

ADTRAN INC
Form 10-Q
May 09, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Quarterly Period Ended March 31, 2012

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Transition Period from _____ to _____

Commission File Number 0-24612

ADTRAN, INC.

(Exact name of Registrant as specified in its charter)

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Delaware
(State of Incorporation)

63-0918200
(I.R.S. Employer

Identification No.)

901 Explorer Boulevard, Huntsville, Alabama 35806-2807

(Address of principal executive offices, including zip code)

(256) 963-8000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (232.405 of this chapter) during the preceding 12 months (or for shorter period that the Registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

Smaller Reporting Company

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

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

Class
Common Stock, \$.01 Par Value

Outstanding at April 23, 2012
63,715,605 shares

Table of Contents**ADTRAN, INC.****Quarterly Report on Form 10-Q****For the Three Months Ended March 31, 2012****Table of Contents**

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FORWARD LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements made by or on behalf of ADTRAN. ADTRAN and its representatives may from time to time make written or oral forward-looking statements, including statements contained in this report, our other filings with the Securities and Exchange Commission (SEC) and other communications with our stockholders. Generally, the words, believe, expect, intend, estimate, anticipate, will, may, could and similar expressions identify forward-looking statements. We want you that any forward-looking statements made by us or on our behalf are subject to uncertainties and other factors that could cause such statements to be wrong. A list of factors that could materially affect our business, financial condition or operating results is included under

Factors that Could Affect Our Future Results in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Item 2 of Part I of this report. They have also been discussed in Item 1A of Part I in our most recent Annual Report on Form 10-K for the year ended December 31, 2011 filed on February 29, 2012 with the SEC. Though we have attempted to list comprehensively these important factors, we caution investors that other factors may prove to be important in the future in affecting our operating results. New factors emerge from time to time, and it is not possible for us to predict all of these factors, nor can we assess the impact each factor or a combination of factors may have on our business.

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

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

| | March 31, 2012 | December 31, 2011 |
|---|-------------------|----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 36,539 | \$ 42,979 |
| Short-term investments | 161,535 | 159,347 |
| Accounts receivable, less allowance for doubtful accounts of \$42 and \$8 at March 31, 2012 and December 31, 2011, respectively | 74,796 | 76,130 |
| Other receivables | 8,037 | 9,743 |
| Inventory | 95,805 | 87,800 |
| Prepaid expenses | 3,861 | 3,119 |
| Deferred tax assets, net | 12,548 | 12,125 |
| Total Current Assets | 393,121 | 391,243 |
| Property, plant and equipment, net | 76,502 | 75,295 |
| Deferred tax assets, net | 5,633 | 8,345 |
| Goodwill | 3,492 | 3,492 |
| Other assets | 6,831 | 7,131 |
| Long-term investments | 367,474 | 332,008 |
| Total Assets | \$ 853,053 | \$ 817,514 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts payable | \$ 31,235 | \$ 29,404 |
| Unearned revenue | 11,376 | 9,965 |
| Accrued expenses | 6,479 | 5,876 |
| Accrued wages and benefits | 12,158 | 13,518 |
| Income tax payable, net | 10,186 | 3,169 |
| Total Current Liabilities | 71,434 | 61,932 |
| Other non-current liabilities | 21,588 | 16,951 |
| Bonds payable | 46,500 | 46,500 |
| Total Liabilities | 139,522 | 125,383 |
| Commitments and contingencies (see Note 13) | | |
| Stockholders' Equity | | |
| Common stock, par value \$0.01 per share; 200,000 shares authorized; 79,652 shares issued and 63,898 shares outstanding at March 31, 2012 and 79,652 shares issued and 63,703 shares outstanding at December 31, 2011 | 797 | 797 |
| Additional paid-in capital | 217,273 | 213,560 |

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| | | |
|---|-------------------|-------------------|
| Accumulated other comprehensive income | 20,012 | 13,102 |
| Retained earnings | 846,386 | 840,206 |
| Less treasury stock at cost: 15,754 and 15,949 shares at March 31, 2012 and December 31, 2011, respectively | (370,937) | (375,534) |
| Total Stockholders' Equity | 713,531 | 692,131 |
| Total Liabilities and Stockholders' Equity | \$ 853,053 | \$ 817,514 |

See notes to consolidated financial statements

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ADTRAN, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)

| | Three Months Ended March 31, | |
|---|---------------------------------|------------------|
| | 2012 | 2011 |
| Sales | \$ 134,735 | \$ 165,522 |
| Cost of sales | 60,648 | 66,727 |
| Gross Profit | 74,087 | 98,795 |
| Selling, general and administrative expenses | 33,111 | 29,552 |
| Research and development expenses | 24,795 | 23,637 |
| Operating Income | 16,181 | 45,606 |
| Interest and dividend income | 1,861 | 1,789 |
| Interest expense | (588) | (602) |
| Net realized investment gain | 2,467 | 2,767 |
| Other income (expense), net | 141 | (125) |
| Income before provision for income taxes | 20,062 | 49,435 |
| Provision for income taxes | (7,102) | (15,177) |
| Net Income | \$ 12,960 | \$ 34,258 |
| Weighted average shares outstanding basic | 63,809 | 64,189 |
| Weighted average shares outstanding diluted | 64,849 | 65,957 |
| Earnings per common share basic | \$ 0.20 | \$ 0.53 |
| Earnings per common share diluted | \$ 0.20 | \$ 0.52 |
| Dividend per share | \$ 0.09 | \$ 0.09 |

See notes to consolidated financial statements

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

| | Three Months Ended March 31, | |
|--|---|------------------|
| | 2012 | 2011 |
| Net Income | \$ 12,960 | \$ 34,258 |
| Other Comprehensive Income (Loss), net of tax: | | |
| Net change in unrealized gains (losses) on marketable securities | 6,755 | (2,651) |
| Reclassification adjustments for amounts included in net income | 2 | (159) |
| Foreign currency translation | 153 | 87 |
| Other Comprehensive Income (Loss), net of tax | 6,910 | (2,723) |
| Comprehensive Income | \$ 19,870 | \$ 31,535 |

