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YOUR WAY FORWARD





ADTRAN is a leading global provider of networking and communications equipment, with a portfolio of smart solutions deployed by some of the world's largest service providers, distributed enterprises and small and medium businesses. ADTRAN solutions enable voice, data, video and Internet communications across copper, fiber and wireless network infrastructures.

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, 2008. These risks and uncertainties could cause actual results to differ materially from those in the forward-looking statements included in this annual report.

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 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 Vice Chairman of the Board, President and
Chief Executive Officer of Nichols Research Corporation

James L. North

Director Emeritus
Counsel to the company since it commenced operations
in 1986, 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

P. Steven Locke

Vice President – Service Provider 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

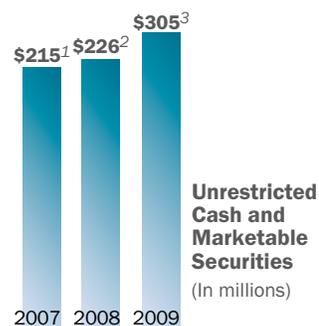
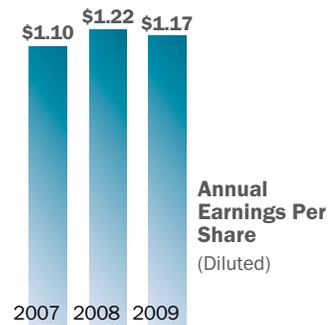
ADTRAN's 2009 Annual Report on Form 10-K
(without exhibits) as filed with the Securities and
Exchange Commission is available to stockholders
without charge upon written request to:

Investor Relations

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Annual Meeting

The 2010 Annual Meeting of Stockholders will be held
at ADTRAN corporate headquarters, 901 Explorer
Boulevard, Huntsville, Alabama, on Wednesday,
May 5, 2010, at 10:30 a.m. Central time.



Consolidated Statements of Income Data

(In thousands, except per share amounts)

Years Ended December 31	2009	2008	2007
Total sales	\$484,185	\$500,676	\$476,778
Income before provision for income taxes	\$107,568	\$118,273	\$115,571
Net income	\$74,221	\$78,581	\$76,335
Earnings per common share (Diluted)	\$1.17	\$1.22	\$1.10

Consolidated Balance Sheets Data

(In thousands)

Years Ended December 31	2009	2008	2007
Working capital⁴	\$278,044	\$212,740	\$251,261
Total assets	\$564,463	\$473,615	\$479,220
Stockholders' equity	\$452,515	\$375,819	\$378,431

¹ Net of \$139 million in stock repurchases and \$25 million in dividend payments during 2007

² Net of \$64 million in stock repurchases and \$23 million in dividend payments during 2008

³ Net of \$16 million in stock repurchases and \$22 million in dividend payments during 2009

⁴ Working capital consists of current assets less current liabilities

ADTRAN: Your Way Forward

In today's marketplace, businesses of all sizes are looking for a competitive advantage – a way to stand out from the crowd. They are looking for a means to streamline operations, increase productivity and reduce costs. For many of these businesses, their network has become that competitive advantage. ADTRAN® provides the innovative solutions that enhance the capability, reliability, and profitability of our customers' networks - within enterprises and between service providers and their customers. ADTRAN's extensive suite of purpose-built solutions improve network performance and connectivity. These solutions address the needs for faster performance and enhanced productivity. ADTRAN solutions are your way forward — an investment in the future of your business.

Letter to Shareholders

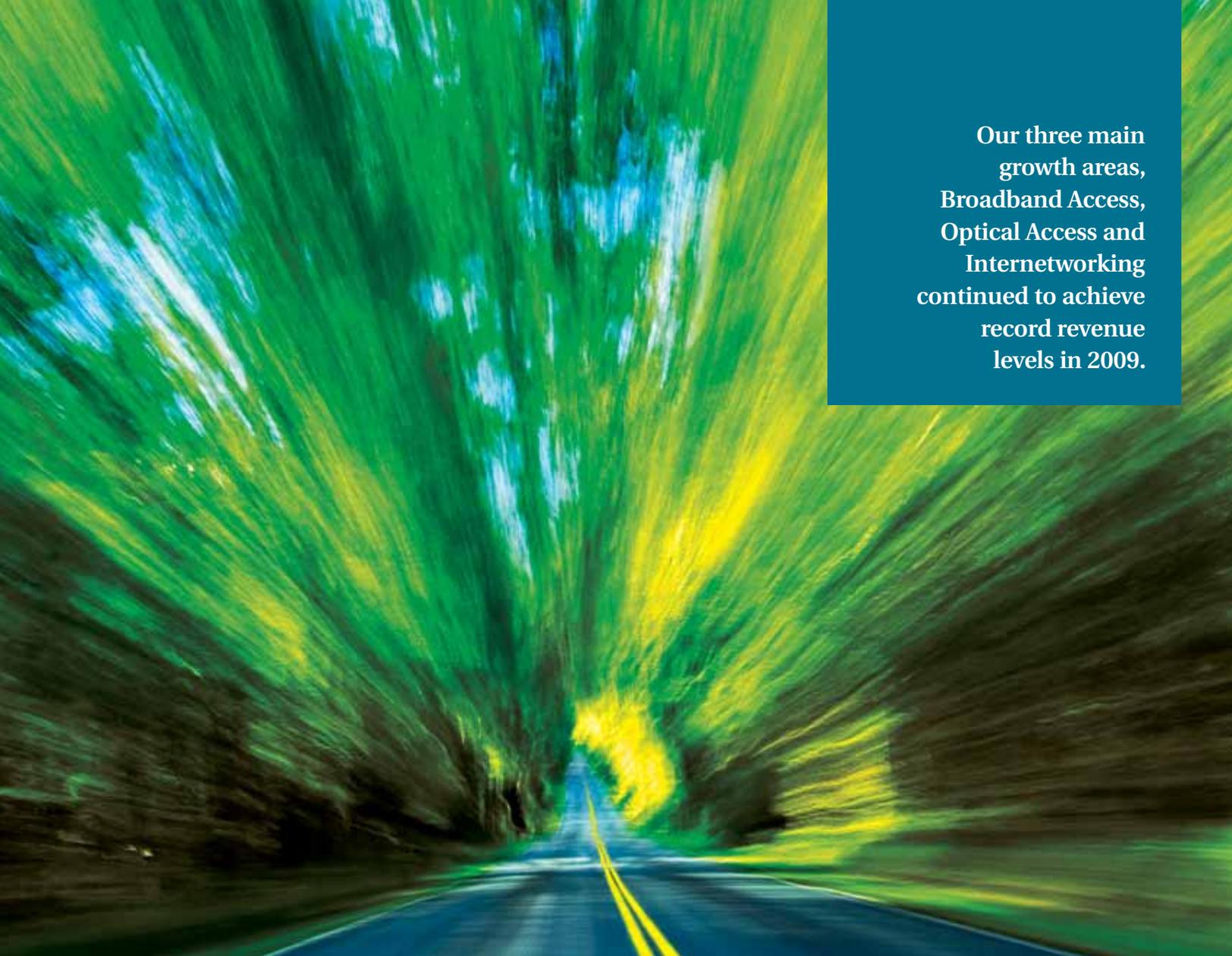
In 2009, we grew stronger through challenging times. We strengthened our product portfolio and increased our investment in Research and Development (R&D) activities, allowing us to increase our market share and enter the New Year with renewed optimism.

Our investment in product development was highlighted in 2009 with the introduction of a number of new solutions. We helped service providers move forward, taking fiber to the customer with an innovative new line of products based on proven technology from our industry-leading IP Business Gateways. Service providers also benefitted from the introduction of advanced video capabilities for the Total Access® 5000 enabling the delivery of high-definition IPTV along with voice and data services. As a leader in mobile backhaul solutions, we addressed the need for increased mobility with new Ethernet capabilities for our Total Access 5000 and OPTI-6100®. The Total Access 5000 not only allows carriers to deploy a variety of services including IPTV, mobile backhaul, and ultra high-speed broadband from a single platform, but along with the OPTI-6100 delivers industry-leading flexibility, eliminating the bandwidth bottlenecks that often occur at cell sites.

During the year, ADTRAN's Total Access 5000 continued to gain momentum. This platform showed strength with carriers of all sizes both in the U.S. and abroad. Tier Two and Tier Three service providers placed an even greater emphasis on this solution in both urban and rural communities as a means of new next-generation services. ADTRAN also became a trusted resource for the industry, as it fought on the front lines to positively influence the broadband stimulus initiative that was part of the American Recovery and Reinvestment Act signed into law in February 2009.

In our Enterprise Networks Division, we introduced a new line of Layer 3 multiservice switch platforms as well as Carrier Ethernet-enhanced high-performance routers to address the ever-growing capacity needs of today's business customer. Without a doubt, one of our most notable introductions was a new line of Unified Communications (UC) solutions. These new solutions enable customers to not only connect, but to integrate all of their communication processes such as email, voice mail, mobile phone and work phone into a single, easy-to-use application. The ability to seamlessly interface to third-party database and applications software will allow users to enhance productivity and lower costs.

These products, combined with our portfolio of more than 1,700 solutions, enable our customers to move forward, connecting with one another, their customers and the world at large.



Our three main growth areas, Broadband Access, Optical Access and Internetworking continued to achieve record revenue levels in 2009.

A Proven Business Model

Our sound financial and growth strategies allowed ADTRAN to strengthen its resilience during the economic downturn and emerge an even stronger company with a growing customer base and product portfolio. These strengths have provided a significant advantage and have allowed us to emerge from 2009 with a strong cash flow, healthy profitability and approximately \$305 million in unrestricted cash and marketable securities. With a strong operating model, and a growing number of revenue opportunities, we look forward to continued long-term growth and profitability.

Key Growth Areas: Paving the Way to Success

As carriers and end-users sought new ways to address the need for bandwidth,

they increasingly chose ADTRAN solutions as their way forward. As a result, our three main growth areas, Broadband Access, Optical Access and Internetworking continued to achieve record revenue levels in 2009. These three areas contributed 52 percent to company revenue and as a group were up 14 percent year-over-year. We anticipate that expanded global deployments will contribute to the growth of these solutions for many years to come as service providers and businesses continue to invest in applications like Carrier Ethernet, fiber connectivity and broadband service upgrades.

Broadband Access: Defining Next-generation Service Delivery

We offer a comprehensive portfolio of broadband access solutions, enabling carriers

around the globe to expand their footprint for advanced, high-speed services. These products enable carriers to increase bandwidth and offer new, differentiated capabilities.

Broadband Access set a new revenue record in 2009 at \$111 million. The success in this area is due in large part to the rapid acceptance of the Total Access 5000 and continuing deployments of Fiber-to-the-X products. The Total Access 5000 experienced record sales in 2009. This solution is now being deployed in the U.S. by all Tier One and Tier Two service providers, as well as by more than 130 Tier Three customers. The versatility and flexibility of this solution allow service providers to address a broad range of customer needs economically from a single platform.

Optical Access: Making Mobility and Data Transport Easier

The number of mobile subscribers globally is expected to exceed five billion in 2010, according to the International Telecommunications Union. This increase, along with the rise in mobile data and video usage, is fueling the demand for increased capacity throughout the network. Our comprehensive portfolio of optical solutions positions us well to meet this demand by enabling service providers to cost-effectively scale their mobile backhaul facilities. During the year, our optical products continued to gain momentum in the market. In 2009, this product segment achieved another record revenue level of more than \$60 million as a result of demand created due to wireless and wireline infrastructure upgrades. We believe these solutions, are positioned well to meet the needs of the rapidly increasing demand for Internet access and mobile backhaul.

Internetworking: Making Every Connection Count

Spending for network infrastructure met new challenges in 2009 due to the weakened economy and hesitancy by businesses to make capital expenditures. Despite this, many businesses made the choice to invest in new networking technology resulting in increased productivity and operational efficiency – ADTRAN solutions were a perfect fit. As a result, we moved forward, outpacing our competition, growing our revenue, and gaining market share in multiple product areas. We strengthened our number two position in branch office routers, increasing our market share, and continued to lead in the IP Business Gateway market.

Our Internetworking solutions set another record for revenue with a 22 percent increase over 2008. Internetworking now contributes approximately 70 percent to the total revenue of the Enterprise Networks Division, providing a firm foundation for the future. ADTRAN also entered the Unified Communications

market in 2009. Late in the year, ADTRAN announced a new product line — NetVanta® Unified Communications (UC). NetVanta UC is a direct complement to our NetVanta family of router, switch, IP Telephony and IP Business Gateway platforms. With this product line, we are now able to provide a complete solution for customers ranging from five to over 2,000 employees per location, greatly broadening our addressable market.

Growth Products Contribute to Solid Financial Performance

Although economic conditions continued to be difficult in the first half of the year, we saw stabilization in the second half. Throughout the year, our growth products continued to perform well. During the year, we continued to achieve record revenue levels in our growth areas, a testament to the strong market acceptance we received. The outstanding performance of these product areas enabled our company to achieve revenue of \$484 million for the year.

Combined, our growth areas increased 14 percent to \$252 million, up from \$222 million in 2008. Earnings in 2009 were \$74 million, while fully diluted earnings per share were \$1.17 in 2009. Our gross margins remained strong for the year at 59 percent and our cash flow remained strong with net cash from operating activities of \$90 million for the year. We also provided \$22.5 million in dividend payouts and invested \$15.9 million for stock repurchases. We believe our solid financial position allows for continued growth and the necessary working capital to fund product development.

Committed to Ethical and Principled Management

In business, many compromises are reached, but at ADTRAN there is no room for compromise when it comes to business ethics and corporate governance. These have been our highest standards since inception in 1985 and our commitment to these standards drives the way we do business today. We are disciplined in our approach to compliance as mandated by the Sarbanes-Oxley Act. This includes Section 404 which requires that we





**Our growth areas
increased 14 percent
to \$252 million, up
from \$222 million
in 2008.**

document and routinely test key internal controls over financial reporting and our strict Code of Business Conduct and Ethics, adopted in 2003. This comprehensive set of internal governing principles is yet another example of our commitment to adhering to the highest ethical standards of conduct possible.

