

ADTRAN INC
Form 10-Q
May 05, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended March 31, 2008

OR

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

Commission File Number 0-24612

ADTRAN, INC.

(Exact name of Registrant as specified in its charter)

Delaware
(State of Incorporation)

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

901 Explorer Boulevard, Huntsville, Alabama 35806-2807

(Address of principal executive offices, including zip code)

(256) 963-8000

(Registrant's telephone number, including area code)

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

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

Large Accelerated Filer Accelerated Filer Non-accelerated Filer Smaller Reporting Company

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

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

Class	Outstanding at April 29, 2008
Common Stock, \$.01 Par Value	64,196,437 shares

Table of Contents**ADTRAN, INC.****Quarterly Report on Form 10-Q****For the Three Months Ended March 31, 2008****Table of Contents**

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The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by or on behalf of ADTRAN. ADTRAN and its representatives may from time to time make written or oral forward-looking statements, including statements contained in this report, our other filings with the Securities and Exchange Commission (SEC) and in our reports to our stockholders. Generally, the words, believe, expect, intend, estimate, anticipate, will, may, could and similar expressions identify forward-looking statements. We caution that any forward-looking statements made by us or on our behalf are subject to uncertainties and other factors that could cause such statements to be wrong. A list of factors that could materially affect our business, financial condition or operating results is included under "Factors that Could Affect Our Future Results" in "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained in Item 2 of Part I of this report. They have also been discussed in Item 1A of Part I in our most recent Annual Report on Form 10-K filed on February 28, 2008 with the SEC. Though we have attempted to list comprehensively these important factors, we caution investors that other factors may prove to be important in the future in affecting our operating results. New factors emerge from time to time, and it is not possible for us to predict all of these factors, nor can we assess the impact each factor or a combination of factors may have on our business.

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

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

	March 31, 2008 (Unaudited)	December 31, 2007
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 39,085	\$ 13,941
Short-term investments	153,578	148,416
Accounts receivable, less allowance for doubtful accounts of \$116 at March 31, 2008 and \$109 at December 31, 2007	70,794	70,667
Other receivables	3,183	3,085
Inventory, net	47,445	48,546
Prepaid expenses	2,337	2,023
Deferred tax assets, net	7,789	7,659
Total current assets	324,211	294,337
Property, plant and equipment, net	75,482	75,969
Deferred tax assets, net	3,047	1,113
Other assets	505	505
Long-term investments	86,262	107,296
Total assets	\$ 489,507	\$ 479,220
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	\$ 25,557	\$ 22,200
Unearned revenue	5,719	5,361
Accrued expenses	4,139	3,801
Accrued wages and benefits	8,305	10,497
Income tax payable, net	11,707	1,217
Total current liabilities	55,427	43,076
Other non-current liabilities	9,438	9,213
Bonds payable	48,500	48,500
Total liabilities	113,365	100,789
Commitments and contingencies (see Note 10)		
Stockholders Equity		
Common stock, par value \$0.01 per share; 200,000 shares authorized; 79,652 shares issued at March 31, 2008 and December 31, 2007	797	797
Additional paid-in capital	166,543	164,385
Accumulated other comprehensive income	4,297	5,704
Retained earnings	562,372	551,764
Less treasury stock at cost: 15,457 shares at March 31, 2008 and 14,739 shares at December 31, 2007	(357,867)	(344,219)

Total stockholders' equity	376,142	378,431
Total liabilities and stockholders' equity	\$ 489,507	\$ 479,220

