from the Bank and to make further advances to the Authority with the total amount not to exceed $50,000,000. Upon approval by the Authority, an Amended and Restated Taxable Revenue Bond (Adtran, Inc. Project) Series 1995 will be issued and the original financing agreement will be amended. The Company anticipates that the Amended and Restated Bond and associated documents will be completed during the second quarter of 1997. The Amended and Restated Bond will bear interest, payable monthly, at the rate of 45 basis points over the money market rate of the Bondholder and will mature on January 1, 2020. The Company has agreed to make payments to the Authority in amounts necessary to pay the principal of and interest on the Amended and Restated Bond. Construction on the project began in March 1995 and certain phases were completed by December 31, 1996.

7. Income Taxes

Effective July 1, 1994, the Company converted from an S corporation to a C corporation for income tax purposes and therefore is subject to corporate income taxes. The 1994 statement of income includes a presentation of the pro forma effects of income taxes on the Company's operations as if the Company had been subject to corporate income taxes prior to July 1, 1994. As of July 1, 1994, deferred income tax assets and liabilities were recorded to reflect differences between the bases of the Company's assets and liabilities for financial reporting and income tax purposes.

The 1994 financial statements reflect the transfer of the Company's retained earnings as an S corporation to additional paid-in-capital in connection with the July 1, 1994 conversion to a C corporation. This transfer reflects the assumption of a constructive distribution to the prior S corporation stockholders followed by an assumed contribution to the paid-in capital of the Company.

A summary of the components of the historical and pro forma tax provisions as of December 31 is as follows:

	1994	1995	1996
Historical:			
Current:			
Federal	$5,626,413	$13,896,982	$21,329,522
State	621,542	968,492	2,247,809
Total Current	6,247,955	14,865,474	23,577,331
Deferred	40,720	(31,910)	104,561
Historical provision for income taxes for period after June 30, 1994	6,288,675	14,833,564	23,681,892
Pro forma provision for income taxes for period prior to July 1, 1994	4,202,219		
Total provision for income taxes	$10,490,894	$14,833,564	$23,681,892

The provision for income taxes differs from the amounts computed by applying the federal statutory rate due to the following:

	1994	1995	1996
Tax provision computed at the federal statutory rate (34% in 1994, 35% in 1995 and 1996)	$ 9,893,830	$15,501,952	$22,225,629
State income tax provision, net of federal benefit	758,212	629,520	1,461,076
Federal research credits	(329,774)	(815,408)	(151,500)
Permanent differences and other	168,626	(482,500)	146,687
	$10,490,894	$14,833,564	$23,681,892

Temporary differences which create deferred tax assets and liabilities at December 31, 1995 and 1996 are detailed below.

	1995		1996	
	Current	Noncurrent	Current	Noncurrent
Property, plant and equipment		($967,666)		($1,602,116)
Accounts receivable	$201,257		$341,584	
Inventory	493,456		584,204	
Accruals	374,148		672,962	
Deferred tax asset (liability)	$1,068,861	($967,666)	$1,598,750	($1,602,116)

No valuation allowance is deemed necessary by management as the realization of recorded deferred tax assets is considered more likely than not.

8. Stock Split

On April 20, 1995, the stockholders approved the board of directors' recommendation to increase authorized common stock from 30 million shares to 60 million shares, par value $.01.

Following approval by the board of directors, the Company declared a 2 for 1 stock split, payable on May 12, 1995, to stockholders of record on April 27, 1995. All common stock information included in the financial statements, except in the statements of changes in stockholders' equity, give retroactive effect to this stock split.

9. Operating Leases

The company leases office space and equipment under operating leases. As of December 31, 1996, minimum rental payments under the noncancelable operating leases are approximately as follows:

1997	$540,000
1998	387,000
1999	271,000
2000	92,500
	$1,290,500

Rental expense was approximately $464,000, $447,000 and $851,000 in 1994,

1995 and 1996, respectively.