Excellence in Innovation Acknowledged with Awards

As our portfolio of products continued to expand in 2009, our recognition within the industry also grew. We received many accolades from notable publications and organizations. ADTRAN was again named one of the “200 Best Small Companies” by Forbes and we were also recognized for our sustainability efforts. Our innovative and high-performance products were recognized with several Product of the Year awards and named as a Channel Best Seller. Our partner community honored us with several awards, including being named as a Top 10 Strategic Vendor and as a Five-Star Partner Program. In

addition, our partners voted us as the Small and Medium Business Networking Company of the Year in Everything Channel’s Annual Report Card.

Some of the most meaningful recognition we received this year was a result of our commitment to employees. We were named a top 50 employer by a leading industry publication, and were then selected as a “Best Places to Work” recipient within our local community. This award was the result of a survey of our employees measuring their perception of the quality of their workplace, making it one of our most meaningful honors.

A Connected Community: People of Excellence

We consider our company to be more than a manufacturer of telecommunications equipment. Rather, it is a community of more than 1,600 intelligent, innovative and dedicated team members who are responsible for moving our company forward. Following a year of uncertainty and change, there is one con-

stant that has remained – the commitment of our employees. In the last year, we have had a large number of customers, vendors and journalists visit our campus. Without fail, one of the most noted observations is the quality, dedication and ingenuity of our team members. On a daily basis, I see the results that these employees bring to our company, across every functional area and within each department. I am honored to be surrounded by a team of people who are engaged and excited about their work and who are driven to help our company and our customers achieve success. It is truly our employees who help us connect with our customers, moving them forward with solutions that make a difference in our world.



Tom Stanton
Chairman and Chief Executive Officer

Financial Results

- 7 Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities**
- 8 Stock Performance Graph**
- 9 Selected Financial Data**
- 10 Management's Discussion and Analysis of Financial Condition and Results of Operations**
 - Overview
 - Critical Accounting Policies and Estimates
 - Results of Operations
 - 2009 Compared to 2008
 - 2008 Compared to 2007
 - Liquidity and Capital Resources
 - Effect of Recent Accounting Pronouncements
 - Subsequent Events
 - Quantitative and Qualitative Disclosures About Market Risk
- 24 Management's Report on Internal Control Over Financial Reporting**
- 25 Report of Independent Registered Public Accounting Firm**
- 26 Financial Statements**
- 31 Notes to Consolidated Financial Statements**
 - Note 1 – Nature of Business and Summary of Significant Accounting Policies
 - Note 2 – Stock Incentive Plans
 - Note 3 – Investments
 - Note 4 – Inventory
 - Note 5 – Property, Plant and Equipment
 - Note 6 – Alabama State Industrial Development Authority Financing and Economic Incentives
 - Note 7 – Income Taxes
 - Note 8 – Employee Benefit Plans
 - Note 9 – Segment Information and Major Customers
 - Note 10 – Commitments and Contingencies
 - Note 11 – Earnings Per Share
 - Note 12 – Summarized Quarterly Financial Data (Unaudited)
 - Note 13 – Related Party Transactions
 - Note 14 – Subsequent Events

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 5, 2010, ADTRAN had 273 stockholders of record and approximately 32,348 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

2009	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	\$16.71	\$21.49	\$25.04	\$25.71
Low	\$13.84	\$16.70	\$20.74	\$20.44
2008	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
High	\$21.17	\$25.68	\$26.06	\$19.58
Low	\$17.32	\$18.86	\$19.04	\$12.31

The following table shows the dividends paid in each quarter of 2009 and 2008. 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

2009	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2008	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09

Stock Repurchases

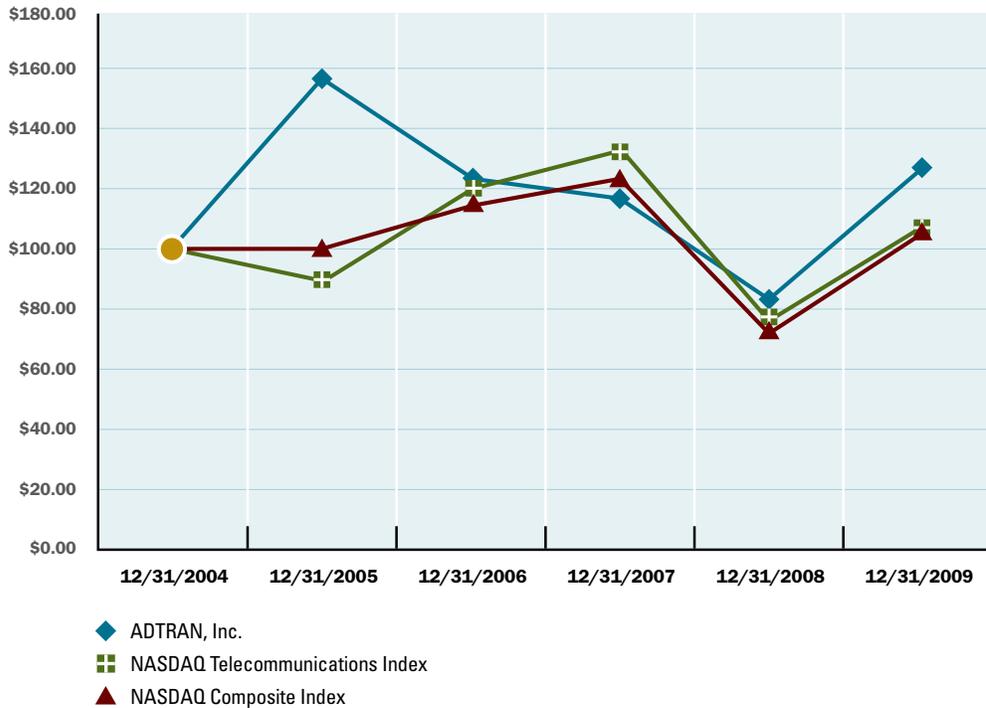
The following table sets forth ADTRAN's repurchases of its common stock for the months indicated.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
October 1, 2009 – October 31, 2009	—	—	—	3,294,691
November 1, 2009 – November 30, 2009	596,115	\$22.00	596,115	2,698,576
December 1, 2009 – December 31, 2009	—	—	—	2,698,576
Total	596,115	\$22.00	596,115	

(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.

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, 2004 through December 31, 2009, 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, 2004, in each of our common stock, the NASDAQ Telecommunications Index and the NASDAQ Composite Index and also assume dividend reinvestment.



	12/31/04	12/31/05	12/31/06	12/31/07	12/31/08	12/31/09
ADTRAN, Inc.	\$100.00	\$157.52	\$122.15	\$116.75	\$82.76	\$127.68
NASDAQ Telecommunications Index	\$100.00	\$101.33	\$114.01	\$123.71	\$73.11	\$105.61
NASDAQ Composite Index	\$100.00	\$91.66	\$119.67	\$132.55	\$77.09	\$107.17

Selected Financial Data

Income Statement Data (1)

(In thousands, except per share amounts)

Year Ended December 31,	2009	2008	2007	2006	2005
Sales					
Carrier Networks Division	\$371,349	\$392,219	\$358,023	\$356,606	\$386,051
Enterprise Networks Division	112,836	108,457	118,755	116,102	127,164
Total sales	484,185	500,676	476,778	472,708	513,215
Cost of sales	197,223	201,771	193,792	193,747	209,895
Gross profit	286,962	298,905	282,986	278,961	303,320
Selling, general, and administrative expenses	99,446	103,286	103,329	102,646	96,411
Research and development expenses	83,285	81,819	75,367	70,700	62,654
Operating income	104,231	113,800	104,290	105,615	144,255
Interest and dividend income	6,933	8,708	11,521	13,493	10,001
Interest expense	(2,430)	(2,514)	(2,502)	(2,532)	(2,535)
Net realized investment gain (loss)	(1,297)	(2,409)	498	1,379	1,712
Other income (expense), net	131	688	764	570	(59)
Life insurance proceeds	—	—	1,000	—	—
Income before provision for income taxes	107,568	118,273	115,571	118,525	153,374
Provision for income taxes	33,347	39,692	39,236	40,192	52,224
Net income	\$74,221	\$78,581	\$76,335	\$78,333	\$101,150

Year Ended December 31,	2009	2008	2007	2006	2005
Weighted average shares outstanding – basic	62,459	63,549	67,848	73,451	75,775
Weighted average shares outstanding – assuming dilution (2)	63,356	64,408	69,212	75,197	77,966
Earnings per common share – basic	\$1.19	\$1.24	\$1.13	\$1.07	\$1.33
Earnings per common share – assuming dilution (2)	\$1.17	\$1.22	\$1.10	\$1.04	\$1.30
Dividends declared and paid per common share	\$0.36	\$0.36	\$0.36	\$0.36	\$0.34

Balance Sheet Data

(In thousands)

At December 31,	2009	2008	2007	2006	2005
Working capital (3)	\$278,044	\$212,740	\$251,261	\$219,636	\$344,305
Total assets	\$564,463	\$473,615	\$479,220	\$539,658	\$651,720
Total debt	\$48,250	\$48,750	\$49,000	\$49,500	\$50,000
Stockholders' equity	\$452,515	\$375,819	\$378,431	\$435,956	\$542,171

(1) Net income for 2009, 2008, 2007 and 2006 includes stock-based compensation expense under the Stock Compensation Topic of the Financial Accounting Standards Board Accounting Standards Codification of \$6.4 million, \$6.7 million, \$7.1 million and \$7.2 million, respectively, net of tax, related to stock option awards. See Note 2 of Notes to the Consolidated Financial Statements.

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

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

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

Overview

ADTRAN, Inc. designs, manufactures, markets and services network access solutions for communications networks. Our solutions are widely deployed by providers of telecommunications services (served by our Carrier Networks Division), and small and mid-sized businesses (SMBs) and enterprises (served 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 service provider and many global ones, as well as by many public, private and governmental organizations worldwide.

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

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

Carrier Systems products are used by communications service providers to provide last mile access in support of data, voice and video services to consumers and enterprises. The Carrier Systems category includes our broadband access products comprised of Total Access 5000 multi-service access and aggregation platform products, Total Access 1100/1200 Series Fiber-To-The-Node (FTTN) products, and Digital Subscriber Line Access Multiplexer (DSLAM) products. Our broadband access products are used by service providers to deliver high-speed Internet access, Voice over Internet Protocol (VoIP), IP Television (IPTV), and/or Ethernet services from 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 including our family of OPTI products. Optical access products are used to deliver higher bandwidth services, or to aggregate large numbers of low bandwidth services for transportation across fiber optic infrastructure. Total Access 1500 products, 303 concentrator products, M13 multiplexer products, and 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 SMB and Enterprise markets. The Business Networking category includes Internetworking products, Optical Network Terminals (ONTs), and Integrated Access Devices (IADs). Internetworking products consist of our Total Access IP Business Gateways 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, and Carrier Ethernet Network Terminating Equipment.

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

In addition, we identify sub-categories of product revenues, which we divide into growth products, representing our primary growth areas, and traditional products. Our growth products consist of Broadband Access and Optical Access products (included in Carrier Systems) and Internetworking products (included in Business Networking) and our traditional products include HDSL products (included in Loop Access) and other products. Many of our customers are migrating their networks to deliver higher bandwidth services by utilizing newer technologies. We believe that products in our primary growth areas position us well for this migration. We anticipate that revenues of many of our traditional products, including HDSL, although declining, may continue for years because of the time required for our customers to transition to newer technologies.

Sales were \$484.2 million in 2009 compared to \$500.7 million in 2008 and \$476.8 million in 2007. Sales increased in each of our primary growth areas, Broadband Access, Optical Access and Internetworking. Total sales of products in these three growth areas increased 13.5% in 2009 compared to 2008 and 23.0% in 2008 compared to 2007. Our gross profit margin decreased in 2009 to 59.3% from 59.7% in 2008 and 59.4% in 2007, and our operating income margin decreased to 21.5%

in 2009 compared to 22.7% in 2008 and 21.9% in 2007. Net income was \$74.2 million in 2009 compared to \$78.6 million in 2008 and \$76.3 million in 2007. Earnings per share, assuming dilution, were \$1.17 in 2009 compared to \$1.22 in 2008 and \$1.10 in 2007. Earnings per share in 2009, 2008 and 2007 reflect the repurchase of 0.8 million, 3.1 million and 5.8 million shares of our stock, respectively.

Our operating results have fluctuated on a quarterly basis in the past, and may vary significantly in future periods due to a number of factors. We normally operate with very little order backlog. A majority of our sales in each quarter result from customer orders received in that quarter under agreements containing non-binding purchase commitments. Many of our customers require prompt delivery of products. This results in a limited backlog of orders and requires us to maintain sufficient inventory levels to satisfy anticipated customer demand. If near-term demand for our products declines, or if potential sales in any quarter do not occur as anticipated, our financial results could be adversely affected. Operating expenses are relatively fixed in the short term; therefore, a shortfall in quarterly revenues could significantly impact our financial results in a given quarter.

Our operating results may also fluctuate as a result of a number of other factors, including a decline in general economic and market conditions, increased competition, customer order patterns, changes in product mix, timing differences between price decreases and product cost reductions, product warranty returns, 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 12 of Notes to Consolidated Financial Statements. For a discussion of risks associated with our operating results, see Item 1A of our Form 10-K for the year ended December 31, 2009.