See notes to consolidated financial statements

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ADTRAN, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended March 31,	
	2008	2007
Sales	\$ 119,885	\$ 110,312
Cost of sales	49,645	44,522
Gross profit	70,240	65,790
Selling, general and administrative expenses	25,547	26,476
Research and development expenses	19,553	18,358
Operating income	25,140	20,956
Interest and dividend income	2,283	2,908
Interest expense	(619)	(619)
Net realized investment gain (loss)	(89)	83
Other income, net	127	298
Life insurance proceeds		1,000
Income before provision for income taxes	26,842	24,626
Provision for income taxes	(9,795)	(7,698)
Net income	\$ 17,047	\$ 16,928
Weighted average shares outstanding basic	64,598	69,358
Weighted average shares outstanding diluted	65,452	70,889
Earnings per common share basic	\$ 0.26	\$ 0.24
Earnings per common share diluted	\$ 0.26	\$ 0.24
Dividend per share	\$ 0.09	\$ 0.09

See notes to consolidated financial statements

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

	Three Months Ended	
	March 31,	
	2008	2007
Cash flows from operating activities:		
Net income	\$ 17,047	\$ 16,928
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,392	2,628
Amortization of net premium on available-for-sale investments	372	586
Net realized loss (gain) on long-term investments	89	(83)
Loss (gain) on disposal of property, plant and equipment	(1)	65
Stock-based compensation expense	2,039	2,239
Deferred income taxes	(1,046)	(1,041)
Tax benefits from stock option exercises	119	1,284
Excess tax benefits from stock-based compensation arrangements	(36)	(1,082)
Changes in operating assets and liabilities:		
Accounts receivable, net	(127)	522
Other receivables	(98)	3,678
Income tax receivable, net		1,446
Inventory, net	1,101	4,219
Prepaid expenses	(314)	181
Accounts payable	3,357	(11,070)
Accrued expenses and other liabilities	(1,271)	(2,416)
Income tax payable, net	10,490	5,190
Net cash provided by operating activities	34,113	23,274
Cash flows from investing activities:		
Purchases of property, plant and equipment	(1,904)	(2,054)
Proceeds from sales and maturities of available-for-sale investments	73,768	43,846
Purchases of available-for-sale investments	(61,089)	(67,040)
Net cash provided by (used in) investing activities	10,775	(25,248)
Cash flows from financing activities:		
Proceeds from stock option exercises	630	6,218
Purchases of treasury stock	(14,871)	(15,188)
Dividend payments	(5,846)	(6,236)
Excess tax benefits from stock-based compensation arrangements	36	1,082
Net cash used in financing activities	(20,051)	(14,124)
Net increase (decrease) in cash and cash equivalents	24,837	(16,098)
Effect of exchange rate changes	307	119
Cash and cash equivalents, beginning of period	13,941	40,147

Cash and cash equivalents, end of period

\$ 39,085 \$ 24,168

See notes to consolidated financial statements

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ADTRAN, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements of ADTRAN[®], Inc. and its subsidiaries (ADTRAN) have been prepared pursuant to the rules and regulations for reporting on Quarterly Reports on Form 10-Q. Accordingly, certain information and notes required by generally accepted accounting principles for complete financial statements are not included herein. The December 31, 2007 Consolidated Balance Sheet is derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States.

In the opinion of management, all adjustments necessary for a fair presentation of these interim statements have been included and are of a normal and recurring nature. The results of operations for an interim period are not necessarily indicative of the results for the full year. The interim statements should be read in conjunction with the financial statements and notes thereto included in ADTRAN's Annual Report on Form 10-K for the year ended December 31, 2007.

Changes in Classifications

Certain changes in classifications have been made to the prior period balances in order to conform to the current period's presentation. These reclassifications have no effect on previously reported total assets, total liabilities, stockholders' equity or net income.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expense during the reporting period. ADTRAN's more significant estimates include the allowance for doubtful accounts, obsolete and excess inventory reserves, warranty reserves, rebates, allowance for sales returns, determination of the deferred revenue components of multiple element sales agreements, estimated income tax contingencies, the fair value of stock-based compensation and the evaluation of other-than-temporary declines in the value of investments. Actual amounts could differ significantly from these estimates.

