ANNUAL REPORT 2011

11


**Annual Revenue**
(In millions)


**Annual Earnings Per Share**
(Diluted)


**Gross Margin**


**Unrestricted Cash and Marketable Securities**
(In millions)

## Consolidated Statements of Income Data

*(In thousands, except per share amounts)*

| Years Ended December 31 | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Total sales** | $717,229 | $605,674 | $484,185 |
| **Income before provision for income taxes** | $206,142 | $168,189 | $107,568 |
| **Net income** | $138,577 | $113,989 | $74,221 |
| **Earnings per common share** (Diluted) | $2.12 | $1.78 | $1.17 |

## Consolidated Balance Sheets Data

*(In thousands)*

| Years Ended December 31 | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Working capital**[4] | $329,311 | $304,952 | $278,044 |
| **Total assets** | $817,514 | $691,974 | $564,463 |
| **Stockholders' equity** | $692,131 | $572,322 | $452,515 |

[1] Net of $16 million in stock repurchases and $22 million in dividend payments during 2009

[2] Net of $18 million in stock repurchases and $23 million in dividend payments during 2010

[3] Net of $36 million in stock repurchases and $23 million in dividend payments during 2011

[4] Working capital consists of current assets less current liabilities

# Letter
## to Shareholders

**2011 was a fantastic year for ADTRAN®,** with nearly all areas of the company setting new all-time records. Revenue of $717 million marked a new record for the company, up 18 percent over the prior year. Other company records included operating income of $189 million, up 23 percent, sales per employee at $412,912, and cash flow from operations of $151 million, up 62 percent. Finally, international revenues, a major focus of ours, grew 165 percent reaching a record $84 million. We ended the year with Earnings per Share (diluted) of $2.12 up 19 percent over the previous year.

Even more importantly during the year, we expanded our role as a major provider of communications solutions to both businesses and service providers around the globe. We substantially increased our customer base in both our Enterprise and Carrier segments and launched new initiatives focused on increasing the importance of our core product areas. These areas, which include Broadband Access, Optical Access and Internetworking, posted combined year-over-year growth of 48 percent and now comprise 73 percent of our total company revenue.

### Balanced Performance

Our Carrier Networks Division reported another outstanding year, with growth of 20 percent over the previous year. Core products for this division comprised almost 70 percent of Carrier Networks revenue, representing a revenue increase of 56 percent over 2010. This growth was led by our Broadband Access area which grew a strong 65 percent (to $290 Million). Optical Access followed, growing 25 percent for the company (to $82.5 million) over the previous year.

Our Enterprise Networks Division success was driven by the solid growth of our internetworking solutions which grew 36 percent for the company over the previous year. Growth was broad-based with Unified Communications (UC), Ethernet Switches, IP Business Gateways, and Router products all experiencing double-digit growth during the year. Also of note, was the growth across all our Enterprise distribution channels with both direct (service provider) and indirect (distribution/dealers) segments showing solid growth throughout the year.

### Focus Leads to Success

Our focus on three key areas drove our business in 2011, and we believe that they will continue to be the catalyst for growth in our industry for years to come. Broadband Connectivity, Mobility and Cloud Computing are driving an infrastructure upgrade not seen in the technology industry since the emergence of the personal computer and the Internet. As these technologies become widely adopted they will change the way business is conducted driving productivity, efficiency and profitability. They will fuel our customers' focus on bandwidth, connectivity, unified communications, and business process improvement.

### #1 Market Share in Broadband

For the first time in our history, we achieved the number one market share positions in both broadband DSL and Multi-Service Access Platforms (MSAP) in North America. Our global market share rankings climbed to the top three and top four positions for broadband DSL and MSAP, respectively.[1]

This success was built upon several years of focused effort by all areas of the company, and this focus continues. The strategic moves during 2011 in areas such as product development, our sales organization, and our planned acquisition of Nokia Siemens Networks Broadband Access (BBA) business are all significant steps to position us to achieve greater success in the years ahead.

In product development, two major areas of our success have come from the significant extension of our Ultra Broadband portfolio and the introduction of our Optical Networking Edge (ONE™) products. Our Ultra Broadband solutions allow service providers to economically deploy high capacity optical broadband solutions deep into neighborhoods. Our ONE product line "resizes" packet optical technology to redefine the boundaries of the access network. With these newer technologies, we have delivered solutions to the industry that allow service providers to offer up to 100 Mbps broadband services to residential communities and surrounding businesses.

At ADTRAN, we have a strong track record and proven recipe for entering targeted markets and rapidly gaining dominant market share. The latest example is our move over the past 2.5 years to expand our strong market position with Tier 1 and Tier 2 service providers to include targeting the smaller service providers in the Tier 3 market. In 2011, we

1 *Infonetics Research*

made significant progress by adding over 150 new service provider customers to our base of over 1,200 customers and growing our Fiber-To-The-Home customers fivefold.

In December, we announced our plans to acquire the Nokia Siemens Networks Broadband Access business. The Nokia Siemens Networks Broadband business brings an incumbent customer base of carriers across over 20 countries from Europe, Middle East, Africa, India, Russia and Asia. In addition to a very complementary broadband access product portfolio tailored for these markets, the Broadband Access business includes a strong team of up to approximately 400 people, including engineering, R&D, sales and professional services employees expected to transfer to ADTRAN globally. The agreement also includes provisions which would allow existing ADTRAN solutions to be incorporated by Nokia Siemens Networks into its customer propositions, broadening our business opportunities. This planned acquisition will significantly accelerate our plans for global expansion, regional diversity and global market leadership. ADTRAN combined with the Nokia Siemens Networks BBA business moves our company to the top two MSAP and the top two broadband DSL global market share positions.[2]

### Mobility and Cloud Computing

At ADTRAN, Cloud and Mobility go hand in hand. Mobility drives business productivity by enabling pervasive access through mobile devices: smart phones, tablets, and laptops. This application driven ecosystem of the mobile device world is essentially cloud-based with applications providing access to vast amounts of data and capability in the cloud. Network scale, speed and connectivity have therefore become paramount in our cloud and mobility driven world. Our Carrier Networks solutions are instrumental in enabling higher speed connectivity to business customers as well as high capacity backhaul solutions for mobile networks.

During the past year, we expanded our Enterprise Networks wireless networking portfolio with the acquisition of Boston-based start-up, Bluesocket®, Inc. Bluesocket developed the industry's first virtual Wireless LAN (vWLAN®) solution that enables limitless scale, security and sustainability for wireless networks. Mobility continues to drive the need for availability, security, reliability and bandwidth to businesses. We enable service providers to meet these needs with an industry-leading portfolio of Cloud Connectivity solutions that connect businesses to the public and/or private cloud.

In 2011, our Enterprise Networks Cloud Connectivity solutions gained even broader adoption as more service providers created new ADTRAN NetVanta® based service bundles for the delivery of cloud service offerings. Our Cloud Connectivity solutions continue to hold the top market share position in North America and we continue to gain meaningful market share as a top provider of branch office routers.

As CIOs continue to leverage the significant capacity and peaking efficiencies of virtualized servers, businesses gain significant scale and cost advantages from cloud services. With businesses embracing high speed cloud connectivity, wireless networking, and mobility, as well as becoming more reliant on cloud-based hosted services, we are well positioned to enable our service provider and reseller partners to compete with highly differentiated solutions.

## Investment in Channels and People

At ADTRAN, we have long been known for our investment in research and development. This past year was no exception. During 2011, we invested more than $100 million in R&D activities, an increase of 11 percent over 2010. Through this investment, we have continued to build our expertise, and strengthened our reputation as a strong engineering company driving worldwide industry standards.

In addition to our focus on R&D, we clearly see that one of the fundamental keys to our long term growth resides in the development of our channels to market. With that in mind, we invested heavily in our Enterprise channel and significantly increased our Enterprise channel sales team to provide greater support to our 3,000 plus value-added resellers and distribution partners. Our channel development programs resulted in broader partner support, better enabling us to focus on our partners' unique business needs and models. In addition, we launched a comprehensive Partner Enablement Program that provides a robust set of tools to prepare new partners for success and re-energize those that may be under performing. Through these and other initiatives we increased productivity in the top tiers of our channel partner community in excess of 24 percent.

2 *Infonetics Research*

## The Right Markets

Over the past 25 years we have managed our company with a long term perspective for investment and growth. With this thought in mind, we have developed our plans and strategy to focus on markets and opportunities with sustained growth potential. The Broadband, Mobility and the Cloud markets will all have tremendous growth for the foreseeable future and fit perfectly with our technology direction and key core company competencies.

As broadband has become critical for global competitiveness and economic prosperity, many countries around the world have launched broadband stimulus programs. As an example, in the U.S., Congress launched a $7.2 billion broadband stimulus program to fund broadband build-outs in rural communities. In Europe, the European Union (EU) set an objective to ensure that all 500 million EU residents have broadband access at speeds of 30 Mbps or greater by the year 2020, with at least half of those broadband connections delivering ultra-fast speeds of over 100 Mbps. The continued investment in broadband will be a combination of private and public funding. In another example, the Federal Communications Commission (FCC) issued an Order at the end of 2011 to reform the Universal Service Fund (USF), repurposing $4.5 billion per year for broadband expansion. Over the remainder of this decade we will continue to see significant capital investment in broadband infrastructure as businesses and consumers demand greater broadband speeds and availability around the globe.

Mobility and Cloud services will continue to transform business and communications. Mobile data usage is poised to grow greater than 15 times over the next three years.[3] The adoption of public cloud services and products is estimated to be a $56 billion market by 2014.[4] . Our focus on these continuing transitions with investments in research and development, products, and services will uphold our position as a key supplier to service providers worldwide as they also adapt to these trends. The mobile business is driven by bandwidth, connectivity, and communications. We expect these key productivity drivers to continue to remake networks within both service providers and businesses.

## Solid Financial Management and Stability

At ADTRAN, we place the upmost importance on sound financial management and stability. Despite weakness in the economy and instability experienced by many in our industry, our focus on these areas has enabled the company to remain financially solid, with strong profitability, and a healthy return on investment for our stockholders. Our business model and strong management team have allowed us to maintain a steady cash flow, healthy profitability and $476.2 million in unrestricted cash and marketable securities. Earnings in 2011 were $139 million, with fully diluted earnings per share of $2.12. Our gross margins remained strong at 57.8 percent and we provided $23.1 million in dividend payouts to our stockholders. With a proven business model and a growing number of revenue opportunities, we are well positioned for long-term growth and profitability.

**Tom Stanton**
Chairman and Chief Executive Officer

*3 Yankee Group*
*4 IDC Research*

# Financial Results



This annual report contains forward-looking statements which reflect management's best judgment based on factors currently known. However, these statements involve risks and uncertainties, including the successful development and market acceptance of new products, the degree of competition in the market for such products, the product and channel mix, component costs, manufacturing efficiencies, and other risks detailed in our annual report on Form 10-K for the year ended December 31, 2011. These risks and uncertainties could cause actual results to differ materially from those in the forward-looking statements included in this annual report.

# Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

ADTRAN's common stock is traded on the NASDAQ Global Select Market under the symbol ADTN. As of February 2, 2012, ADTRAN had 243 stockholders of record and approximately 16,400 beneficial owners of shares held in street name. The following table shows the high and low closing prices per share for our common stock as reported by NASDAQ for the periods indicated.

### Common Stock Prices

| 2011 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| High | $47.24 | $43.20 | $42.55 | $34.30 |
| Low | $36.28 | $37.31 | $26.46 | $25.99 |
| **2010** | **First Quarter** | **Second Quarter** | **Third Quarter** | **Fourth Quarter** |
| High | $26.95 | $29.60 | $35.30 | $36.38 |
| Low | $20.96 | $25.35 | $27.04 | $30.96 |

The following table shows the dividends paid in each quarter of 2011 and 2010. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

### Dividends per Common Share

| 2011 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| | $0.09 | $0.09 | $0.09 | $0.09 |
| **2010** | **First Quarter** | **Second Quarter** | **Third Quarter** | **Fourth Quarter** |
| | $0.09 | $0.09 | $0.09 | $0.09 |

### Stock Repurchases

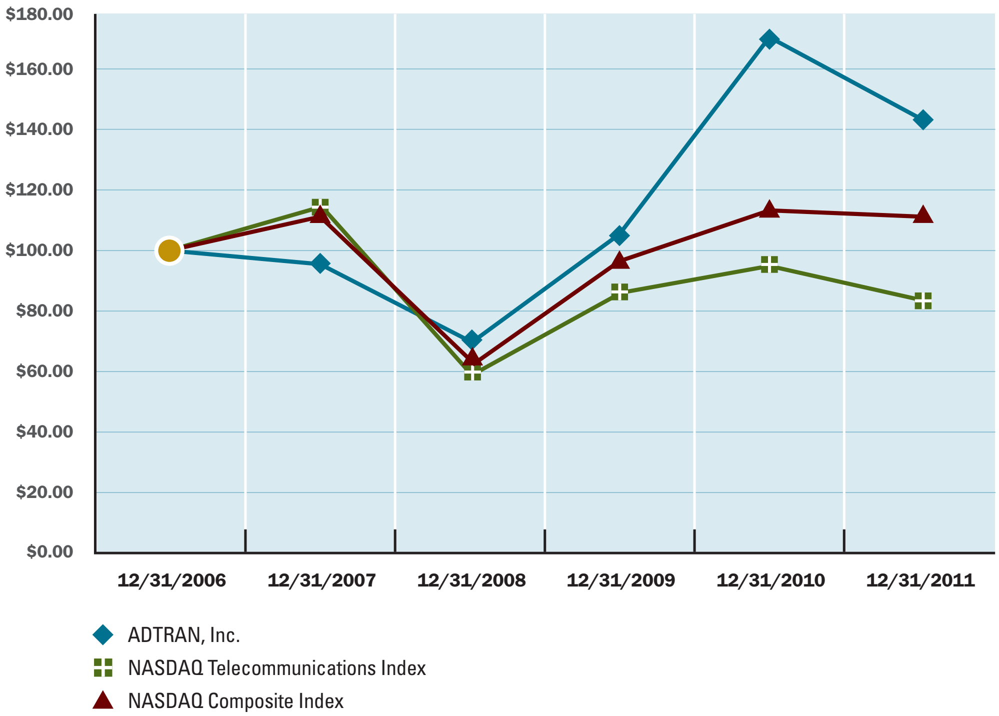
The following table sets forth repurchases of our common stock for the months indicated.

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1) | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| October 1, 2011 – October 31, 2011 | — | — | — | 5,869,425 |
| November 1, 2011 – November 30, 2011 | 12,463 | $31.02 | 12,463 | 5,856,962 |
| December 1, 2011 – December 31, 2011 | — | — | — | 5,856,962 |
| **Total** | **12,463** | | **12,463** | |

*(1) On April 14, 2008, ADTRAN's Board of Directors approved the repurchase of up to 5,000,000 shares of its common stock. This plan is being implemented through open market purchases from time to time as conditions warrant. On October 11, 2011, our Board of Directors approved additional repurchases of up to 5,000,000 shares of our common stock. Upon completion of the current plan, this plan will be implemented through open market purchases from time to time as conditions warrant.*

# Stock Performance Graph

Our common stock began trading on the NASDAQ National Market on August 9, 1994. The price information reflected for our common stock in the following performance graph and accompanying table represents the closing sales prices of the common stock for the period from December 31, 2006 through December 31, 2011, on an annual basis. The graph and the accompanying table compare the cumulative total stockholders' return on our common stock with the NASDAQ Telecommunications Index and the NASDAQ Composite Index. The calculations in the following graph and table assume that $100 was invested on December 31, 2006 in each of our common stock, the NASDAQ Telecommunications Index and the NASDAQ Composite Index and also assume dividend reinvestment.




| | 12/31/06 | 12/31/07 | 12/31/08 | 12/31/09 | 12/31/10 | 12/31/11 |
|---|---|---|---|---|---|---|
| ADTRAN, Inc. | $100.00 | $95.58 | $67.76 | $104.53 | $170.07 | $143.06 |
| NASDAQ Telecommunications Index | $100.00 | $113.32 | $61.52 | $85.61 | $94.28 | $83.51 |
| NASDAQ Composite Index | $100.00 | $110.26 | $65.65 | $95.19 | $112.10 | $110.81 |

# Selected Financial Data

## Income Statement Data (1)

*(In thousands, except per share amounts)*

| Year Ended December 31, | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| **Sales** | | | | | |
| Carrier Networks Division | $569,579 | $476,030 | $371,349 | $392,219 | $358,023 |
| Enterprise Networks Division | 147,650 | 129,644 | 112,836 | 108,457 | 118,755 |
| **Total sales** | **717,229** | **605,674** | **484,185** | **500,676** | **476,778** |
| Cost of sales | 302,911 | 246,811 | 197,223 | 201,771 | 193,792 |
| **Gross profit** | **414,318** | **358,863** | **286,962** | **298,905** | **282,986** |
| Selling, general and administrative expenses | 124,879 | 114,699 | 99,446 | 103,286 | 103,329 |
| Research and development expenses | 100,301 | 90,300 | 83,285 | 81,819 | 75,367 |
| **Operating income** | **189,138** | **153,864** | **104,231** | **113,800** | **104,290** |
| Interest and dividend income | 7,642 | 6,557 | 6,933 | 8,708 | 11,521 |
| Interest expense | (2,398) | (2,436) | (2,430) | (2,514) | (2,502) |
| Net realized investment gain (loss) | 12,454 | 11,008 | (1,297) | (2,409) | 498 |
| Other income (expense), net | (694) | (804) | 131 | 688 | 764 |
| Life insurance proceeds | — | — | — | — | 1,000 |
| **Income before provision for income taxes** | **206,142** | **168,189** | **107,568** | **118,273** | **115,571** |
| Provision for income taxes | (67,565) | (54,200) | (33,347) | (39,692) | (39,236) |
| **Net income** | **$138,577** | **$113,989** | **$74,221** | **$78,581** | **$76,335** |

| Year Ended December 31, | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| Weighted average shares outstanding—basic | 64,145 | 62,490 | 62,459 | 63,549 | 67,848 |
| Weighted average shares outstanding—assuming dilution (2) | 65,416 | 63,879 | 63,356 | 64,408 | 69,212 |
| Earnings per common share—basic | $2.16 | $1.82 | $1.19 | $1.24 | $1.13 |
| Earnings per common share—assuming dilution (2) | $2.12 | $1.78 | $1.17 | $1.22 | $1.10 |
| Dividends declared and paid per common share | $0.36 | $0.36 | $0.36 | $0.36 | $0.36 |

## Balance Sheet Data

*(In thousands)*

| At December 31, | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| Working capital (3) | $329,311 | $304,952 | $278,044 | $212,740 | $251,261 |
| Total assets | $817,514 | $691,974 | $564,463 | $473,615 | $479,220 |
| Total debt | $47,000 | $48,000 | $48,250 | $48,750 | $49,000 |
| Stockholders' equity | $692,131 | $572,322 | $452,515 | $375,819 | $378,431 |

*(1) Net income for 2011, 2010, 2009, 2008 and 2007 includes stock-based compensation expense under the Stock Compensation Topic of the Financial Accounting Standards Board Accounting Standards Codification of $7.8 million, $7.1 million, $6.4 million, $6.7 million and $7.1 million, respectively, net of tax, related to stock option awards. See Note 3 of Notes to the Consolidated Financial Statements.*

*(2) Assumes exercise of dilutive stock options calculated under the treasury method. See Notes 1 and 13 of Notes to Consolidated Financial Statements.*

*(3) Working capital consists of current assets less current liabilities.*

# Management's Discussion and Analysis of Financial Condition and Results of Operations

## Overview

ADTRAN, Inc. designs, manufactures and markets solutions and provides services and support for communications networks. Our solutions are widely deployed by providers of communications services (serviced by our Carrier Networks Division), and Small and Mid-sized Enterprises (SMEs) (serviced by our Enterprise Networks Division), and enable voice, data, video and Internet communications across wireline and wireless networks. Many of these solutions are currently in use by every major United States and many global service providers, as well as by many public, private and governmental organizations worldwide.