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. When contracts contain multiple elements, contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple element contract should be treated as separate units of accounting for revenue recognition purposes, and, if so, how the price should be allocated among the elements and when to recognize revenue for each element. We record revenue associated with installation services when the installation and all contractual obligations are complete. When contracts include both installation and product sales, the installation is considered as a separate deliverable item. Either the purchaser, ADTRAN, or a third party can perform installation of our products. Revenues related to maintenance services are recognized on a straight line basis over the contract term.
- Sales returns are accrued based on historical sales return experience, which we believe provides a reasonable estimate of future returns. 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 \$0.1 million at December 31, 2009 and \$38 thousand at December 31, 2008.

- We carry our inventory at the lower of cost or market, with cost being determined using the first-in, first-out method. We use standard costs for material, labor, and manufacturing overhead to value our inventory. Our standard costs are updated on at least a quarterly basis and any variances are expensed in the current period; therefore, our inventory costs approximate actual costs at the end of each reporting period. We write down our inventory for estimated obsolescence or unmarketable inventory by an amount equal to the difference between the cost of inventory and the estimated fair value based upon assumptions about future demand and market conditions. If actual future demand or market conditions are less favorable than those projected by management, we may be required to make additional inventory write-downs. Our reserve for excess and obsolete inventory was \$7.8 million and \$7.7 million at December 31, 2009 and 2008, respectively. Inventory write-downs charged to the reserve were \$1.7 million, \$1.0 million and \$1.6 million for the years ended December 31, 2009, 2008 and 2007, respectively.
- The objective of our short-term investment policy is to preserve principal and maintain adequate liquidity with appropriate diversification, while emphasizing 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. 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, 2009, we categorized \$246.1 million and \$38.1 million of our available-for-sale investments as Level 2 and Level 1, respectively, and \$18.4 million of our cash equivalents as Level 1.

We review our investment portfolio for potential "other-than-temporary" declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 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 did not record any other-than-temporary impairment charge during the fourth quarter of 2009. For the years ended December 31, 2009, 2008 and 2007, we recorded charges of \$2.9 million, \$2.4 million and \$0.1 million, respectively, related to the

other-than-temporary impairment of certain publicly traded equity securities, a fixed income bond fund, and deferred compensation 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 3 of Notes to the Consolidated Financial Statements in this report for more information about our investments.

We also invest in privately held entities and private equity funds and record these investments at cost. We review these investments periodically in order to determine if circumstances (both financial and non-financial) exist that indicate that we will not recover our initial investment. Impairment charges are recorded on investments having a cost basis that is greater than the value that we would reasonably expect to receive in an arm's length sale of the investment. We have not been required to record any impairment losses relating to these investments in 2009, 2008 or 2007.

- 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 the 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 and vest at the end of a three-year performance period. 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. For 2009 and 2008 respectively, the valuation allowance was \$5.3 million and \$1.6 million. As of December 31, 2009, we have state research tax credit carry-forwards of \$1.8 million, which will expire between 2015 and 2024. 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, 2009, we have net operating loss carry-forwards of \$3.8 million which will expire between 2014 and 2029. These carry-forwards are the result of a foreign acquisition in 2009. 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 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 \$2.8 million at December 31, 2009 and 2008, respectively. These liabilities are included in accrued expenses in the accompanying consolidated balance sheets.

Results of Operations

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

Year Ended December 31,	2009	2008	2007
Sales			
Carrier Networks Division	76.7%	78.3%	75.1%
Enterprise Networks Division	23.3%	21.7%	24.9%
Total sales	100.0%	100.0%	100.0%
Cost of sales	40.7	40.3	40.6
Gross profit	59.3	59.7	59.4
Selling, general and administrative expenses	20.5	20.6	21.7
Research and development expenses	17.2	16.4	15.8
Operating income	21.6	22.7	21.9
Interest and dividend income	1.4	1.7	2.4
Interest expense	(0.5)	(0.5)	(0.5)
Net realized investment gain (loss)	(0.3)	(0.5)	0.1
Other income, net	—	0.2	0.1
Life insurance proceeds	—	—	0.2
Income before provision for income taxes	22.2	23.6	24.2
Provision for income taxes	6.9	7.9	8.2
Net income	15.3%	15.7%	16.0%

2009 Compared to 2008

Sales

ADTRAN's sales decreased 3.3% from \$500.7 million in 2008 to \$484.2 million in 2009. This decrease in sales is primarily attributable to a \$46.6 million decrease in sales of HDSL and other traditional products, partially offset by a \$9.1 million increase in sales of our Broadband Access products, a \$6.8 million increase in sales of our Optical Access products, and a \$14.2 million increase in sales of our Internetworking products.

Carrier Networks sales decreased 5.3% from \$392.2 million in 2008 to \$371.3 million in 2009. The decrease is primarily attributable to decreases in HDSL, DDS, and other traditional TDM products sales, partially offset by an increase in Broadband Access and Optical Access product sales.

Enterprise Networks sales increased 4.0% from \$108.5 million in 2008 to \$112.8 million in 2009. The increase is primarily attributable to an increase in sales of Internetworking products, partially offset by declines in sales of traditional IAD products, and Enterprise T1 products. Internetworking product sales were 67.4% of Enterprise Network sales in 2009 compared with 58.3% in 2008. Traditional products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales increased from 21.7% in 2008 to 23.3% in 2009.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, decreased 7.7% from \$30.1 million in 2008 to \$27.8 million in 2009. International sales, as a percentage of total sales, decreased from 6.0% in 2008 to 5.7% in 2009. International sales in 2009 decreased primarily due to a decline in macroeconomic conditions.

Carrier Systems product sales increased \$9.5 million in 2009 compared to 2008 primarily due to a \$9.1 million increase in Broadband Access product sales and a \$6.8 million increase in Optical Access product sales. These increases were primarily attributable to increased shipments of our Total Access 5000 products, our OPTI family of products and continuing deployments of FTTN products, resulting from market share gains across all major market segments. Partially offsetting these increases were decreases in TDM and other traditional product sales as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Broadband Access and Optical Access product areas.

Business Networking product sales increased \$10.9 million in 2009 compared to 2008 due to a \$14.2 million increase in Internetworking product sales, primarily as a result of market share gains in SMB and distributed enterprise applications.

Partially offsetting this increase in Internetworking product sales was a decline in sales of traditional IAD products as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales decreased \$36.9 million in 2009 compared to 2008 primarily due to declines in HDSL, Enterprise T1, and DDS product sales.

Cost of Sales

Cost of sales increased from 40.3% of sales in 2008 to 40.7% of sales in 2009. The increase in cost of sales as a percentage of sales is primarily related to costs incurred to expedite delivery of materials and costs related to a new product release, which were partially offset by cost reductions generated through improved manufacturing efficiencies.

Carrier Networks cost of sales increased from 39.8% of sales in 2008 to 40.8% of sales in 2009. The increase was primarily related to costs incurred to expedite delivery of materials and costs related to a new product release.

Enterprise Networks cost of sales decreased from 42.2% of sales in 2008 to 40.4% of sales in 2009. The decrease was primarily related to lower freight costs and other cost reductions generated through improved manufacturing efficiencies.

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 decreased 3.7% from \$103.3 million, or 20.6% of sales in 2008, to \$99.4 million, or 20.5% of sales in 2009. 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 decrease in selling, general, and administrative expenses was primarily related to a reduction in discretionary expenditures including temporary labor, travel, and various promotional expenses.

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

Research and Development Expenses

Research and development expenses increased 1.8% from \$81.8 million, or 16.3% of sales, in 2008 to \$83.3 million, or 17.2% of sales, in 2009. The increase in research and development expenses was a result of increased staffing, 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 will fluctuate whenever there are incremental product development activities or a significant fluctuation in revenues for the periods being compared.

ADTRAN expects to continue to incur research and development expenses in connection with its new and existing products and its expansion into international markets. ADTRAN continually evaluates new product opportunities and engages in intensive research and product development efforts which provides for new product development, enhancement of existing products and product cost reductions. ADTRAN may incur significant research and development expenses prior to the receipt of revenues from a major new product group or market expansion.

Interest and Dividend Income

Interest and dividend income decreased 20.4% from \$8.7 million in 2008 to \$6.9 million in 2009. This decrease was the result of a 39.6% reduction in the average rate of return on our investments due to lower interest rates.

Interest Expense

Interest expense decreased from \$2.5 million in 2008 to \$2.4 million in 2009. The decrease was due to a lower principal balance in 2009 as compared to 2008. See "Liquidity and Capital Resources" below for additional information.

Net Realized Investment Gain (Loss)

Net realized investment gain (loss) changed from a \$2.4 million loss in 2008 to a \$1.3 million loss in 2009. The change is a result of fewer other-than-temporary impairments of certain securities in our equity portfolio during 2009 as compared to 2008 and the sales of certain securities for a gain. See "Investing Activities" in "Liquidity and Capital Resources" below for additional information.

Other Income, net

Other income, net, comprised primarily of miscellaneous income, gains and losses on foreign currency 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 \$0.7 million in 2008 to \$0.1 million in 2009.

Income Taxes

Our effective tax rate decreased from 33.6% in 2008 to 31.0% in 2009, primarily due to increased benefits relating to the deduction for manufacturer's domestic production activities under Internal Revenue Code Section 199 and an increase in our federal research and development credits, partially offset by an increase in state income tax expense.

Net Income

As a result of the above factors, net income decreased from \$78.6 million in 2008 to \$74.2 million in 2009. As a percentage of sales, net income decreased from 15.7% in 2008 to 15.3% in 2009.

2008 Compared to 2007**Sales**

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

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

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

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

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

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

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

Cost of Sales

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

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

elements to the division. Enterprise Networks cost of sales, as a percent of division sales, increased from 40.9% in 2007 to 42.2% in 2008. The increase was primarily related to a higher cost product mix plus the impact of allocated manufacturing costs to the division.

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

Selling, General and Administrative Expenses

Selling, general and administrative expenses were \$103.3 million in 2008 and 2007, and represented 20.6% of sales for 2008 and 21.7% of sales for 2007. Selling, general and administrative expenses include personnel costs for administration, finance, information systems, human resources, sales and marketing, and general management, as well as rent, utilities, legal and accounting expenses, bad debt expense, advertising, promotional material, trade show expenses, and related travel costs.

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

Research and Development Expenses

Research and development expenses increased 8.5% from \$75.4 million, or 15.8% as a percentage of sales, in 2007 to \$81.8 million, or 16.3% as a percentage of sales, in 2008. The increase in research and development expenses primarily reflects increased staffing expense related to customer specific product development activities, as well as costs related to product approvals, primarily for one or more of the top three U.S. carriers. Research and development expenses as a percentage of sales will fluctuate whenever there is a significant fluctuation in revenues for the periods being compared.

ADTRAN expects to continue to incur research and development expenses in connection with its new and existing products and its expansion into international markets. ADTRAN continually evaluates new product opportunities and engages in intensive research and product development efforts which provides for new product development, enhancement of existing products and product cost reductions. ADTRAN may incur significant research and development expenses prior to the receipt of revenues from a major new product group or market expansion.

Interest and Dividend Income

Interest and dividend income decreased 24.3% from \$11.5 million in 2007 to \$8.7 million in 2008. This decrease is due to a 14% reduction in our average investment balances in 2008 as compared to 2007, primarily as a result of our share repurchase activity, and a 25% reduction in the average rate of return on these investments, due to lower interest rates.

Interest Expense

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

Net Realized Investment Gain (Loss)

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

Other Income, net

Other income, net, comprised primarily of miscellaneous income, gains and losses on foreign currency transactions, investment account management fees, gains or losses on the disposal of property, plant, and equipment occurring in the normal course of business, decreased from \$0.8 million in 2007 to \$0.7 million in 2008.

Life Insurance Proceeds

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

Income Taxes

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

Net Income

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

Liquidity and Capital Resources

Liquidity

At December 31, 2009, cash on hand was \$24.1 million and short-term investments were \$172.5 million, which placed our short-term liquidity at \$196.6 million. At December 31, 2008, our cash on hand of \$41.9 million and short-term investments of \$96.3 million placed our short-term liquidity at \$138.2 million. The increase in liquidity from 2008 to 2009 is primarily the result of positive cash flow generated from operating activities and the purchase of fewer shares of our common stock in the first three quarters of 2009 due to the uncertainty in the economy during that period. Purchases of our common stock totaled \$15.9 million in 2009 compared to \$63.6 million in 2008.

Operating Activities

Our working capital, which consists of current assets less current liabilities, increased 30.7% from \$212.7 million as of December 31, 2008 to \$278.0 million as of December 31, 2009. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, increased from 4.76 as of December 31, 2008 to 5.54 as of December 31, 2009. The current ratio, defined as current assets divided by current liabilities, increased from 6.30 as of December 31, 2008 to 6.82 as of December 31, 2009. Our working capital, the quick ratio, and the current ratio increased from 2008 to 2009 mainly due to a \$76.2 million increase in short-term investments as we generated positive cash flow from operations while purchasing fewer shares of our common stock in 2009.

Net accounts receivable increased 29.0% from \$52.7 million at December 31, 2008 to \$68.0 million at December 31, 2009. Our allowance for doubtful accounts increased from \$38 thousand at December 31, 2008 to \$0.1 million at December 31, 2009. Quarterly accounts receivable days sales outstanding (DSO) increased from 43 days as of December 31, 2008 to 50 days as of December 31, 2009. Net accounts receivable and DSO increased for the year ended December 31, 2009 primarily due to the timing of shipments during the fourth quarter of 2009.

Quarterly inventory turnover increased from 3.8 turns as of December 31, 2008 to 4.5 turns as of December 31, 2009. Inventory decreased 3.7% from December 31, 2008 to December 31, 2009. We expect inventory levels to fluctuate as we attempt to maintain sufficient inventory to ensure competitive lead times while managing the risk of inventory obsolescence that may occur due to rapidly changing technology and customer demand.