See notes to consolidated financial statements

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

| | Three Months Ended | |
|---|---------------------------|-----------------|
| | March 31, | |
| | 2012 | 2011 |
| Cash flows from operating activities: | | |
| Net income | \$ 12,960 | \$ 34,258 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,095 | 2,724 |
| Amortization of net premium on available-for-sale investments | 2,171 | 1,299 |
| Net realized gain on long-term investments | (2,467) | (2,767) |
| Net (gain) loss on disposal of property, plant and equipment | (214) | 12 |
| Stock-based compensation expense | 2,221 | 2,089 |
| Deferred income taxes | (2,030) | 877 |
| Tax benefit from stock option exercises | 1,492 | 9,942 |
| Excess tax benefits from stock-based compensation arrangements | (1,153) | (8,847) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 1,334 | (13,562) |
| Other receivables | 1,706 | (8,725) |
| Income tax receivable, net | | 2,741 |
| Inventory | (8,005) | (4,760) |
| Prepaid expenses and other assets | (710) | (216) |
| Accounts payable | 1,831 | 10,117 |
| Accrued expenses and other liabilities | 5,287 | 9,606 |
| Income tax payable, net | 7,017 | 1,699 |
| Net cash provided by operating activities | 24,535 | 36,487 |
| Cash flows from investing activities: | | |
| Purchases of property, plant and equipment | (4,086) | (3,045) |
| Proceeds from disposals of property, plant and equipment | 266 | |
| Proceeds from sales and maturities of available-for-sale investments | 69,364 | 161,687 |
| Purchases of available-for-sale investments | (95,646) | (224,459) |
| Net cash used in investing activities | (30,102) | (65,817) |
| Cash flows from financing activities: | | |
| Proceeds from stock option exercises | 3,560 | 31,815 |
| Dividend payments | (5,739) | (5,775) |
| Excess tax benefits from stock-based compensation arrangements | 1,153 | 8,847 |
| Net cash provided by (used in) financing activities | (1,026) | 34,887 |
| Net increase (decrease) in cash and cash equivalents | (6,593) | 5,557 |
| Effect of exchange rate changes | 153 | 87 |
| Cash and cash equivalents, beginning of period | 42,979 | 31,677 |

Cash and cash equivalents, end of period

\$ 36,539

\$ 37,321

See notes to consolidated financial statements

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ADTRAN, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(In thousands, except per share amounts)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements of ADTRAN[®], Inc. and its subsidiaries (ADTRAN) have been prepared pursuant to the rules and regulations for reporting on Quarterly Reports on Form 10-Q. Accordingly, certain information and notes required by generally accepted accounting principles for complete financial statements are not included herein. The December 31, 2011 Consolidated Balance Sheet is derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States.

In the opinion of management, all adjustments necessary for a fair presentation of these interim statements have been included and are of a normal and recurring nature. The results of operations for an interim period are not necessarily indicative of the results for the full year. The interim statements should be read in conjunction with the financial statements and notes thereto included in ADTRAN's Annual Report on Form 10-K for the year ended December 31, 2011, filed on February 29, 2012 with the SEC.

Use of Estimates

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

Recent Accounting Pronouncements

During the first quarter of 2012, we adopted the following accounting standards, which had no material effect on our consolidated results of operations or financial condition:

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income (ASU 2011-05). ASU 2011-05 requires companies to present the components of net income and other comprehensive income either as one continuous statement or as two consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. While ASU 2011-05 changes the presentation of comprehensive income, it does not change the components that are recognized in net income or comprehensive income under current accounting guidance. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We adopted this amendment during the three months ended March 31, 2012, and we have provided the disclosures required for the three months ended March 31, 2012 and 2011.

In December 2011, the FASB issued Accounting Standards Update No. 2011-12, Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05 (ASU 2011-12). ASU 2011-12 defers the effective date for certain presentation requirements that relate to reclassification adjustments and the effect of those reclassification adjustments on the financial statements. This update is effective for fiscal years, and interim periods within those years, ending after December 15, 2011, with early adoption permitted. We adopted this amendment during the three months ended March 31, 2012. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the three months ended March 31, 2012.

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In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IRFSs (ASU 2011-04). ASU 2011-04 is intended to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with U.S. GAAP and IFRS. The amendments are of two types: (i) those that clarify the Board's intent about the application of existing fair value measurement and disclosure requirements and (ii) those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This update is effective for annual periods beginning after December 15, 2011. We adopted this amendment during the three months ended March 31, 2012. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the three months ended March 31, 2012.

2. BUSINESS COMBINATIONS

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

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

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

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

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

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

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

For the three months ended March 31, 2012, we incurred acquisition related adjustments and amortization of acquired intangibles of \$0.5 million related to this acquisition.

Table of Contents**3. INCOME TAXES**

Our effective tax rate increased from 30.7% in the three months ended March 31, 2011 to 35.4% in the three months ended March 31, 2012. The tax provision rate in the first quarter of 2012 did not include the benefit of the research tax credit, which expired on December 31, 2011. The exclusion of this benefit in the first quarter of 2012 resulted in a 2.2 percentage point increase in our effective tax rate. Also, decreased benefits from a lower volume of stock option exercises in the first quarter of 2012 resulted in a 3.1 percentage point increase in our effective tax rate.

4. STOCK-BASED COMPENSATION

The following table summarizes the stock-based compensation expense related to stock options, restricted stock units (RSUs) and restricted stock for the three months ended March 31, 2012 and 2011, which was recognized as follows:

| <i>(In thousands)</i> | Three Months Ended March 31, | |
|--|---|-----------------|
| | 2012 | 2011 |
| Stock-based compensation expense included in cost of sales | \$ 101 | \$ 91 |
| Selling, general and administrative expense | 1,051 | 1,007 |
| Research and development expense | 1,069 | 991 |
| Stock-based compensation expense included in operating expenses | 2,120 | 1,998 |
| Total stock-based compensation expense | 2,221 | 2,089 |
| Tax benefit for expense associated with non-qualified options | (301) | (440) |
| Total stock-based compensation expense, net of tax | \$ 1,920 | \$ 1,649 |

The fair value of our stock options was estimated using the Black-Scholes model. The determination of the fair value of stock options on the date of grant using the Black-Scholes model is affected by our stock price as well as assumptions regarding a number of complex and subjective variables that may have a significant impact on the fair value estimate. There were no stock options granted during the three months ended March 31, 2012 or 2011.

The fair value of our RSUs is calculated using a Monte Carlo Simulation valuation method. There were no RSU grants during the three months ended March 31, 2012 or 2011.