Recent Accounting Pronouncements

Updates to recent accounting standards as disclosed in ADTRAN's Annual Report on Form 10-K for the year ended December 31, 2007 are as follows:

In December 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), *Business Combinations*, (SFAS 141R) which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any non-controlling interest in the acquiree in a business combination. SFAS 141R establishes principles stipulating how goodwill acquired in a business combination or a gain from a bargain purchase should be recognized and measured. The statement also expands the disclosure requirements related to the nature and financial impact of business combinations. SFAS 141R is effective for financial statements issued for fiscal years beginning after December 15, 2008. We are currently evaluating the impact the adoption of SFAS 141R might have on our consolidated results of operations and financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an Amendment of ARB No. 51* (SFAS 160), which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS 160 clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated

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entity that should be reported as equity in the consolidated financial statements. SFAS 160 also requires consolidated net income to be reported at

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amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. SFAS 160 also provides guidance when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners of a subsidiary. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. We are currently evaluating the impact the adoption of SFAS 160 might have on our consolidated results of operations and financial condition.

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

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

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

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The following table summarizes the stock-based compensation expense related to stock options under SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), for the three months ended March 31, 2008 and 2007, which was allocated as follows:

<i>(In thousands)</i>	Three Months Ended March 31,	
	2008	2007
Stock-based compensation expense included in cost of sales	\$ 79	\$ 93
Selling, general and administrative expense	954	1,079
Research and development expense	1,006	1,067
Stock-based compensation expense included in operating expenses	1,960	2,146
Total stock-based compensation expense	2,039	2,239
Tax benefit for expense associated with non-qualified options	(208)	(186)
Total stock-based compensation expense, net of tax	\$ 1,831	\$ 2,053

The fair value of ADTRAN's options was estimated using the Black-Scholes Model. The determination of the fair value of stock options on the date of grant using the Black-Scholes Model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables that may have a significant impact on the fair value estimate.

The weighted-average assumptions and value of options granted for the three months ended March 31, 2008 and 2007 are summarized as follows:

	Three Months Ended March 31,	
	2008	2007
Expected volatility	42.33%	46.02%
Risk-free interest rate	2.85%	4.76%
Expected dividend yield	1.85%	1.61%
Expected life (in years)	5.01	4.58
Weighted-average estimated value	\$ 6.74	\$ 8.76

Stock-based compensation expense recognized in our Consolidated Statements of Income for the three months ended March 31, 2008 is based on options ultimately expected to vest, and has been reduced for estimated forfeitures. Estimated forfeitures were based upon historical experience and approximate 4.0% annually.

As of March 31, 2008, total compensation cost related to non-vested stock options not yet recognized was approximately \$13.5 million, which is expected to be recognized over an average remaining recognition period of 2.6 years using the ratable single-option approach.

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The following schedule summarizes the activity in our stock-based compensation plans for the three months ended March 31, 2008:

<i>(In thousands, except per share amounts)</i>	Number of Options	Weighted Avg. Exercise Price	Weighted Avg. Remaining Contractual Life In years	Aggregate Intrinsic Value
Options outstanding, December 31, 2007	6,375	\$ 19.79	5.94	\$ 24,737
Options granted	3	\$ 19.47		
Options cancelled/forfeited	(43)	\$ 25.71		
Options exercised	(52)	\$ 12.00		
Options outstanding, March 31, 2008	6,283	\$ 19.82	5.74	\$ 16,180
Options exercisable, March 31, 2008	4,267	\$ 17.87	4.31	\$ 16,178

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic value (the difference between ADTRAN's closing stock price on the last trading day of the quarter and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on March 31, 2008. The aggregate intrinsic value will change based on the fair market value of ADTRAN's stock. The total pre-tax intrinsic value of options exercised during the three month period ended March 31, 2008 was \$0.4 million.

3. INVESTMENTS

At March 31, 2008, we held the following securities and investments, recorded at either fair value or cost.