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

Our three major product categories are:

- Carrier Systems
- Business Networking
- Loop Access.

**Carrier Systems** products are used by communications service providers to provide data, voice and video services to consumers and enterprises. The Carrier Systems category includes our broadband access products comprised of Total Access® 5000 multi-service access and aggregation platform products, Total Access 1100/1200 Series Fiber-To-The-Node (FTTN) products, Ultra Broadband Ethernet (UBE) and Digital Subscriber Line Access Multiplexer (DSLAM) products. Our broadband access products are used by service providers to deliver high-speed Internet access, Voice over Internet Protocol (VoIP), IP Television (IPTV), and/or Ethernet services from the 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 and transceivers including those used in our Optical Networking Edge (ONE) products, NetVanta 8000 series products, and our family of OPTI products. Optical access products are used to deliver higher bandwidth services, aggregate large numbers of low bandwidth services, or transport wavelength services across a fiber optic infrastructure. Total Access 1500 products, 303 concentrator products, M13 multiplexer products, and a number of mobile backhaul products are also included in the Carrier Systems product category.

**Business Networking** products provide access to telecommunication services, facilitating the delivery of converged services and Unified Communications to the SME market. The Business Networking category includes Internetworking products and Integrated Access Devices (IADs). Internetworking products consist of our Total Access IP Business Gateways, Optical Network Terminals (ONTs), virtual Wireless LAN (vWLAN) products and NetVanta product lines. NetVanta products include multi-service routers, managed Ethernet switches, IP Private Branch Exchange (PBX) products, IP phone products, Unified Communications solutions, Unified Threat Management (UTM) solutions, and Carrier Ethernet Network Terminating Equipment (NTE). IAD products consist of our Total Access 600 Series and the Total Access 850.

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

In addition, we identify subcategories of product revenues, which we divide into our core products and legacy products. Our core products consist of Broadband Access and Optical Access products (included in Carrier Systems) and Internetworking products (included in Business Networking) and our legacy products include HDSL products (included in Loop Access) and other products not included in the aforementioned core products. Many of our customers are migrating their networks to deliver higher bandwidth services by utilizing newer technologies. We believe that products and services offered in our core product areas position us well for this migration. Despite occasional increases, we anticipate that revenues of many of our legacy products, including HDSL, will decline over time; however, revenues from these products may continue for years because of the time required for our customers to transition to newer technologies.

Sales were $717.2 million in 2011 compared to $605.7 million in 2010 and $484.2 million in 2009. Sales increased in each of our core areas, Broadband Access, Optical Access and Internetworking. Total sales of products in these three core areas increased 48.2% in 2011 compared to 2010 and 40.2% in 2010 compared to 2009. Our gross profit margin for the Company decreased to 57.8% in 2011 from 59.3% in 2010 and 2009. Our operating income margin increased to 26.4% in 2011 compared to 25.4% in 2010 and 21.5% in 2009. Net income was $138.6 million in 2011 compared to $114.0 million in 2010 and $74.2 million in 2009. Earnings per share, assuming dilution, were $2.12 in 2011 compared to $1.78 in 2010 and $1.17 in 2009. Earnings per share in 2011, 2010 and 2009 include the effect of the repurchase of 1.1 million, 0.7 million and 0.8 million shares of our stock in those years, respectively.

Our operating results have fluctuated on a quarterly basis in the past, and may vary significantly in future periods due to a number of factors, including customer order activity and backlog. Backlog levels vary because of seasonal trends, the timing of customer projects and other factors that affect customer order lead times. Many of our customers require prompt delivery of products. This 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.

Our operating results may also fluctuate as a result of a number of other factors, including a decline in general economic and market conditions, increased competition, customer order patterns, changes in product and services mix, timing differences between price decreases and product cost reductions, product warranty returns, expediting costs and announcements of new products by us or our competitors. Additionally, maintaining sufficient inventory levels to assure prompt delivery of our products increases the amount of inventory that may become obsolete and increases the risk that the obsolescence of this inventory may have an adverse effect on our business and operating results. Also, not maintaining sufficient inventory levels to assure prompt delivery of our products may cause us to incur expediting costs to meet customer delivery requirements, which may negatively impact our operating results in a given quarter.

Accordingly, our historical financial performance is not necessarily a meaningful indicator of future results, and, in general, management expects that our financial results may vary from period to period. See Note 14 of Notes to Consolidated Financial Statements for additional information. For a discussion of risks associated with our operating results, see Item 1A of this report.

## Critical Accounting Policies and Estimates

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

- We review customer contracts to determine if all of the requirements for revenue recognition have been met prior to recording revenues from sales transactions. We generally record sales revenue upon shipment of our products, net of any rebates or discounts, since: (i) we generally do not have significant post-delivery obligations, (ii) the product price is fixed or determinable, (iii) collection of the resulting receivable is probable, and (iv) product returns are reasonably estimable. We generally ship products upon receipt of a purchase order from a customer. We evaluate shipping terms and we record revenue on products shipped in accordance with the terms of each respective contract where applicable, or under our standard shipping terms for purchase orders accepted without a contract, generally FOB shipping point. In the case of consigned inventory, revenue is recognized when the customer assumes ownership of the product. Contracts that contain multiple deliverables are evaluated to determine the units of accounting, and the revenue from the arrangement is allocated to each item requiring separate revenue recognition based on the relative selling price and corresponding terms of the contract. We strive to use vendor-specific objective evidence of selling price. When this evidence is not available, we are generally not able to determine third-party evidence of selling price because of the extent of customization among competing products or services from other companies. We record revenue associated with installation services when all contractual obligations are complete. Contracts that include both installation services and product sales are evaluated for revenue recognition in accordance with contract terms. As a result, depending on contract terms, installation services may be considered as a separate deliverable item or may be considered an element of the delivered product. Either the purchaser, ADTRAN, or a third party can perform installation of our products. Revenues related to maintenance services are recognized on a straight line basis over the contract term.

- Sales returns are accrued based on historical sales return experience, which we believe provides a reasonable estimate of future returns. A significant portion of Enterprise Networks products are sold in the United States through a non-exclusive distribution network of major technology distributors. These organizations then distribute to an extensive network of value-added resellers and system integrators. Value-added resellers and system integrators may be affiliated with us as a channel partner, or they may purchase from the distributor on an unaffiliated basis. Additionally, with certain limitations, our distributors may return unused and unopened product for stock-balancing purposes when these returns are accompanied by offsetting orders for products of equal or greater value.

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

Prior to issuing payment terms to a new customer, we perform a detailed credit review of the customer. Credit limits and payment terms are established for each new customer based on the results of this credit review. Collection experience is reviewed periodically in order to determine if the customer's payment terms and credit limits need to be revised. We maintain allowances for doubtful accounts for losses resulting from the inability of our customers to make required payments. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, we may be required to make additional allowances. If circumstances change with regard to individual receivable balances that have previously been determined to be uncollectible (and for which a specific reserve has been established), a reduction in our allowance for doubtful accounts may be required. Our allowance for doubtful accounts was $8 thousand at December 31, 2011 and $0.2 million at December 31, 2010.

- We carry our inventory at the lower of cost or market, with cost being determined using the first-in, first-out method. We use standard costs for material, labor, and manufacturing overhead to value our inventory. Our standard costs are updated on at least a quarterly basis and any variances are expensed in the current period; therefore, our inventory costs approximate actual costs at the end of each reporting period. We write down our inventory for estimated obsolescence or unmarketable inventory by an amount equal to the difference between the cost of inventory and the estimated fair value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, we may be required to make additional inventory write-downs. Our reserve for excess and obsolete inventory was $9.4 million and $8.9 million at December 31, 2011 and 2010, respectively. Inventory write-downs charged to the reserve were $0.7 million, $0.8 million and $1.7 million for the years ended December 31, 2011, 2010 and 2009, respectively.

- The objective of our short-term investment policy is to preserve principal and maintain adequate liquidity with appropriate diversification, while achieving market returns. The objective of our long-term investment policy is principal preservation and total return; that is, the aggregate return from capital appreciation, dividend income, and interest income. These objectives are achieved through investments with appropriate diversification in fixed and variable rate income securities, public equity, and private equity portfolios. Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio. We have experienced significant volatility in the market prices of our publicly traded equity investments. These investments are recorded on the consolidated balance sheets at fair value with unrealized gains and losses reported as a component of accumulated other comprehensive income, net of tax. The ultimate realized value on these equity investments is subject to market price volatility.

In accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC, we have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows:

Level 1—Values based on unadjusted quoted prices for identical assets or liabilities in an active market; Level 2—Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability; Level 3—Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs include information supplied by investees. At December 31, 2011, we categorized $39.7 million and $401.2 million of our available-for-sale investments as Level 1 and Level 2, respectively, and $13.7 million of our cash equivalents as Level 1. At December 31, 2010, we categorized $53.0 million and $315.3 million of our available-for-sale investments as Level 1 and Level 2, respectively, and $14.5 million of our cash equivalents as Level 1.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of $36 thousand during the fourth quarter of 2011. For the years ended December 31, 2011, 2010 and 2009, we recorded charges of $68 thousand, $43 thousand and $2.9 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities, a fixed income bond fund, and deferred compensation plan assets. Actual losses, if any, could ultimately differ from these estimates. Future adverse changes in market conditions or poor operating results of underlying investments could result in additional losses that may not be reflected in an investment's current carrying value, thereby possibly requiring an impairment charge in the future. See Note 4 of Notes to the Consolidated Financial Statements in this report for more information about our investments.

We also invest in privately held entities and private equity funds and record these investments at cost. We review these investments periodically in order to determine if circumstances (both financial and non-financial) exist that indicate that we will not recover our initial investment. Impairment charges are recorded on investments having a cost basis that is greater than the value that we would reasonably expect to receive in an arm's length sale of the investment. We have not been required to record any impairment losses relating to these investments in 2011, 2010 or 2009.

- For purposes of determining the estimated fair value of our stock option awards on the date of grant under the Stock Compensation Topic of the FASB ASC, we use the Black-Scholes Model. This model requires the input of certain assumptions that require subjective judgment. These assumptions include, but are not limited to, expected stock price volatility over the term of the awards and actual and projected employee stock option exercise behaviors. Because our stock option awards have characteristics significantly different from those of traded options, and because changes in the input assumptions can materially affect the fair value estimate, the existing model may not provide a reliable single measure of the fair value of our stock option awards. For purposes of determining the estimated fair value of our performance-based restricted stock unit awards on the date of grant, we use a Monte Carlo Simulation valuation method. The restricted stock units are subject to a market condition based on the relative total shareholder return of ADTRAN against a peer group of companies (2009 grant) or against all companies in the NASDAQ Telecommunications Index (2010 and 2011 grants) and vest at the end of a three-year performance period. The fair value of restricted stock issued to our Directors in 2011 is equal to the closing price of our stock on the date of grant. Management will continue to assess the assumptions and methodologies used to calculate the estimated fair value of stock-based compensation. Circumstances may change and additional data may become available over time, which could result in changes to these assumptions and methodologies and thereby materially impact our fair value determination. If factors change and we use different assumptions in the application of the Stock Compensation Topic of the FASB ASC in future periods, the compensation expense that we record may differ significantly from what we have recorded in the current period.
- We estimate our income tax provision or benefit in each of the jurisdictions in which we operate, including estimating exposures related to examinations by taxing authorities. We also make judgments regarding the realization of deferred tax assets, and establish reserves where we believe it is more likely than not that future taxable income in certain jurisdictions will be insufficient to realize these deferred tax assets in accordance with the Income Taxes Topic of the FASB ASC. Our estimates regarding future taxable income and income tax provision or benefit may vary due to changes in market

conditions, changes in tax laws, or other factors. If our assumptions, and consequently our estimates, change in the future, the valuation allowances we have established may be increased or decreased, impacting future income tax expense. At December 31, 2011 and 2010 respectively, the valuation allowance was $7.6 million and $5.6 million. As of December 31, 2011, we have state research tax credit carry-forwards of $2.7 million, which will expire between 2015 and 2026. These carry-forwards were caused by tax credits in excess of our annual tax liabilities to an individual state where we no longer generate sufficient state income. In addition, as of December 31, 2011, we have a deferred tax asset of $5.2 million relating to net operating loss carry-forwards which will expire between 2012 and 2030. These carry-forwards are the result of an acquisition in 2009 and another in 2011. The acquired net operating losses are in excess of the amount of estimated earnings. In accordance with the Income Taxes Topic of the FASB ASC, we believe it is more likely than not that we will not realize the full benefits of our deferred tax asset arising from these credits and net operating losses, and accordingly, have provided a valuation allowance against them. This valuation allowance is included in non-current deferred tax liabilities in the accompanying balance sheets.

- Our products generally include warranties of one to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty returns totaled $4.1 million and $3.3 million at December 31, 2011 and 2010, respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets.
- We use the acquisition method to account for business combinations. Under the acquisition method of accounting, we recognize the assets acquired and liabilities assumed at their fair value on the acquisition date. Goodwill is measured as the excess of the consideration transferred over the net assets acquired. The acquisition method of accounting requires us to exercise judgment and make significant estimates and assumptions regarding the fair value of the assets acquired and liabilities assumed, including the fair values of inventory, deferred revenue, identifiable intangible assets and deferred tax asset valuation allowances. This method also requires us to refine these estimates over a one-year measurement period to reflect information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the asset and liabilities recorded on that date, which could affect our net income.
- We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If we determine that the two-step quantitative test is necessary, then we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. There were no impairment losses during 2011.

## Results of Operations

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

| Year Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Sales** | | | |
| Carrier Networks Division | 79.4% | 78.6% | 76.7% |
| Enterprise Networks Division | 20.6 | 21.4 | 23.3 |
| **Total sales** | **100.0%** | **100.0%** | **100.0%** |
| Cost of sales | 42.2 | 40.7 | 40.7 |
| **Gross profit** | **57.8** | **59.3** | **59.3** |
| Selling, general and administrative expenses | 17.4 | 19.0 | 20.5 |
| Research and development expenses | 14.0 | 14.9 | 17.2 |
| **Operating income** | **26.4** | **25.4** | **21.6** |
| Interest and dividend income | 1.1 | 1.1 | 1.4 |
| Interest expense | (0.3) | (0.4) | (0.5) |
| Net realized investment gain (loss) | 1.7 | 1.8 | (0.3) |
| Other income (expense), net | (0.1) | (0.1) | — |
| **Income before provision for income taxes** | **28.7** | **27.8** | **22.2** |
| Provision for income taxes | (9.4) | (9.0) | (6.9) |
| **Net income** | **19.3%** | **18.8%** | **15.3%** |

## Acquisition Expenses

On August 4, 2011, we closed on the acquisition of Bluesocket, Inc. and on December 12, 2011, we announced the planned acquisition of the Nokia Siemens Networks Broadband Access business. Acquisition related expenses, amortizations and adjustments for the twelve months ended December 31, 2011 for both transactions are as follows:

| *(In Thousands)* | 2011 |
|---|---|
| **Bluesocket, Inc. Acquisition** | |
| Acquisition related professional fees and travel expenses | $730 |
| Amortization of acquired intangible assets | 495 |
| Amortization and adjustments of other acquisition related non-cash items | 521 |
| **Subtotal** | **$1,746** |
| *Planned NSN BBA acquisition* | |
| Acquisition related professional fees, travel and other expenses | 2,027 |
| **Total acquisition related expenses, amortizations and adjustments** | **$3,773** |
| **Tax effect** | **(1,434)** |
| **Total acquisition related expenses, amortizations and adjustments, net of tax** | **$2,339** |

The acquisition related expenses, amortizations and adjustments above were recorded in the following Consolidated Statements of Income categories for the twelve months ended December 31, 2011:

| *(In Thousands)* | **2011** |
|---|---|
| Revenue (adjustments to deferred revenue recognized in the period) | $362 |
| Cost of goods sold | 165 |
| **Subtotal** | **$527** |
| Selling, general and administrative expenses | 2,557 |
| Research and development expenses | 689 |
| **Subtotal** | **$3,246** |
| **Total acquisition related expenses, amortizations and adjustments** | **$3,773** |
| **Tax effect** | **(1,434)** |
| **Total acquisition related expenses, amortizations and adjustments, net of tax** | **$2,339** |

## 2011 Compared to 2010

### Sales

ADTRAN's sales increased 18.4% from $605.7 million in 2010 to $717.2 million in 2011. This increase in sales is primarily attributable to a $113.7 million increase in sales of our Broadband Access products, a $40.4 million increase in sales of our Internetworking products, a $16.3 million increase in sales of our Optical Access products, partially offset by a $58.8 million decrease in sales of our HDSL and other legacy products.

Carrier Networks sales increased 19.7% from $476.0 million in 2010 to $569.6 million in 2011. The increase is primarily attributable to increases in Broadband Access, Optical Access and Internetworking NTE product sales, partially offset by a decrease in HDSL and other legacy product sales.