The fair value of restricted stock is equal to the closing price of our stock on the date of grant. There were no restricted stock grants during the three months ended March 31, 2012 or 2011.

Stock-based compensation expense recognized in our Consolidated Statements of Income for the three months ended March 31, 2012 and 2011 is based on stock options, RSUs and restricted stock ultimately expected to vest, and has been reduced for estimated forfeitures. Estimated forfeitures for stock options were based upon historical experience and approximate 1.6% annually. We estimated a 0% forfeiture rate for our RSUs and restricted stock due to the limited number of recipients and historical experience for these awards.

As of March 31, 2012, total compensation expense related to non-vested stock options, RSUs and restricted stock not yet recognized was approximately \$19.6 million, which is expected to be recognized over an average remaining recognition period of 2.7 years.

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The following table is a summary of our stock options outstanding as of December 31, 2011 and March 31, 2012 and the changes that occurred during the three months ended March 31, 2012:

| <i>(In thousands, except per share amounts)</i> | Number of Options | Weighted Avg. Exercise Price | Weighted Avg. Remaining Contractual Life In Years | Aggregate Intrinsic Value |
|---|----------------------|------------------------------------|---|---------------------------------|
| Options outstanding, December 31, 2011 | 5,400 | \$ 25.66 | 6.78 | \$ 27,270 |
| Options granted | | \$ | | |
| Options cancelled/forfeited | (16) | \$ 27.59 | | |
| Options exercised | (180) | \$ 19.71 | | |
| Options outstanding, March 31, 2012 | 5,204 | \$ 25.86 | 6.59 | \$ 30,189 |
| Options exercisable, March 31, 2012 | 2,878 | \$ 23.72 | 4.98 | \$ 22,332 |

The aggregate intrinsic values in the table above represent the total pre-tax intrinsic value (the difference between ADTRAN's closing stock price on the last trading day of the quarter and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on March 31, 2012. The aggregate intrinsic value will change based on the fair market value of ADTRAN's stock.

The total pre-tax intrinsic value of options exercised during the three months ended March 31, 2012 was \$3.0 million.

The following table is a summary of our RSUs and restricted stock outstanding as of December 31, 2011 and March 31, 2012 and the changes that occurred during the three months ended March 31, 2012:

| <i>(In thousands, except per share amounts)</i> | Number of shares | Weighted Average Grant Date Fair Value |
|--|------------------------|---|
| Unvested RSUs and restricted stock outstanding, December 31, 2011 | 90 | \$ 34.21 |
| RSUs and restricted stock granted | | |
| RSUs and restricted stock vested | | |
| RSUs and restricted stock cancelled/forfeited | | |
| Unvested RSUs and restricted stock, March 31, 2012 | 90 | \$ 34.21 |

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At March 31, 2012, we held the following securities and investments, recorded at either fair value or cost.

| <i>(In thousands)</i> | Amortized Cost | Gross Unrealized Gains | Losses | Carrying Value |
|---|-------------------|---------------------------|-----------------|-------------------|
| Deferred compensation plan assets | \$ 10,627 | \$ 663 | \$ (74) | \$ 11,216 |
| Corporate bonds | 183,193 | 748 | (549) | 183,392 |
| Municipal fixed-rate bonds | 192,853 | 588 | (147) | 193,294 |
| Municipal variable rate demand notes | 47,920 | | | 47,920 |
| Fixed income bond fund | 527 | 219 | | 746 |
| Marketable equity securities | 15,786 | 26,505 | (215) | 42,076 |
| Available-for-sale securities held at fair value | \$ 450,906 | \$ 28,723 | \$ (985) | \$ 478,644 |
| Restricted investment held at cost | | | | 48,250 |
| Other investments held at cost | | | | 2,115 |
| Total carrying value of available-for-sale investments | | | | \$ 529,009 |

At December 31, 2011, we held the following securities and investments, recorded at either fair value or cost.

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

As of March 31, 2012, our corporate bonds and municipal fixed-rate bonds had the following contractual maturities:

| <i>(In thousands)</i> | Corporate bonds | Municipal fixed-rate bonds |
|-----------------------|--------------------|----------------------------------|
| Less than one year | \$ 24,172 | \$ 89,443 |
| One to two years | 112,900 | 50,570 |
| Two to three years | 44,163 | 16,576 |
| Three to four years | 2,157 | 36,705 |
| Total | \$ 183,392 | \$ 193,294 |

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

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We review our investment portfolio for potential other-than-temporary declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of \$33 thousand during the three months ended March 31, 2012 related to seven marketable equity securities. For the three months ended March 31, 2011, we recorded an other-than-temporary impairment charge of \$4 thousand related to one marketable equity security.

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.

| Three Months Ended March 31, (In thousands) | 2012 | 2011 |
|--|-------------|-------------|
| Gross realized gains | \$ 2,669 | \$ 2,864 |
| Gross realized losses | \$ (202) | \$ (97) |

As of March 31, 2012 and 2011, gross unrealized losses related to individual securities that had been in a continuous loss position for 12 months or longer were not significant.

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.

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| <i>(In thousands)</i> | Fair Value Measurements at March 31, 2012 Using | | | |
|--|---|--|---|--|
| | Fair Value | Quoted Prices in Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Cash equivalents | | | | |
| Money market funds | \$ 10,988 | \$ 10,988 | \$ | \$ |
| Available-for-sale securities | | | | |
| Deferred compensation plan assets | 11,216 | 11,216 | | |
| Available-for-sale debt securities | | | | |
| Corporate bonds | 183,392 | | 183,392 | |
| Municipal fixed-rate bonds | 193,294 | | 193,294 | |
| Municipal variable rate demand notes | 47,920 | | 47,920 | |
| Fixed income bond fund | 746 | 746 | | |
| Available-for-sale marketable equity securities | | | | |
| Equity securities technology industry | 25,773 | 25,773 | | |
| Equity securities other | 16,302 | 16,302 | | |
| Available-for-sale securities | 478,643 | 54,037 | 424,606 | |
| Total | \$ 489,631 | \$ 65,025 | \$ 424,606 | \$ |

| <i>(In thousands)</i> | Fair Value Measurements at December 31, 2011 Using | | | |
|--|--|--|---|--|
| | Fair Value | Quoted Prices in Active Market for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Cash equivalents | | | | |
| Money market funds | \$ 13,696 | \$ 13,696 | \$ | \$ |
| Available-for-sale securities | | | | |
| Deferred compensation plan assets | 7,712 | 7,712 | | |
| Available-for-sale debt securities | | | | |
| Corporate bonds | 156,753 | | 156,753 | |
| Municipal fixed-rate bonds | 174,826 | | 174,826 | |
| Municipal variable rate demand notes | 69,660 | | 69,660 | |
| Fixed income bond fund | 721 | 721 | | |
| Available-for-sale marketable equity securities | | | | |
| Equity securities technology industry | 18,743 | 18,743 | | |
| Equity securities other | 12,567 | 12,567 | | |
| Available-for-sale securities | 440,982 | 39,743 | 401,239 | |
| Total | \$ 454,678 | \$ 53,439 | \$ 401,239 | \$ |