Accounts payable increased 26.9% from \$20.3 million at December 31, 2008 to \$25.8 million at December 31, 2009. 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 \$8.7 million, \$9.5 million and \$6.5 million for the years ended December 31, 2009, 2008 and 2007, 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 \$97.1 million from \$237.5 million at December 31, 2008 to \$334.6 million at December 31, 2009. This increase reflects the impact of net funds available for investment provided by our operating activities, reduced by our cash needs for equipment acquisitions, stock repurchases and dividends, as well as net realized and unrealized losses and amortization of net premiums on our combined investments.

We invest all available cash not required for immediate use in operations primarily in securities that we believe bear minimal risk of loss. At December 31, 2009, these investments included municipal variable rate demand notes of \$84.4 million, municipal fixed-rate bonds of \$141.3 million and corporate bonds guaranteed by the FDIC of \$20.4 million. At December 31, 2008, these investments included municipal variable rate demand notes of \$52.6 million, municipal fixed-rate bonds of \$116.9 million and a government agency security of \$2.0 million.

Our municipal variable rate demand notes are classified as available-for-sale short-term investments. At December 31, 2009, 98% had a credit rating of VMIG-1 or A-1+ with the remaining 2% rated A-1 and all contained put options of seven days. Thus, despite the long-term nature of their stated contractual maturities, we believe that we have the ability to quickly liquidate these securities. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. 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. Approximately 22% of our variable rate demand notes are supported by letters of credit from banks that we believe to be in good financial condition. The remaining 78% of our variable rate demand notes are supported by standby purchase agreements. As a result of all of these factors, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments at December 31, 2009. All income generated from these investments was recorded as interest income. We have not been required to record any losses relating to municipal variable rate demand notes or auction rate securities, and we have held no auction rate securities since February 7, 2008.

At December 31, 2009, approximately 49% of our municipal fixed-rate bond portfolio had a credit rating of AAA, 45% had a credit rating of AA, and the remaining 6% had a credit rating of A. These bonds are classified as available-for-sale investments and had an average duration of 1.04 years at December 31, 2009. 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 15% from \$141.2 million at December 31, 2008 to \$162.2 million at December 31, 2009. Municipal fixed-rate bonds classified as long-term investments decreased \$22.1 million from \$75.3 million at December 31, 2008 to \$53.2 million at December 31, 2009. The primary reason for the decrease in our long-term municipal fixed rate bonds was the investment in corporate bonds to increase the yield of our long-term portfolio. Long-term investments at December 31, 2009 and 2008 include an investment in a certificate of deposit of \$48.3 million and \$48.8 million, respectively, which serves as collateral for our revenue bonds, as discussed below. Long-term investments at December 31, 2009 also include \$20.4 million of FDIC guaranteed corporate bonds. All of our corporate bond investments had a credit rating of AAA at December 31, 2009. We have various equity investments included in long-term investments at a cost of \$9.8 million and \$12.0 million, and with a fair value of \$33.5 million and \$11.6 million, at December 31, 2009 and 2008, respectively. Included in our marketable equity securities is a single equity security, of which we held 2.1 million shares and 2.5 million shares, carried at \$22.4 million and \$2.5 million of fair value, at December 31, 2009 and 2008, respectively. The single security traded approximately 395 thousand shares per day in 2009, in an active market on a European stock exchange. This single security carried \$21.7 million and \$1.6 million of the gross unrealized gains included in the fair value of our marketable securities at December 31, 2009 and 2008, respectively. The remaining \$2.2 million of gross unrealized gains and \$0.2 million in gross unrealized losses at December 31, 2009 were spread amongst more than 375 equity securities. Long-term investments at December 31, 2009 and 2008 also included \$3.4 million and \$2.5 million, respectively, related to our deferred compensation plan; \$2.2 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 \$1.2 million and \$0.9 million, respectively, of a fixed income bond fund. This bond fund had unrealized gains of \$0.3 million and unrealized losses \$0.4 million at December 31, 2009 and 2008, respectively.

We review our investment portfolio for potential “other-than-temporary” declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical 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 did not record any other-than-temporary impairment charge during the fourth quarter of December 31, 2009. For the years ended December 31, 2009, 2008 and 2007 we recorded charges of \$2.9 million, \$2.4 million and \$0.1 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities, a fixed income bond fund, and deferred compensation assets.

On September 15, 2009, we acquired all of the outstanding stock of Objectworld Communications Corporation (Objectworld), a provider of unified communication solutions. The purpose of this acquisition was to acquire unified communications technologies. These technologies have been integrated into our NetVanta® product line. The purchase price was approximately \$1.5 million in cash subject to certain post closing adjustments, and was allocated to the individual assets and liabilities acquired. There was no goodwill determined in the final purchase price allocation. Objectworld’s financial statements have been included in our consolidated statements of income and cash flows from the date of the acquisition to December 31, 2009 and our consolidated balance sheet dated December 31, 2009.

Financing Activities

Fifty million dollars of the expansion of Phase III of our corporate headquarters was approved for participation in an incentive program offered by the Alabama State Industrial Development Authority (the Authority). Pursuant to the program, on January 13, 1995, the Authority issued \$20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the Bank). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee, Nashville, Tennessee) (the Bondholder), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to \$50.0 million. The incentive program enables participating companies to generate Alabama corporate income tax credits that can be used to reduce the amount of Alabama corporate income taxes that would otherwise be payable, in exchange for investing capital and creating jobs in Alabama. We cannot be certain that the state of Alabama will continue to make these corporate income tax credits available; therefore, we may not realize the full benefit of these incentives. Through December 31, 2009, the Authority had issued \$50.0 million of its taxable revenue bonds pursuant to the incentive program and loaned the proceeds from the sale of the bonds to ADTRAN. We are required to make payments to the Authority in the amounts necessary to pay the principal of, and interest on, the Authority's Taxable Revenue Bond, Series 1995, as amended, currently outstanding in the aggregate principal amount of \$48.3 million. The bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. Included in long-term investments at December 31, 2009 is \$48.3 million of restricted funds, which is a collateral deposit against the principal amount of this bond. We have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness. In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program.

Due to continued positive cash flow from operating activities, we made a business decision to begin an early partial redemption of the Bond. It is our intent to make annual principal payments in addition to the interest amounts that are due. In connection with this decision, \$0.5 million of the bond debt has been reclassified to a current liability in the Consolidated Balance Sheets at December 31, 2009 and 2008.

The following table shows dividends paid in each quarter of 2009, 2008 and 2007. During 2009, 2008 and 2007, ADTRAN paid dividends totaling \$22.5 million, \$22.9 million and \$24.6 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

2009	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2008	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	\$0.09	\$0.09	\$0.09	\$0.09
2007	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. As of December 31, 2009, the Board of Directors has authorized cumulative repurchases of up to 30 million shares of our common stock. We currently have the authority to purchase an additional 2.7 million shares of our common stock under the plan approved by the Board of Directors on April 14, 2008. For the years 2009, 2008 and 2007, we repurchased 0.8 million shares, 3.1 million shares and 5.8 million shares, respectively, for a cost of \$15.9 million, \$63.6 million and \$138.6 million, respectively, at an average price of \$21.05, \$20.65 and \$24.08 per share, respectively.

To accommodate employee stock option exercises, we issued 0.9 million shares of treasury stock for \$13.5 million during the year ended December 31, 2009, 0.3 million shares of treasury stock for \$3.7 million during the year ended December 31, 2008, and 1.2 million shares of treasury stock for \$15.3 million during the year ended December 31, 2007.

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, 2009.

Contractual Obligations

<i>(In millions)</i>	Total	2010	2011	2012	2013	After 2013
Long-term debt	\$48.3	—	—	—	—	\$48.3
Interest on long-term debt	24.1	2.4	2.4	2.4	2.4	14.5
Investment commitments	0.5	0.2	—	0.3	—	—
Operating lease obligations	2.3	1.3	0.7	0.3	—	—
Purchase obligations	44.1	43.0	0.9	0.2	—	—
Totals	\$119.3	\$46.9	\$4.0	\$3.2	\$2.4	\$62.8

We are required to make payments necessary to pay the interest on the Taxable Revenue Bond, Series 1995, as amended, currently outstanding in the aggregate principal amount of \$48.3 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 \$7.9 million as of December 31, 2009, of which \$7.4 million has been applied to these commitments. See Note 3 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 7 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 6 and 10 of Notes to Consolidated Financial Statements for additional information on our revenue bond and operating lease obligations, respectively.

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.

Effect of Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued Update No. 2010-06, which amends the Fair Value Measurements and Disclosures topic of the FASB Accounting Standards Codification (Codification). The amendments in this update require new disclosures about transfers in and out of Levels 1 and 2 fair value measurements and the activity in Level 3 fair value measurements and, in addition, clarify existing disclosures required for levels of disaggregation and inputs and valuation techniques. These amendments will be effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about activity in Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We plan to adopt this amendment and provide any additional disclosures required for the period ending March 31, 2010.

In October 2009, the FASB issued Update No. 2009-13, which amends the Revenue Recognition topic of the Codification. This update provides amendments to the criteria in Subtopic 605-25 of the Codification for separating consideration in multiple-deliverable arrangements. As a result of those amendments, multiple-deliverable arrangements will be separated in more circumstances than under existing U.S. GAAP. The amendments establish a selling price hierarchy for determining the selling price of a deliverable and will replace 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. The amendments will also eliminate the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method and will require 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. These amendments will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We do not expect the adoption of this amendment will have a material impact on our consolidated results of operations or financial condition.

In October 2009, the FASB issued Update No. 2009-14, which amends the Software topic of the Codification. The amendments in this update change 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 is no longer within the scope of the software revenue guidance in Subtopic 985-605 of the Codification. In addition, the amendments in this update require that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. In that regard, the amendments provide 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. The amendments also provide guidance on how a vendor should allocate arrangement consideration to deliverables in an arrangement that includes both tangible products and software. The amendments also provide 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. These amendments will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We do not expect the adoption of this amendment will have a material impact on our consolidated results of operations or financial condition.

During 2009, we adopted the following accounting guidance, none of which had a material effect on our consolidated results of operations or financial condition:

In December 2007, the FASB revised the authoritative guidance for business combinations, which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree in a business combination. The guidance establishes principles stipulating how goodwill acquired in a business combination or a gain from a bargain purchase should be recognized and measured. The guidance also expands the disclosure requirements related to the nature and financial impact of business combinations. We adopted this guidance as of January 1, 2009. We have applied this guidance to the business combination that occurred in the third quarter of 2009.

In June 2009, the FASB established the FASB Codification as the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied to nongovernmental entities and rules and interpretive releases of the SEC as authoritative GAAP for SEC registrants. The Codification supersedes all the existing non-SEC accounting and reporting standards upon its effective date and subsequently, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. This guidance is effective for interim periods ending after September 15, 2009. We adopted this guidance for the period ended September 30, 2009, with no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In December 2007, the FASB revised the authoritative guidance for consolidation, which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The guidance clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. The guidance also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. It also provides guidance when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners of a subsidiary. We adopted this guidance as of January 1, 2009. The adoption of this guidance had no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In June 2008, the FASB revised the authoritative guidance for earnings per share, which establishes that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. In contrast, the right to receive dividends or dividend equivalents that the holder will forfeit if the award does not vest does not constitute a participation right and such an award does not meet the definition of a participating security in its current form (that is, prior to the requisite service having been rendered for the award). We adopted this guidance as of January 1, 2009. The adoption of this guidance had no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In April 2009, the FASB revised the authoritative guidance for financial instruments. The guidance requires disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements. This guidance is effective for interim periods ending after June 15, 2009. We adopted this guidance in the second quarter of 2009, and have provided the disclosures required for the period ending December 31, 2009.

In April 2009, the FASB revised the authoritative guidance for fair value measurements and disclosures to provide additional guidance in determining whether a market for a financial asset is not active and a transaction is not distressed for fair value measurement purposes. This guidance is effective for interim periods ending after June 15, 2009. We adopted this guidance for the period ending June 30, 2009. The adoption of this guidance had no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In April 2009, the FASB revised the authoritative guidance for investments in debt and equity securities to provide guidance in determining whether impairments in debt securities are other-than-temporary, and modifies the presentation and disclosures surrounding such instruments. This guidance is effective for interim periods ending after June 15, 2009. We adopted the provisions of this guidance for the period ending June 30, 2009. The adoption of this guidance had no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In May 2009, the FASB revised the authoritative guidance for subsequent events, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance is effective for financial statements issued for interim and annual reporting periods ending after June 15, 2009. We adopted this guidance for the period ended June 30, 2009, and have provided the disclosures required for the period ending December 31, 2009.

Subsequent Events

On January 19, 2010, 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 4, 2010. The quarterly dividend payment was \$5.6 million and was paid on February 18, 2010.

During the first quarter of 2010 and as of February 26, 2010, ADTRAN repurchased 0.5 million shares of its common stock through open market purchases at an average cost of \$21.62 per share and has the authority to repurchase an additional 2.2 million shares under the plan approved by the Board of Directors on April 14, 2008.

We have evaluated all subsequent events through February 26, 2010, the date the financial statements were issued.

Quantitative and Qualitative Disclosures About Market Risk

Details regarding the fair value of our available-for-sale investments as of December 31, 2009 are discussed in Note 3 of Notes to Consolidated Financial Statements included in this report.

We are exposed to financial market risks, including changes in interest rates and prices of marketable equity and fixed-income securities. The primary objective of our investment activities is to preserve principal while at the same time achieving appropriate yields without significantly increasing risk. To achieve this objective, a majority of our marketable securities are investment grade, municipal fixed-rate bonds, municipal variable rate demand notes and municipal money market instruments denominated in United States dollars. At December 31, 2009, 98% of our municipal variable rate demand notes had a credit rating of VMIG-1 or A-1+ while the remaining 2% had a rating of A-1. Approximately 49% of our municipal fixed-rate bonds had a credit rating of AAA, 45% had a credit rating of AA, and the remaining 6% had a credit rating of A. We also held \$20.4 million of corporate bonds that are guaranteed by the Federal Deposit Insurance Corporation (FDIC) and issued by various banks. At December 31, 2009, all of our corporate bonds had a credit rating of AAA.