Enterprise Networks sales increased 13.9% from $129.6 million in 2010 to $147.7 million in 2011. The increase is primarily attributable to an increase in sales of Internetworking products, partially offset by decreases in sales of legacy products. Internetworking product sales attributable to Enterprise Networks were 87.4% of the division's sales in 2011 compared with 77.3% in 2010. Legacy products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales decreased from 21.4% in 2010 to 20.6% in 2011.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 165.3% from $31.8 million in 2010 to $84.4 million in 2011. International sales, as a percentage of total sales, increased from 5.3% in 2010 to 11.8% in 2011. The increase in international sales in 2011 was primarily due to an increase in sales to Latin America, Asia-Pacific and Europe regions.

Carrier Systems product sales increased $131.0 million in 2011 compared to 2010 primarily due to a $113.7 million increase in Broadband Access product sales and a $16.3 million increase in Optical Access product sales. The increase in Broadband Access product sales was primarily attributable to continued growth in deployments of our Total Access 5000 and Fiber-to-the-Node platforms.

Business Networking product sales increased $35.0 million in 2011 compared to 2010 primarily due to a $40.4 million increase in Internetworking product sales across both divisions, partially offset by a $5.8 million decrease in legacy product sales. The decrease in sales of legacy products is a result of customers shifting to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales decreased $54.4 million in 2011 compared to 2010 primarily due to a $50.3 million decrease in HDSL product sales.

### Cost of Sales

As a percentage of sales, cost of sales increased from 40.7% in 2010 to 42.2% in 2011. The increase was primarily the result of higher services related revenue including cabinet shipments, and specific customer price movements related to market share expansion. These effects were partially offset by cost absorption and manufacturing efficiencies achieved at the higher production volumes.

Carrier Networks cost of sales increased from 40.5% of sales in 2010 to 42.4% of sales in 2011. The increase in Carrier Networks cost of sales as a percentage of sales was primarily attributable to higher services related revenue including cabinet shipments, and specific customer price movements related to market share expansion.

Enterprise Networks cost of sales decreased from 41.7% of sales in 2010 to 41.4% of sales in 2011. The decrease in Enterprise Networks cost of sales as a percentage of sales was primarily attributable to cost absorption and manufacturing efficiencies achieved at higher production volumes.

An important part of our strategy is to reduce the product cost of each succeeding product generation and then to lower the product's price based on the cost savings achieved. This may cause variations in our gross profit percentage due to timing differences between the recognition of cost reductions and the lowering of product selling prices.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses increased 8.9% from $114.7 million in 2010 to $124.9 million in 2011. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing, and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, trade show expenses, and related travel costs. The increase in selling, general and administrative expenses is primarily related to increases in staffing and fringe benefit costs due to increased headcount, contract services, professional services, recruiting expenses and travel expenses. These increases included expenses related to Bluesocket, Inc., which was acquired on August 4, 2011, and the announced planned acquisition of Nokia Siemens Networks Broadband Access business.

Selling, general and administrative expenses as a percentage of sales decreased from 18.9% for the year ended December 31, 2010 to 17.4% for the year ended December 31, 2011. Selling, general and administrative expenses as a percent of sales will generally fluctuate whenever there is a significant fluctuation in revenues for the periods being compared.

**Research and Development Expenses**

Research and development expenses increased 11.1% from $90.3 million in 2010 to $100.3 million in 2011. The increase in research and development expense is primarily related to increases in staffing and fringe benefit costs due to increased headcount. These increases included research and development expenses related to Bluesocket, Inc., and amortization of intangible assets related to the acquisition of Bluesocket, Inc.

Research and development expenses as a percentage of sales decreased from 14.9% for the year ended December 31, 2010 to 14.0% for the year ended December 31, 2011. Research and development expenses as a percentage of sales will fluctuate whenever there are incremental product development activities or a significant fluctuation in revenues for the periods being compared.

We expect to continue to incur research and development expenses in connection with our new and existing products and our expansion into international markets. We continually evaluate new product opportunities and engage in intensive research and product development efforts which provide for new product development, enhancement of existing products and product cost reductions. We may incur significant research and development expenses prior to the receipt of revenues from a major new product group.

**Interest and Dividend Income**

Interest and dividend income increased 16.5% from $6.6 million in 2010 to $7.6 million in 2011. This increase was primarily attributable to a 19.9% increase in our average investment balances, partially offset by a 22.6% reduction in the average rate of return on our investments as a result of lower interest rates.

**Interest Expense**

Interest expense remained consistent at $2.4 million in 2011 and 2010, as we had no substantial change in our fixed rate borrowing. See "Liquidity and Capital Resources" below for additional information.

**Net Realized Investment Gain (Loss)**

Net realized investment gain (loss) increased from an $11.0 million gain in 2010 to a $12.5 million gain in 2011. This change is related to a $0.7 million increase related to sales of marketable equity securities and an increase of $0.8 million related to distributions from two private equity funds. See "Investing Activities" in "Liquidity and Capital Resources" below for additional information.

**Other Income (Expense), net**

Other income (expense), net, comprised primarily of miscellaneous income, gains and losses on foreign currency transactions, investment account management fees, and gains or losses on the disposal of property, plant and equipment occurring in the normal course of business, decreased from $0.8 million of expense in 2010 to $0.7 million of expense in 2011.

### Income Taxes

Our effective tax rate increased from 32.2% in 2010 to 32.8% in 2011. This increase is primarily due to the reduced impact of available statutory tax benefits applied to the increased level of pretax income in 2011. The statutory benefits include the research tax credit, deduction for domestic manufacturing under Internal Revenue Code Section 199 and stock option related tax benefits.

### Net Income

As a result of the above factors, net income increased from $114.0 million in 2010 to $138.6 million in 2011. As a percentage of sales, net income increased from 18.8% in 2010 to 19.3% in 2011.

## 2010 Compared to 2009

### Sales

ADTRAN's sales increased 25.1% from $484.2 million in 2009 to $605.7 million in 2010. This increase in sales is primarily attributable to a $64.6 million increase in sales of our Broadband Access products, a $31.1 million increase in sales of our Internetworking products, a $27.0 million increase in sales of our HDSL products, and a $5.6 million increase in our Optical Access products, partially offset by a $4.2 million decrease in traditional IAD products and a $2.6 million decrease in enterprise T1 products.

Carrier Networks sales increased 28.2% from $371.3 million in 2009 to $476.0 million in 2010. The increase is primarily attributable to increases in Broadband Access, Optical Access, TDM, HDSL and Internetworking NTE product sales, partially offset by a decrease in other traditional products.

Enterprise Networks sales increased 14.9% from $112.8 million in 2009 to $129.6 million in 2010. The increase is primarily attributable to an increase in Enterprise Networks related Internetworking product sales, partially offset by decreases in IAD and enterprise T1 product sales. Internetworking product sales were 77.3% of Enterprise Network sales in 2010 compared with 67.4% in 2009. Traditional products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales decreased from 23.3% in 2009 to 21.4% in 2010.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 14.6% from $27.8 million in 2009 to $31.8 million in 2010. International sales, as a percentage of total sales, decreased from 5.7% in 2009 to 5.3% in 2010. The increase in international sales in 2010 was primarily attributable to an increase in sales in Australia, Mexico and Europe, partially offset by a decrease in sales in Canada.

Carrier Systems product sales increased $73.6 million in 2010 compared to 2009 primarily due to a $64.6 million increase in Broadband Access product sales and a $5.6 million increase in Optical Access product sales. The increase in Broadband Access product sales was primarily attributable to continued growth in deployments of our TA 5000 platform and Fiber to the Node products resulting from market share gains across all major market segments.

Business Networking product sales increased $26.8 million in 2010 compared to 2009 primarily due to an increase in Internetworking product sales. Growth in Internetworking product sales occurred across all areas, including routers, Ethernet switches, IP gateways, access termination products and our IP PBX segment as a result of market share gains in SME and distributed enterprise applications. This increase was partially offset by a decrease in traditional IAD product sales as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales increased $21.1 million in 2010 compared to 2009 primarily due to a $27.0 million increase in HDSL product sales, partially offset by decreases in other traditional product sales. The increase in HDSL product sales is primarily attributable to carriers increasing investment to cost effectively and quickly add capacity to mobility networks.

### Cost of Sales

Cost of sales remained consistent in 2010 and 2009 at 40.7% of sales. Gross margins benefited from improved product mix, cost absorption and manufacturing efficiencies achieved at the higher production volumes, offset by higher warranty expense and an increase in lower gross margin installation services related revenue. However, installation services related revenue was accretive to operating income margins in 2010.

Carrier Networks cost of sales decreased from 40.8% of sales in 2009 to 40.5% of sales in 2010. The decrease was primarily related to improved cost absorption and manufacturing efficiencies achieved at the higher production volumes, which was partially offset by an increase in lower margin installation services revenue.

Enterprise Networks cost of sales increased from 40.4% of sales in 2009 to 41.7% of sales in 2010. The increase was primarily related to a higher cost product mix and the impact of cost allocations between divisions.

An important part of our strategy is to reduce the product cost of each succeeding product generation and then to lower the product's price based on the cost savings achieved. This may cause variations in our gross profit percentage due to timing differences between the recognition of cost reductions and the lowering of product selling prices.

### Selling, General and Administrative Expenses

Selling, general and administrative expenses increased 15.3% from $99.4 million in 2009 to $114.7 million in 2010. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing, and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, trade show expenses, and related travel costs. The increase in selling, general and administrative expenses was primarily related to an increase in staffing costs and fringe benefits due to increased headcount, and increases in incentive compensation, contract services and travel expenses.

Selling, general and administrative expenses as a percentage of sales decreased from 20.5% for the year ended December 31, 2009 to 18.9% for the year ended December 31, 2010. Selling, general and administrative expenses as a percent of sales will generally fluctuate whenever there is a significant fluctuation in revenues for the periods being compared.

### Research and Development Expenses

Research and development expenses increased 8.4% from $83.3 million in 2009 to $90.3 million in 2010. The increase in research and development expenses was a result of increased staffing costs and fringe benefits, engineering and testing expense primarily related to customer specific product development activities as well as costs related to product approvals, primarily for one or more of the top three U.S. carriers.

Research and development expenses as a percentage of sales decreased from 17.2% for the year ended December 31, 2009 to 14.9% for the year ended December 31, 2010. Research and development expenses as a percentage of sales will fluctuate whenever there are incremental product development activities or a significant fluctuation in revenues for the periods being compared.

We expect to continue to incur research and development expenses in connection with our new and existing products and our expansion into international markets. We continually evaluate new product opportunities and engage in intensive research and product development efforts which provides for new product development, enhancement of existing products and product cost reductions. We may incur significant research and development expenses prior to the receipt of revenues from a major new product group.

### Interest and Dividend Income

Interest and dividend income decreased 5.4% from $6.9 million in 2009 to $6.6 million in 2010. This decrease was primarily attributable to a 22.2% reduction in the average rate of return on our investments as a result of lower interest rates, partially offset by a 23.7% increase in our average investment balances.

### Interest Expense

Interest expense remained consistent at $2.4 million in 2010 and 2009, as we had no substantial change in our fixed rate borrowing. See "Liquidity and Capital Resources" below for additional information.

### Net Realized Investment Gain (Loss)

Net realized investment gain (loss) changed from a $1.3 million loss in 2009 to an $11.0 million gain in 2010. This change is primarily a result of the other-than-temporary impairments of $2.0 million related to our marketable equity securities, $0.4 million related to our investment in a fixed income bond fund, and $0.5 million related to our deferred compensation plan assets in 2009 and the realized gains of $8.1 million on the sale of one security and $1.6 million from the sale of previously impaired marketable equity securities in 2010. See "Investing Activities" in "Liquidity and Capital Resources" below for additional information.

### Other Income (Expense), net

Other income (expense), net, comprised primarily of miscellaneous income, gains and losses on foreign currency transactions, investment account management fees, and gains or losses on the disposal of property, plant and equipment occurring in the normal course of business, changed from $0.1 million of income in 2009 to $0.8 million of expense in 2010.

### Income Taxes

Our effective tax rate increased from 31.0% in 2009 to 32.2% in 2010. This increase is primarily due to the reduced impact of available statutory tax benefits applied to the increased level of pretax income in 2010. The statutory benefits include the research and development tax credit, deduction for domestic manufacturing under Internal Revenue Code Section 199 and stock option related tax benefits.

### Net Income

As a result of the above factors, net income increased from $74.2 million in 2009 to $114.0 million in 2010. As a percentage of sales, net income increased from 15.3% in 2009 to 18.8% in 2010.

## Liquidity and Capital Resources

### Liquidity

We intend to finance our operations with cash flow from operations. We have used, and expect to continue to use, the cash generated from operations for working capital, purchases of treasury stock, dividend payments, and other general corporate purposes, including (i) product development activities to enhance our existing products and develop new products and (ii) expansion of sales and marketing activities. We believe our cash and cash equivalents, investments and cash generated from operations to be adequate to meet our operating and capital needs for the foreseeable future.

At December 31, 2011, cash on hand was $43.0 million and short-term investments were $159.3 million, which placed our short-term liquidity at $202.3 million. At December 31, 2010, our cash on hand of $31.7 million and short-term investments of $157.5 million placed our short-term liquidity at $189.2 million. The increase in liquidity from 2010 to 2011 relates to additional funds provided by our operating activities and proceeds from stock option exercises by our employees, reduced by our cash needs for equipment acquisitions, business acquisition, stock repurchases and dividends.

### Operating Activities

Our working capital, which consists of current assets less current liabilities, increased 8.0% from $305.0 million as of December 31, 2010 to $329.3 million as of December 31, 2011, primarily due to an increase in cash of $11.3 million, an increase in inventory of $13.5 million, an increase in accounts receivable of $5.2 million, and an increase in other receivables of $5.8 million, partially offset by an increase in accounts payable of $6.6 million. Generally, the change in net accounts receivable is due to the timing of sales and collections during the quarter. Inventory increased during 2011 to support increasing customer demand, increases in inventories related to an increase in installation services activities, and to mitigate component supply constraints broadly affecting the industry. Generally, the change in other receivables is due to the timing of shipments and collections for materials supplied to our contract manufacturers during the quarter. Generally, the change in accounts payable is due to variations in the timing of the receipt of supplies, inventory and services and our subsequent payments for these purchases. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 5.21 as of December 31, 2010 to 4.50 as of December 31, 2011. The current ratio, defined as current assets divided by current liabilities, decreased from 7.10 as of December 31, 2010 to 6.32 as of December 31, 2011. The quick ratio and the current ratio decreases were primarily due to the working capital changes described above.

Net accounts receivable increased 7.4% from $70.9 million at December 31, 2010 to $76.1 million at December 31, 2011. Our allowance for doubtful accounts decreased from $0.2 million at December 31, 2010 to $8 thousand at December 31, 2011. Quarterly accounts receivable days sales outstanding (DSO) increased from 39 days as of December 31, 2010 to 40 days as of December 31, 2011. Generally, the change in net accounts receivable and DSO is due to the timing of sales and collections during the quarter. Other receivables increased from $4.0 million at December 31, 2010 to $9.7 million at December 31, 2011. Other receivables may fluctuate due to the timing of shipments and collections for materials supplied to our contract manufacturers during the quarter.

Quarterly inventory turnover decreased from 3.8 turns as of December 31, 2010 to 3.5 turns as of December 31, 2011. Inventory increased 18.2% from December 31, 2010 to December 31, 2011. Our investment in inventory increased during 2011 to support increasing customer demand, increases in inventories related to an increase in installation services activities, and to mitigate component supply constraints broadly affecting the industry. We expect inventory levels to fluctuate as we attempt to maintain sufficient inventory in response to seasonal cycles of our business; ensuring competitive lead times while managing the risk of inventory obsolescence that may occur due to rapidly changing technology and customer demand.

Accounts payable increased 29.0% from $22.8 million at December 31, 2010 to $29.4 million at December 31, 2011. Generally, the change in accounts payable is due to variations in the timing of the receipt of supplies, inventory and services and our subsequent payments for these purchases.

### Investing Activities

Capital expenditures totaled approximately $11.9 million, $9.9 million and $8.7 million for the years ended December 31, 2011, 2010 and 2009, respectively. These expenditures were primarily used to purchase computer hardware, software and manufacturing and test equipment.

Our combined short-term and long-term investments increased $72.7 million from $418.6 million at December 31, 2010 to $491.4 million at December 31, 2011. This increase reflects the impact of additional funds available for investment provided by our operating activities and proceeds from stock option exercises by our employees, reduced by our cash needs for equipment acquisitions, business acquisition, stock repurchases and dividends, as well as net realized and unrealized losses and amortization of net premiums on our combined investments.

We invest all available cash not required for immediate use in operations primarily in securities that we believe bear minimal risk of loss. At December 31, 2011, these investments included municipal variable rate demand notes of $69.7 million, municipal fixed-rate bonds of $174.8 million and corporate bonds of $156.8 million. At December 31, 2010, these investments included municipal variable rate demand notes of $116.7 million, municipal fixed-rate bonds of $71.5 million and corporate bonds of $127.1 million.

At December 31, 2011, we held $69.7 million of municipal variable rate demand notes, all of which were classified as available-for-sale. At December 31, 2011, 18% of our municipal variable rate demand notes had a credit rating of AAA, 58% had a credit rating of AA, 24% had a credit rating of A, and all contained put options of seven days. Despite the long-term nature of their stated contractual maturities, we routinely buy and sell these securities and we believe that we have the ability to quickly liquidate them. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. We believe we have the ability to sell our variable rate demand notes to the remarketing agent, tender agent or issuer at par value plus accrued interest in the event we decide to liquidate our investment in a particular variable rate demand note. At December 31, 2011, approximately 34% of our variable rate demand notes were supported by letters of credit from banks that we believe to be in good financial condition. The remaining 66% of our variable rate demand notes were supported by standby purchase agreements. As a result of these factors, 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 recorded any losses relating to municipal variable rate demand notes.