The fair value of our Level 2 securities is calculated using a weighted average market price for each security. Market prices are obtained from a variety of industry standard data providers, security master files from large financial institutions, and other third-party sources. These multiple market prices are used as inputs into a distribution-curve-based algorithm to determine the daily market value of each security.

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Our municipal variable rate demand notes have a structure that implies a standard expected market price. The frequent interest rate resets make it reasonable to expect the price to stay at par. These securities are priced at the expected market price.

6. INVENTORY

At March 31, 2012 and December 31, 2011, inventory consisted of the following:

| <i>(In thousands)</i> | March 31, 2012 | December 31, 2011 |
|-----------------------|---------------------------|------------------------------|
| Raw materials | \$ 44,758 | \$ 44,588 |
| Work in process | 5,081 | 3,954 |
| Finished goods | 45,966 | 39,258 |
| Total | \$ 95,805 | \$ 87,800 |

We establish reserves for estimated excess, obsolete, or unmarketable inventory equal to the difference between the cost of the inventory and the estimated fair value of the inventory based upon assumptions about future demand and market conditions. At March 31, 2012 and December 31, 2011, raw materials reserves totaled \$8.2 million and \$7.9 million, respectively, and finished goods inventory reserves totaled \$1.5 million.

7. GOODWILL AND INTANGIBLE ASSETS

The changes in the carrying value of goodwill, all of which is included in our Enterprise Networks division, for the three months ended March 31, 2012 are as follows:

| | |
|-------------------------------------|-----------------|
| <i>(In thousands)</i> | |
| Balance, December 31, 2011 | \$ 3,492 |
| Acquisitions | |
| Impairment losses | |
| Balance, March 31, 2012 | \$ 3,492 |
| Balance as of March 31, 2012 | |
| Goodwill | \$ 3,492 |
| Accumulated impairment losses | |
| Total goodwill | \$ 3,492 |

We evaluate the carrying value of goodwill during the fourth quarter of each year and between annual evaluations if events occur or circumstances change that would more likely than not reduce the fair value of the reporting unit below its carrying amount. When evaluating whether goodwill is impaired, we first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If we determine that the two-step quantitative test is necessary, then we compare the fair value of the reporting unit to which the goodwill is assigned to the reporting unit's carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, then the amount of the impairment loss is measured. There were no impairment losses during the three months ended March 31, 2012.

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The following table presents our intangible assets as of March 31, 2012 and December 31, 2011. Intangible assets are included in other assets in the accompanying Consolidated Balance Sheets and include intangibles acquired in conjunction with our acquisition of Objectworld Communications Corporation on September 15, 2009 and Bluesocket, Inc. on August 4, 2011.

| <i>(In thousands)</i> | March 31, 2012 | | | December 31, 2011 | | |
|------------------------|-----------------|--------------------------|-----------------|-------------------|--------------------------|-----------------|
| | Gross Value | Accumulated Amortization | Net Value | Gross Value | Accumulated Amortization | Net Value |
| Customer relationships | \$ 1,623 | \$ (239) | \$ 1,384 | \$ 1,623 | \$ (194) | \$ 1,429 |
| Developed technology | 3,230 | (439) | 2,791 | 3,230 | (303) | 2,927 |
| Intellectual property | 2,340 | (600) | 1,740 | 2,340 | (525) | 1,815 |
| Trade names | 270 | (40) | 230 | 270 | (28) | 242 |
| Total | \$ 7,463 | \$ (1,318) | \$ 6,145 | \$ 7,463 | \$ (1,050) | \$ 6,413 |

Amortization expense was \$0.3 million and \$0.1 million for the three months ended March 31, 2012 and 2011, respectively.

As of March 31, 2012, the estimated future amortization expense of our intangible assets is as follows:

| <i>(In thousands)</i> | Amount |
|-----------------------|-----------------|
| Remainder of 2012 | \$ 953 |
| 2013 | 1,271 |
| 2014 | 1,120 |
| 2015 | 1,018 |
| 2016 | 781 |
| Thereafter | 1,002 |
| Total | \$ 6,145 |

8. STOCKHOLDERS EQUITY

A summary of the changes in stockholders equity for the three months ended March 31, 2012 is as follows:

| <i>(In thousands)</i> | Stockholders Equity |
|--|---------------------|
| Balance, December 31, 2011 | \$ 692,131 |
| Net income | 12,960 |
| Dividend payments | (5,739) |
| Dividends accrued for unvested restricted stock units | (4) |
| Net change in unrealized gains and losses on marketable securities (net of deferred taxes) | 6,755 |
| Reclassification adjustment for amounts included in net income (net of deferred taxes) | 2 |
| Foreign currency translation adjustment | 153 |
| Proceeds from stock option exercises | 3,560 |
| Tax benefits from stock option exercises | 1,492 |
| Stock-based compensation expense | 2,221 |
| Balance, March 31, 2012 | \$ 713,531 |

Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 35 million shares of our common stock. During the three months ended March 31, 2012, we did not repurchase any shares of our common stock. We have the authority to purchase an additional 5.9 million shares of our common stock under plans approved by the Board of Directors on April 14, 2008 and October 11, 2011.

Table of Contents*Stock Option Exercises*

We issued 0.2 million shares of treasury stock during the three months ended March 31, 2012 to accommodate employee stock option exercises. The stock options had exercise prices ranging from \$8.70 to \$33.70. We received proceeds totaling \$3.6 million from the exercise of these stock options during the three months ended March 31, 2012.