<i>(In thousands)</i>	Amortized Cost	Gross Unrealized		Fair Value / Carrying Value
		Gains	Losses	
Restricted investments	\$ 2,951	\$	\$ (52)	\$ 2,899
Municipal fixed-rate bonds	111,680	736		112,416
Municipal variable rate demand notes	53,560			53,560
Marketable equity securities	16,310	5,208	(1,469)	20,049
Available-for-sale securities held at fair value	\$ 184,501	\$ 5,944	\$ (1,521)	\$ 188,924
Restricted investments held at cost				49,000
Other investments held at cost				1,916
Total carrying value of available-for-sale securities and investments				\$ 239,840

At March 31, 2008, we held \$2.9 million of restricted deferred compensation plan assets, carried at fair value.

At March 31, 2008, we held \$112.4 million of municipal fixed-rate bonds having an average credit rating of AA+. These bonds are classified as available-for-sale investments and had an average duration of 0.3 years at March 31, 2008. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain quoted prices for these bonds, or for similar securities traded in an active market, on a daily basis.

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At March 31, 2008, we held \$53.6 million of municipal variable rate demand notes, all of which are classified as available-for-sale short-term investments. Despite the long-term nature of their stated contractual maturities, we have the

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ability to quickly liquidate these securities. Our investments in these securities are recorded at fair value, and the interest rates typically reset every seven, 28, or 35 days. As a result, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments. All income generated from these investments was recorded as interest income. We have not been required to record any losses relating to municipal variable rate demand notes or municipal auction rate securities and we have held no municipal auction rate securities since February 7, 2008.

At March 31, 2008, we held \$20.0 million of marketable equity securities, including a single security, of which we held 2.5 million shares, carried at \$5.0 million of fair value. We estimate that this single security trades approximately 40,000 shares per day, in an active market on a European stock exchange. Of the gross unrealized gains included in the fair market value of our marketable equity securities, this single security carried \$4.1 million of this unrealized gain.

At March 31, 2008, we held a \$49.0 million restricted certificate of deposit, carried at cost. This investment serves as a collateral deposit against the principal amount outstanding under loans made to ADTRAN pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond). For more information on the Bond, see **Debt** under **Liquidity and Capital Resources** in the **Management's Discussion and Analysis of Financial Condition and Results of Operations** contained in Item 2 of Part I of this report.

At March 31, 2008, we held \$1.9 million of other investments carried at cost consisting of two private equity funds and a direct investment in a telecommunications equipment manufacturer. The fair value of these investments was estimated to be approximately \$15.3 million at March 31, 2008, based on unobservable inputs including information supplied by the investees. We have committed to invest up to an aggregate of \$7.8 million in the two private equity funds, and we have contributed \$7.7 million to date, of which \$7.2 million has been applied toward these commitments. As of March 31, 2008, we have received distributions related to these two private equity funds of \$5.8 million. These investments are carried at cost, net of distributions. The duration of each of these commitments is ten years with \$0.2 million expiring in 2010 and \$0.4 million expiring in 2012.

We review our investment portfolio for potential **other-than-temporary** declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered **other-than-temporary** and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential **other-than-temporary** impairments by reviewing any security with a market value that has declined from its original or adjusted cost basis by 25% for more than six months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. For the three months ended March 31, 2008, we had a charge of \$0.2 million related to the impairment of certain publicly traded equity securities. There were no such charges in the three months ended March 31, 2007.