At December 31, 2011, we held $174.8 million of municipal fixed-rate bonds. These bonds are classified as available-for-sale and had an average duration of 1.3 years at December 31, 2011. At December 31, 2011, approximately 19% of our municipal fixed-rate bond portfolio had a credit rating of AAA, 64% had a credit rating of AA, 15% had a credit rating of A, and 2% had a credit rating of BBB. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

At December 31, 2011, we held $156.8 million of corporate bonds. These bonds are classified as available-for-sale and had an average duration of 0.8 years. At December 31, 2011, approximately 1% of our corporate bond portfolio had a credit rating of AAA, 11% had a credit rating of AA, 50% had a credit rating of A, and 38% had a credit rating of BBB. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

Our long-term investments increased 27.1% from $261.2 million at December 31, 2010 to $332.0 million at December 31, 2011. The primary reasons for the increase in our long-term investments were cash generated from operations and proceeds from stock option exercises by our employees. Long-term investments at December 31, 2011 and December 31, 2010 included an investment in a certificate of deposit of $48.3 million, which serves as collateral for our revenue bonds, as discussed below. We have various equity investments included in long-term investments at a cost of $12.8 million and $11.5 million, and with a fair value of $31.3 million and $48.0 million, at December 31, 2011 and December 31, 2010, respectively, including a single equity security, of which we held 1.1 million shares and 1.5 million shares, carried at $17.3 million and $34.2 million of fair value at December 31, 2011 and December 31, 2010, respectively. The single security traded approximately 0.8 million shares per day in 2011 in an active market on a European stock exchange. Of the gross unrealized gains included in the fair value of our marketable securities at December 31, 2011 and 2010, this single security comprised $16.9 million and $33.7 million, respectively, of the unrealized gain. The remaining $2.2 million of gross unrealized gains and $0.6 million in gross unrealized losses at December 31, 2011 were spread amongst more than 400 marketable equity securities. Long-term investments at December 31, 2011 and 2010 also included $7.7 million and $4.2 million, respectively, related to our deferred compensation plan; $2.1 million of other investments carried at cost, consisting of interests in two private equity funds and an investment in a privately held telecommunications equipment manufacturer; and $0.7 million of a fixed income bond fund. This bond fund had unrealized gains of $0.2 million at December 31, 2011 and 2010.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of $36 thousand during the fourth quarter of 2011. For the years ended December 31, 2011, 2010 and 2009 we recorded charges of $68 thousand, $43 thousand and $2.9 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities, a fixed income bond fund, and deferred compensation plan assets.

On August 4, 2011, we acquired all of the outstanding stock of Bluesocket, Inc., a provider of wireless network solutions with virtual control, for $23.7 million in cash. The acquisition provides us with IEEE802.11N enterprise class wireless LAN expertise, technology, and products to address the growing transition within small-medium enterprises and large enterprises to wireless networks and mobile devices. We have included the financial results of Bluesocket in our consolidated financial statements since the date of acquisition.

**Financing Activities**

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the "Authority"). Pursuant to the program, on January 13, 1995, the Authority issued $20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the "Bondholder"), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to $50.0 million. An Amended and Restated Taxable Revenue Bond ("Amended and Restated Bond") was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 5% per annum. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond at December 31, 2011 was approximately $46.9 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A+. We are required to make payments to the Authority in amounts necessary to pay the principal of and interest on the Amended and Restated Bond. Included in long-term investments at December 31, 2011 is $48.3 million which is invested in a restricted certificate of deposit. These funds serve as a collateral deposit against the principal of this bond, and we have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness. In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. For the years ended December 31, 2011, 2010 and 2009, we realized economic incentives related to payroll withholdings totaling $1.9 million, $1.5 million and $1.5 million, respectively.

Due to continued positive cash flow from operating activities, we made a business decision in 2006 to begin an early partial redemption of the Bond. We made principal payments of $1.0 million and $0.3 million for the years ended December 31, 2011 and 2010, respectively. It is our intent to make annual principal payments in addition to the interest amounts that are due. In connection with this decision, $0.5 million of the bond debt has been reclassified to a current liability in accounts payable in the Consolidated Balance Sheets at December 31, 2011 and 2010.

The following table shows dividends paid in each quarter of 2011, 2010 and 2009. During 2011, 2010 and 2009, we paid dividends totaling $23.1 million, $22.5 million and $22.5 million, respectively. The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the present tax treatment of dividends exists and adequate levels of liquidity are maintained.

## Dividends per Common Share

| 2011 | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| | $0.09 | $0.09 | $0.09 | $0.09 |
| **2010** | **First Quarter** | **Second Quarter** | **Third Quarter** | **Fourth Quarter** |
| | $0.09 | $0.09 | $0.09 | $0.09 |
| **2009** | **First Quarter** | **Second Quarter** | **Third Quarter** | **Fourth Quarter** |
| | $0.09 | $0.09 | $0.09 | $0.09 |

### Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 35 million shares of our common stock. We currently have the authority to purchase an additional 5.9 million shares of our common stock under the plans approved by the Board of Directors on April 14, 2008 and October 11, 2011. For the years 2011, 2010 and 2009, we repurchased 1.1 million shares, 0.7 million shares and 0.8 million shares, respectively, for a cost of $35.6 million, $18.3 million and $15.9 million, respectively, at an average price of $31.97, $25.12 and $21.05 per share, respectively.

To accommodate employee stock option exercises, we issued 1.8 million shares of treasury stock for $34.1 million during the year ended December 31, 2011, 1.5 million shares of treasury stock for $24.9 million during the year ended December 31, 2010, and 0.9 million shares of treasury stock for $13.5 million during the year ended December 31, 2009.

### Off-Balance Sheet Arrangements and Contractual Obligations

We have various contractual obligations and commercial commitments. The following table sets forth, in millions, the annual payments we are required to make under contractual cash obligations and other commercial commitments at December 31, 2011.

## Contractual Obligations

| *(In millions)* | Total | 2012 | 2013 | 2014 | 2015 | After 2015 |
|---|---|---|---|---|---|---|
| Long-term debt | $47.0 | $— | $— | $— | $— | $47.0 |
| Interest on long-term debt | 18.8 | 2.4 | 2.4 | 2.4 | 2.4 | 9.2 |
| Purchase obligations | 69.6 | 67.5 | 1.5 | 0.6 | — | — |
| Operating lease obligations | 5.0 | 2.0 | 1.2 | 1.0 | 0.7 | 0.1 |
| Investment commitments | 0.2 | 0.1 | 0.1 | — | — | — |
| **Totals** | **$140.6** | **$72.0** | **$5.2** | **$4.0** | **$3.1** | **$56.3** |

We are required to make payments necessary to pay the interest on the Taxable Revenue Bond, Series 1995, as amended, currently outstanding in the aggregate principal amount of $47.0 million. The bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. Included in long-term investments are $48.3 million of restricted funds, which is a collateral deposit against the principal amount of this bond.

We have committed to invest up to an aggregate of $7.9 million in two private equity funds, and we have contributed $8.4 million as of December 31, 2011, of which $7.7 million has been applied to these commitments. See Note 4 of Notes to Consolidated Financial Statements for additional information.

We also have obligations related to uncertain income tax positions that have not been included in the table above due to the uncertainty of when the related expense will be recognized. See Note 9 of Notes to Consolidated Financial Statements for additional information.

We do not have off-balance sheet financing arrangements and have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of or requirements for capital resources. See Notes 8 and 12 of Notes to Consolidated Financial Statements for additional information on our revenue bond and operating lease obligations, respectively.

## Effect of Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 requires companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. While ASU 2011-05 changes the presentation of comprehensive income, it does not change the components that are recognized in net income or comprehensive income under current accounting guidance. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We plan to adopt this amendment during the first quarter of 2012. Since ASU 2011-05 affects presentation only, it will have no effect on our consolidated results of operations or financial condition.

In December 2011, the FASB issued Accounting Standards Update No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12). ASU 2011-12 defers the effective date for certain presentation requirements that relate to reclassification adjustments and the effect of those reclassification adjustments on the financial statements. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We plan to adopt this amendment during the first quarter of 2012. Since ASU 2011-12 affects presentation only, it will have no effect on our consolidated results of operations or financial condition.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. The amendments are of two types: (i) those that clarify the Board's intent about the application of existing fair value measurement and disclosure requirements and (ii) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This update is effective for annual periods beginning after December 15, 2011. We do not expect the adoption of this amendment will have a material impact on our consolidated results of operations or financial condition.

During 2011, we adopted the following accounting standards, which had no material effect on our consolidated results of operations or financial condition:

In October 2009, the FASB issued Accounting Standards Update No. 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13). ASU 2009-13 provides amendments to the criteria in Subtopic 605-25 of the ASC for separating consideration in multiple-deliverable arrangements. As a result of those amendments, multiple-deliverable arrangements are separated in more circumstances than under previously existing U.S. GAAP. ASU 2009-13 established a selling price hierarchy for determining the selling price of a deliverable and replaced the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. ASU 2009 -13 also eliminated the residual method of allocation and required that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method and required that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis.

We generally sell our products and services separately, but in some circumstances products and services may be sold in bundles that contain multiple deliverables. A sale that includes multiple deliverables is evaluated to determine the units of accounting, and the revenue from the arrangement is allocated to each item requiring separate revenue recognition based on the relative selling price and corresponding terms of the contract. We strive to use vendor-specific objective evidence of selling price. When this evidence is not available, we are generally not able to determine third-party evidence of selling price because of the extent of customization among competing products or services from other companies. In these cases, estimated selling price is determined based on the particular circumstances of the arrangement and is used to allocate revenues to each unit of accounting. Revenue is recognized incrementally as the necessary criteria for each item are met.

We adopted this amendment during the first quarter of 2011. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the year ended December 31, 2011.

In October 2009, the FASB issued Accounting Standards Update No. 2009-14, Certain Revenue Arrangements that Include Software Arrangements. ASU 2009-14 changed the accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality are no longer within the scope of the software revenue guidance in Subtopic 985-605 of the ASC. In addition, ASU 2009-14 requires that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. In that regard, ASU 2009-14 provides additional guidance on how to determine which software, if any, relating to the tangible product also would be excluded from the scope of the software revenue guidance. ASU 2009-14 also provides guidance on how a vendor should allocate arrangement consideration to deliverables in an arrangement that includes both tangible products and software. ASU 2009-14 also provides further guidance on how to allocate arrangement consideration when an arrangement includes deliverables both included and excluded from the scope of the software revenue guidance. We adopted this amendment during the first quarter of 2011. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the year ended December 31, 2011.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Testing Goodwill for Impairment (ASU 2011-08). Existing accounting guidance requires that an entity perform a test for goodwill impairment, on at least an annual basis, by first comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit is less than its carrying amount, then the second step of the test is to be performed to measure the amount of impairment loss, if any. ASU 2011-08 will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity will no longer be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We adopted this amendment during the fourth quarter of 2011. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the year ended December 31, 2011.

## Subsequent Events

On January 17, 2012, the Board declared a quarterly cash dividend of $0.09 per common share to be paid to stockholders of record at the close of business on February 2, 2012. The quarterly dividend payment was $5.7 million and was paid on February 16, 2012.

## Quantitative and Qualitative Disclosures About Market Risk

We are exposed to financial market risks, including changes in interest rates and prices of marketable equity and fixed-income securities. The primary objective of the large majority of our investment activities is to preserve principal while at the same time achieving appropriate yields without significantly increasing risk. To achieve this objective, a majority of our marketable securities are investment grade, municipal, fixed-rate bonds, municipal variable rate demand notes and municipal money market instruments denominated in United States dollars. Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio. At December 31, 2011, 18% of our municipal variable rate demand notes had a credit rating of AAA, 58% had a rating of AA, and 24% had a credit rating of A, and all contained put options of seven days. At December 31, 2011, approximately 19% of our municipal fixed-rate bonds had a credit rating of AAA, 64% had a credit rating of AA, 15% had a credit rating of A, and the remaining 2% had a credit rating of BBB. At December 31, 2011, approximately 1% of our corporate bond portfolio had a credit rating of AAA, 11% had a credit rating of AA, 50% had a credit rating of A, and 38% had a credit rating of BBB.

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of December 31, 2011, $23.4 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

As of December 31, 2011, approximately $417.4 million of our cash and investments may be directly affected by changes in interest rates. We have performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps) for an entire year, while all other variables remain constant. At December 31, 2011, we held $180.7 million of cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes where a change in interest rates would impact our interest income. A hypothetical 50 bps decline in interest rates as of December 31, 2011 would reduce annualized interest income on our cash, money market instruments, floating rate corporate bonds and municipal variable rate demand notes by approximately $0.7 million. In addition, we held $322.4 million of municipal and corporate bonds whose fair values may be directly affected by a change in interest rates. A hypothetical 50 bps increase in interest rates as of December 31, 2011 would reduce the fair value of our municipal and corporate bonds by approximately $1.7 million.

As of December 31, 2010, interest income on approximately $333.3 million of our cash and investments was subject to being directly affected by changes in interest rates. We performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 bps for an entire year, while all other variables remain constant. A hypothetical 50 bps decline in interest rates as of December 31, 2010 would have reduced annualized interest income on our money market instruments and municipal variable rate demand notes by approximately $0.5 million. In addition, a hypothetical 50 bps increase in interest rates as of December 31, 2010 would have reduced the fair value of our municipal fixed-rate bonds and corporate bonds by approximately $1.7 million.

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

# Management's Report on Internal Control over Financial Reporting

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

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

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

Management assessed the effectiveness of ADTRAN's internal control over financial reporting as of December 31, 2011. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*.

Based on our assessment and those criteria, management has concluded that ADTRAN maintained effective internal control over financial reporting as of December 31, 2011.

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

# Report of Independent Registered Public Accounting Firm

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

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of ADTRAN, Inc. and its subsidiaries at December 31, 2011 and December 31, 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report On Internal Control Over Financial Reporting. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Birmingham, Alabama
February 29, 2012

# Financial Statements

## ADTRAN, INC.

### Consolidated Balance Sheets

December 31, 2011 and 2010

*(In thousands, except per share amounts)*

| Assets | 2011 | 2010 |
|---|---|---|
| **Current Assets** | | |
| Cash and cash equivalents | $42,979 | $31,677 |
| Short-term investments | 159,347 | 157,479 |
| Accounts receivable, less allowance for doubtful accounts of $8 and $162 at December 31, 2011 and 2010, respectively | 76,130 | 70,893 |
| Other receivables | 9,743 | 3,962 |
| Income tax receivable, net | — | 2,741 |
| Inventory | 87,800 | 74,274 |
| Prepaid expenses | 3,119 | 3,270 |
| Deferred tax assets, net | 12,125 | 10,617 |
| **Total Current Assets** | **391,243** | **354,913** |
| Property, plant and equipment, net | 75,295 | 73,986 |
| Deferred tax assets, net | 8,345 | — |
| Goodwill | 3,492 | — |
| Other assets | 7,131 | 1,915 |
| Long-term investments | 332,008 | 261,160 |
| **Total Assets** | **$817,514** | **$691,974** |
| **Liabilities and Stockholders' Equity** | | |
| **Current Liabilities** | | |
| Accounts payable | $29,404 | $22,785 |
| Unearned revenue | 9,965 | 10,138 |
| Accrued expenses | 5,876 | 4,913 |
| Accrued wages and benefits | 13,518 | 12,125 |
| Income tax payable, net | 3,169 | — |
| **Total Current Liabilities** | **61,932** | **49,961** |
| Deferred tax liabilities, net | — | 10,350 |
| Other non-current liabilities | 16,951 | 11,841 |
| Bonds payable | 46,500 | 47,500 |
| **Total Liabilities** | **125,383** | **119,652** |
| Commitments and contingencies (see Note 12) | | |
| **Stockholders' Equity** | | |
| Common stock, par value $0.01 per share; 200,000 shares authorized; 79,652 shares issued and 63,703 shares outstanding at December 31, 2011 and 79,652 shares issued and 63,010 shares outstanding at December 31, 2010 | 797 | 797 |
| Additional paid-in capital | 213,560 | 193,866 |
| Accumulated other comprehensive income | 13,102 | 26,948 |
| Retained earnings | 840,206 | 731,962 |
| Less treasury stock at cost: 15,949 and 16,642 shares at December 31, 2011 and 2010, respectively | (375,534) | (381,251) |
| **Total Stockholders' Equity** | **692,131** | **572,322** |
| **Total Liabilities and Stockholders' Equity** | **$817,514** | **$691,974** |

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

## ADTRAN, INC.

### Consolidated Statements of Income

Years ended December 31, 2011, 2010 and 2009

| *(In thousands, except per share amounts)* | 2011 | 2010 | 2009 |
|---|---|---|---|
| Sales | $717,229 | $605,674 | $484,185 |
| Cost of sales | 302,911 | 246,811 | 197,223 |
| **Gross Profit** | **414,318** | **358,863** | **286,962** |
| Selling, general and administrative expenses | 124,879 | 114,699 | 99,446 |
| Research and development expenses | 100,301 | 90,300 | 83,285 |
| **Operating Income** | **189,138** | **153,864** | **104,231** |
| Interest and dividend income | 7,642 | 6,557 | 6,933 |
| Interest expense | (2,398) | (2,436) | (2,430) |
| Net realized investment gain (loss) | 12,454 | 11,008 | (1,297) |
| Other income (expense), net | (694) | (804) | 131 |
| **Income before provision for income taxes** | **206,142** | **168,189** | **107,568** |
| Provision for income taxes | (67,565) | (54,200) | (33,347) |
| **Net Income** | **$138,577** | **$113,989** | **$ 74,221** |
| Weighted average shares outstanding—basic | 64,145 | 62,490 | 62,459 |
| Weighted average shares outstanding—diluted (1) | 65,416 | 63,879 | 63,356 |
| Earnings per common share—basic | $2.16 | $1.82 | $1.19 |
| Earnings per common share—diluted (1) | $2.12 | $1.78 | $1.17 |

*(1) Assumes exercise of dilutive stock options calculated under the treasury method. See Notes 1 and 13 of the Notes to Consolidated Financial Statements*