Dividend Payments

During the three months ended March 31, 2012, we paid cash dividends as follows (in thousands except per share amount):

| Record Date | Payment Date | Per Share Amount | Total Dividend Paid |
|--------------------|---------------------|-------------------------|----------------------------|
| February 2, 2012 | February 16, 2012 | \$0.09 | \$5,739 |

Other Comprehensive Income

Other comprehensive income consists of the net change in unrealized gains and losses on marketable securities, reclassification adjustments for amounts included in net income related to realized gains on previously impaired marketable securities and foreign currency translation adjustments.

The components of other comprehensive income for the three months ended March 31, 2012 are as follows:

| <i>(In thousands)</i> | Three Months Ended March 31, 2012 | | |
|--|--|--------------------------------------|------------------------------|
| | Before-Tax Amount | Tax (Expense) Benefit | Net-of-Tax Amount |
| Net change in unrealized gains (losses) related to marketable securities | \$ 11,073 | \$ (4,318) | \$ 6,755 |
| Reclassification adjustment for amounts included in net income | 3 | (1) | 2 |
| Foreign currency translation adjustment | 153 | | 153 |
| Total Other Comprehensive Income (Loss) | \$ 11,229 | \$ (4,319) | \$ 6,910 |

The components of other comprehensive income for the three months ended March 31, 2011 are as follows:

| <i>(In thousands)</i> | Three Months Ended March 31, 2011 | | |
|--|--|--------------------------------------|------------------------------|
| | Before-Tax Amount | Tax (Expense) Benefit | Net-of-Tax Amount |
| Net change in unrealized gains (losses) related to marketable securities | \$ (3,324) | \$ 673 | \$ (2,651) |
| Reclassification adjustment for amounts included in net income | (202) | 43 | (159) |
| Foreign currency translation adjustment | 87 | | 87 |
| Total Other Comprehensive Income (Loss) | \$ (3,439) | \$ 716 | \$ (2,723) |

Table of Contents**9. EARNINGS PER SHARE**

A summary of the calculation of basic and diluted earnings per share for the three months ended March 31, 2012 and 2011 is as follows:

| <i>(In thousands, except per share amounts)</i> | Three Months Ended March 31, | |
|---|---|-------------|
| | 2012 | 2011 |
| Numerator | | |
| Net income | \$ 12,960 | \$ 34,258 |
| Denominator | | |
| Weighted average number of shares basic | 63,809 | 64,189 |
| Effect of dilutive securities | | |
| Stock options | 1,008 | 1,711 |
| Restricted stock and restricted stock units | 32 | 57 |
| Weighted average number of shares diluted | 64,849 | 65,957 |
| Net income per share basic | \$ 0.20 | \$ 0.53 |
| Net income per share diluted | \$ 0.20 | \$ 0.52 |

Anti-dilutive options to purchase common stock outstanding were excluded from the above calculations. Anti-dilutive options totaled 1.9 million and 0.9 million for the three months ended March 31, 2012 and 2011, respectively.

10. SEGMENT INFORMATION

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

The following table presents information about the reported sales and gross profit of our reportable segments for the three months ended March 31, 2012 and 2011. Asset information by reportable segment is not reported, since we do not produce such information internally.

| <i>(In thousands)</i> | Three Months Ended | | | |
|-----------------------|---------------------------|---------------------|-----------------------|---------------------|
| | March 31, 2012 | | March 31, 2011 | |
| | Sales | Gross Profit | Sales | Gross Profit |
| Carrier Networks | \$ 96,654 | \$ 52,883 | \$ 132,360 | \$ 79,498 |
| Enterprise Networks | 38,081 | 21,204 | 33,162 | 19,297 |
| Total | \$ 134,735 | \$ 74,087 | \$ 165,522 | \$ 98,795 |

Sales by Product

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

Carrier Systems products are used by communications service providers to provide data, voice and video services to consumers and enterprises. The Carrier Systems category includes our broadband access products comprised of Total Access® 5000 multi-service access and aggregation platform products, Total Access 1100/1200 Series Fiber-To-The-Node (FTTN) products, Ultra Broadband Ethernet (UBE) and Digital Subscriber Line Access Multiplexer (DSLAM) products. Our broadband access products are used by service providers to deliver high-speed Internet access, Voice over Internet Protocol (VoIP), IP Television (IPTV), and/or Ethernet services from the central office or remote terminal locations to customer premises. The Carrier Systems category also includes our optical products. These products consist of optical multiplexers

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and transceivers including those used in our Optical Networking Edge (ONE) products, NetVanta 8000 series products, and our family of OPTI products. Optical products are used to deliver higher bandwidth services, aggregate large numbers of low bandwidth services, or transport wavelength services across a fiber optic infrastructure. Total Access 1500 products, 303 concentrator products, M13 multiplexer products, and a number of mobile backhaul products are also included in the Carrier Systems product category.

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

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

The table below presents sales information by product category for the three months ended March 31, 2012 and 2011.

| <i>(In thousands)</i> | Three Months Ended | |
|-----------------------|--------------------|------------------|
| | March 31, | |
| | 2012 | 2011 |
| Carrier Systems | \$ 71,258 | \$ 86,750 |
| Business Networking | 43,142 | 36,363 |
| Loop Access | 20,335 | 42,409 |
| Total | \$134,735 | \$165,522 |

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

Subcategory revenues included in the above are as follows:

| <i>(In thousands)</i> | Three Months Ended | |
|--|--------------------|-------------------|
| | March 31, | |
| | 2012 | 2011 |
| Core Products | | |
| Broadband Access (included in Carrier Systems) | \$ 49,482 | \$ 51,782 |
| Optical (included in Carrier Systems) | 14,255 | 20,916 |
| Internetworking (NetVanta & Multi-service Access Gateways) (included in Business Networking) | 40,974 | 32,883 |
| Subtotal | 104,711 | 105,581 |
| Legacy Products | | |
| HDSL (does not include T1) (included in Loop Access) | 18,959 | 40,945 |
| Other products (excluding HDSL) | 11,065 | 18,996 |
| Subtotal | 30,024 | 59,941 |
| Total | \$ 134,735 | \$ 165,522 |

Table of Contents**Sales by Geographic Region**

The table below presents sales information by geographic area for the three months ended March 31, 2012 and 2011. International sales correlate to shipments with a non-U.S. destination.

| <i>(In thousands)</i> | Three Months Ended | |
|-----------------------|---------------------------|---------------------------|
| | March 31, 2012 | March 31, 2011 |
| United States | \$ 116,443 | \$ 153,113 |
| International | 18,292 | 12,409 |
| Total | \$ 134,735 | \$ 165,522 |

11. LIABILITY FOR WARRANTY RETURNS

Our products generally include warranties of 90 days to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled \$4.7 million at March 31, 2012 and \$4.1 million at December 31, 2011. These liabilities are included in accrued expenses in the accompanying Consolidated Balance Sheets.