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

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<i>(In thousands)</i>	Fair Value Measurements at March 31, 2008 Using			
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Restricted investments	\$ 2,899	\$ 2,899	\$	\$
Municipal fixed-rate bonds	112,416		112,416	
Municipal variable rate demand notes	53,560		53,560	
Marketable equity securities	20,049	20,049		
Available-for-sale securities held at fair value	\$ 188,924	\$ 22,948	\$ 165,976	\$

4. INVENTORY

At March 31, 2008 and December 31, 2007, inventory consisted of the following:

<i>(In thousands)</i>	March 31, 2008	December 31, 2007
Raw materials	\$ 32,987	\$ 30,519
Work in progress	1,734	2,552
Finished goods	19,154	21,899
Inventory reserves	(6,430)	(6,424)
Inventory, net	\$ 47,445	\$ 48,546

5. STOCKHOLDERS EQUITY

A summary of the changes in stockholders equity for the three months ended March 31, 2008 is as follows:

<i>(In thousands)</i>	Stockholders Equity
Balance, December 31, 2007	\$ 378,431
Net income	17,047
Dividend payments	(5,846)
Change in unrealized loss on marketable securities (net of deferred taxes)	(1,816)
Reclassification adjustment for amounts included in net income (net of tax)	102
Foreign currency translation adjustment	307
Proceeds from stock option exercises	630
Tax benefits from stock option exercises	119
Stock-based compensation expense	2,039
Purchases of treasury stock	(14,871)
Balance, March 31, 2008	\$ 376,142

Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions. As of March 31, 2008, the Board of Directors had authorized cumulative repurchases of up to 29 million shares of our common stock. During

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the three months ended March 31, 2008, we repurchased 0.8 million shares of our common stock at an average price of \$19.29 per share. We have the authority to purchase an additional 0.8 million shares of our common stock under the plan approved by the Board of Directors on July 16, 2007.

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On April 14, 2008, we announced that our Board of Directors had authorized the repurchase of an additional 5.0 million shares of our common stock to commence upon completion of the repurchase plan announced on July 16, 2007. Upon completion of the current plan, under which ADTRAN has the remaining authority to purchase 0.8 million shares, the new plan to repurchase 5.0 million shares will be implemented through open market or private purchases from time to time as conditions warrant.

We issued 0.1 million shares of treasury stock during the three months ended March 31, 2008 to accommodate employee stock option exercises. The stock options had exercise prices ranging from \$8.70 to \$18.03. We received proceeds totaling \$0.6 million from the exercise of these stock options during the first three months of 2008.

Dividend Payments

During 2008, ADTRAN has paid cash dividends as follows (in thousands except per share amount):

Record Date	Payment Date	Per Share Amount	Total Dividend Paid
February 7, 2008	February 21, 2008	\$ 0.09	\$ 5,846

Comprehensive Income

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

<i>(In thousands)</i>	Three Months Ended March 31,	
	2008	2007
Net income	\$ 17,047	\$ 16,928
Foreign currency translation gain, net of deferred taxes	307	119
Reclassification adjustment for amounts included in net income	102	
Change in net unrealized gains (losses) on available-for-sale securities, net of deferred taxes	(1,816)	826
Total comprehensive income	\$ 15,640	\$ 17,873

6. EARNINGS PER SHARE

A summary of the calculation of basic and diluted earnings per share for the three months ended March 31, 2008 and 2007 is as follows:

<i>(In thousands, except per share amounts)</i>	Three Months Ended March 31,	
	2008	2007
Numerator		
Net income	\$ 17,047	\$ 16,928
Denominator		
Weighted average number of shares - basic	64,598	69,358
Effect of dilutive securities - stock options	854	1,531
Weighted average number of shares - diluted	65,452	70,889
Net income per share - basic	\$ 0.26	\$ 0.24

Net income per share - diluted

\$ 0.26 \$ 0.24

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Anti-dilutive options to purchase common stock outstanding were excluded from the above calculations. Anti-dilutive options totaled 3.5 million and 2.8 million for the three months ended March 31, 2008 and 2007, respectively.