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

## ADTRAN, INC.

### Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income

Years ended December 31, 2011, 2010 and 2009

| *(In thousands)* | Common Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2008** | **79,652** | **$797** | **$172,704** | **$603,600** | **$(400,273)** | **$(1,009)** | **$375,819** |
| Net income | | | | 74,221 | | | 74,221 |
| Net change in unrealized gains (losses) related to marketable securities, net of deferred tax expense of $9,218 | | | | | | 15,384 | 15,384 |
| Reclassification adjustment for amounts included in net income, net of deferred tax expense of $617 | | | | | | 1,010 | 1,010 |
| Foreign currency translation adjustment | | | | | | 2,468 | 2,468 |
| **Comprehensive Income** | | | | | | | **93,083** |
| Dividend payments | | | | (22,486) | | | (22,486) |
| Dividends accrued for unvested restricted stock units | | | | (12) | | | (12) |
| Stock options exercised: Various prices per share | | | | (6,067) | 19,538 | | 13,471 |
| Purchase of treasury stock: 755 shares | | | | | (15,896) | | (15,896) |
| Income tax benefit from exercise of stock options | | | 1,549 | | | | 1,549 |
| Stock-based compensation expense | | | 6,987 | | | | 6,987 |
| **Balance, December 31, 2009** | **79,652** | **$797** | **$181,240** | **$649,256** | **$(396,631)** | **$17,853** | **$452,515** |
| Net income | | | | 113,989 | | | 113,989 |
| Net change in unrealized gains (losses) related to marketable securities, net of deferred tax expense of $5,223 | | | | | | 8,700 | 8,700 |
| Reclassification adjustment for amounts included in net income, net of deferred tax benefit of $598 | | | | | | (999) | (999) |
| Foreign currency translation adjustment | | | | | | 1,394 | 1,394 |
| **Comprehensive Income** | | | | | | | **123,084** |
| Dividend payments | | | | (22,502) | | | (22,502) |
| Dividends accrued for unvested restricted stock units | | | | (27) | | | (27) |
| Stock options exercised: Various prices per share | | | | (8,754) | 33,696 | | 24,942 |
| Purchase of treasury stock: 729 shares | | | | | (18,316) | | (18,316) |
| Income tax benefit from exercise of stock options | | | 4,909 | | | | 4,909 |
| Stock-based compensation expense | | | 7,717 | | | | 7,717 |
| **Balance, December 31, 2010** | **79,652** | **$797** | **$193,866** | **$731,962** | **$(381,251)** | **$26,948** | **$572,322** |

## ADTRAN, INC.

### Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income

Years ended December 31, 2011, 2010 and 2009

*Continued*

| *(In thousands)* | Common Shares | Common Stock | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2010** | **79,652** | **$797** | **$193,866** | **$731,962** | **$(381,251)** | **$26,948** | **$572,322** |
| Net income | | | | 138,577 | | | 138,577 |
| Net change in unrealized gains (losses) related to marketable securities, net of deferred tax benefit of $7,427 | | | | | | (13,004) | (13,004) |
| Reclassification adjustment for amounts included in net income, net of deferred tax benefit of $389 | | | | | | (688) | (688) |
| Foreign currency translation adjustment | | | | | | (154) | (154) |
| **Comprehensive Income** | | | | | | | **124,731** |
| Dividend payments | | | | (23,124) | | | (23,124) |
| Dividends accrued for unvested restricted stock units | | | | (52) | | | (52) |
| Stock options exercised: Various prices per share | | | | (6,345) | 40,470 | | 34,125 |
| Restricted stock units vested | | | | (812) | 812 | | — |
| Purchase of treasury stock: 1,112 shares | | | | | (35,565) | | (35,565) |
| Income tax benefit from exercise of stock options | | | 10,525 | | | | 10,525 |
| Stock-based compensation expense | | | 9,169 | | | | 9,169 |
| **Balance, December 31, 2011** | **79,652** | **$797** | **$213,560** | **$840,206** | **$(375,534)** | **$13,102** | **$692,131** |

ADTRAN issued 1,813 shares, 1,483 shares and 856 shares of treasury stock to accommodate employee stock option exercises and vesting of restricted stock units during 2011, 2010 and 2009, respectively. During 2011 and 2010, ADTRAN received 7 shares and 4 shares, respectively, previously held by employees for at least six months as payment of the exercise price for employee stock options. None of the transactions with respect to these shares were made in the open market. The average price paid per share with respect to these transactions was based on the closing price of the common stock on the NASDAQ Global Select Market on the date of the transaction. There were no such transactions during 2009.

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

## ADTRAN, INC.
### Consolidated Statements of Cash Flows
Years ended December 31, 2011, 2010 and 2009

| *(In thousands)* | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net income | $138,577 | $113,989 | $74,221 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 11,499 | 10,545 | 10,084 |
| Amortization of net premium on available-for-sale investments | 6,617 | 4,380 | 3,686 |
| Net realized (gain) loss on long-term investments | (12,454) | (11,008) | 1,297 |
| Net (gain) loss on disposal of property, plant, and equipment | 6 | 2 | (31) |
| Stock-based compensation expense | 9,169 | 7,717 | 6,987 |
| Deferred income taxes | 575 | (1,324) | (1,024) |
| Tax benefit from stock option exercises | 10,525 | 4,909 | 1,549 |
| Excess tax benefits from stock-based compensation arrangements | (9,373) | (4,404) | (998) |
| Change in operating assets and liabilities: | | | |
| Accounts receivable, net | (4,939) | (2,849) | (15,143) |
| Other receivables | (5,781) | 135 | (1,195) |
| Income tax receivable, net | 2,741 | (2,741) | — |
| Inventory | (12,734) | (28,600) | 1,732 |
| Prepaid expenses and other assets | 522 | (574) | (489) |
| Accounts payable | 6,178 | (2,997) | 5,442 |
| Accrued expenses and other liabilities | 6,309 | 8,626 | 1,010 |
| Income taxes payable, net | 3,169 | (3,017) | 3,027 |
| **Net cash provided by operating activities** | **150,606** | **92,789** | **90,155** |
| **Cash flows from investing activities** | | | |
| Purchases of property, plant, and equipment | (11,912) | (9,872) | (8,740) |
| Proceeds from sales and maturities of available-for-sale investments | 466,243 | 275,442 | 186,193 |
| Purchases of available-for-sale investments | (554,629) | (340,489) | (262,067) |
| Acquisition of business, net of cash acquired | (22,661) | — | (1,370) |
| **Net cash used in investing activities** | **(122,959)** | **(74,919)** | **(85,984)** |
| **Cash flows from financing activities** | | | |
| Proceeds from stock option exercises | 34,125 | 24,942 | 13,471 |
| Purchases of treasury stock | (35,565) | (18,316) | (15,896) |
| Dividend payments | (23,124) | (22,502) | (22,486) |
| Payments on long-term debt | (1,000) | (250) | (500) |
| Excess tax benefits from stock-based compensation arrangements | 9,373 | 4,404 | 998 |
| **Net cash used in financing activities** | **(16,191)** | **(11,722)** | **(24,413)** |
| Net increase (decrease) in cash and cash equivalents | 11,456 | 6,148 | (20,242) |
| Effect of exchange rate changes | (154) | 1,394 | 2,468 |
| **Cash and cash equivalents, beginning of year** | **31,677** | **24,135** | **41,909** |
| **Cash and cash equivalents, end of year** | **$42,979** | **$31,677** | **$24,135** |
| Supplemental disclosure of cash flow information | | | |
| Cash paid during the year for interest | $2,396 | $2,411 | $2,435 |
| Cash paid during the year for income taxes | $51,402 | $57,662 | $30,869 |

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

# Notes to Consolidated Financial Statements

## 1 Nature of Business and Summary of Significant Accounting Policies

ADTRAN, Inc. designs, manufactures and markets solutions and provides services and support for communications networks. Our solutions are widely deployed by providers of communications services (serviced by our Carrier Networks Division), and SMEs (serviced by our Enterprise Networks Division), and enable voice, data, video and Internet communications across wireline and wireless networks. Many of these solutions are currently in use by every major United States and many global service providers, as well as by many public, private and governmental organizations worldwide.

### Principles of Consolidation

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

### Cash and Cash Equivalents

Cash and cash equivalents represent demand deposits, money market funds, and short-term investments classified as available-for-sale with original maturities of three months or less. We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these applicable financial institutions, and determined the risk of material financial loss due to the exposure of such credit risk to be minimal. As of December 31, 2011, $23.4 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

### Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the immediate or short-term maturity of these financial instruments. The carrying amount reported for bonds payable was $47.0 million compared to an estimated fair value of $46.9 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A+.

Investments with maturities beyond one year, such as our municipal variable rate demand notes, may be classified as short-term based on their highly liquid nature and because such marketable securities represent the investment of cash that is available for current operations. At December 31, 2011, 18% of our municipal variable rate demand notes had a credit rating of AAA, 58% had a credit rating of AA, 24% had a credit rating of A, and all contained put options of seven days. Despite the long-term nature of their stated contractual maturities, we routinely buy and sell these securities and we believe that we have the ability to quickly liquidate them. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. We believe we have the ability to sell our variable rate demand notes to the remarketing agent, tender agent, or issuer at par value plus accrued interest in the event we decide to liquidate our investment in a particular variable rate demand note. At December 31, 2011, approximately 34% of our variable rate demand notes were supported by letters of credit from banks that we believe to be in good financial condition. The remaining 66% of our variable rate demand notes were supported by standby purchase agreements. As a result of these factors, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments at December 31, 2011. 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.

Long-term investments represent a restricted certificate of deposit, municipal fixed-rate bonds, corporate bonds, a fixed income bond fund, marketable equity securities, and other equity investments. Marketable equity securities are reported at fair value as determined by the most recently traded price of the securities at the balance sheet date, although the securities may not be readily marketable due to the size of the available market. Unrealized gains and losses, net of tax, are reported as a separate component of stockholders' equity. Realized gains and losses on sales of securities are computed under the specific identification method and are included in current income. We periodically review our investment portfolio for investments considered to have sustained an other-than-temporary decline in value. Impairment charges for other-than-temporary declines in value are recorded as realized losses in the accompanying consolidated statements of income. All of our investments at December 31, 2011 and 2010 are classified as available-for-sale securities (see Note 4).

### Accounts Receivable

We record accounts receivable at net realizable value. Prior to issuing payment terms to a new customer, we perform a detailed credit review of the customer. Credit limits are established for each new customer based on the results of this credit review. Payment terms are established for each new customer, and collection experience is reviewed periodically in order to determine if the customer's payment terms and credit limits need to be revised. At December 31, 2011, three customers, each of which accounted for more than 10% of our accounts receivable, accounted for 57.3% of our total accounts receivable in the aggregate. At December 31, 2010, three customers, each of which accounted for more than 10% of our accounts receivable, accounted for 54.7% of our total accounts receivable in the aggregate.

We maintain an allowance for doubtful accounts for losses resulting from the inability of our customers to make required payments. We regularly review the allowance for doubtful accounts and consider factors such as the age of accounts receivable balances, the current economic conditions that may affect a customer's ability to pay, significant one-time events and our historical experience. If the financial condition of a customer deteriorates, resulting in an impairment of their ability to make payments, we may be required to make additional allowances. If circumstances change with regard to individual receivable balances that have previously been determined to be uncollectible (and for which a specific reserve has been established), a reduction in our allowance for doubtful accounts may be required. Our allowance for doubtful accounts was $8 thousand at December 31, 2011 and $162 thousand at December 31, 2010.

### Other Receivables

Other receivables are comprised primarily of amounts due from subcontract manufacturers for product component transfers, accrued interest on investments and on a restricted certificate of deposit and amounts due from employee stock option exercises.

### Inventory

Inventory is carried at the lower of cost or market, with cost being determined using the first-in, first-out method. Standard costs for material, labor and manufacturing overhead are used to value inventory. Standard costs are updated at least quarterly; therefore, inventory costs approximate actual costs at the end of each reporting period. We establish reserves for estimated excess, obsolete or unmarketable inventory equal to the difference between the cost of the inventory and the estimated fair value of the inventory based upon assumptions about future demand and market conditions. When we dispose of excess and obsolete inventories, the related write-downs are charged against the inventory reserve. See Note 5 of Notes to Consolidated Financial Statements for additional information.

### Property, Plant and Equipment

Property, plant and equipment, which is stated at cost, is depreciated using the straight-line method over the estimated useful lives of the assets. We depreciate building and land improvements from five to 39 years, office machinery and equipment from three to seven years, engineering machinery and equipment from three to seven years and computer software from three to five years. Expenditures for repairs and maintenance are charged to expense as incurred. Betterments that materially prolong the lives of the assets are capitalized. The cost of assets retired or otherwise disposed of and the related accumulated depreciation are removed from the accounts, and the gain or loss on such disposition is included in other income (expense), net in the accompanying consolidated statements of income. See Note 6 of Notes to Consolidated Financial Statements for additional information.

### Liability for Warranty

Our products generally include warranties of one to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled $4.1 million and $3.3 million at December 31, 2011 and 2010, respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets.

A summary of warranty expense and write-off activity for the years ended December 31, 2011 and 2010 is as follows:

*(In thousands)*

| Year Ended December 31, | 2011 | 2010 |
|---|---|---|
| Balance at beginning of period | $3,304 | $2,833 |
| Plus: amounts acquired or charged to cost and expenses | 2,893 | 5,309 |
| Less: deductions | (2,079) | (4,838) |
| **Balance at end of period** | **$4,118** | **$3,304** |

### Stock-Based Compensation

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

Under the provisions of our approved plans, we made grants of performance-based restricted stock units to five of our executive officers in 2011, 2010 and 2009. The restricted stock units are subject to a market condition based on the relative total shareholder return of ADTRAN against a peer group of companies (2009 grant) or against all the companies in the NASDAQ Telecommunications Index (2010 and 2011 grant) and vest at the end of a three-year performance period. The restricted stock units are converted into shares of common stock upon vesting. Depending on the relative total shareholder return over the performance period, the executive officers may earn from 0% to 150% of the number of restricted stock units granted. The fair value of the award is based on the market price of our common stock on the date of grant, adjusted for the expected outcome of the impact of market conditions using a Monte Carlo Simulation valuation method. The recipients of the restricted stock units also earn dividend credits during the performance period, which will be paid in cash upon the issuance of common stock for the restricted stock units.

Stock-based compensation expense recognized under the Stock Compensation Topic of the Financial Accounting Standards Board Accounting Standards Codification (FASB ASC) in 2011, 2010 and 2009 was approximately $9.2 million, $7.7 million and $7.0 million, respectively. As of December 31, 2011, total compensation cost related to non-vested stock options, restricted stock units and restricted stock not yet recognized was approximately $21.9 million, which is expected to be recognized over an average remaining recognition period of 2.9 years. See Note 3 of Notes to Consolidated Financial Statements for additional information.

### Impairment of Long-Lived Assets

We review long-lived assets used in operations for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and the undiscounted cash flows estimated to be generated by the asset are less than the asset's carrying value. An impairment loss would be recognized in the amount by which the recorded value of the asset exceeds the fair value of the asset, measured by the quoted market price of an asset or an estimate based on the best information available in the circumstances. There were no such impairment losses recognized during 2011, 2010 or 2009.

### Goodwill and Purchased Intangible Assets

We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If we determine that the two-step quantitative test is necessary, then we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. There were no impairment losses during 2011. Purchased intangible assets with finite lives are carried at cost, less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets, which is 2.5 to seven years.

### Research and Development Costs

Research and development costs include compensation for engineers and support personnel, outside contracted services, depreciation and material costs associated with new product development, the enhancement of current products, and product cost reductions. We continually evaluate new product opportunities and engage in intensive research and product development efforts. Research and development costs totaled $100.3 million, $90.3 million and $83.3 million for the years ended December 31, 2011, 2010 and 2009, respectively.

### Comprehensive Income

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

| *(In thousands)* | Change in Unrealized Gains and (Losses) on Marketable Securities, Net of Tax | Foreign Currency Translation Adjustment | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|
| **Balance at December 31, 2008** | **$(243)** | **$(766)** | **$(1,009)** |
| Activity in 2009 | 15,384 | 2,468 | 17,852 |
| Reclassification adjustment for amounts included in net income | 1,010 | — | 1,010 |
| **Balance at December 31, 2009** | **16,151** | **1,702** | **17,853** |
| Activity in 2010 | 8,700 | 1,394 | 10,094 |
| Reclassification adjustment for amounts included in net income | (999) | — | (999) |
| **Balance at December 31, 2010** | **23,852** | **3,096** | **26,948** |
| Activity in 2011 | (13,004) | (154) | (13,158) |
| Reclassification adjustment for amounts included in net income | (688) | — | (688) |
| **Balance at December 31, 2011** | **$10,160** | **$2,942** | **$13,102** |

### Income Taxes

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

### Foreign Currency

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

### Revenue Recognition

Revenue is generally recognized upon shipment of the product to our customer in accordance with the title transfer terms of the sales agreement, generally FOB shipping point. In the case of consigned inventory, revenue is recognized when the end customer assumes ownership of the product. Contracts that contain multiple deliverables are evaluated to determine the units of accounting, and the revenue from the arrangement is allocated to each item requiring separate revenue recognition based on the relative selling price and corresponding terms of the contract. We strive to use vendor-specific objective evidence of selling price. When this evidence is not available, we are generally not able to determine third-party evidence of selling price because of the extent of customization among competing products or services from other companies. We record revenue associated with installation services when all contractual obligations are complete. Contracts that include both installation services and product sales are evaluated for revenue recognition in accordance with contract terms. As a result, depending on contract terms, installation services may be considered as a separate deliverable item or may be considered an element of the delivered product. Either the purchaser, ADTRAN, or a third party can perform the installation of our products. Shipping fees are recorded as revenue and the related cost is included in cost of sales. Revenue is recorded net of discounts. Also, revenue is recorded when the product price is fixed or determinable, collection of the resulting receivable is probable, and product returns are reasonably estimable. Sales returns are accrued based on historical sales return experience, which we believe provides a reasonable estimate of future returns.

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

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

**Unearned Revenue**

Unearned revenue primarily represents customer billings on our maintenance service programs and deferred revenues relating to multiple element contracts where we still have contractual obligations to our customers. We currently offer maintenance contracts ranging from one to five years, primarily on Enterprise Networks Division products sold through distribution channels. Revenue attributable to maintenance contracts is recognized on a straight-line basis over the related contract term. In addition, we provide software maintenance and a variety of hardware maintenance services to Carrier Network Division customers under contracts with terms up to ten years. Non-current unearned revenue is included in other non-current liabilities in the accompanying consolidated balance sheets. At December 31, 2011 and 2010, unearned revenue was as follows:

| *(In thousands)* | 2011 | 2010 |
|---|---|---|
| Current unearned revenue | $9,965 | $10,138 |
| Non-current unearned revenue | 4,874 | 3,801 |
| **Total** | **$14,839** | **$13,939** |

**Other Income (Expense), Net**

Other income (expense), net, is comprised primarily of miscellaneous income and expense, gains and losses on foreign currency transactions, investment account management fees, and gains or losses on the disposal of property, plant and equipment occurring in the normal course of business.

**Earnings per Share**

Earnings per common share, and earnings per common share assuming dilution, are based on the weighted average number of common shares and, when dilutive, common equivalent shares outstanding during the year (see Note 13).