10. EMPLOYEE INCENTIVE STOCK OPTION PLAN and DIRECTOR'S STOCK OPTION PLAN

1996 Employees Incentive Stock Option Plan The Board of Directors of the Company adopted the 1996 Employees Incentive Stock Option Plan (the "1996 Plan") effective February 14, 1996, under which 488,100 shares of common stock have been reserved as of December 31, 1996 for issuance to certain employees and officers through incentive stock options and nonqualified stock options. At December 31, 1996, there were no shares of common stock issued under the 1996 Plan as initial vesting will not occur until 1997. In addition, the Company currently has options outstanding under its 1986 Employee Incentive Stock Option Plan (the "1986 Plan"), which plan expired on February 14, 1996. Options granted under the 1996 Plan or the 1986 Plan become exercisable after one year of continued employment after the date of grant or pursuant to a five year vesting schedule beginning on the first anniversary of the grant date. Expiration dates of options outstanding under the 1996 Plan and the 1986 Plan at December 31, 1996 range from 1997 to 2007.

Director's Stock Option Plan
The Board of Directors of the Company adopted a Director's Stock Option Plan effective October 31, 1995 under which 70,000 shares of common stock have been reserved. The Plan is a formula plan to provide options to non-employee directors of the Company. At December 31, 1996, 28,000 options have been granted under the plan. Expiration dates of options outstanding under the Director's Stock Option Plan at December 31, 1996 range from 2005 to 2006.

Pertinent information regarding the Plans is as follows:

	Number of Options	Range of Exercise Prices	Weighted Average Exercise Price	Vesting Provisions
Options outstanding, December 31, 1993	3,218,640	$ .06 - $3.34	$0.43	100% / year
Options granted	28,250	$3.33 -$12.53	$5.91	100% / year
Options exercised	(344,316)	$ .06 - $1.67	$0.41	100% / year
Options outstanding December 31, 1994	2,902,574	$.06 - $12.53	$0.49	100% / year
Options granted	84,350	$22.50 - $46.25	$34.86	100% / year
Options cancelled	(1,450)	$31.75	$31.75	100% / year
Options exercised	(815,079)	$.06 - $3.33	$0.43	100% / year
Options outstanding, December 31, 1995	2,170,395	$.06 - $46.25	$1.83	100% / year
Options granted	342,000	$39.75 - $65.75	$63.99	20% / year
Options granted	7,950	$30.50 - $65.75	$44.43	100% / year
Options cancelled	(9,050)	$3.33 - $65.75	$61.78	various
Options exercised	(1,307,239)	$.06 - $31.75	$0.60	100% / year
Options outstanding, December 31, 1996	1,204,056	$.11 - $65.75	$20.38	various

The following table summarizes information about stock options outstanding at December 31, 1996:

Range of Exercise Prices	Number Outstanding 12/31/96	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable 12/31/96	Weighted Average Exercise Price
$0.11 - $0.11	251,800	0.45	$0.11	251,800	$0.11
$0.17 - $0.17	176,000	1.89	$0.17	176,000	$0.17
$0.50 - $0.50	127,415	2.20	$0.50	127,415	$0.50
$0.75 - $2.50	170,666	4.08	$1.85	170,666	$1.85
$3.00 - $3.33	59,525	6.84	$3.31	59,525	$3,31
$12.53 - $12.53	8,000	7.66	$12.53	8,000	$12.53
$22.50 - $46.25	93,150	8.89	$36.44	68,200	$35.60
$56.25 - $56.25	5,000	9.54	$56.25	0	$0.00
$59.50 - $59.50	3,500	9.56	$59.50	0	$0.00
$63.75 - $63.75	22,500	9.65	$63.75	0	$0.00
$65.75 - $65.75	286,500	9.53	$65.75	0	$0.00
	1,204,056			861,606	

The options above were issued at exercise prices which approximate fair market value at the date of grant. At December 31, 1996, 200,600 shares are available for grant under the plans.

The Company applies APB Opinion 25 and related Interpretations in accounting for its stock plans. Accordingly, no compensation cost has been recognized related to stock options. Had compensation cost for the Company'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 SFAS No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	1995	1996
Net income - as reported	$29,457,727	$39,819,904
Net income - pro forma	$28,852,035	$38,018,766
Earnings per share - as reported	$.75	$1.01
Earnings per share - pro forma	$.73	$.96

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 and additional awards are made each year. 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:

	1995	1996
Dividend yield	0%	0%
Expected life (years)	5	5
Expected volatility (range)	49.40% - 52.37%	48.59% - 49.25%
Risk-free interest rate (range)	6.23% - 8.29%	5.86% - 7.12%

11. Employee Benefit Plan

In March 1990, the Company adopted an incentive savings plan (the Savings Plan) for all of its employees. The Savings Plan provides certain employment benefits to all eligible employees and qualifies as a deferred arrangement under Section 401(k) of the Internal Revenue Code. The Company matches one-third of a participant's contribution, limited to 5% of a participant's income. An employee's interest in the Company's contributions becomes 100% vested at the date participation in the Savings Plan commenced. Charges to operations for the plan amounted to $260,392, $415,791, and $547,072 in 1994, 1995, and 1996, respectively.