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these applicable financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of December 31, 2009, \$23.1 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits. The Temporary Liquidity Guarantee Program adopted during 2008 by the FDIC provided full coverage of our domestic depository accounts through December 2009. Although this program was extended through June 30, 2010, the banks where we maintain our depository accounts opted out of participation in this program after December 31, 2009.

As of December 31, 2009, approximately \$264.1 million of our cash and investments may be directly affected by changes in interest rates. We have performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps), 100 bps and 150 bps for the entire year, while all other variables remain constant. At December 31, 2009, we held \$110.3 million of money market instruments and municipal variable rate demand notes. Hypothetical 50 bps, 100 bps and 150 bps declines in interest rates as of December 31, 2009 would reduce annualized interest income on our money market instruments and municipal variable rate demand notes by approximately \$0.6 million, \$1.1 million and \$1.7 million,

respectively. In addition, we held a combined \$153.8 million of fixed-rate municipal bonds and corporate bonds guaranteed by the FDIC whose fair value may be directly affected by a change in interest rates. Hypothetical 50 bps, 100 bps and 150 bps increases in interest rates as of December 31, 2009 would reduce the fair value of our bonds by approximately \$0.8 million, \$1.6 million and \$2.3 million, respectively.

As of December 31, 2008, interest income on approximately \$208.2 million of our cash and investments was subject to being directly affected by changes in interest rates. We performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 bps, 100 bps and 150 bps for the entire year, while all other variables remain constant. Hypothetical 50 bps, 100 bps and 150 bps declines in interest rates as of December 31, 2008 would have reduced annualized interest income on our money market instruments, municipal variable rate demand notes and municipal auction rate securities by approximately \$0.4 million, \$0.9 million and \$1.3 million, respectively. In addition, hypothetical 50 bps, 100 bps and 150 bps increases in interest rates as of December 31, 2008 would have reduced the fair value of our municipal fixed-rate bonds by approximately \$0.6 million, \$1.1 million and \$1.7 million, respectively.

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

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, 2009. 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, 2009.

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

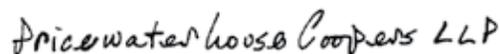
To Board of Directors and Stockholders of ADTRAN, Inc.:

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of ADTRAN, Inc. and its subsidiaries at December 31, 2009 and December 31, 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, 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, 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 and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

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

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



PricewaterhouseCoopers LLP
Birmingham, Alabama
February 26, 2010

Financial Statements

ADTRAN, Inc.

Consolidated Balance Sheets

December 31, 2009 and 2008

(In thousands, except per share amounts)

Assets	2009	2008
Current assets		
Cash and cash equivalents	\$ 24,135	\$ 41,909
Short-term investments	172,469	96,277
Accounts receivable, less allowance for doubtful accounts of \$138 and \$38 at December 31, 2009 and 2008, respectively	68,044	52,749
Other receivables	4,097	2,896
Inventory	45,674	47,406
Prepaid expenses	2,795	2,974
Deferred tax assets, net	8,603	8,653
Total current assets	325,817	252,864
Property, plant, and equipment, net	74,309	75,487
Deferred tax assets, net	—	3,920
Other assets	2,168	103
Long-term investments	162,169	141,241
Total assets	\$564,463	\$473,615
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 25,782	\$ 20,313
Unearned revenue	7,138	6,141
Accrued expenses	4,202	3,536
Accrued wages and benefits	7,634	9,868
Income tax payable, net	3,017	266
Total current liabilities	47,773	40,124
Deferred tax liabilities, net	5,035	—
Other non-current liabilities	11,390	9,422
Bonds payable	47,750	48,250
Total liabilities	111,948	97,796
Commitments and contingencies (see Note 10)		
Stockholders' equity		
Common stock, par value \$0.01 per share; 200,000 shares authorized; 79,652 issued in 2009 and 2008	797	797
Additional paid-in capital	181,240	172,704
Accumulated other comprehensive income (loss)	17,853	(1,009)
Retained earnings	649,256	603,600
Less treasury stock at cost: 17,392 shares at December 31, 2009 and 17,493 shares at December 31, 2008	(396,631)	(400,273)
Total stockholders' equity	452,515	375,819
Total liabilities and stockholders' equity	\$564,463	\$473,615

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

ADTRAN, Inc.**Consolidated Statements of Income**

Years ended December 31, 2009, 2008, 2007

<i>(In thousands, except per share amounts)</i>	2009	2008	2007
Sales	\$484,185	\$500,676	\$476,778
Cost of sales	197,223	201,771	193,792
Gross profit	286,962	298,905	282,986
Selling, general, and administrative expenses	99,446	103,286	103,329
Research and development expenses	83,285	81,819	75,367
Operating income	104,231	113,800	104,290
Interest and dividend income	6,933	8,708	11,521
Interest expense	(2,430)	(2,514)	(2,502)
Net realized investment gain (loss)	(1,297)	(2,409)	498
Other income, net	131	688	764
Life insurance proceeds	—	—	1,000
Income before provision for income taxes	107,568	118,273	115,571
Provision for income taxes	33,347	39,692	39,236
Net income	\$ 74,221	\$ 78,581	\$76,335
Weighted average shares outstanding – basic	62,459	63,549	67,848
Weighted average shares outstanding – diluted (1)	63,356	64,408	69,212
Earnings per common share – basic	\$1.19	\$1.24	\$1.13
Earnings per common share – diluted (1)	\$1.17	\$1.22	\$1.10

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

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

ADTRAN, Inc.**Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income**

Years ended December 31, 2009, 2008 and 2007

<i>(In thousands)</i>	Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balance, December 31, 2006	79,652	\$797	\$152,162	\$513,515	\$(233,214)	\$2,696	\$435,956
Net income				76,335			76,335
Net change in unrealized gains/losses related to:							
Marketable securities (net of deferred tax of \$1,409)						2,375	2,375
Impaired marketable securities (net of deferred tax of \$31)						52	52
Foreign currency translation adjustment						581	581
Comprehensive income							79,343
Dividend payments				(24,600)			(24,600)
Adoption of FIN 48				(1,190)			(1,190)
Stock options exercised: Various prices per share				(12,296)	27,584		15,288
Purchase of treasury stock: 5,756 shares					(138,589)		(138,589)
Income tax benefit from exercise of stock options			4,408				4,408
Stock-based compensation expense			7,815				7,815
Balance, December 31, 2007	79,652	\$797	\$164,385	\$551,764	\$(344,219)	\$5,704	\$378,431
Net income				78,581			78,581
Net change in unrealized gains/losses related to:							
Marketable securities (net of deferred tax of \$3,638)						(6,127)	(6,127)
Impaired marketable securities (net of deferred tax of \$740)						1,238	1,238
Foreign currency translation adjustment						(1,824)	(1,824)
Comprehensive income							71,868
Dividend payments				(22,919)			(22,919)
Dividends accrued for unvested restricted stock units				(2)			(2)
Stock options exercised: Various prices per share				(3,824)	7,515		3,691
Purchase of treasury stock: 3,078 shares					(63,569)		(63,569)
Income tax benefit from exercise of stock options			981				981
Stock-based compensation expense			7,338				7,338
Balance, December 31, 2008	79,652	\$797	\$172,704	\$603,600	\$(400,273)	\$(1,009)	\$375,819

ADTRAN, Inc.**Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income***Continued*

<i>(In thousands)</i>	Common Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Net income				74,221			74,221
Net change in unrealized gains/losses related to:							
Marketable securities (net of deferred tax of \$9,218)						15,384	15,384
Impaired marketable securities (net of deferred tax 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

ADTRAN issued 856 shares, 325 shares and 1,197 shares of treasury stock to accommodate employee stock option exercises during 2009, 2008 and 2007, respectively. During 2008 and 2007, ADTRAN received 9 shares and 2 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, 2009, 2008 and 2007

<i>(In thousands)</i>	2009	2008	2007
Cash flows from operating activities			
Net income	\$74,221	\$78,581	\$76,335
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	10,084	9,891	10,695
Amortization of net premium on available-for-sale investments	3,686	2,101	2,094
Net realized loss (gain) on long-term investments	1,297	2,409	(498)
Loss (gain) on disposal of property, plant, and equipment	(31)	83	65
Stock-based compensation expense	6,987	7,338	7,815
Deferred income taxes	(1,024)	(903)	(2,990)
Tax benefit from stock option exercises	1,549	981	4,408
Excess tax benefits from stock-based compensation arrangements	(998)	(619)	(3,249)
Change in operating assets and liabilities:			
Accounts receivable, net	(15,143)	17,918	(13,898)
Other receivables	(1,195)	189	4,396
Income tax receivable, net	—	—	1,446
Inventory	1,732	1,140	4,571
Prepaid expenses and other assets	(489)	(549)	596
Accounts payable	5,442	(1,887)	(7,933)
Accrued expenses and other liabilities	1,010	93	3,517
Income taxes payable, net	3,027	(951)	1,507
Net cash provided by operating activities	90,155	115,815	88,877
Cash flows from investing activities			
Purchases of property, plant, and equipment	(8,740)	(9,492)	(6,535)
Proceeds from sales and maturities of available-for-sale investments	186,193	248,688	253,339
Purchases of available-for-sale investments	(262,067)	(242,791)	(217,316)
Acquisition of business, net of cash acquired	(1,370)	—	—
Net cash (used in) provided by investing activities	(85,984)	(3,595)	29,488
Cash flows from financing activities			
Proceeds from stock option exercises	13,471	3,691	15,288
Purchases of treasury stock	(15,896)	(63,569)	(138,589)
Dividend payments	(22,486)	(22,919)	(24,600)
Payments on long-term debt	(500)	(250)	(500)
Excess tax benefits from stock-based compensation arrangements	998	619	3,249
Net cash used in financing activities	(24,413)	(82,428)	(145,152)
Net increase (decrease) in cash and cash equivalents	(20,242)	29,792	(26,787)
Effect of exchange rate changes	2,468	(1,824)	581
Cash and cash equivalents, beginning of year	41,909	13,941	40,147
Cash and cash equivalents, end of year	\$24,135	\$41,909	\$13,941
Supplemental disclosure of cash flow information			
Cash paid during the year for interest	\$2,435	\$2,447	\$2,469
Cash paid during the year for income taxes	\$30,869	\$42,267	\$35,099

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, markets and services network access solutions for communications networks. Our solutions are widely deployed by providers of communications services (served by our Carrier Networks Division), and small and mid-sized businesses (SMBs) and enterprises (served 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 service provider and many global ones, as well as by many public, private and governmental organizations worldwide.

Principles of Consolidation

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

Cash and Cash Equivalents

Cash and cash equivalents represent demand deposits, money market funds, and short-term investments classified as available for sale with original maturities of three months or less. We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these applicable financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of December 31, 2009, \$23.1 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits. The Temporary Liquidity Guarantee Program adopted during 2008 by the Federal Deposit Insurance Corporation provided full coverage of our domestic depository accounts through December 2009. Although this program was extended through June 30, 2010, the banks where we maintain our depository accounts opted out of participation in the program after December 31, 2009.

Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, and accounts payable approximate fair value due to the immediate or short-term maturity of these financial instruments. The carrying amount reported for bonds payable was \$48.3 million compared to an estimated fair value of \$45.8 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 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, 2009, 98% of our variable rate demand notes had a credit rating of VMIG-1 or A-1+ with the remaining 2% rated A-1 and all contained put options of seven days. Thus, despite the long-term nature of their stated contractual maturities, we believe that we have the ability to quickly liquidate these securities. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. 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. Approximately 22% of our variable rate demand notes are supported by letters of credit from banks that we believe to be in good financial condition. The remaining 78% of our variable rate demand notes are supported by standby purchase agreements. As a result of all of these factors, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments at December 31, 2009. All income generated from these investments was recorded as interest income. We have not been required to record any losses relating to municipal variable rate demand notes or auction rate securities, and we have held no auction rate securities since February 7, 2008.

Long-term investments represent a restricted certificate of deposit, municipal fixed-rate bonds, FDIC guaranteed 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, 2009 and 2008 are classified as available-for-sale (see Note 3).

Accounts Receivable

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

We maintain 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 \$138 thousand at December 31, 2009 and \$38 thousand at December 31, 2008.

Other Receivables

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

Inventory

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

Property, Plant, and Equipment

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

Liability for Warranty

Our products generally include warranties of one to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled \$2.8 million at December 31, 2009 and 2008. 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, 2009 and 2008 is as follows:

(In thousands)

Year Ended December 31,	2009	2008
Balance at beginning of period	\$2,812	\$2,944
Plus: amounts acquired or charged to cost and expenses	2,665	2,261
Less: deductions	(2,644)	(2,393)
Balance at end of period	\$2,833	\$2,812

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 2009 and 2008. 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 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 2009, 2008 and 2007 was approximately \$7.0 million, \$7.3 million and \$7.8 million, respectively. As of December 31, 2009, total compensation cost related to non-vested stock options and restricted stock units not yet recognized was approximately \$16.1 million, which is expected to be recognized over an average remaining recognition period of 2.9 years. See Note 2 of Notes to Consolidated Financial Statements for additional information.

Impairment of Long-Lived Assets

We review long-lived assets for impairment under the guidance prescribed by the Property, Plant, and Equipment Topic of the FASB ASC. We evaluate long-lived assets used in operations for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable and the undiscounted cash flows estimated to be generated by the asset are less than the asset's carrying value. An impairment loss would be recognized in the amount by which the recorded value of the asset exceeds the fair value of the asset, measured by the quoted market price of an asset or an estimate based on the best information available in the circumstances. There were no such impairment losses recognized during 2009, 2008 and 2007.