A summary of warranty expense and write-off activity for the three months ended March 31, 2012 and 2011 is as follows:

| Three Months Ended March 31, <i>(In thousands)</i> | 2012 | 2011 |
|--|-----------------|-----------------|
| Balance at beginning of period | \$ 4,118 | \$ 3,304 |
| Plus: Amounts charged to cost and expenses | 1,181 | 835 |
| Less: Deductions | (568) | (620) |
| Balance at end of period | \$ 4,731 | \$ 3,519 |

12. RELATED PARTY TRANSACTIONS

We employ the law firm of our director emeritus for legal services. All bills for services rendered by this firm are reviewed and approved by our Chief Financial Officer. We believe that the fees for such services are comparable to those charged by other firms for services rendered to us. For the three months ended March 31, 2012 and 2011, we incurred fees of \$10 thousand per month for these legal services.

13. 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.

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We have committed to invest up to an aggregate of \$7.9 million in two private equity funds, and we have contributed \$8.4 million as of March 31, 2012, of which \$7.7 million has been applied to these commitments.

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14. SUBSEQUENT EVENTS

On April 10, 2012, we announced that our Board of Directors declared a quarterly cash dividend of \$0.09 per common share to be paid to stockholders of record at the close of business on April 26, 2012. The payment date will be May 10, 2012. The quarterly dividend payment will be approximately \$5.7 million. 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.

On May 4, 2012, we closed on the acquisition of Nokia Siemens Networks Broadband Access Business. This acquisition provides us with an established customer base in key markets and complementary products. The net consideration exchanged between Nokia Siemens Networks and Adtran was not material. The final net consideration is subject to post-closing adjustments. This acquisition will be accounted for as a business combination. Due to the timing of the closing, we have not completed the purchase accounting associated with this acquisition as of the date of this report.

During the second quarter of 2012 and as of May 9, 2012, we repurchased 0.3 million shares of our common stock through open market purchases at an average cost of \$29.63 per share. We have the authority to purchase an additional 5.5 million shares of our common stock under plans approved by the Board of Directors on April 14, 2008 and October 11, 2011.

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

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

OVERVIEW

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

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

Our three major product categories are Carrier Systems, Business Networking and Loop Access. Carrier Systems products are used by communications service providers to provide data, voice and video services to consumers and enterprises. Business Networking products provide access to telecommunication services, facilitating the delivery of converged services and Unified Communications to the SME market. Loop Access products are used by carrier and enterprise customers for access to copper-based telecommunications networks.

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

See Note 10 of Notes to Consolidated Financial Statements in this report for further information regarding these product categories.

Sales were \$134.7 million for the three months ended March 31, 2012 compared to \$165.5 million for the three months ended March 31, 2011. Product revenues for our core areas, Broadband Access, Optical and Internetworking, were \$104.7 million for the three months ended March 31, 2012 compared to \$105.6 million for the three months ended March 31, 2011. Our gross margin decreased to 55.0% for the three months ended March 31, 2012 from 59.7% for the three months ended March 31, 2011. Our operating income margin decreased to 12.0% for the three months ended March 31, 2012 from 27.6% for the three months ended March 31, 2011. Net income was \$13.0 million for the three months ended March 31, 2012 compared to \$34.3 million for the three months ended March 31, 2011. Our effective tax rate increased to 35.4% for the three months ended March 31, 2012 from 30.7% for the three months ended March 31, 2011. Earnings per share, assuming dilution, were \$0.20 for the three months ended March 31, 2012 compared to \$0.52 for the three months ended March 31, 2011.

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Our operating results have fluctuated on a quarterly basis in the past, and may vary significantly in future periods due to a number of factors, including customer order activity and backlog. Backlog levels vary because of seasonal trends, the timing of customer projects and other factors that affect customer order lead times. Many of our customers require prompt delivery of products. This requires us to maintain sufficient inventory levels to satisfy anticipated customer demand. If near-term demand for our products declines, or if potential sales in any quarter do not occur as anticipated, our financial results could be adversely affected. Operating expenses are relatively fixed in the short term; therefore, a shortfall in quarterly revenues could significantly impact our financial results in a given quarter.

Our operating results may also fluctuate as a result of a number of other factors, including a decline in general economic and market conditions, increased competition, customer order patterns, changes in product 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. A list of factors that could materially affect our business, financial condition or operating results is included under Factors That Could Affect Our Future Results in Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Item 2 of Part I of this report. These factors have also been discussed in more detail in Item 1A of Part I in our most recent Annual Report on Form 10-K for the year ended December 31, 2011, filed on February 29, 2012 with the SEC.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our critical accounting policies and estimates have not changed significantly from those detailed in our most recent Annual Report on Form 10-K for the year ended December 31, 2011, filed on February 29, 2012 with the SEC.

EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS

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

Table of Contents**ACQUISITION EXPENSES**

On August 4, 2011, we closed on the acquisition of Bluesocket, Inc. and on December 12, 2011, we announced the planned acquisition of the Nokia Siemens Networks Broadband Access business (NSN BBA). Acquisition related expenses, amortizations and adjustments for the three months ended March 31, 2012 for both transactions are as follows:

| | Three Months Ended March 31, 2012 |
|--|--|
| <i>Bluesocket, Inc. acquisition</i> | |
| Amortization of acquired intangible assets | \$ 218 |
| Amortization and adjustments of other acquisition related non-cash items | 266 |
| Subtotal | \$ 484 |
| <i>Planned NSN BBA acquisition</i> | |
| Acquisition related professional fees, travel and other expenses | 1,580 |
| Total acquisition related expenses, amortizations and adjustments | \$ 2,064 |
| Tax effect | (803) |
| Total acquisition related expenses, amortizations and adjustments, net of tax | \$ 1,261 |