**Dividends**

The Board of Directors presently anticipates that it will declare a regular quarterly dividend as long as the current tax treatment of dividends exists and adequate levels of liquidity are maintained. During the years ended December 31, 2011, 2010 and 2009, we paid $23.1 million, $22.5 million and $22.5 million, respectively, in dividend payments. On January 17, 2012, the Board of Directors declared a quarterly cash dividend of $0.09 per common share to be paid to holders of record at the close of business on February 2, 2012. The ex-dividend date was January 31, 2012 and the payment date was February 16, 2012. The quarterly dividend payment was $5.7 million.

### Business Combinations

We use the acquisition method to account for business combinations. Under the acquisition method of accounting, we recognize the assets acquired and liabilities assumed at their fair value on the acquisition date. Goodwill is measured as the excess of the consideration transferred over the net assets acquired. Costs incurred to complete the business combination, such as legal, accounting or other professional fees, are charged to general and administrative expenses as they are incurred.

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

### Recently Issued Accounting Standards

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 requires companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. While ASU 2011-05 changes the presentation of comprehensive income, it does not change the components that are recognized in net income or comprehensive income under current accounting guidance. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We plan to adopt this amendment during the first quarter of 2012. Since ASU 2011-05 affects presentation only, it will have no effect on our consolidated results of operations or financial condition.

In December 2011, the FASB issued Accounting Standards Update No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12). ASU 2011-12 defers the effective date for certain presentation requirements that relate to reclassification adjustments and the effect of those reclassification adjustments on the financial statements. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We plan to adopt this amendment during the first quarter of 2012. Since ASU 2011-12 affects presentation only, it will have no effect on our consolidated results of operations or financial condition.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (ASU 2011-04). ASU 2011-04 is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. The amendments are of two types: (i) those that clarify the Board's intent about the application of existing fair value measurement and disclosure requirements and (ii) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This update is effective for annual periods beginning after December 15, 2011. We do not expect the adoption of this amendment will have a material impact on our consolidated results of operations or financial condition.

During 2011, we adopted the following accounting standards, which had no material effect on our consolidated results of operations or financial condition:

In October 2009, the FASB issued Accounting Standards Update No. 2009-13, Multiple-Deliverable Revenue Arrangements (ASU 2009-13). ASU 2009-13 provides amendments to the criteria in Subtopic 605-25 of the ASC for separating consideration in multiple-deliverable arrangements. As a result of those amendments, multiple-deliverable arrangements are separated in more circumstances than under previously existing U.S. GAAP. ASU 2009-13 established a selling price hierarchy for determining the selling price of a deliverable and replaced the term fair value in the revenue allocation guidance with selling price to clarify that the allocation of revenue is based on entity-specific assumptions rather than assumptions of a marketplace participant. ASU 2009 -13 also eliminated the residual method of allocation and required that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method and required that a vendor determine its best estimate of selling price in a manner that is consistent with that used to determine the price to sell the deliverable on a standalone basis.

We generally sell our products and services separately, but in some circumstances products and services may be sold in bundles that contain multiple deliverables. A sale that includes multiple deliverables is evaluated to determine the units of accounting, and the revenue from the arrangement is allocated to each item requiring separate revenue recognition based on the relative selling price and corresponding terms of the contract. We strive to use vendor-specific objective evidence of selling price. When this evidence is not available, we are generally not able to determine third-party evidence of selling price because of the extent of customization among competing products or services from other companies. In these cases, estimated selling price is determined based on the particular circumstances of the arrangement and is used to allocate revenues to each unit of accounting. Revenue is recognized incrementally as the necessary criteria for each item are met.

We adopted this amendment during the first quarter of 2011. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the year ended December 31, 2011.

In October 2009, the FASB issued Accounting Standards Update No. 2009-14, Certain Revenue Arrangements that Include Software Arrangements. ASU 2009-14 changed the accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and non-software components that function together to deliver the tangible product's essential functionality are no longer within the scope of the software revenue guidance in Subtopic 985-605 of the ASC. In addition, ASU 2009-14 requires that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. In that regard, ASU 2009-14 provides additional guidance on how to determine which software, if any, relating to the tangible product also would be excluded from the scope of the software revenue guidance. ASU 2009-14 also provides guidance on how a vendor should allocate arrangement consideration to deliverables in an arrangement that includes both tangible products and software. ASU 2009-14 also provides further guidance on how to allocate arrangement consideration when an arrangement includes deliverables both included and excluded from the scope of the software revenue guidance. We adopted this amendment during the first quarter of 2011. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the year ended December 31, 2011.

In September 2011, the FASB issued Accounting Standards Update No. 2011-08, Testing Goodwill for Impairment (ASU 2011-08). Existing accounting guidance requires that an entity perform a test for goodwill impairment, on at least an annual basis, by first comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit is less than its carrying amount, then the second step of the test is to be performed to measure the amount of impairment loss, if any. ASU 2011-08 will allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity will no longer be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This update is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. We adopted this amendment during the fourth quarter of 2011. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the year ended December 31, 2011.

## 2 Business Combinations

On August 4, 2011, we acquired all of the outstanding stock of Bluesocket, Inc., a provider of wireless network solutions with virtual control, for $23.7 million in cash. The acquisition provides us with IEEE802.11N enterprise class wireless LAN expertise, technology, and products to address the growing transition within small-medium enterprises and large enterprises to wireless networks and mobile devices. We have included the financial results of Bluesocket in our consolidated financial statements since the date of acquisition. Pro forma results of operations prior to the closing date for the acquisition have not been presented because the effect of the acquisition was not material to our financial results. The allocation of the purchase price to the estimated fair value of the assets acquired and liabilities assumed at the acquisition date is as follows:

| *(In thousands)* | |
|---|---|
| Cash | $1,027 |
| Accounts receivable | 298 |
| Inventory | 792 |
| Prepaid expenses | 357 |
| Property, plant and equipment | 173 |
| Deferred tax assets, net | 12,962 |
| Accounts payable | (441) |
| Unearned revenue | (600) |
| Accrued expenses | (332) |
| **Net assets acquired** | **14,236** |
| Customer relationships | 1,530 |
| Developed technology | 3,230 |
| Intellectual property | 930 |
| Trade names | 270 |
| Goodwill | 3,492 |
| **Total purchase price** | **$23,688** |

During the fourth quarter of 2011, the purchase price and purchase price allocation were adjusted for our final valuations. The adjustments resulted in a decrease to the goodwill recognized in the transaction.

The net deferred tax assets acquired are primarily related to net operating losses and previously capitalized and unamortized research and development expense for tax deduction purposes.

The fair value of the customer relationships, developed technology and intellectual property acquired was calculated using an income approach (excess earnings method) and is being amortized using the straight-line method. The customer relationships and intellectual property are being amortized over an estimated useful life of 7 years and the developed technology is being amortized over an average estimated useful life of 4.5 years.

The fair value of the trade names acquired was calculated using an income approach (relief from royalty method) and is being amortized using the straight-line method over the estimate useful life of 4.5 years.

The goodwill of $3.5 million generated from this acquisition is primarily related to expected synergies and was assigned to our Enterprise Networks division. The goodwill will not be deductible for U.S. federal income tax purposes.

For the year ended December 31, 2011, we incurred acquisition related expenses and amortization of acquired intangibles of $1.7 million related to this acquisition.

## 3 Stock Incentive Plans

### Stock Incentive Program Descriptions

Our Board of Directors adopted the 1996 Employee Incentive Stock Option Plan (1996 Plan) effective February 14, 1996, as amended, under which 17.0 million shares of common stock were authorized for issuance to certain employees and officers through incentive stock options and non-qualified stock options. Options granted under the 1996 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four or five-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. The 1996 Plan expired February 14, 2006, and expiration dates of options outstanding at December 31, 2011 under the 1996 Plan range from 2012 to 2015.

On January 23, 2006, the Board of Directors adopted the 2006 Employee Stock Incentive Plan (2006 Plan), which authorizes 13.0 million shares of common stock for issuance to certain employees and officers through incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. The 2006 Plan was adopted by stockholder approval at our annual meeting of stockholders held on May 9, 2006. Options granted under the 2006 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. Expiration dates of options outstanding at December 31, 2011 under the 2006 Plan range from 2016 to 2021.

Our stockholders approved the 2010 Directors Stock Plan (2010 Directors Plan) on May 5, 2010, under which 0.5 million shares of common stock have been reserved. This plan replaces the 2005 Directors Stock Option Plan. The 2010 Directors Plan provides that the Company may issue stock options, restricted stock and restricted stock units to our non-employee directors. Stock awards issued under the 2010 Directors Plan normally become vested in full on the first anniversary of the grant date. Options issued under the 2010 Directors Plan have a ten-year contractual term. We currently also have options outstanding under the 1995 Directors Plan, as amended, and the 2005 Directors Plan. Expiration dates of options outstanding under both plans at December 31, 2011 range from 2012 to 2020.

The following table is a summary of our stock options outstanding as of December 31, 2010 and 2011 and the changes that occurred during 2011:

| *(In thousands, except per share amounts)* | Number of Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life in Years | Aggregate Intrinsic Value |
|---|---|---|---|---|
| **Options outstanding, December 31, 2010** | **6,234** | **$23.09** | **6.21** | **$81,561** |
| Options granted | 1,031 | $30.42 | | |
| Options cancelled/forfeited | (87) | $26.32 | | |
| Options exercised | (1,778) | $19.36 | | |
| **Options outstanding, December 31, 2011** | **5,400** | **$25.66** | **6.78** | **$27,270** |
| **Options exercisable, December 31, 2011** | **3,054** | **$23.49** | **5.20** | **$21,042** |

The following table further describes our stock options outstanding as of December 31, 2011:

| | **Options Outstanding** | | | **Options Exercisable** | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Options Outstanding at 12/31/11 *(in thousands)* | Weighted Avg. Remaining Contractual Life in Years | Weighted Average Exercise Price | Options Exercisable at 12/31/11 *(in thousands)* | Weighted Average Exercise Price |
| $8.70 - $23.46 | 2,806 | 5.98 | $20.30 | 2,135 | $20.16 |
| $23.47 - $30.04 | 473 | 4.66 | $29.13 | 421 | $29.29 |
| $30.05 - $33.33 | 1,262 | 7.96 | $30.77 | 279 | $32.18 |
| $33.34 - $41.92 | 859 | 8.81 | $33.79 | 219 | $33.80 |
| | **5,400** | | | **3,054** | |

All of the options above were issued at exercise prices that approximate fair market value at the date of grant. At December 31, 2011, 8.0 million options were available for grant under the shareholder approved plans.

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic value (the difference between ADTRAN's closing stock price on the last trading day of 2011 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on December 31, 2011. The amount of aggregate intrinsic value will change based on the fair market value of ADTRAN's stock.

The total pre-tax intrinsic value of options exercised during 2011, 2010 and 2009 was $39.8 million, $20.3 million and $5.3 million, respectively. The fair value of options fully vesting during 2011, 2010 and 2009 was $7.3 million, $6.9 million and $7.1 million, respectively.

#### Restricted Stock Program Description

On November 6, 2008, the Compensation Committee of the Board of Directors approved the Performance Shares Agreement under the 2006 Plan which sets forth the terms and conditions of awards of performance-based restricted stock units (RSUs). Of the 13.0 million shares of common stock authorized for issuance under the 2006 Plan, we may grant up to 5.0 million shares of common stock for issuance to certain employees and officers for awards other than stock options, which would include RSUs. Under a proposal that was approved by the Board of Directors and shareholders at the 2010 annual meeting, the number of shares available for awards other than stock options under all stock plans was reduced to 3.3 million. The number of shares of common stock earned by a recipient pursuant to the RSUs is subject to a market condition based on ADTRAN's relative total shareholder return against a peer group (2009 grant) or against all companies in the NASDAQ Telecommunications Index (2010 and 2011 grant) at the end of a three-year performance period. Depending on the relative total shareholder return over the performance period, the recipient may earn from 0% to 150% of the shares underlying the RSUs, with the shares earned distributed upon the vesting of the RSUs at the end of the three-year performance period. The fair value of the award is based on the market price of our common stock on the date of grant, adjusted for the expected outcome of the impact of market conditions using a Monte Carlo Simulation valuation method. A portion of the granted RSUs also vest and the underlying shares become deliverable upon the death or disability of the recipient or upon a change of control of ADTRAN, as defined by the 2006 Plan. The recipients of the RSUs receive dividend credits based on the shares of common stock underlying the RSUs. The dividend credits are vested and earned in the same manner as the RSUs and will be paid in cash upon the issuance of common stock for the RSUs.

The following table is a summary of our RSUs and restricted stock outstanding as of December 31, 2010 and 2011 and the changes that occurred during 2011:

| *(In thousands except per share amounts)* | Number of Shares | Weighted Average Grant Date Fair Value |
|---|---|---|
| **Unvested RSUs and restricted stock outstanding, December 31, 2010** | **87** | **$28.46** |
| RSUs and restricted stock granted | 39 | $36.09 |
| RSUs and restricted stock vested | (49) | $22.36 |
| RSUs and restricted stock cancelled/forfeited | — | $— |
| Adjustments to shares granted due to shares earned at vesting | 13 | $17.05 |
| **Unvested RSUs and restricted stock outstanding, December 31, 2011** | **90** | **$34.21** |

As of December 31, 2011, there was approximately $2.2 million of total unamortized compensation cost related to the non-vested portion of RSUs and restricted stock granted, which will be recognized on a straight-line basis over the remainder of the three-year performance period for RSUs and over the remainder of the one-year vesting period for restricted stock.

#### Valuation and Expense Information

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

The following table summarizes stock-based compensation expense related to stock options, RSUs and restricted stock under the Stock Compensation Topic of the FASB ASC for the years ended December 31, 2011, 2010 and 2009, which was recognized as follows:

| *(In thousands)* | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Stock-based compensation expense included in cost of sales** | **$412** | **$317** | **$268** |
| Selling, general and administrative expense | 4,316 | 3,575 | 3,039 |
| Research and development expense | 4,441 | 3,825 | 3,680 |
| **Stock-based compensation expense included in operating expenses** | **8,757** | **7,400** | **6,719** |
| **Total stock-based compensation expense** | **9,169** | **7,717** | **6,987** |
| Tax benefit for expense associated with non-qualified options | (1,321) | (650) | (634) |
| **Total stock-based compensation expense, net of tax** | **$7,848** | **$7,067** | **$6,353** |

At December 31, 2011, total compensation cost related to non-vested stock options, RSUs and restricted stock not yet recognized was approximately $21.9 million, which is expected to be recognized over an average remaining recognition period of 2.9 years.

The stock option pricing model requires the use of several significant assumptions that impact the fair value estimate. These variables include, but are not limited to, the volatility of our stock price and employee exercise behaviors. The assumptions and variables used for the current period grants were developed based on guidance in the Stock Compensation Topic of the FASB ASC. There were no material changes made during 2011 to the methodology used to determine our assumptions.

The weighted-average estimated fair value of stock options granted to employees and directors during the twelve months ended December 31, 2011, 2010 and 2009 was $9.53 per share, $11.69 per share and $8.11 per share, respectively, with the following weighted-average assumptions:

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Expected volatility | 38.32% | 39.57% | 41.86% |
| Risk-free interest rate | 1.01% | 1.35% | 2.29% |
| Expected dividend yield | 1.19% | 1.08% | 1.55% |
| Expected life (in years) | 5.15 | 5.78 | 5.10 |

We based our estimate of expected volatility for the 12 months ended December 31, 2011, 2010 and 2009 on the sequential historical daily trading data of our common stock for a period equal to the expected life of the options granted. The selection of the historical volatility method was based on available data indicating our historical volatility is as equally representative of our future stock price trends as is our implied volatility. We have no reason to believe the future volatility of our stock price is likely to differ from its past volatility.

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

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

The RSU pricing model also requires the use of several significant assumptions that impact the fair value estimate. The estimated fair value of the RSUs granted to employees in 2011, 2010 and 2009 was $38.73 per share, $39.21 per share and $26.65 per share, respectively, with the following assumptions:

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Expected volatility | 39.32% | 40.82% | 41.41% |
| Risk-free interest rate | 0.37% | 0.51% | 1.40% |
| Expected dividend yield | 1.08% | 1.07% | 1.53% |

Stock-based compensation expense recognized in our Consolidated Statements of Income for the 12 months ended December 31, 2011, 2010 and 2009 is based on RSUs and options ultimately expected to vest, and has been reduced for estimated forfeitures. Estimates for forfeiture rates are based upon historical experience and are evaluated quarterly. We expect our forfeiture rate for stock option awards to be approximately 1.6% annually. We estimated a 0% forfeiture rate for our RSUs and restricted stock due to the limited number of recipients and historical experience for these awards.

## 4 Investments

We classify our investments as available-for-sale. At December 31, 2011, we held the following securities and investments, recorded at either fair value or cost.

| *(In thousands)* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value/ Carrying Value |
|---|---|---|---|---|
| Deferred compensation plan assets | $7,994 | $119 | $(401) | $7,712 |
| Corporate bonds | 159,077 | 181 | (2,505) | 156,753 |
| Municipal fixed-rate bonds | 174,300 | 579 | (53) | 174,826 |
| Municipal variable rate demand notes | 69,660 | — | — | 69,660 |
| Fixed income bond fund | 527 | 194 | — | 721 |
| Marketable equity securities | 12,771 | 19,098 | (559) | 31,310 |
| **Available-for-sale securities held at fair value** | **$424,329** | **$20,171** | **$(3,518)** | **$440,982** |
| **Restricted investment held at cost** | | | | **48,250** |
| **Other investments held at cost** | | | | **2,123** |
| **Total carrying value of available-for-sale investments** | | | | **$491,355** |

At December 31, 2010, we held the following securities and investments, recorded at either fair value or cost.

| *(In thousands)* | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value/ Carrying Value |
|---|---|---|---|---|
| Deferred compensation plan assets | $3,483 | $770 | $(7) | $4,246 |
| Corporate bonds | 126,671 | 630 | (229) | 127,072 |
| Municipal fixed-rate bonds | 71,212 | 268 | (13) | 71,467 |
| Municipal variable rate demand notes | 116,745 | — | — | 116,745 |
| Fixed income bond fund | 526 | 220 | — | 746 |
| Marketable equity securities | 11,486 | 36,657 | (133) | 48,010 |
| **Available-for-sale securities held at fair value** | **$330,123** | **$38,545** | **$(382)** | **$368,286** |
| **Restricted investment held at cost** | | | | **48,250** |
| **Other investments held at cost** | | | | **2,103** |
| **Total carrying value of available-for-sale investments** | | | | **$418,639** |

At December 31, 2011 and 2010, we held $7.7 million and $4.2 million, respectively, of deferred compensation plan assets, carried at fair value.