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 \$83.3 million, \$81.8 million and \$75.4 million for the years ended December 31, 2009, 2008 and 2007, 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:

<i>(In thousands)</i>	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, 2006	\$2,219	\$477	\$2,696
Activity in 2007	2,427	581	3,008
Balance at December 31, 2007	4,646	1,058	5,704
Activity in 2008	(4,889)	(1,824)	(6,713)
Balance at December 31, 2008	(243)	(766)	(1,009)
Activity in 2009	16,394	2,468	18,862
Balance at December 31, 2009	\$16,151	\$1,702	\$17,853

Income Taxes

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

Foreign Currency

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

Revenue Recognition

Revenue is generally recognized upon shipment of the product to the customer in accordance with the terms of the sales agreement, generally FOB shipping point. In the case of consigned inventory, revenue is recognized when the end customer assumes ownership of the product. When contracts contain multiple elements, contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple element contract should be treated as separate units of accounting for revenue recognition purposes, and, if so, how the price should be allocated among the elements and when to recognize the revenue for each element. We record revenue associated with installation services when the installation and all contractual obligations are complete. When contracts include both installation and product sales, the installation is considered as a separate deliverable item. Either the purchaser, ADTRAN, or a third party can perform the installation of our products. Shipping fees are recorded as revenue and the related cost is included in cost of sales. Revenue is recorded net of discounts. Also, revenue is recorded when the product price is fixed 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 in the United States through a non-exclusive distribution network of major technology distributors. These large organizations then distribute to an extensive network of value-added resellers and system integrators. Value-added resellers and system integrators may be affiliated with us as a channel partner, or they may purchase from the distributor in an unaffiliated fashion. Additionally, with certain limitations our distributors may return unused and unopened product for stock-balancing purposes when such returns are accompanied by offsetting orders for products of equal or greater value.

We participate in cooperative advertising and market development programs with certain customers. We use these programs to reimburse customers for certain forms of advertising, and in general, to allow our customers credits up to a specified percentage of their net purchases. Our costs associated with these programs are estimated and 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, 2009 and 2008, unearned revenue was as follows:

<i>(In thousands)</i>	2009	2008
Current unearned revenue	\$7,138	\$6,141
Non-current unearned revenue	3,915	3,235
Total	\$11,053	\$9,376

Other Income, net

Other income, net, is comprised primarily of miscellaneous income and expense, gains and losses on foreign currency transactions, investment account management fees, 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 11).

Dividends

The Board of Directors presently anticipates that it will declare a regular quarterly dividend so long as the current tax treatment of dividends exists and adequate levels of liquidity are maintained. During the years ended December 31, 2009, 2008 and 2007, ADTRAN paid \$22.5 million, \$22.9 million and \$24.6 million, respectively, in dividend payments. On January 19, 2010, 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 4, 2010. The ex-dividend date was February 2, 2010 and the payment date was February 18, 2010. The quarterly dividend payment was \$5.6 million.

Business Combinations

On September 15, 2009, we acquired all of the outstanding stock of Objectworld Communications Corporation (Objectworld), a provider of unified communication solutions. The purpose of this acquisition was to acquire unified communications technologies. These technologies have been integrated into our NetVanta® product line. The purchase price was approximately \$1.5 million in cash subject to certain post closing adjustments, and was allocated to the individual assets and liabilities acquired. There was no goodwill determined in the final purchase price allocation. Objectworld's financial statements have been included in our consolidated statements of income and cash flows from the date of the acquisition to December 31, 2009 and our consolidated balance sheet dated December 31, 2009.

Use of Estimates

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

Recently Issued Accounting Standards

In January 2010, the Financial Accounting Standards Board (FASB) issued Update No. 2010-06, which amends the Fair Value Measurements and Disclosures topic of the FASB Accounting Standards Codification (Codification). The amendments in this update require new disclosures about transfers in and out of Levels 1 and 2 fair value measurements and the activity in Level 3 fair value measurements and, in addition, clarify existing disclosures required for levels of disaggregation and inputs and valuation techniques. These amendments will be effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about activity in Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We plan to adopt this amendment and provide any additional disclosures required for the period ending March 31, 2010.

In October 2009, the FASB issued Update No. 2009-13, which amends the Revenue Recognition topic of the Codification. This update provides amendments to the criteria in Subtopic 605-25 of the Codification for separating consideration in multiple-deliverable arrangements. As a result of those amendments, multiple-deliverable arrangements will be separated in more circumstances than under existing U.S. GAAP. The amendments establish a selling price hierarchy for determining the selling price of a deliverable and will replace 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. The amendments will also eliminate the residual method of allocation and require that arrangement consideration be allocated at the inception of the arrangement to all deliverables using the relative selling price method and will require 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. These amendments will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We do not expect the adoption of this amendment will have a material impact on our consolidated results of operations or financial condition.

In October 2009, the FASB issued Update No. 2009-14, which amends the Software topic of the Codification. The amendments in this update change 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 is no longer within the scope of the software revenue guidance in Subtopic 985-605 of the Codification. In addition, the amendments in this update require that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. In that regard, the amendments provide 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. The amendments also provide guidance on how a vendor should allocate arrangement consideration to deliverables in an arrangement that includes both tangible products and software. The amendments also provide 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. These amendments will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We do not expect the adoption of this amendment will have a material impact on our consolidated results of operations or financial condition.

During 2009, we adopted the following accounting guidance, none of which had a material effect on our consolidated results of operations or financial condition:

In December 2007, the FASB revised the authoritative guidance for business combinations, which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree in a business combination. The guidance establishes principles stipulating how goodwill acquired in a business combination or a gain from a bargain purchase should be recognized and measured. The guidance also expands the disclosure requirements related to the nature and financial impact of business combinations. We adopted this guidance as of January 1, 2009. We have applied this guidance to the business combination that occurred in the third quarter of 2009.

In June 2009, the FASB established the FASB Codification as the source of authoritative U.S. generally accepted accounting principles (GAAP) recognized by the FASB to be applied to nongovernmental entities and rules and interpretive releases of the SEC as authoritative GAAP for SEC registrants. The Codification supersedes all the existing non-SEC accounting and reporting standards upon its effective date and subsequently, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. This guidance is effective for interim periods ending after September 15, 2009. We adopted this guidance for the period ended September 30, 2009, with no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In December 2007, the FASB revised the authoritative guidance for consolidation, which establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The guidance clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. The guidance also requires consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest. It also requires disclosure, on the face of the consolidated statement of income, of the amounts of consolidated net income attributable to the parent and to the noncontrolling interest. It also provides guidance when a subsidiary is deconsolidated and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners of a subsidiary. We adopted this guidance as of January 1, 2009. The adoption of this guidance had no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In June 2008, the FASB revised the authoritative guidance for earnings per share, which establishes that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. In contrast, the right to receive dividends or dividend equivalents that the holder will forfeit if the award does not vest does not constitute a participation right and such an award does not meet the definition of a participating security in its current form (that is, prior to the requisite service having been rendered for the award). We adopted this guidance as of January 1, 2009. The adoption of this guidance had no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In April 2009, the FASB revised the authoritative guidance for financial instruments. The guidance requires disclosures about fair value of financial instruments in interim financial statements as well as in annual financial statements. This guidance is effective for interim periods ending after June 15, 2009. We adopted this guidance in the second quarter of 2009, and have provided the disclosures required for the period ending December 31, 2009.

In April 2009, the FASB revised the authoritative guidance for fair value measurements and disclosures to provide additional guidance in determining whether a market for a financial asset is not active and a transaction is not distressed for fair value measurement purposes. This guidance is effective for interim periods ending after June 15, 2009. We adopted this guidance for the period ending June 30, 2009. The adoption of this guidance had no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In April 2009, the FASB revised the authoritative guidance for investments in debt and equity securities to provide guidance in determining whether impairments in debt securities are other-than-temporary, and modifies the presentation and disclosures surrounding such instruments. This guidance is effective for interim periods ending after June 15, 2009. We adopted the provisions of this guidance for the period ending June 30, 2009. The adoption of this guidance had no effect on our consolidated results of operations and financial condition for the three and twelve months ended December 31, 2009.

In May 2009, the FASB revised the authoritative guidance for subsequent events, which establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This guidance is effective for financial statements issued for interim and annual reporting periods ending after June 15, 2009. We adopted this guidance for the period ended June 30, 2009, and have provided the disclosures required for the period ending December 31, 2009.

2 Stock Incentive Plans

Stock Incentive Program Descriptions

Our Board of Directors adopted the 1996 Employee Incentive Stock Option Plan (1996 Plan) effective February 14, 1996, as amended, under which 17.0 million shares of common stock were authorized for issuance to certain employees and officers through incentive stock options and non-qualified stock options. Options granted under the 1996 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four or five-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. The 1996 Plan expired February 14, 2006, and expiration dates of options outstanding at December 31, 2009 under the 1996 Plan range from 2010 to 2016.

On January 23, 2006, the Board of Directors adopted the 2006 Employee Stock Incentive Plan (2006 Plan), which authorizes 13.0 million shares of common stock for issuance to certain employees and officers through incentive stock options and non-qualified stock options, stock appreciation rights, restricted stock and restricted stock units. The 2006 Plan was adopted by stockholder approval at our annual meeting of stockholders held on May 9, 2006. Options granted under the 2006 Plan typically become exercisable beginning after one year of continued employment, normally pursuant to a four-year vesting schedule beginning on the first anniversary of the grant date, and have a ten-year contractual term. Expiration dates of options outstanding at December 31, 2009 under the 2006 Plan range from 2016 to 2019.

Our stockholders approved the 2005 Directors Stock Option Plan (Directors Plan) on May 18, 2005, under which 0.4 million shares of common stock have been reserved. The Directors Plan is a formula plan to provide options to our non-employee directors. Options granted under the Directors Plan normally become exercisable in full on the first anniversary of the grant date, and have a ten-year contractual term. We currently also have options outstanding under the 1995 Directors Stock Option Plan, as amended, which expired October 31, 2005. Expiration dates of options outstanding under both plans at December 31, 2009 range from 2010 to 2019.

The following table is a summary of our stock options outstanding as of December 31, 2008 and 2009 and the changes that occurred during 2009:

<i>(In thousands, except per share amounts)</i>	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Options outstanding, December 31, 2008	6,826	\$19.43	5.79	\$6,889
Options granted	996	\$23.34		
Options cancelled/forfeited	(50)	\$23.31		
Options exercised	(856)	\$15.74		
Options outstanding, December 31, 2009	6,916	\$20.42	6.05	\$25,719
Options exercisable, December 31, 2009	4,598	\$20.18	4.61	\$20,677

The following table further describes our stock options outstanding as of December 31, 2009:

Range of Exercise Prices	Options Outstanding			Options Exercisable		
	Options Outstanding at 12/31/09 <i>(in thousands)</i>	Weighted Avg. Remaining Contractual Life in Years	Weighted Average Exercise Price	Options Exercisable at 12/31/09 <i>(in thousands)</i>	Weighted Average Exercise Price	
\$8.69 - \$10.65	898	2.40	\$10.16	898	\$10.16	
\$10.66 - \$18.02	1,715	5.60	\$14.28	1,028	\$13.60	
\$18.03 - \$22.52	567	5.04	\$21.86	551	\$21.93	
\$22.53 - \$30.04	3,227	7.82	\$24.42	1,613	\$25.52	
\$30.05 - \$37.18	509	3.81	\$32.37	508	\$32.37	
	6,916			4,598		

All of the options above were issued at exercise prices that approximate fair market value at the date of grant. At December 31, 2009, 9.7 million options were available for grant under the shareholder approved plans.

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic value (the difference between ADTRAN's closing stock price on the last trading day of 2009 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, 2009. 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 2009, 2008 and 2007 was \$5.3 million, \$3.7 million and \$14.5 million, respectively. The fair value of options fully vesting during 2009, 2008 and 2007 was \$7.1 million, \$7.4 million and \$11.2 million, respectively.

Restricted Stock Program Description

On November 6, 2008, the Compensation Committee of the Board of Directors approved the Performance Shares Agreement under the 2006 Plan which sets forth the terms and conditions of awards of performance-based restricted stock units (RSUs). Of the 13.0 million shares of common stock authorized for issuance under the 2006 Plan, ADTRAN may grant up to 5.0 million shares of common stock for issuance to certain employees and officers for awards other than stock options, which would include RSUs. Under a proposal approved by the Board of Directors, which is subject to shareholder approval at the 2010 annual meeting, the number of shares available for awards other than stock options under all stock plans will be reduced to 3.3 million. For the grants made in 2008 and 2009, 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 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, earned and distributed in the same manner as the RSUs. The Compensation Committee granted 26 thousand RSUs on November 7, 2009 and November 6, 2008, all of which remained outstanding at December 31, 2009, with a fair value at the date of grant of \$26.65 and \$17.05 per unit, respectively, to certain executive officers. As of December 31, 2009, there was approximately \$0.9 million of total unamortized compensation cost related to the non-vested portion of this grant which will be recognized on a straight-line basis over the remainder of the three-year performance period.