The acquisition related expenses, amortizations and adjustments above were recorded in the following Consolidated Statements of Income categories for the three months ended March 31, 2012:

| | |
|--|-----------------|
| Revenue (adjustments to deferred revenue recognized in the period) | \$ 146 |
| Cost of goods sold | 137 |
| Subtotal | \$ 283 |
| Selling, general and administrative expenses | 1,561 |
| Research and development expenses | 220 |
| Subtotal | \$ 1,781 |
| Total acquisition related expenses, amortizations and adjustments | \$ 2,064 |
| Tax effect | (803) |
| Total acquisition related expenses, amortizations and adjustments, net of tax | \$ 1,261 |

RESULTS OF OPERATIONS THREE MONTHS ENDED MARCH 31, 2012 COMPARED TO THREE MONTHS ENDED MARCH 31, 2011**SALES**

ADTRAN's sales decreased 18.6% from \$165.5 million in the three months ended March 31, 2011 to \$134.7 million in the three months ended March 31, 2012. The decrease in sales is primarily attributable to a \$29.9 million decrease in sales of our HDSL and other legacy products, a

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\$6.7 million decrease in sales of our Optical products, and a \$2.3 million decrease in sales of our Broadband Access products, partially offset by an \$8.1 million increase in sales of our Internetworking products.

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Carrier Networks sales decreased 27.0% from \$132.4 million in the three months ended March 31, 2011 to \$96.7 million in the three months ended March 31, 2012. The decrease is primarily attributable to decreases in sales of our Broadband Access products, Optical products, and HDSL and other legacy products, partially offset by an increase in sales of our Internetworking NTE products. The decrease in Carrier Networks sales is primarily attributable to a slower-than-normal start to the seasonal buying pattern at our larger carrier customers and a delay in both the start and ramp-up of orders from one of these customers due to a new systems implementation.

Enterprise Networks sales increased 14.8% from \$33.2 million in the three months ended March 31, 2011 to \$38.1 million in the three months ended March 31, 2012. The increase is primarily attributable to an increase in sales of our Internetworking products, partially offset by a decrease in sales of our legacy products. Internetworking product sales attributable to Enterprise Networks were 91.2% of the division's sales in the three months ended March 31, 2012, compared to 85.0% in the three months ended March 31, 2011. Legacy products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales increased from 20.0% for the three months ended March 31, 2011 to 28.3% for the three months ended March 31, 2012.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 47.4% from \$12.4 million in the three months ended March 31, 2011 to \$18.3 million in the three months ended March 31, 2012. International sales, as a percentage of total sales, increased from 7.5% for the three months ended March 31, 2011 to 13.6% for the three months ended March 31, 2012. International sales increased in the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to an increase in sales in Latin America and the Asia-Pacific region.

Carrier System product sales decreased \$15.5 million in the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to a \$6.7 million decrease in Optical product sales, a \$6.5 million decrease in legacy product sales, and a \$2.3 million decrease in Broadband Access product sales. The decrease in Carrier System product sales is primarily attributable to a slower-than-normal start to the seasonal buying pattern at our larger carrier customers and a delay in both the start and ramp-up of orders from one of these customers due to a new systems implementation.

Business Networking product sales increased \$6.8 million in the three months ended March 31, 2012 compared to the three months ended March 31, 2011, primarily due to a \$8.1 million increase in Internetworking product sales across both divisions, partially offset by a \$1.3 million decrease in legacy product sales. The decrease in sales of legacy products is a result of customers shifting to newer technologies. Many of these newer technologies are integral to our Internetworking product area.

Loop Access product sales decreased \$22.1 million in the three months ended March 31, 2012 compared to the three months ended March 31, 2011 primarily due to a \$22.0 million decrease in HDSL product sales.

COST OF SALES

As a percentage of sales, cost of sales increased from 40.3% in the three months ended March 31, 2011 to 45.0% in the three months ended March 31, 2012. The increase in cost of sales as a percentage of sales is primarily attributable to lower cost absorption due to the lower production volumes and higher cost product mix.

Carrier Networks cost of sales, as a percent of division sales, increased from 39.9% in the three months ended March 31, 2011 to 45.3% in the three months ended March 31, 2012. The increase in Carrier Networks cost of sales as a percentage of sales is primarily attributable to lower cost absorption due to lower production volumes.

Enterprise Networks cost of sales, as a percent of division sales, increased from 41.8% in the three months ended March 31, 2011 to 44.3% in the three months ended March 31, 2012. The increase in Enterprise Networks cost of sales as a percentage of sales is primarily attributable to the impact of changes in the cost elements discussed above.

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.

Table of Contents***SELLING, GENERAL AND ADMINISTRATIVE EXPENSES***

Selling, general and administrative expenses increased 12.0% from \$29.6 million in the three months ended March 31, 2011 to \$33.1 million in the three months ended March 31, 2012. The increase in selling, general and administrative expenses is primarily related to increases in staffing and fringe benefit costs due to increased headcount, including expenses and increased headcount related to Bluesocket, Inc., which was acquired on August 4, 2011, professional services, legal services, and travel expenses. The increases in professional services, legal services and travel expenses were primarily attributable to the planned acquisition of Nokia Siemens Networks Broadband Access business.

Selling, general and administrative expenses as a percentage of sales increased from 17.9% in the three months ended March 31, 2011 to 24.6% in the three months ended March 31, 2012. Selling, general and administrative expenses as a percentage of sales may fluctuate whenever there is a significant fluctuation in revenues for the periods being compared.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses increased 4.9% from \$23.6 million in the three months ended March 31, 2011 to \$24.8 million in the three months ended March 31, 2012. The increase in research and development expenses is primarily related to increases in staffing and fringe benefit costs due to increased headcount, including expenses and increased headcount related to Bluesocket Inc., which was acquired on August 4, 2011, and amortization of intangibles related to the Bluesocket acquisition.

Research and development expenses as a percentage of sales increased from 14.3% in the three months ended March 31, 2011 to 18.4% in the three months ended March 31, 2012. Research and development expenses as a percentage of sales will fluctuate whenever there are incremental product development activities or a significant fluctuation in revenues for the periods being compared.

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

INTEREST AND DIVIDEND INCOME

Interest and dividend income increased 4.0% from \$1.8 million in the three months ended March 31, 2011 to \$1.9 million in the three months ended March 31, 2012. This increase is primarily related to a 22.1% increase in our average investment balance, partially offset by an 11.1% reduction in the average rate of return on these investments as a result of lower interest rates.