7. SEGMENT INFORMATION

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

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

	Three Months Ended			
	March 31, 2008		March 31, 2007	
	Sales	Gross Profit	Sales	Gross Profit
<i>(In thousands)</i>				
Carrier Networks	\$ 94,472	\$ 55,745	\$ 84,446	\$ 50,789
Enterprise Networks	25,413	14,495	25,866	15,001
Total	\$ 119,885	\$ 70,240	\$ 110,312	\$ 65,790

Sales by Geographic Region

The table below presents sales information by geographic region for the three months ended March 31, 2008 and 2007.

	Three Months Ended	
	March 31, 2008	March 31, 2007
<i>(In thousands)</i>		
United States	\$ 113,439	\$ 102,472
International	6,446	7,840
Total	\$ 119,885	\$ 110,312

Sales by Product

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

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

Carrier Systems products are used by telecommunications service providers to provide last mile access in support of data, voice and video services to consumers and enterprises. The Carrier Systems category includes our broadband access products comprising Digital Subscriber Line Access Multiplexer (DSLAM) products, Total Access[®] 5000 multi-access and aggregation platform products, and Fiber-To-The-Node (FTTN) products. Our broadband access products are used by service providers to deliver high speed Internet access, Voice over Internet Protocol (VoIP), IPTV, and/or Ethernet services from central office or remote terminal locations to customer premises. The Carrier Systems category

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also includes our optical access products. These products consist of optical access multiplexers including our family of OPTI products. Optical access products are used to deliver higher bandwidth services, or to aggregate large numbers of low bandwidth services for transportation across fiber optic infrastructure. Total Access[®] 1500 systems, 303 concentrator products, M13 multiplexer products and wireless network backhaul products are also included in the Carrier Systems product category.

Business Networking products provide enterprises access to today's telecommunication networks and facilitate networking capabilities for voice, data and video networks. The Business Networking category includes integrated access devices (IAD) and Internetworking products. Internetworking products consist of our NetVanta[®] product lines, including IP access routers, Ethernet switches, Internet security/firewall appliances, IP Private Branch Exchange (PBX) products, Carrier Ethernet Network Terminating Equipment (NTE) and IP Business Gateways.

The table below presents sales information by product for the three months ended March 31, 2008 and 2007.

<i>(In thousands)</i>	Three Months Ended March 31,	
	2008	2007
Loop Access	\$ 47,697	\$ 51,248
Carrier Systems	51,202	39,564
Business Networking	20,986	19,500
Total	\$ 119,885	\$ 110,312

Additionally, we are providing sub-categories of product revenues for broadband access and optical access products (included in Carrier Systems) and Internetworking products (included in Business Networking) to provide greater transparency into our primary growth areas. Further, we are providing HDSL revenues (included in Loop Access) as a sub-category.

Subcategory revenues included in the above are as follows:

<i>(In thousands)</i>	Three Months Ended March 31,	
	2008	2007
Broadband Access (included in Carrier Systems)	\$ 28,602	\$ 18,271
Optical Access (included in Carrier Systems)	11,166	8,617
Internetworking (NetVanta & Multi-service Access Gateways) (included in Business Networking)	14,913	11,092
Growth Products	54,681	37,980
HDSL (does not include T1) (included in Loop Access)	41,950	43,752
Other products (included in the above table)	23,254	28,580
Traditional Products	65,204	72,332
Total	\$ 119,885	\$ 110,312

8. LIABILITY FOR WARRANTY RETURNS

Our products generally include warranties of one to ten years for product defects. We accrue for warranty returns based on our estimate of the cost to repair or replace the defective products at the time revenue is recognized. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. These products could require more warranty cost to be incurred at the installed location due to their size and complexity, rather than at a manufacturing site or repair

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depot. This field service obligation, as well as the increasing complexity of our products, may cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be higher than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods.

The liability for warranty returns totaled \$3.0 million and \$2.9 million at March 31, 2008 and December 31, 2007, respectively. These liabilities are included in accrued expenses in the accompanying Consolidated Balance Sheets.