Valuation and Expense Information

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

The following table summarizes stock-based compensation expense related to stock options and RSUs under the Stock Compensation Topic of the FASB ASC for the years ended December 31, 2009, 2008 and 2007, which was recognized as follows:

<i>(In thousands)</i>	2009	2008	2007
Stock-based compensation expense included in cost of sales	\$268	\$253	\$268
Selling, general and administrative expense	3,039	3,263	3,495
Research and development expense	3,680	3,822	4,052
Stock-based compensation expense included in operating expenses	6,719	7,085	7,547
Total stock-based compensation expense	6,987	7,338	7,815
Tax benefit for expense associated with non-qualified options	(634)	(669)	(680)
Total stock-based compensation expense, net of tax	\$6,353	\$6,669	\$7,135

At December 31, 2009, total compensation cost related to non-vested stock options and RSUs not yet recognized was approximately \$16.1 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 2009 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, 2009, 2008 and 2007 was \$8.11 per share, \$4.96 per share and \$8.76 per share, respectively, with the following weighted-average assumptions:

	2009	2008	2007
Expected volatility	41.86%	41.70%	43.42%
Risk-free interest rate	2.29%	2.43%	4.02%
Expected dividend yield	1.55%	2.33%	1.56%
Expected life (in years)	5.10	4.97	4.98

We based our estimate of expected volatility for the 12 months ended December 31, 2009, 2008 and 2007 on the sequential historical daily trading data of our common stock for a period equal to the expected life of the options granted. The selection of the historical volatility method was based on available data indicating our historical volatility is as equally representative of ADTRAN's future stock price trends as is implied volatility. We have no reason to believe the future volatility of our stock price is likely to differ from its past volatility.

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

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

The RSU pricing model also requires the use of several significant assumptions that impact the fair value estimate. The estimated fair value of the RSUs granted to employees on November 7, 2009 and November 6, 2008 was \$26.65 and \$17.05, respectively, with the following assumptions:

	2009	2008
Expected volatility	41.41%	38.61%
Risk-free interest rate	1.40%	1.63%
Expected dividend yield	1.53%	2.35%
Fair value of future dividend payments	\$1.06	\$1.06

Stock-based compensation expense recognized in our Consolidated Statements of Income for the 12 months ended December 31, 2009, 2008 and 2007 is based on RSUs and options ultimately expected to vest, and has been reduced for estimated forfeitures. Estimates for forfeiture rates are based upon historical experience and are evaluated quarterly. We expect our forfeiture rate for stock option awards to be approximately 5% annually. We estimated a 0% forfeiture rate for our RSUs due to the limited number of recipients and lack of historical experience for these awards.

3 Investments

We classify our investments as available-for-sale. At December 31, 2009, we held the following securities and investments, recorded at either fair value or cost.

<i>(In thousands)</i>	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value Carrying Value
Deferred compensation plan assets	\$2,904	\$528	\$(8)	\$3,424
Corporate bonds (FDIC guaranteed)	20,127	287	—	20,414
Municipal fixed-rate bonds	140,278	1,009	(2)	141,285
Municipal variable rate demand notes	84,359	—	—	84,359
Fixed income bond fund	867	296	—	1,163
Marketable equity securities	9,805	23,927	(197)	33,535
Available-for-sale securities held at fair value	\$258,340	\$26,047	\$(207)	\$284,180
Restricted investment held at cost				48,250
Other investments held at cost				2,208
Total carrying value of available-for-sale investments				\$334,638

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

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

At December 31, 2009 and 2008, we held \$3.4 million and \$2.5 million, respectively, of deferred compensation plan assets, carried at fair value.

At December 31, 2009, we held \$20.4 million of corporate bonds issued by various banks that are guaranteed by the Federal Deposit Insurance Corporation (FDIC). These bonds are classified as available-for-sale and had an average duration of 2.19 years at December 31, 2009. All of these bonds had a credit rating of AAA at December 31, 2009.

At December 31, 2009 and 2008, we held \$141.3 million and \$116.9 million of municipal fixed-rate bonds. At December 31, 2009, approximately 49% of our municipal fixed-rate bond portfolio had a credit rating of AAA, 45% had a credit rating of AA, and the remaining 6% had a credit rating of A. These bonds are classified as available-for-sale investments and had an average duration of 1.04 years at December 31, 2009. 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, 2009, municipal fixed-rate bonds had the following contractual maturities:

<i>(In thousands)</i>	
Less than one year	\$ 88,110
One year to three years	53,175
Total	\$ 141,285

At December 31, 2009 and 2008, we held \$84.4 million and \$52.6 million of municipal variable rate demand notes, all of which were classified as available-for-sale short-term investments. At December 31, 2009, 98% of our municipal variable rate demand notes had a credit rating of VMIG-1 or A-1+ with the remaining 2% rated A-1 and all contained put options of seven days. Thus, despite the long-term nature of their stated contractual maturities, we believe we have the ability to quickly liquidate these securities. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. We have the ability to sell our variable rate demand notes to the remarketing agent, tender agent or issuer at par value plus accrued interest in the event we decide to liquidate our investment in a particular variable rate demand note. Approximately 22% of our variable rate demand notes are supported by letters of credit from banks that we believe to be in good financial condition. The remaining 78% of our variable rate demand notes are 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 or municipal auction rate securities, and we have held no municipal auction rate securities since February 7, 2008.

At December 31, 2009 and 2008, we held \$1.2 million and \$0.9 million of a fixed income bond fund. This bond fund had unrealized gains of \$0.3 million at December 31, 2009 and unrealized losses of \$0.4 million at December 31, 2008.

At December 31, 2009, we held \$33.5 million of marketable equity securities, including a single security, of which we held 2.1 million shares, carried at a fair value of \$22.4 million. We sold 470 thousand shares of this security during the 12 months ended December 31, 2009. The sales resulted in proceeds of \$1.7 million and a realized gain of \$1.5 million. This single security traded approximately 395 thousand shares per day in 2009, in an active market on a European stock exchange. This single security carried \$21.7 million of the gross unrealized gains included in the fair value of our marketable equity securities at December 31, 2009. The remaining \$2.2 million of gross unrealized gains and \$0.2 million of gross unrealized losses at December 31, 2009 were spread amongst more than 375 equity securities. At December 31, 2008, we held \$11.6 million of marketable equity securities, including the single security mentioned above, of which we held 2.5 million shares, carried at a fair value of \$2.5 million. This single security carried \$1.6 million of the gross unrealized gains included in the fair value of our marketable equity securities at December 31, 2008. The remaining \$0.1 million of unrealized gains and \$2.1 million of gross unrealized losses at December 31, 2008 were spread amongst more than 350 equity securities.

At December 31, 2009 and 2008, we held a \$48.3 million and \$48.8 million, respectively, restricted certificate of deposit, which is carried at cost. This investment serves as a collateral deposit against the principal amount outstanding under loans made to ADTRAN pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond). At December 31, 2009, the estimated fair value of the Bond was approximately \$45.8 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A+. ADTRAN has the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness. For more information on the Bond, see Note 6 of Notes to Consolidated Financial Statements.

At December 31, 2009 and 2008, we held \$2.2 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 \$10.1 million at December 31, 2009, 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 \$7.9 million as of December 31, 2009, of which \$7.4 million has been applied toward these commitments. As of December 31, 2009 we have received distributions related to these two private equity funds of \$6.3 million, of which \$0.6 million was recorded as a realized investment gain. These investments are carried at cost, net of distributions, with distributions in excess of our investment recorded as a realized investment gain. The duration of each of these commitments is ten years with \$0.2 million expiring in 2010 and \$0.3 million expiring in 2012. We have not been required to record any impairment losses related to these investments during the years ended December 31, 2009, 2008 or 2007.

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 did not record any other-than-temporary impairment charge during the fourth quarter of 2009. For each of the years ended December 31, 2009, 2008 and 2007 we recorded a charge of \$2.9 million, \$2.4 million and \$0.1 million, respectively, related to the other-than-temporary impairment of certain publicly traded equity securities, a fixed income bond fund and deferred compensation assets.

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

(In thousands)

Year Ended December 31,	2009	2008	2007
Gross realized gains	\$1,978	\$1,884	\$1,075
Gross realized losses	\$(3,275)	\$(4,293)	\$(577)

The following table presents the breakdown of investments with unrealized losses at December 31, 2009.

(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	—	—	\$160	\$(8)	\$160	\$(8)
Municipal fixed-rate bonds	1,481	(2)	—	—	1,481	(2)
Marketable equity securities	2,428	(91)	1,834	(106)	4,262	(197)
Total	\$3,909	\$(93)	\$1,994	\$(114)	\$5,903	\$(207)

The decrease in unrealized losses during 2009, as reflected in the table above, primarily occurred due to the improvements in the credit markets and improved equity market conditions. At December 31, 2009, a total of 145 of our marketable equity securities were in an unrealized loss position.

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

(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	\$2,435	\$(658)	\$22	\$(22)	\$2,457	\$(680)
Municipal fixed-rate bonds	1,573	(1)	—	—	1,573	(1)
Fixed income bond fund	—	—	884	(395)	884	(395)
Marketable equity securities	5,627	(1,848)	554	(262)	6,181	(2,110)
Total	\$9,635	\$(2,507)	\$1,460	\$(679)	\$11,095	\$(3,186)

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

In accordance with 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, 2009 Using

<i>(In thousands)</i>	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	\$18,370	\$18,370	—	—
Available-for-sale securities held at fair value				
Deferred compensation plan assets	3,424	3,424	—	—
Corporate bonds (FDIC guaranteed)	20,414	—	20,414	—
Municipal fixed-rate bonds	141,285	—	141,285	—
Municipal variable rate demand notes	84,359	—	84,359	—
Fixed income bond fund	1,163	1,163	—	—
Marketable equity securities	33,535	33,535	—	—
Available-for-sale securities held at fair value	284,180	38,122	246,058	—
Total	\$302,550	\$56,492	\$246,058	—

Fair Value Measurements at December 31, 2008 Using

<i>(In thousands)</i>	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	\$25,389	\$25,389	—	—
Available-for-sale securities held at fair value				
Deferred compensation plan assets	2,457	2,457	—	—
Government agency security	1,999	—	1,999	—
Municipal fixed-rate bonds	116,943	—	116,943	—
Municipal variable rate demand notes	52,633	—	52,633	—
Fixed income bond fund	884	884	—	—
Marketable equity securities	11,644	11,644	—	—
Available-for-sale securities held at fair value	186,560	14,985	171,575	—
Total	\$211,949	\$40,374	\$171,575	—

4 Inventory

At December 31, 2009 and 2008, inventory was comprised of the following:

<i>(In thousands)</i>	2009	2008
Raw materials	\$33,930	\$32,591
Work in process	2,662	1,552
Finished goods	16,832	20,991
Inventory reserve	(7,750)	(7,728)
Total	\$45,674	\$47,406

5 Property, Plant, and Equipment

At December 31, 2009 and 2008, property, plant, and equipment were comprised of the following:

<i>(In thousands)</i>	2009	2008
Land	\$4,263	\$4,263
Building and land improvements	14,638	13,508
Building	68,495	68,495
Furniture and fixtures	15,746	15,690
Computer hardware and software	57,218	55,125
Engineering and other equipment	80,289	74,864
Total Property, Plant, and Equipment	240,649	231,945
Less accumulated depreciation	(166,340)	(156,458)
Total Property, Plant, and Equipment (net)	\$74,309	\$75,487

Depreciation expense was \$10.0 million, \$9.9 million and \$10.7 million in 2009, 2008 and 2007, respectively.

6 Alabama State Industrial Development Authority Financing and Economic Incentives

In conjunction with an expansion of our Huntsville, Alabama, facility, we were approved for participation in an incentive program offered by the State of Alabama Industrial Development Authority (the "Authority"). Pursuant to the program, on January 13, 1995, the Authority issued \$20.0 million of its taxable revenue bonds and loaned the proceeds from the sale of the bonds to ADTRAN. The bonds were originally purchased by AmSouth Bank of Alabama, Birmingham, Alabama (the "Bank"). Wachovia Bank, N.A., Nashville, Tennessee (formerly First Union National Bank of Tennessee) (the "Bondholder"), which was acquired by Wells Fargo & Company on December 31, 2008, purchased the original bonds from the Bank and made further advances to the Authority, bringing the total amount outstanding to \$50.0 million. An Amended and Restated Taxable Revenue Bond ("Amended and Restated Bond") was issued and the original financing agreement was amended. The Amended and Restated Bond bears interest, payable monthly. The interest rate is 5%. The Amended and Restated Bond matures on January 1, 2020. The estimated fair value of the bond at December 31, 2009 was approximately \$45.8 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, 2009 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 ADTRAN has the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness. In conjunction with this program, we are eligible to receive certain economic incentives from the state of Alabama that reduce the amount of payroll withholdings that we are required to remit to the state for those employment positions that qualify under the program. We realized \$1.5 million in economic incentives for the year ended December 31, 2009 and \$1.4 million for each of the years ended December 31, 2008 and 2007.

Due to continued positive cash flow from operating activities, ADTRAN made a business decision to begin an early partial redemption of the bond as evidenced by a \$0.5 million principal payment in the fourth quarter of 2009, a \$0.2 million principal payment in the third quarter of 2008, and a \$0.5 million principal payment in the third quarter of 2007. 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 the Consolidated Balance Sheet at December 31, 2009 and 2008.