12. Major Customers

Sales of the Company's transmission and test equipment to the Regional Bell Operating Companies (RBOCs) amounted to approximately 38%, 40% and 36% of total sales during the years ended December 31, 1994, 1995 and 1996, respectively. At December 31, 1994, 1995 and 1996, respectively, 27%, 36%, and 23% of the accounts receivable balance consisted of amounts due from RBOCs.

13. Summarized Quarterly Financial Data (Unaudited)

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

	Three Months Ended			
(In thousands, except for share amounts)	March 31, 1995	June 30, 1995	September 30, 1995	December 31, 1995
Net sales	$38,097	$45,462	$48,002	$49,917
Gross profit	18,672	21,723	23,446	24,630
Income from operations	9,091	10,423	11,250	11,317
Net income	6,075	7,048	7,770	8,566
Net income per common and common equivalent share	0.15	0.18	0.20	0.22

	Three Months Ended			
(In thousands, except for share amounts)	March 31, 1996	June 30, 1996	September 30, 1996	December 31, 1996
Net sales	$54,544	$63,305	$62,635	$69,637
Gross profit	25,735	29,960	29,419	35,054
Income from operations	12,976	15,802	14,963	17,472
Net Income	8,623	10,340	9,406	11,451
Net income per common and common equivalent share	0.22	0.26	0.24	0.29

Directors and Executive Officers

Mark C. Smith
Chairman of the Board and Chief Executive Officer of the Company

Lonnie S. McMillian
Senior Vice President - Engineering, Secretary and Director of the Company

Howard A. Thrailkill
President, Director of the Company, and Chief Operating Officer of the Company.

O. Gene Gabbard
Director of the Company; Director of Dynatech Corporation, telecommunications equipment manufacturer; InterCel, Inc., a provider of wireless communications services; and Mindspring Enterprises, Inc., a provider of Internet access services.

William L. Marks
Director of the Company; Chairman of the Board and Chief Executive Officer of Whitney Holding Corp., the holding company for Whitney National Bank of New Orleans.

Roy J. Nichols
Director of the Company; Vice Chairman of the Board and Chief Technical Officer of Nichols Research Corporation (a defense and information systems company), Huntsville, Alabama

James L. North
Director of the Company and Counsel to the Company since it commenced operations in 1986. Attorney with James L. North and Associates, Birmingham, Alabama.

John R. Cooper
Vice President - Finance and Chief Financial Officer of the Company.

Danny J. Windham
Vice President - CPE Marketing

Thomas R. Stanton
Vice President - Telco Marketing

Irwin O. Goldstein
Vice President - Administration

Peter O. Brackett
Vice President - Technology

M. Melvin Bruce
Vice President - Engineering

Robert A. Fredrickson
Vice President - Telco Sales

Steven L. Harvey
Vice President - CPE Sales

Jude T. Panetta
Vice President - Manufacturing

Gregory A. Peters
Vice President - International Sales

Corporate Address
901 Explorer Boulevard
P.O. Box 140000
Huntsville, Alabama 35814-4000

Registrar and Transfer Agent
First Union National Bank of
North Carolina
Charlotte, North Carolina

Independent Auditors
Coopers & Lybrand L.L.P.
Birmingham, Alabama

General Counsel
James L. North, Attorney at Law
Birmingham, Alabama

Special Counsel
Long, Aldridge & Norman
Atlanta, Georgia

Form 10-K

The Company's 1996 Annual Report on Form 10-K (without exhibits) as filed with the Securities and Exchange Commissions is available to stockholders without charge upon written request to:

Investor Relations
ADTRAN, Inc.
901 Explorer Blvd.
Huntsville, Alabama 35806

Price Range of Common Stock
The Company's Common Stock has been traded on the Nasdaq National Market under the symbol "ADTN" since the Company's initial public offering of Common Stock in August 1994. Prior to the initial public offering, there was no established trading market for the Company's Common Stock. As of January 31, 1997, the Company had 561 shareholders of record and approximately 10,500 beneficial owners of shares held in street name.