<i>(In thousands)</i>	March 31, 2008
Balance at beginning of period	\$ 2,944
Plus: amounts charged to cost and expenses	714
Less: deductions	(636)
Balance at end of period	\$ 3,022

9. RELATED PARTY TRANSACTIONS

We employ the law firm of our director emeritus for legal services. All bills for services rendered by this firm are reviewed and approved by our chief financial officer. We believe that the fees for such services are comparable to those charged by other firms for services rendered to us. We paid \$30 thousand during each of the three month periods ended March 31, 2008 and 2007 for legal services rendered.

10. COMMITMENTS AND CONTINGENCIES

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

We have committed to invest up to an aggregate of \$7.8 million in two private equity funds. See Note 3 to the Consolidated Financial Statements for additional information.

11. SUBSEQUENT EVENTS

On April 14, 2008, we announced that our Board of Directors declared a quarterly cash dividend of \$0.09 per common share to be paid to stockholders of record at the close of business on May 1, 2008. The payment date will be May 15, 2008. The quarterly dividend payment will be approximately \$5.8 million. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

On April 14, 2008, we announced that our Board of Directors had authorized the repurchase of an additional 5.0 million shares of our common stock to commence upon completion of the repurchase plan announced on July 16, 2007. Upon completion of the current plan, under which ADTRAN has the remaining authority to purchase 0.8 million shares, the new plan to repurchase 5.0 million shares will be implemented through open market or private purchases from time to time as conditions warrant.

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

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

OVERVIEW

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

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

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

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

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

Business Networking products provide enterprises access to today's telecommunication networks and facilitate networking capabilities for voice, data and video networks. The Business Networking category includes integrated access devices (IAD) and Internetworking products. Internetworking products consist of our NetVanta® product lines, including IP access routers, Ethernet switches, Internet security/firewall appliances, IP Private Branch Exchange (PBX) products, Carrier Ethernet Network Terminating Equipment (NTE) and IP Business Gateways.

Additionally, we are providing subcategory product revenues for our three primary growth areas of Broadband Access, Optical Access and Internetworking products, as well as subcategory product revenues for HDSL and all other products.

See Note 7 of Notes to Consolidated Financial Statements in this report for further information regarding these product categories.

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Sales were \$119.9 million for the three months ended March 31, 2008 compared to \$110.3 million for the three months ended March 31, 2007. Product revenues for our three primary growth areas, including Broadband Access, Optical Access and Internetworking, were \$54.7 million for the three months ended March 31, 2008 compared to \$38.0 million for the three months ended March 31, 2007. Our gross margin decreased for the three months ended March 31, 2008 to 58.6% from 59.6% for the three months ended March 31, 2007, while our operating income margin increased to 21.0% for the three months ended March 31, 2008 from 19.0% for the three months ended March 31, 2007. Net income was \$17.0 million for the three months ended March 31, 2008 compared to \$16.9 million for the three months ended March 31, 2007. Our effective tax rate increased from 31.3% for the three months ended March 31, 2007 to 36.5% for the three months ended March 31, 2008. Earnings per share, assuming dilution, were \$0.26 for the three months ended March 31, 2008 compared to \$0.24 for the three months ended March 31, 2007. The results for the three months ended March 31, 2007 included a benefit of \$0.9 million in Provision for Income Taxes primarily relating to closure of tax audits from prior years and also included a pre-tax life insurance benefit of \$1.0 million. These two items increased earnings per share, assuming dilution, by approximately \$0.02 in the three months ended March 31, 2007. The higher earnings per share for the three months ended March 31, 2008 compared to the same period in 2007 reflects a lower weighted average number of shares outstanding in 2008 due to stock repurchases under the share repurchase plans approved by our Board of Directors.