7 Income Taxes

A summary of the components of the provision for income taxes as of December 31, 2009, 2008 and 2007 is as follows:

<i>(In thousands)</i>	2009	2008	2007
Current			
Federal	\$30,756	\$37,245	\$38,956
State	3,615	3,350	3,270
Total current	34,371	40,595	42,226
Deferred tax benefit	(1,024)	(903)	(2,990)
Total provision for income taxes	\$33,347	\$39,692	\$39,236

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

	2009	2008	2007
Tax provision computed at the federal statutory rate	35.00%	35.00%	35.00%
State income tax provision, net of federal benefit	3.68	2.95	2.95
Federal research credits	(3.37)	(1.86)	(1.64)
Tax-exempt income	(1.05)	(1.59)	(2.43)
State tax incentives	(1.36)	(1.15)	(1.19)
Stock-based compensation	1.64	1.59	1.71
Domestic production activity deduction	(3.33)	(1.62)	(0.95)
Other, net	(0.21)	0.24	0.50
Effective tax rate	31.00%	33.56%	33.95%

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:

<i>(In thousands)</i>	2009	2008
Current deferred tax assets		
Accounts receivable	\$46	\$14
Inventory	4,682	4,656
Accrued expenses	3,875	3,959
State tax and interest expense	—	24
Total current deferred tax assets	8,603	8,653
Non-current deferred tax assets		
Accrued expenses	103	55
Deferred compensation	1,364	1,249
Stock-based compensation	2,891	2,248
State tax and interest expense	1,002	900
Investments	—	2,220
Other	—	107
Foreign loss and state credit carry-forwards	5,559	1,581
Valuation allowance	(5,340)	(1,581)
Total non-current deferred tax assets	5,579	6,779
Total deferred tax assets	\$14,182	\$15,432
Non-current deferred tax liabilities		
Accumulated depreciation	\$(3,809)	\$(2,859)
Investments	(6,805)	—
Total non-current deferred tax liabilities	\$(10,614)	\$(2,859)
Net deferred tax assets	\$3,568	\$12,573

At December 31, 2009 and 2008, 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 provision of \$9.8 million in 2009 and a deferred tax benefit of \$2.9 million in 2008, is recorded as an adjustment to other comprehensive income, presented in the Consolidated Statements of Changes in Stockholders' Equity and Comprehensive Income.

We have foreign loss and state credit carry-forwards of \$5.6 million which will expire between 2014 and 2029. 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 and net operating loss carry-forwards acquired through the acquisition of a foreign 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, 2009, 2008 and 2007, foreign profits before income taxes were not material.

During 2009, 2008 and 2007, we recorded an income tax benefit of \$1.5 million, \$1.0 million and \$4.4 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. For the years ended December 31, 2009, 2008 and 2007, approximately 62%, 64% and 52%, respectively, of the income tax deduction related to disqualifying dispositions of shares acquired upon exercise of incentive stock options and 38%, 36% and 48%, respectively, related to non-qualified stock options.

On January 1, 2007, ADTRAN adopted the revised authoritative guidance for income taxes, which requires a company to recognize the benefit of a tax position in its financial statements only if that position is "more likely than not" of being sustained on an audit basis solely on the technical merit of the position. The adoption of this guidance resulted in a decrease to stockholders' equity of \$1.2 million on January 1, 2007 for unrecognized tax expense, of which \$0.5 million was related to estimated interest and penalties. The change in the unrecognized income tax benefits for 2009, 2008 and 2007 is reconciled below:

<i>(In thousands)</i>	2009 Gross Unrecognized Income Tax Benefit	2008 Gross Unrecognized Income Tax Benefit	2007 Gross Unrecognized Income Tax Benefit
Unrecognized income tax benefit as of January 1, 2009, 2008 and 2007, respectively	\$2,775	\$2,645	\$2,153
Increases for tax position related to:			
Prior years	390	159	633
Current year	610	718	411
Decreases for tax positions related to:			
Prior years	(1)	(119)	(50)
Current year	—	—	—
Settlements with taxing authorities	(413)	(49)	(502)
Expiration of applicable statute of limitations	(442)	(579)	—
Unrecognized income tax benefit as of December 31, 2009, 2008 and 2007, respectively	\$2,919	\$2,775	\$2,645

As of December 31, 2009, 2008, and 2007, our total liability for unrecognized tax benefits was \$2.9 million, \$2.8 million, and \$2.6 million, respectively, of which \$2.3 million, \$2.2 million, and \$2.1 million, respectively, would reduce our effective tax rate if we were successful in upholding all of the uncertain positions and recognized the amounts recorded. We classify interest and penalties recognized on the liability for unrecognized tax benefits as income tax expense. The balances of accrued interest and penalties were \$1.2 million as of December 31, 2009 and 2008, and \$1.1 million as of December 31, 2007.

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 are currently under audit by the Internal Revenue Service for the 2006 and 2007 tax years and have been audited by 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 2006.

8 Employee Benefit Plans

401(k) Savings Plan

We maintain the ADTRAN, Inc. 401(k) Retirement Plan (Savings Plan) for the benefit of our eligible employees. The Savings Plan is intended to qualify under Sections 401(a) and 401(k) of the Internal Revenue Code of 1986, as amended (Code), and is intended to be a “safe harbor” 401(k) plan under Code Section 401(k)(12). The Savings Plan allows employees to save for retirement by contributing part of their compensation to the plan on a tax-deferred basis. The Savings Plan also requires us to contribute a “safe harbor” amount each year. In 2007, we contributed an amount equal to 3% of compensation for eligible employees who had completed a year of service by the end of the year. Beginning January 1, 2008, we changed our contribution such that we matched up to 4% of employee contributions (100% of an employee’s first 3% of contributions and 50% of 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 2009). 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 \$4.2 million, \$3.9 million and \$3.1 million in 2009, 2008 and 2007, respectively.

Deferred Compensation Plan

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

Assets of the Trust are deemed invested in mutual funds that cover an investment spectrum ranging from equities to money market instruments. These mutual funds are publicly quoted and reported at fair value. We account for these investments in accordance with the Investments in Debt and Equity Securities Topic of the FASB ASC. The fair value of the assets held by the Trust and the amounts payable to the plan participants are as follows:

<i>(In thousands)</i>	2009	2008
Fair Value of Plan Assets		
Short-term Investments	—	—
Long-term Investments	3,424	2,457
Total Fair Value of Plan Assets	\$3,424	\$2,457
Amounts Payable to Plan Participants		
Current Liabilities	—	—
Non-current Liabilities	3,424	2,457
Total Amounts Payable to Plan Participants	\$3,424	\$2,457

In accordance with the Compensation Topic of the FASB ASC, changes in the fair value of the plan assets held by the Trust have been included as other income in the accompanying 2009 and 2008 Consolidated Statements of Income and in other comprehensive income in the accompanying 2009 and 2008 Consolidated Balance Sheets. Changes in the fair value of the deferred compensation liability are included as selling, general and administrative expense in the accompanying 2009, 2008 and 2007 Consolidated Statements of Income. Based on the changes in the total fair value of the Trust’s assets, we recorded deferred compensation adjustments in 2009, 2008 and 2007 of \$0.6 million, \$(0.9) million and \$0.3 million, respectively.

Retiree Medical Coverage

We provide medical, dental and prescription drug coverage to one retired former officer and his spouse, for his life, on the same terms as provided to our active officers, and to the spouse of a former deceased officer for up to 30 years. This liability totaled \$0.2 million at December 31, 2009 and 2008.

9 Segment Information and Major Customers

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

The following table presents information about the reported sales and gross profit of our reportable segments for each of the years ended December 31, 2009, 2008 and 2007. Asset information by reportable segment is not reported, since ADTRAN does not produce such information internally.

<i>(In thousands)</i>	2009		2008		2007	
	Sales	Gross Profit	Sales	Gross Profit	Sales	Gross Profit
Carrier Networks	\$371,349	\$219,681	\$392,219	\$236,168	\$358,023	\$212,818
Enterprise Networks	112,836	67,281	108,457	62,737	118,755	70,168
	\$484,185	\$286,962	\$500,676	\$298,905	\$476,778	\$282,986

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 last mile access in support of 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, 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 including our family of OPTI products. Optical access products are used to deliver higher bandwidth services, or to aggregate large numbers of low bandwidth services for transportation across fiber optic infrastructure. Total Access 1500 products, 303 concentrator products, M13 multiplexer products, and 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 SMB and Enterprise markets. The Business Networking category includes Internetworking products, Optical Network Terminals (ONTs), and Integrated Access Devices (IADs). Internetworking products consist of our Total Access IP Business Gateways 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, and Carrier Ethernet Network Terminating Equipment.

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

The table below presents sales information by product category for the years ended December 31, 2009, 2008 and 2007:

<i>(In thousands)</i>	2009	2008	2007
Carrier Systems	\$215,715	\$206,225	\$179,769
Business Networking	100,451	89,577	88,329
Loop Access	168,019	204,874	208,680
Total	\$484,185	\$500,676	\$476,778

In addition, we identify sub-categories of product revenues, which we divide into growth products, representing our primary growth areas, and traditional products. Our growth products consist of Broadband Access and Optical Access products (included in Carrier Systems) and Internetworking products (included in Business Networking) and our traditional products include HDSL products (included in Loop Access) and other products.

The table below presents subcategory revenues for the years ended December 31, 2009, 2008 and 2007:

<i>(In thousands)</i>	2009	2008	2007
Broadband Access (included in Carrier Systems)	\$111,470	\$102,335	\$ 83,951
Optical Access (included in Carrier Systems)	60,596	53,844	43,109
Internetworking (NetVanta and Multi-service Access Gateways) (included in Business Networking)	79,979	65,791	53,381
Growth Products	\$252,045	\$221,970	\$180,441
HDSL (does not include T1) (included in Loop Access)	150,276	179,814	173,550
Other products (excluding HDSL)	81,864	98,892	122,787
Traditional Products	\$232,140	\$278,706	\$296,337
Total	\$484,185	\$500,676	\$476,778

Sales by Geographic Region

The following is sales information by geographic area for the years ended December 31, 2009, 2008 and 2007. International sales correlate to shipments with a non-U.S. destination.

<i>(In thousands)</i>	2009	2008	2007
United States	\$456,402	\$470,563	\$437,159
International	27,783	30,113	39,619
Total	\$484,185	\$500,676	\$476,778

Single customers comprising more than 10% of our revenue in 2009 include AT&T Inc. at 22%, Qwest Communications International, Inc. at 19%, and Verizon Communications, Inc. at 11%. Single customers comprising more than 10% of our revenue in 2008 include AT&T Inc. at 24%, Qwest Communications International, Inc. at 16%, Verizon Communications, Inc. at 12%, and Embarq Corporation (formerly Sprint Corporation) at 10%. Single customers comprising more than 10% of our revenue in 2007 included AT&T Inc. at 23%, Qwest Communications International, Inc. at 13%, Embarq Corporation at 12%, and Verizon Communications, Inc. at 12%. No other customer accounted for 10% or more of our sales in 2009, 2008 or 2007.

Sales to domestic incumbent local exchange carriers (ILECs) amounted to approximately 57%, 62% and 60% of total sales during the years ended December 31, 2009, 2008 and 2007, respectively. In addition, a significant portion of our products are sold directly to distributors and certain value-added resellers, which accounted for approximately 30%, 26% and 26% of our revenue for each of the years ended December 31, 2009, 2008 and 2007, respectively.

As of December 31, 2009, long-lived assets, net totaled \$74.3 million, which includes \$73.9 million held in the United States and \$0.4 million held outside the United States. As of December 31, 2008, long-lived assets, net, totaled \$75.5 million, which includes \$75.3 million held in the United States and \$0.2 million held outside the United States.

10 Commitments and Contingencies

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

We lease office space and equipment under operating leases which expire at various dates through 2013. As of December 31, 2009, future minimum rental payments under non-cancelable operating leases with original maturities of greater than 12 months are approximately as follows:

(In thousands)

2010	\$1,335
2011	664
2012	304
2013	18
Total	\$2,321

Rental expense was approximately \$1.5 million for each of the years ended December 31, 2009, 2008 and 2007.

11 Earnings Per Share

A summary of the calculation of basic and diluted earnings per share (EPS) for the years ended December 31, 2009, 2008 and 2007 is as follows:

Year Ended	2009	2008	2007
Numerator			
Net Income	\$74,221	\$78,581	\$76,335
Denominator			
Weighted average number of shares – basic	62,459	63,549	67,848
Effect of dilutive securities – stock options	897	859	1,364
Weighted average number of shares – diluted	63,356	64,408	69,212
Net income per share – basic	\$1.19	\$1.24	\$1.13
Net income per share – diluted	\$1.17	\$1.22	\$1.10

For each of the years ended December 31, 2009, 2008 and 2007, 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.

12 Summarized Quarterly Financial Data (Unaudited)

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

Unaudited Quarterly Operating Results

(in thousands, except per share amounts)

Three Months Ended	March 31, 2009	June 30, 2009	September 30, 2009	December 31, 2009
Net sales	\$110,364	\$121,528	\$128,062	\$124,231
Gross profit	\$67,460	\$71,690	\$74,457	\$73,355
Operating income	\$22,901	\$26,135	\$28,959	\$26,236
Net income	\$15,184	\$18,839	\$21,583	\$18,615
Earnings per common share	\$0.24	\$0.30	\$0.34	\$0.30
Earnings per common share assuming dilution (1)	\$0.24	\$0.30	\$0.34	\$0.29
Three Months Ended	March 31, 2008	June 30, 2008	September 30, 2008	December 31, 2008
Net sales	\$119,885	\$131,183	\$137,195	\$112,413
Gross profit	\$70,240	\$79,394	\$81,683	\$67,588
Operating income	\$25,140	\$33,470	\$33,678	\$21,512
Net income	\$17,047	\$22,414	\$22,411	\$16,709
Earnings per common share	\$0.26	\$0.35	\$0.36	\$0.27
Earnings per common share assuming dilution (1)	\$0.26	\$0.34	\$0.35	\$0.27

13 Related Party Transactions

We employ the law firm of our director emeritus for legal services. All bills for services rendered by this firm are reviewed and approved by our chief financial officer. We believe that the fees for such services are reasonable and comparable to those charged by other firms for services rendered to us. We paid \$0.1 million during each of the years ended December 31, 2009, 2008 and 2007 for these legal services.

14 Subsequent Events

On January 19, 2010, 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 4, 2010. The quarterly dividend payment was \$5.6 million and was paid on February 18, 2010. 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.

During the first quarter of 2010 and as of February 26, 2010, ADTRAN repurchased 0.5 million shares of its common stock through open market purchases at an average cost of \$21.62 per share and has the authority to repurchase an additional 2.2 million shares under the plan approved by the Board of Directors on April 14, 2008.

We have evaluated subsequent events through February 26, 2010, the date the financial statements were issued.