FISCAL 1996	HIGH	LOW
First Quarter	$54-3/4	$26-1/2
Second Quarter	$73-1/2	$45
Third Quarter	$75-1/4	$47-1/2
Fourth Quarter	$52-1/4	$33-1/2

Annual Meeting
The 1997 Annual Meeting of Shareholders will be held at the Company Headquarters, 901 Explorer Blvd., Huntsville, Alabama, on Wednesday, April 23, 1997 at 10:00 a.m. local time.

Web Address
http://www.adtran.com

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the registration statement of ADTRAN, Inc. on Form S-8 of our reports dated January 14, 1997, on our audits of the financial statements of ADTRAN, Inc. as of December 31, 1996 and 1995, and for the years ended December 31, 1996, 1995, and 1994, which reports are incorporated by reference in this annual report on Form 10-K.

/s/COOPERS & LYBRAND L.L.P.

Birmingham, Alabama

March 24, 1997

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned constitutes and appoints Mark C. Smith, Lonnie S. McMillian and John R. Cooper, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution, for him and in his name, place and stead, in any and all capacities, to sign the Annual Report on Form 10-K of ADTRAN, Inc. for the fiscal year ended December 31, 1996, and any and all amendments thereto, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission and the National Association of Security Dealers, Inc., granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

This 11th day of March, 1997.

/s/ MARK C. SMITH

MARK C. SMITH

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned constitutes and appoints Mark C. Smith, Lonnie S. McMillian and John R. Cooper, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution, for him and in his name, place and stead, in any and all capacities, to sign the Annual Report on Form 10-K of ADTRAN, Inc. for the fiscal year ended December 31, 1996, and any and all amendments thereto, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission and the National Association of Security Dealers, Inc., granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

This 11th day of March, 1997.

/s/Lonnie S.McMillian

Lonnie S. McMillian

POWER OF ATTORNEY

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This 12th day of March, 1997.

/s/Howard A. Thrailkill

Howard A. Thrailkill

POWER OF ATTORNEY

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This 6th day of March, 1997.

/s/John R. Cooper

John R. Cooper

POWER OF ATTORNEY

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This 6th day of March, 1997.

/s/Roy J. Nichols

Roy J. Nichols

POWER OF ATTORNEY

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This 21st day of February, 1997.

/s/William L.Marks

William L. Marks

POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that the undersigned constitutes and appoints Mark C. Smith, Lonnie S. McMillian and John R. Cooper, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution, for him and in his name, place and stead, in any and all capacities, to sign the Annual Report on Form 10-K of ADTRAN, Inc. for the fiscal year ended December 31, 1996, and any and all amendments thereto, and to file the same, with all exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission and the National Association of Security Dealers, Inc., granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite or necessary to be done, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

This 21st day of February, 1997.

/s/ O.Gene Gabbard

O. Gene Gabbard

POWER OF ATTORNEY

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This 21st day of February, 1997.

/s/James L. North

James L. North

ARTICLE 5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM 1996 ANNUAL REPORT AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

PERIOD TYPE	12 MOS
FISCAL YEAR END	DEC 31 1996
PERIOD START	JAN 01 1996
PERIOD END	DEC 31 1996
CASH	44,839,131
SECURITIES	32,555,930
RECEIVABLES	34,698,284
ALLOWANCES	(872,724)
INVENTORY	40,792,646
CURRENT ASSETS	156,235,933
PP&E	67,608,220
DEPRECIATION	(13,637,007)
TOTAL ASSETS	210,207,146
CURRENT LIABILITIES	15,726,131
BONDS	20,000,000
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	387,695
OTHER SE	172,491,204
TOTAL LIABILITY AND EQUITY	210,207,146
SALES	250,120,836
TOTAL REVENUES	250,120,836
CGS	129,953,371
TOTAL COSTS	129,953,371
OTHER EXPENSES	34,308,436
LOSS PROVISION	430,637
INTEREST EXPENSE	(894,657)
INCOME PRETAX	63,501,796
INCOME TAX	23,681,892
INCOME CONTINUING	39,819,904
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	39,819,904
EPS PRIMARY	1.01
EPS DILUTED	1.01