Our operating results have fluctuated on a quarterly basis in the past, and may vary significantly in future periods due to a number of factors. We normally operate with very little order backlog. A majority of our sales in each quarter result from orders booked in that quarter and firm purchase orders released in that quarter by customers under agreements containing non-binding purchase commitments. Many of our customers require prompt delivery of products. This results in a limited backlog of orders for these products and requires us to maintain sufficient inventory levels to satisfy anticipated customer demand. If near-term demand for our products declines, or if potential sales in any quarter do not occur as anticipated, our financial results could be adversely affected. Operating expenses are relatively fixed in the short term; therefore, a shortfall in quarterly revenues could significantly impact our financial results in a given quarter. Maintaining sufficient inventory levels to assure prompt delivery of our products increases the amount of inventory that may become obsolete and increases the risk that the obsolescence of this inventory may have an adverse effect on our business and operating results. Also, not maintaining sufficient inventory levels to assure prompt delivery of our products may cause us to incur expediting costs to meet customer delivery requirements which may impact our operating results in a given quarter.

Our operating results may also fluctuate as a result of a number of other factors, including increased competition, customer order patterns, changes in product mix, timing differences between price decreases and product cost reductions, product warranty returns, and announcements of new products by us or our competitors. Accordingly, our historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that our financial results may vary from period to period. A list of factors that could materially affect our business, financial condition or operating results is included under Factors That Could Affect Our Future Results in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Item 2 of Part I of this report. These factors have also been discussed in more detail in Item 1A of Part I in our most recent Annual Report on Form 10-K filed on February 28, 2008 with the SEC.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our critical accounting policies and estimates have not changed significantly from those detailed in our most recent Annual Report on Form 10-K for the year ended December 31, 2007.

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EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS

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

RESULTS OF OPERATIONS THREE MONTHS ENDED MARCH 31, 2008 COMPARED TO THREE MONTHS ENDED MARCH 31, 2007

SALES

ADTRAN's sales increased 8.7% from \$110.3 million in the three months ended March 31, 2007 to \$119.9 million in the three months ended March 31, 2008. The increase in sales is primarily attributable to an \$11.6 million increase in sales of our Carrier System products. Carrier Systems product sales increased due to a \$10.3 million increase in Broadband Access product sales, primarily attributable to increased shipments of our 1100 series fiber-to-the-node products and our Total Access 5000 platform. Carrier Systems products sales also increased due to a \$2.5 million increase in Optical Access product sales, resulting from increased shipments of our Opti-6100 products and market share gains across numerous customers including the top three U.S. carriers. Partially offsetting these increases in Carrier System product sales were decreases in shipments of traditional TDM products as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Broadband Access and Optical Access product areas.

Business Networking product sales increased \$1.5 million in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 due to a \$3.8 million increase in Internetworking product sales, primarily as a result of increased product shipments due to our efforts to improve our focus on addressing traditional enterprise channels and leveraging our carrier distribution channels. Partially offsetting this increase in Internetworking product sales was a decline in shipments of traditional IAD products as customers shifted to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales decreased \$3.6 million in the three months ended March 31, 2008 compared to the three months ended March 31, 2007 primarily due to a 4.1% or \$1.8 million decrease in HDSL product revenues and declines in Enterprise T1 product sales.

Carrier Networks sales increased 12.0% from \$84.4 million in the three months ended March 31, 2007 to \$94.5 million in the three months ended March 31, 2008. The increase is primarily attributable to the aforementioned increases in Broadband Access and Optical Access product sales, partially offset by declines in HDSL and other TDM product sales.

Enterprise Networks sales decreased 1.9% from \$25.9 million in the three months ended March 31, 2007 to \$25.4 million in the three months ended March 31, 2008. The decrease is primarily attributable to the aforementioned declines in sales of traditional IAD products and Enterprise T1 products, partially offset by increased sales of Internetworking products. Enterprise Networks sales as a percentage of total sales decreased from 23.5% for the three months ended March 31, 2007 to 21.2% for the three months ended March 31, 2008.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, decreased 18.0% from \$7.8 million in the three months ended March 31, 2007 to \$6.4 million in the t