At December 31, 2011 and 2010, we held $156.8 million and $127.1 million, respectively, of corporate bonds. These bonds are classified as available-for-sale and had an average duration of 0.8 years at December 31, 2011. At December 31, 2011, approximately 1% of our corporate bond portfolio had a credit rating of AAA, 11% had a credit rating of AA, 50% had a credit rating of A, and 38% had a credit rating of BBB.

At December 31, 2011 and 2010, we held $174.8 million and $71.5 million, respectively, of municipal fixed-rate bonds. These bonds are classified as available-for-sale investments and had an average duration of 1.3 years at December 31, 2011. At December 31, 2011, approximately 19% of our municipal fixed-rate bond portfolio had a credit rating of AAA, 64% had a credit rating of AA, 15% had a credit rating of A, and 2% had a credit rating of BBB. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

As of December 31, 2011, corporate and municipal fixed-rate bonds had the following contractual maturities:

| *(In thousands)* | Corporate bonds | Municipal fixed-rate bonds |
|---|---|---|
| Less than one year | $10,093 | $79,592 |
| One to two years | 54,245 | 64,001 |
| Two to three years | 92,415 | 18,990 |
| Three to five years | — | 12,243 |
| **Total** | **$156,753** | **$174,826** |

At December 31, 2011 and 2010, we held $69.7 million and $116.7 million, respectively, of municipal variable rate demand notes, all of which were classified as available-for-sale short-term investments. At December 31, 2011, 18% of our municipal variable rate demand notes had a credit rating of AAA, 58% had a credit rating of AA, 24% had a credit rating of A, and all contained put options of seven days. Despite the long-term nature of their stated contractual maturities, we routinely buy and sell these securities and we believe that we have the ability to quickly liquidate them. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. We believe we have the ability to sell our variable rate demand notes to the remarketing agent, tender agent or issuer at par value plus accrued interest in the event we decide to liquidate our investment in a particular variable rate demand note. At December 31, 2011, approximately 34% of our variable rate demand notes were supported by letters of credit from banks that we believe to be in good financial condition. The remaining 66% of our variable rate demand notes were supported by standby purchase agreements. As a result of these factors, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments. All income generated from these investments was recorded as interest income. We have not been required to record any losses relating to municipal variable rate demand notes.

At December 31, 2011 and 2010, we held $0.7 million of a fixed income bond fund. This bond fund had unrealized gains of $0.2 million at December 31, 2011 and 2010.

At December 31, 2011, we held $31.3 million of marketable equity securities, including a single security, of which we held 1.1 million shares, carried at a fair value of $17.3 million. We sold 0.5 million shares of this security during the 12 months ended December 31, 2011. The sales resulted in proceeds of $9.2 million and a realized gain of $9.1 million. This single security traded approximately 0.8 million shares per day in 2011, in an active market on a European stock exchange. This single security comprises $16.9 million of the gross unrealized gains included in the fair value of our marketable equity securities at December 31, 2011. The remaining $2.2 million of gross unrealized gains and $0.6 million of gross unrealized losses at December 31, 2011 were spread amongst more than 400 equity securities. At December 31, 2010, we held $48.0 million of marketable equity securities, including the single security mentioned above, of which we held 1.5 million shares, carried at a fair value of $34.2 million. This single security comprised $33.7 million of the gross unrealized gains included in the fair value of our marketable equity securities at December 31, 2010. The remaining $3.0 million of unrealized gains and $0.1 million of gross unrealized losses at December 31, 2010 were spread amongst more than 415 equity securities.

At December 31, 2011 and 2010, we held a $48.3 million restricted certificate of deposit, which is carried at cost. This investment serves as a collateral deposit against the principal amount outstanding under loans made to ADTRAN pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond). At December 31, 2011, the estimated fair value of the Bond was approximately $46.9 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A+. We have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness. For more information on the Bond, see Note 8 of Notes to Consolidated Financial Statements.

At December 31, 2011 and 2010, we held $2.1 million of other investments carried at cost, consisting of interests in two private equity funds and an investment in a privately held telecommunications equipment manufacturer. The fair value of these investments was estimated to be approximately $10.0 million at December 31, 2011, based on unobservable inputs including information supplied by the company and the fund managers. We have committed to invest up to an aggregate of $7.9 million in the two private equity funds, and we have contributed $8.4 million as of December 31, 2011, of which $7.7 million has been applied toward these commitments. As of December 31, 2011 we have received distributions related to these two private equity funds of $8.8 million, of which $2.2 million was recorded as investment income. These investments are carried at cost, net of distributions, with distributions in excess of our investment recorded as investment income. The duration of each of these commitments is ten years with $0.1 million expiring in 2013 and $0.1 million expiring in 2012. We have not been required to record any impairment losses related to these investments during the years ended December 31, 2011, 2010 or 2009.

Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of $36 thousand during the fourth quarter of 2011. For each of the years ended December 31, 2011, 2010 and 2009 we recorded a charge of $68 thousand, $43 thousand and $2.9 million, respectively, related to the other-than-temporary impairment of certain marketable equity securities, a fixed income bond fund and deferred compensation plan assets.

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

*(In thousands)*

| Year Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Gross realized gains | $13,641 | $12,191 | $1,978 |
| Gross realized losses | $(1,187) | $(1,183) | $(3,275) |

The following table presents the breakdown of investments with unrealized losses at December 31, 2011.

| *(In thousands)* | Continuous Unrealized Loss Position for Less than 12 Months | | Continuous Unrealized Loss Position for 12 Months or Greater | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Deferred compensation plan assets | $5,655 | $(401) | $— | $— | $5,655 | $(401) |
| Corporate bonds | 112,345 | (2,505) | — | — | 112,345 | (2,505) |
| Municipal fixed-rate bonds | 20,076 | (53) | — | — | 20,076 | (53) |
| Marketable equity securities | 4,418 | (543) | 48 | (16) | 4,466 | (559) |
| **Total** | **$142,494** | **$(3,502)** | **$48** | **$(16)** | **$142,542** | **$(3,518)** |

The following table presents the breakdown of investments with unrealized losses at December 31, 2010.

| *(In thousands)* | Continuous Unrealized Loss Position for Less than 12 Months | | Continuous Unrealized Loss Position for 12 Months or Greater | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Deferred compensation plan assets | $338 | $(7) | $— | $— | $338 | $(7) |
| Corporate bonds | 32,326 | (229) | — | — | 32,326 | (229) |
| Municipal fixed-rate bonds | 5,869 | (13) | — | — | 5,869 | (13) |
| Marketable equity securities | 2,021 | (107) | 176 | (26) | 2,197 | (133) |
| **Total** | **$40,554** | **$(356)** | **$176** | **$(26)** | **$40,730** | **$(382)** |

The increase in unrealized losses during 2011, as reflected in the table above, is primarily due to credit yield spreads widening during the second half of 2011 primarily impacting our corporate bonds. At December 31, 2011, a total of 128 of our marketable equity securities were in an unrealized loss position.

In accordance with the Fair Value Measurements and Disclosures Topic of the FASB ASC, we have categorized our cash equivalents held in money market funds and our investments held at fair value into a three-level fair value hierarchy based on the priority of the inputs to the valuation technique for the cash equivalents and investments as follows: Level 1—Values based on unadjusted quoted prices for identical assets or liabilities in an active market; Level 2—Values based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly; Level 3—Values based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs include information supplied by investees.

**Fair Value Measurements at December 31, 2011 Using**

| *(In thousands)* | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| **Cash equivalents** | | | | |
| Money market funds | $13,696 | $13,696 | $— | $— |
| **Available-for-sale securities** | | | | |
| Deferred compensation plan assets | 7,712 | 7,712 | — | — |
| **Available-for-sale debt securities** | | | | |
| Corporate bonds | 156,753 | — | 156,753 | — |
| Municipal fixed-rate bonds | 174,826 | — | 174,826 | — |
| Municipal variable rate demand notes | 69,660 | — | 69,660 | — |
| Fixed income bond fund | 721 | 721 | — | — |
| **Available-for-sale marketable equity securities** | | | | |
| Marketable equity securities—technology industry | 18,743 | 18,743 | — | — |
| Marketable equity securities—other | 12,567 | 12,567 | — | — |
| **Available-for-sale securities** | **440,982** | **39,743** | **401,239** | **—** |
| **Total** | **$454,678** | **$53,439** | **$401,239** | **$—** |

**Fair Value Measurements at December 31, 2010 Using**

| *(In thousands)* | Fair Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| **Cash equivalents** | | | | |
| Money market funds | $14,532 | $14,532 | $— | $— |
| **Available-for-sale securities** | | | | |
| Deferred compensation plan assets | 4,246 | 4,246 | — | — |
| **Available-for-sale debt securities** | | | | |
| Corporate bonds | 127,072 | — | 127,072 | — |
| Municipal fixed-rate bonds | 71,467 | — | 71,467 | — |
| Municipal variable rate demand notes | 116,745 | — | 116,745 | — |
| Fixed income bond fund | 746 | 746 | — | — |
| **Available-for-sale marketable equity securities** | | | | |
| Marketable equity securities—technology industry | 35,596 | 35,596 | — | — |
| Marketable equity securities—other | 12,414 | 12,414 | — | — |
| **Available-for-sale securities** | **368,286** | **53,002** | **315,284** | **—** |
| **Total** | **$382,818** | **$67,534** | **$315,284** | **$—** |

As of December 31, 2011 and 2010, the fair value of the investments in available-for-sale Level 2 corporate bonds and municipal fixed-rate bonds was $331.6 million and $198.5 million, respectively. The fair value of these securities is calculated using a weighted average market price for each security. Market prices are obtained from a variety of industry standard data providers, security master files from large financial institutions, and other third-party sources. These multiple market prices are used as inputs into a distribution-curve-based algorithm to determine the daily market value of each security.

As of December 31, 2011 and 2010, the fair value of the investments in available-for-sale Level 2 municipal variable rate demand notes was $69.7 million and $116.7 million, respectively. These securities have a structure that implies a standard expected market price. The frequent interest rate resets make it reasonable to expect the price to stay at par. These securities are priced at the expected market price.

## 5 Inventory

At December 31, 2011 and 2010, inventory was comprised of the following:

| *(In thousands)* | 2011 | 2010 |
|---|---|---|
| Raw materials | $44,588 | $43,897 |
| Work in process | 3,954 | 2,871 |
| Finished goods | 39,258 | 27,506 |
| **Total** | **$87,800** | **$74,274** |

We establish reserves for estimated excess, obsolete, or unmarketable inventory equal to the difference between the cost of the inventory and the estimated fair value of the inventory based upon assumptions about future demand and market conditions. At December 31, 2011 and 2010, raw materials reserves totaled $7.9 million and $7.3 million, respectively, and finished goods inventory reserves totaled $1.5 million and $1.6 million, respectively.

## 6 Property, Plant and Equipment

At December 31, 2011 and 2010, property, plant and equipment were comprised of the following:

| *(In thousands)* | 2011 | 2010 |
|---|---|---|
| Land | $4,263 | $4,263 |
| Building and land improvements | 16,857 | 15,507 |
| Building | 68,479 | 68,479 |
| Furniture and fixtures | 16,433 | 16,130 |
| Computer hardware and software | 64,053 | 61,898 |
| Engineering and other equipment | 91,232 | 83,946 |
| **Total Property, Plant and Equipment** | **261,317** | **250,223** |
| Less accumulated depreciation | (186,022) | (176,237) |
| **Total Property, Plant and Equipment (net)** | **$75,295** | **$73,986** |

Depreciation expense was $10.8 million, $10.2 million and $10.0 million in 2011, 2010 and 2009, respectively.

## 7 Goodwill and Intangible Assets

The changes in the carrying value of goodwill, all of which is included in our Enterprise Networks division, for the year ended December 31, 2011 are as follows:

*(In thousands)*

| | |
|---|---|
| **Balance, December 31, 2010** | **$—** |
| Acquisitions | 3,492 |
| Impairment losses | — |
| **Balance, December 31, 2011** | **$3,492** |
| **Balance as of December 31, 2011** | |
| Goodwill | $3,492 |
| Accumulated impairment losses | — |
| **Total Goodwill** | **$3,492** |

We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. There were no impairment losses during 2011.

The following table presents our intangible assets as of December 31, 2011 and 2010. Intangible assets are included in other assets in the accompanying Consolidated Balance Sheets and include intangible assets acquired with our acquisitions of Objectworld Communications Corporation on September 15, 2009 and Bluesocket, Inc. on August 4, 2011.

| *(In thousands)* | December 31, 2011 | | | December 31, 2010 | | |
|---|---|---|---|---|---|---|
| | Gross Value | Accumulated Amortization | Net Value | Gross Value | Accumulated Amortization | Net Value |
| Customer relationships | $1,623 | $(194) | $1,429 | $93 | $(60) | $33 |
| Developed technology | 3,230 | (303) | 2,927 | — | — | — |
| Intellectual property | 2,340 | (525) | 1,815 | 1,410 | (260) | 1,150 |
| Trade names | 270 | (28) | 242 | — | — | — |
| **Total** | **$7,463** | **$(1,050)** | **$6,413** | **$1,503** | **$(320)** | **$1,183** |

Amortization expense was $0.7 million, $0.4 million and $0.1 million in 2011, 2010 and 2009, respectively.

As of December 31, 2011, the estimated future amortization expense of intangible assets is as follows:

| *(In thousands)* | Amount |
|---|---|
| 2012 | $1,221 |
| 2013 | 1,271 |
| 2014 | 1,120 |
| 2015 | 1,018 |
| 2016 | 781 |
| Thereafter | 1,002 |
| **Total** | **$6,413** |

## 8 Alabama State Industrial Development Authority Financing and Economic Incentives

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the "Authority"). Pursuant to the program, on January 13, 1995, the Authority issued $20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the "Bondholder"), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to $50.0 million. An Amended and Restated Taxable Revenue Bond ("Amended and Restated Bond") was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 5% per annum. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond at December 31, 2011 was approximately $46.9 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A+. We are required to make payments to the Authority in amounts necessary to pay the principal of and interest on the Amended and Restated Bond. Included in long-term investments at December 31, 2011 is $48.3 million which is invested in a restricted certificate of deposit. These funds serve as a collateral deposit against the principal of this bond, and we have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness. In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. For the years ended December 31, 2011, 2010 and 2009, we realized economic incentives related to payroll withholdings totaling $1.9 million, $1.5 million and $1.5 million, respectively.

Due to continued positive cash flow from operating activities, we made a business decision in 2006 to begin an early partial redemption of the Bond. We made principal payments of $1.0 million and $0.3 million for the years ended December 31, 2011 and 2010, respectively. It is our intent to make annual principal payments in addition to the interest amounts that are due. In connection with this decision, $0.5 million of the bond debt has been reclassified to a current liability in accounts payable in the Consolidated Balance Sheets at December 31, 2011 and 2010.

## 9 Income Taxes

A summary of the components of the provision for income taxes as of December 31, 2011, 2010 and 2009 is as follows:

| *(In thousands)* | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Current** | | | |
| Federal | $59,813 | $49,144 | $30,756 |
| State | 7,177 | 6,380 | 3,615 |
| **Total current** | **66,990** | **55,524** | **34,371** |
| Deferred tax expense (benefit) | 575 | (1,324) | (1,024) |
| **Total Provision for Income Taxes** | **$67,565** | **$54,200** | **$33,347** |

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

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Tax provision computed at the federal statutory rate | 35.00% | 35.00% | 35.00% |
| State income tax provision, net of federal benefit | 3.19 | 3.33 | 3.68 |
| Federal research credits | (2.50) | (2.90) | (3.37) |
| Tax-exempt income | (0.27) | (0.46) | (1.05) |
| State tax incentives | (0.90) | (0.86) | (1.36) |
| Stock-based compensation | 0.03 | 0.34 | 1.64 |
| Domestic production activity deduction | (1.84) | (2.37) | (3.33) |
| Other, net | 0.07 | 0.15 | (0.21) |
| **Effective Tax Rate** | **32.78%** | **32.23%** | **31.00%** |

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

| *(In thousands)* | 2011 | 2010 |
|---|---|---|
| **Current deferred tax assets** | | |
| Accounts receivable | $4 | $61 |
| Inventory | 6,709 | 6,032 |
| Accrued expenses | 5,412 | 4,524 |
| **Total Current Deferred Tax Assets** | **12,125** | **10,617** |
| **Non-current deferred tax assets** | | |
| Accrued expenses | 113 | 102 |
| Deferred compensation | 3,177 | 1,539 |
| Stock-based compensation | 3,808 | 3,542 |
| State tax and interest expense | 947 | 861 |
| Foreign loss and state credit carry-forwards | 7,891 | 5,988 |
| Federal loss and research carry-forwards | 14,778 | — |
| Valuation allowance | (7,585) | (5,627) |
| **Total Non-current Deferred Tax Assets** | **23,129** | **6,405** |
| **Total Deferred Tax Assets** | **$35,254** | **$17,022** |
| **Non-current Deferred Tax Liabilities** | | |
| Accumulated depreciation | $(7,081) | $(4,782) |
| Intellectual property | (2,594) | — |
| Investments | (5,109) | (11,973) |
| **Total Non-current Deferred Tax Liabilities** | **$(14,784)** | **$(16,755)** |
| **Net Deferred Tax Assets** | **$20,470** | **$267** |

At December 31, 2011 and 2010, non-current deferred tax liabilities and non-current deferred tax assets, respectively, related to investments reflect deferred taxes on unrealized gains and losses on available-for-sale investments. The net change in non-current deferred taxes associated with these investments, a deferred tax benefit of $7.8 million in 2011 and a deferred tax provision of $4.6 million in 2010, is recorded as an adjustment to other comprehensive income, presented in the Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income.

We have deferred tax assets for both foreign and domestic loss, unamortized research and development cost and state credit carry-forwards of $22.7 million which will expire between 2012 and 2030. These carry-forwards were caused by tax credits in excess of our annual tax liabilities to an individual state where we no longer generate sufficient state income, net operating loss carry-forwards acquired through the acquisition of a foreign entity and net operating losses and research and development cost acquired through the acquisition of a domestic entity. In accordance with the Income Taxes Topic of the FASB ASC, we believe it is more likely than not that we will not realize the full benefits of the deferred tax asset arising from these losses and credits, and accordingly, have provided a valuation allowance against these assets. We do not provide for U.S. income tax on undistributed earnings of our foreign operations, whose earnings are intended to be permanently reinvested. For years ended December 31, 2011, 2010 and 2009, foreign profits before income taxes were not material.

During 2011, 2010 and 2009, we recorded an income tax benefit of $10.5 million, $4.9 million and $1.5 million, respectively, as an adjustment to equity in accordance with the Stock Compensation Topic of the FASB ASC. This deduction is calculated on the difference between the exercise price of stock option exercises and the market price of the underlying common stock upon exercise.

The change in the unrecognized income tax benefits for 2011, 2010 and 2009 is reconciled below:

| *(In thousands)* | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Balance at beginning of period** | **$2,593** | **$2,919** | **$2,775** |
| **Increases for tax position related to:** | | | |
| Prior years | — | 197 | 390 |
| Current year | 840 | 818 | 610 |
| **Decreases for tax positions related to:** | | | |
| Prior years | (92) | (16) | (1) |
| Settlements with taxing authorities | (354) | (630) | (413) |
| Expiration of applicable statute of limitations | (17) | (695) | (442) |
| **Balance at end of period** | **$2,970** | **$2,593** | **$2,919** |

As of December 31, 2011, 2010, and 2009, our total liability for unrecognized tax benefits was $3.0 million, $2.6 million, and $2.9 million, respectively, of which $2.4 million, $2.0 million, and $2.3 million, respectively, would reduce our effective tax rate if we were successful in upholding all of the uncertain positions and recognized the amounts recorded. We classify interest and penalties recognized on the liability for unrecognized tax benefits as income tax expense. As of December 31, 2011, 2010 and 2009, the balances of accrued interest and penalties were $1.2 million, $1.0 million and $1.2 million, respectively.

We do not anticipate a single tax position generating a significant increase or decrease in our liability for unrecognized tax benefits within 12 months of this reporting date. We file income tax returns in the U.S. federal and various state jurisdictions and several foreign jurisdictions. We have been audited by the Internal Revenue Service and the state of Alabama through the 2007 tax year. Generally, we are not subject to changes in income taxes by any taxing jurisdiction for the years prior to 2008.

## 10 Employee Benefit Plans

### 401(k) Savings Plan

We maintain the ADTRAN, Inc. 401(k) Retirement Plan (Savings Plan) for the benefit of our eligible employees. The Savings Plan is intended to qualify under Sections 401(a) and 401(k) of the Internal Revenue Code of 1986, as amended (Code), and is intended to be a "safe harbor" 401(k) plan under Code Section 401(k)(12). The Savings Plan allows employees to save for retirement by contributing part of their compensation to the plan on a tax-deferred basis. The Savings Plan also requires us to contribute a "safe harbor" amount each year. We match up to 4% of employee contributions (100% of an employee's first 3% of contributions and 50% of their next 2% of contributions), beginning on the employee's one year anniversary date. In calculating our matching contribution, we only use compensation up to the statutory maximum under the Code ($245 thousand for 2011). All contributions under the Savings Plan are 100% vested. Expenses recorded for employer contributions and plan administration costs for the Savings Plan amounted to approximately $4.3 million, $4.6 million and $4.2 million in 2011, 2010 and 2009, respectively.

**Deferred Compensation Plans**

We maintain the ADTRAN, Inc. Deferred Compensation Plan (Deferred Compensation Plan). This plan is offered as a supplement to our tax-qualified 401(k) plan and is available to certain executive management employees who have been designated by our Board of Directors. The deferred compensation plan allows participants to defer all or a portion of certain specified bonuses and up to 25% of remaining cash compensation, and permits us to make matching contributions on a discretionary basis, without the limitations that apply to the 401(k) plan. To date, we have not made any matching contributions under this plan.

We also maintain the ADTRAN, Inc. Equity Deferral Program for Employees for the purpose of providing deferred compensation for certain executive management employees. Participants may elect to defer all or a portion of their vested Performance Share awards to the Plan. Such deferrals shall continue to be held and deemed to be invested in shares of ADTRAN stock unless and until the amounts are distributed or such deferrals are moved to another deemed investment pursuant to an election made by the Participant.

We have set aside the plan assets for both plans in a rabbi trust (Trust) and all contributions are credited to bookkeeping accounts for the participants. The Trust assets are subject to the claims of our creditors in the event of bankruptcy or insolvency. The assets of the Trust are deemed to be invested in pre-approved mutual funds as directed by each participant, and the participant's bookkeeping account is credited with the earnings and losses attributable to those investments. Benefits are scheduled to be distributed six months after termination of employment in a single lump sum payment or annual installments paid over a three or ten year term. Distributions will be made on a pro rata basis from each of the hypothetical investments of the Participant's account in cash. Any whole shares of ADTRAN, Inc. common stock that are distributed will be distributed in-kind.

Assets of the Trust are deemed invested in mutual funds that cover an investment spectrum ranging from equities to money market instruments. These mutual funds are publicly quoted and reported at fair value. The fair value of the assets held by the Trust and the amounts payable to the plan participants are as follows:

| *(In thousands)* | **2011** | **2010** |
|---|---|---|
| **Fair Value of Plan Assets** | | |
| Long-term Investments | $7,710 | $4,246 |
| **Total Fair Value of Plan Assets** | **$7,710** | **$4,246** |
| **Amounts Payable to Plan Participants** | | |
| Non-current Liabilities | $7,710 | $4,246 |
| **Total Amounts Payable to Plan Participants** | **$7,710** | **$4,246** |

Interest and dividend income of the Trust have been included in interest and dividend income in the accompanying 2011, 2010 and 2009 Consolidated Statements of Income. Changes in the fair value of the plan assets held by the Trust have been included in accumulated other comprehensive income in the accompanying 2011 and 2010 Consolidated Balance Sheets. Changes in the fair value of the deferred compensation liability are included as selling, general and administrative expense in the accompanying 2011, 2010 and 2009 Consolidated Statements of Income. Based on the changes in the total fair value of the Trust's assets, we recorded deferred compensation adjustments in 2011, 2010 and 2009 of $(0.2) million, $0.4 million and $0.6 million, respectively.

**Retiree Medical Coverage**

We provide medical, dental and prescription drug coverage to one retired former officer and his spouse, for his life, on the same terms as provided to our active officers, and to the spouse of a former deceased officer for up to 30 years. At December 31, 2011 and 2010, this liability totaled $0.2 million.

## 11 Segment Information and Major Customers

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

The following table presents information about the reported sales and gross profit of our reportable segments for each of the years ended December 31, 2011, 2010 and 2009. Asset information by reportable segment is not reported, since we do not produce such information internally.

| *(In thousands)* | 2011 | | 2010 | | 2009 | |
|---|---|---|---|---|---|---|
| **Sales and Gross Profit by Market Segment** | Sales | Gross Profit | Sales | Gross Profit | Sales | Gross Profit |
| Carrier Networks | $569,579 | $327,813 | $476,030 | $283,310 | $371,349 | $219,681 |
| Enterprise Networks | 147,650 | 86,505 | 129,644 | 75,553 | 112,836 | 67,281 |
| **Total** | **$717,229** | **$414,318** | **$605,674** | **$358,863** | **$484,185** | **$286,962** |

### Sales by Product

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

**Carrier Systems** products are used by communications service providers to provide data, voice and video services to consumers and enterprises. The Carrier Systems category includes our broadband access products comprised of Total Access 5000 multi-service access and aggregation platform products, Total Access 1100/1200 Series FTTN products, UBE and DSLAM products. Our broadband access products are used by service providers to deliver high-speed Internet access, VoIP, IPTV, and/or Ethernet services from the 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 and transceivers including those used in our ONE products, NetVanta 8000 series products, and our family of OPTI products. Optical access products are used to deliver higher bandwidth services, aggregate large numbers of low bandwidth services, or transport wavelength services across a fiber optic infrastructure. Total Access 1500 products, 303 concentrator products, M13 multiplexer products, and a number of mobile backhaul products are also included in the Carrier Systems product category.

**Business Networking** products provide access to telecommunication services, facilitating the delivery of converged services and Unified Communications to the SME market. The Business Networking category includes Internetworking products and IADs. Internetworking products consist of our Total Access IP Business Gateways, ONTs, vWLAN products and NetVanta product lines. NetVanta products include multi-service routers, managed Ethernet switches, IP PBX products, IP phone products, Unified Communications solutions, UTM solutions, and Carrier Ethernet NTE. IAD products consist of our Total Access 600 Series and the Total Access 850.

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

The table below presents sales information by product category for the years ended December 31, 2011, 2010 and 2009:

| *(In thousands)* | 2011 | 2010 | 2009 |
|---|---|---|---|
| Carrier Systems | $420,289 | $289,314 | $215,715 |
| Business Networking | 162,186 | 127,233 | 100,451 |
| Loop Access | 134,754 | 189,127 | 168,019 |
| **Total** | **$717,229** | **$605,674** | **$484,185** |

In addition, we identify subcategories of product revenues, which we divide into our core products and legacy products. Our core products consist of Broadband Access and Optical Access products (included in Carrier Systems) and Internetworking products (included in Business Networking) and our legacy products include HDSL products (included in Loop Access) and other products not included in the aforementioned core products.

The table below presents subcategory revenues for the years ended December 31, 2011, 2010 and 2009:

| *(In thousands)* | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Core Products** | | | |
| Broadband Access (included in Carrier Systems) | $289,776 | $176,116 | $111,470 |
| Optical Access (included in Carrier Systems) | 82,535 | 66,206 | 60,596 |
| Internetworking (NetVanta and Multi-service Access Gateways) (included in Business Networking) | 151,536 | 111,123 | 79,979 |
| **Total** | **$523,847** | **$353,445** | **$252,045** |
| **Legacy Products** | | | |
| HDSL (does not include T1) (included in Loop Access) | 126,976 | 177,249 | 150,276 |
| Other products (excluding HDSL) | 66,406 | 74,980 | 81,864 |
| **Total** | **$193,382** | **$252,229** | **$232,140** |
| **Total** | **$717,229** | **$605,674** | **$484,185** |

## Sales by Geographic Region

The following table presents sales information by geographic area for the years ended December 31, 2011, 2010 and 2009. International sales correlate to shipments with a non-U.S. destination.

| *(In thousands)* | 2011 | 2010 | 2009 |
|---|---|---|---|
| United States | $632,795 | $573,845 | $456,402 |
| International | 84,434 | 31,829 | 27,783 |
| **Total** | **$717,229** | **$605,674** | **$484,185** |

Single customers comprising more than 10% of our revenue in 2011 included two customers at 25% and 10%, respectively. Single customers comprising more than 10% of our revenue in 2010 included three customers at 20%, 18%, and 11%, respectively. Single customers comprising more than 10% of our revenue in 2009 included three customers at 22%, 19%, and 11%, respectively. No other customer accounted for 10% or more of our sales in 2011, 2010 or 2009.

Sales to Major Service Providers amounted to approximately 72%, 72% and 69% of total sales during the years ended December 31, 2011, 2010 and 2009, respectively. In addition, a significant portion of our products are sold directly to distributors and certain value-added resellers, which accounted for approximately 26%, 26% and 28% of our revenue for each of the years ended December 31, 2011, 2010 and 2009, respectively.

As of December 31, 2011, long-lived assets, net totaled $75.3 million, which includes $73.9 million held in the United States and $1.4 million held outside the United States. As of December 31, 2010, long-lived assets, net totaled $74.0 million, which includes $73.0 million held in the United States and $1.0 million held outside the United States.

## 12 Commitments and Contingencies

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

We lease office space and equipment under operating leases which expire at various dates through 2016. As of December 31, 2011, future minimum rental payments under non-cancelable operating leases with original maturities of greater than 12 months are approximately as follows:

*(In thousands)*

| | |
|---|---|
| 2012 | $2,007 |
| 2013 | 1,207 |
| 2014 | 967 |
| 2015 | 710 |
| 2016 | 89 |
| **Total** | **$4,980** |

Rental expense was approximately $2.4 million, $1.8 million and $1.5 million for the years ended December 31, 2011, 2010 and 2009, respectively.

## 13 Earnings per Share

A summary of the calculation of basic and diluted earnings per share (EPS) for the years ended December 31, 2011, 2010 and 2009 is as follows:

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

| Year Ended | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Numerator** | | | |
| Net Income | $138,577 | $113,989 | $74,221 |
| **Denominator** | | | |
| Weighted average number of shares—basic | 64,145 | 62,490 | 62,459 |
| Effect of dilutive securities: | | | |
| Stock options | 1,236 | 1,355 | 887 |
| Restricted stock and restricted stock units | 35 | 34 | 10 |
| **Weighted average number of shares—diluted** | **65,416** | **63,879** | **63,356** |
| Net income per share—basic | $2.16 | $1.82 | $1.19 |
| Net income per share—diluted | $2.12 | $1.78 | $1.17 |

For each of the years ended December 31, 2011, 2010 and 2009, 1.2 million, 2.0 million and 3.5 million stock options were outstanding but were not included in the computation of that year's diluted EPS because the options' exercise prices were greater than the average market price of the common shares, therefore making them anti-dilutive under the treasury stock method.

## 14 Summarized Quarterly Financial Data (Unaudited)

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

### Unaudited Quarterly Operating Results

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

| Three Months Ended | March 31, 2011 | June 30, 2011 | September 30, 2011 | December 31, 2011 |
|---|---|---|---|---|
| Net sales | $165,522 | $184,227 | $192,194 | $175,286 |
| Gross profit | $98,795 | $106,827 | $109,476 | $99,220 |
| Operating income | $45,606 | $51,310 | $51,107 | $41,115 |
| Net income | $34,258 | $36,943 | $36,213 | $31,163 |
| Earnings per common share | $0.53 | $0.57 | $0.57 | $0.49 |
| Earnings per common share assuming dilution (1) | $0.52 | $0.56 | $0.56 | $0.48 |
| **Three Months Ended** | **March 31, 2010** | **June 30, 2010** | **September 30, 2010** | **December 31, 2010** |
| Net sales | $127,027 | $150,361 | $162,957 | $165,329 |
| Gross profit | $75,328 | $89,329 | $97,299 | $96,907 |
| Operating income | $25,345 | $38,617 | $45,045 | $44,857 |
| Net income | $18,194 | $27,751 | $32,084 | $35,960 |
| Earnings per common share | $0.29 | $0.45 | $0.51 | $0.57 |
| Earnings per common share assuming dilution (1) | $0.29 | $0.44 | $0.50 | $0.56 |

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

## 15 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. For the years ended 2011, 2010 and 2009, we incurred fees of $10 thousand per month for these legal services.

## 16 Subsequent Events

On January 17, 2012, the Board declared a quarterly cash dividend of $0.09 per common share to be paid to stockholders of record at the close of business on February 2, 2012. The quarterly dividend payment was $5.7 million and was paid on February 16, 2012. In July 2003, our Board of Directors elected to begin declaring quarterly dividends on our common stock considering the tax treatment of dividends and adequate levels of Company liquidity.

# Directors and Executive Officers

**Thomas R. Stanton**
Chairman and Chief Executive Officer

**James E. Matthews**
Senior Vice President – Finance,
Chief Financial Officer,
Treasurer, Secretary and Director

**H. Fenwick Huss**
Director of the Company
Dean of the J. Mack Robinson College of Business at
Georgia State University

**Ross K. Ireland**
Director of the Company
Former Senior Executive Vice President of Services and
Chief Technology Officer – SBC Communications, Inc.

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

**Balan Nair**
Director of the Company
Senior Vice President and Chief Technology Officer
of Liberty Global, Inc.

**Roy J. Nichols**
Director of the Company
Former Chairman of the Board of Torch Concepts, Inc.,
Former Vice Chairman of the Board, President and
Chief Technical Officer of Nichols Research Corporation

**James L. North**
Director Emeritus
Counsel to the company since its incorporation
in 1985, attorney with James L. North & Associates,
Birmingham, Alabama

**Michael K. Foliano**
Senior Vice President – Global Operations

**Raymond R. Schansman**
Senior Vice President and General Manager,
Enterprise Networks Division

**James D. Wilson, Jr.**
Senior Vice President and General Manager,
Carrier Networks Division

**Robert A. Fredrickson**
Vice President – Carrier Networks Sales

**Kevin W. Schneider**
Vice President – Chief Technology Officer

**Transfer Agent**
American Stock Transfer and Trust Company
New York, NY

**Independent Registered Public Accounting Firm**
PricewaterhouseCoopers LLP
Birmingham, Alabama

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

**Special Counsel**
McKenna Long & Aldridge LLP
Atlanta, Georgia

**Form 10-K**
ADTRAN's 2011 Annual Report on Form 10-K (without exhibits) as filed with the Securities and Exchange Commission is available to stockholders without charge upon written request to:

**Investor Relations**
ADTRAN, Inc.
901 Explorer Blvd.
P.O. Box 140000
Huntsville, Alabama 35814-4000
256 963-8220 or 256 963-7600
investorrelations@adtran.com (email)

**Annual Meeting**
The 2012 Annual Meeting of Stockholders will be held at ADTRAN corporate headquarters, 901 Explorer Boulevard, Huntsville, Alabama, on Wednesday, May 9, 2012, at 10:30 a.m. Central time.

**Corporate Headquarters**

ADTRAN, Inc.
901 Explorer Boulevard
Huntsville, AL 35806
USA

P.O. Box 140000
Huntsville, AL 35814-4000

1 800 9ADTRAN
1 256 963-8000
1 256 963-8004 fax
*investorrelations@adtran.com*
*www.adtran.com*


**International Offices**

ADTRAN Networks Pty. Ltd.
Sydney and Melbourne, Australia

ADTRAN Singapore Pte. Ltd.
Singapore

ADTRAN Europe Limited
Theale, Reading, United Kingdom

ADTRAN, Inc.
Beijing, China

ADTRAN Canada, Inc.
Montreal and Toronto, Canada

ADTRAN Networks Canada, Inc.
Ottawa, Canada

ADTRAN Networks S.A. de C.V.
Mexico, D.F., Mexico

ADTRAN International, Inc.
Hong Kong

TL19.1270

ADTRAN is an ISO 9001, ISO 14001, and a TL 9000 certified supplier.

ADTRAN, Inc. is an Equal Opportunity Employer committed to utilizing Minority Business Enterprises (MBE), Woman-Owned Business Enterprises (WBE) and Disabled Veteran Business Enterprises (DVBE) whenever possible and practical for procurements supporting ADTRAN and our customers.



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