INTEREST EXPENSE

Interest expense, which is primarily related to our taxable revenue bond, remained constant at \$0.6 million in each of the three months ended March 31, 2012 and 2011. See [Liquidity and Capital Resources](#) below for additional information on our revenue bond.

NET REALIZED INVESTMENT GAIN

Net realized investment gain decreased from \$2.8 million in the three months ended March 31, 2011 to \$2.5 million in the three months ended March 31, 2012. The higher amount of realized gains in the period ended March 31, 2011 is primarily driven by the sale of previously impaired assets in the deferred compensation plans. See [Investing Activities](#) in [Liquidity and Capital Resources](#) below for additional information.

OTHER INCOME (EXPENSE), NET

Other income (expense), net, comprised primarily of miscellaneous income, gains and losses on foreign currency transactions, investment account management fees, scrap raw material sales, and gains and losses on the disposal of property, plant and equipment occurring in the normal course of business, changed from \$0.1 million of expense in the three months ended March 31, 2011 to \$0.1 million of income in the three months ended March 31, 2012.

Table of Contents***INCOME TAXES***

Our effective tax rate increased from 30.7% in the three months ended March 31, 2011 to 35.4% in the three months ended March 31, 2012. The tax provision rate in the first quarter of 2012 did not include the benefit of the research tax credit, which expired on December 31, 2011. The exclusion of this benefit in the first quarter of 2012 resulted in a 2.2 percentage point increase in our effective tax rate. Also, decreased benefits from a lower volume of stock option exercises in the first quarter of 2012 resulted in a 3.1 percentage point increase in our effective tax rate.

NET INCOME

As a result of the above factors, net income decreased \$21.3 million from \$34.3 million in the three months ended March 31, 2011 to \$13.0 million in the three months ended March 31, 2012.

As a percentage of sales, net income decreased from 20.7% in the three months ended March 31, 2011 to 9.6% in the three months ended March 31, 2012.

LIQUIDITY AND CAPITAL RESOURCES***Liquidity***

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

At March 31, 2012, cash on hand was \$36.5 million and short-term investments were \$161.5 million, which resulted in available short-term liquidity of \$198.1 million. At December 31, 2011, our cash on hand of \$43.0 million and short-term investments of \$159.3 million resulted in available short-term liquidity of \$202.3 million. The decrease in short-term liquidity from December 31, 2011 to March 31, 2012 primarily reflects an increase in the purchase of long-term investments, equipment acquisitions and dividends, offset by funds provided by our operating activities and proceeds from stock option exercises.

Operating Activities

Our working capital, which consists of current assets less current liabilities, decreased 2.3% from \$329.3 million as of December 31, 2011 to \$321.7 million as of March 31, 2012. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 4.50 as of December 31, 2011 to 3.82 as of March 31, 2012. The current ratio, defined as current assets divided by current liabilities, decreased from 6.32 as of December 31, 2011 to 5.50 as of March 31, 2012. Our working capital, quick ratio, and current ratio decreased due to a \$7.0 million increase in income tax payable, a \$1.8 million increase in accounts payable, and a \$1.4 million increase in unearned revenue. 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. Generally, fluctuations in unearned revenue result from variations in the timing of customer payments received in advance of revenue recognition and our revenue recognition under contract terms for hardware acceptance, installation services and post-sale support and maintenance services.

Net accounts receivable decreased 1.8% from \$76.1 million at December 31, 2011 to \$74.8 million at March 31, 2012. Our allowance for doubtful accounts was \$8 thousand at December 31, 2011 and \$42 thousand at March 31, 2012. Quarterly accounts receivable days sales outstanding (DSO) increased from 40 days as of December 31, 2011 to 51 days as of March 31, 2012. DSO increased for the quarter ended March 31, 2012 due to the timing of sales and collections during the quarter. Other receivables decreased from \$9.7 million at December 31, 2011 to \$8.0 million at March 31, 2012. Generally, the change in other receivables is due to the timing of shipments and payments received for raw materials supplied to our contract manufacturers.

Quarterly inventory turnover decreased from 3.5 turns as of December 31, 2011 to 2.6 turns as of March 31, 2012. Inventory increased 9.1% from December 31, 2011 to March 31, 2012. Inventory increased during the first quarter of 2012 due to a delay in both the start and ramp-up of orders from a large carrier customer due to a new systems implementation. We expect inventory levels to fluctuate as we attempt to maintain sufficient inventory in response to seasonal cycles of our business; ensuring competitive lead times while managing the risk of inventory obsolescence that may occur due to rapidly changing technology and customer demand.

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Accounts payable increased 6.2% from \$29.4 million at December 31, 2011 to \$31.2 million at March 31, 2012. 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 \$4.1 million and \$3.0 million for the three months ended March 31, 2012 and 2011, respectively. These expenditures were primarily used to purchase manufacturing and test equipment and computer software and hardware.

Our combined short-term and long-term investments increased \$37.7 million from \$491.4 million at December 31, 2011 to \$529.0 million at March 31, 2012. This increase reflects the impact of additional funds available for investment provided by our operating activities and stock option exercises by our employees, reduced by our cash needs for equipment acquisitions 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 March 31, 2012 these investments included municipal variable rate demand notes of \$47.9 million, municipal fixed-rate bonds of \$193.3 million and corporate bonds of \$183.4 million. At December 31, 2011, these investments included municipal variable rate demand notes of \$69.7 million, municipal fixed-rate bonds of \$174.8 million and corporate bonds of \$156.8 million. As of March 31, 2012, our corporate bonds, municipal fixed-rate bonds, and municipal variable rate demand notes were classified as available-for-sale and had a combined duration of 1.0 years with an average credit rating of AA-. 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 10.7% from \$332.0 million at December 31, 2011 to \$367.5 million at March 31, 2012. The primary reason for the increase in our long-term investments during the first quarter of 2012 was cash generated from operations. Long-term investments at March 31, 2012 and December 31, 2011 included an investment in a certificate of deposit of \$48.3 million, which serves as collateral for our revenue bonds, as discussed below. We have various equity investments included in long-term investments at a cost of \$15.8 million and \$12.8 million, and with a fair value of \$42.1 million and \$31.3 million, at March 31, 2012 and December 31, 2011, respectively.

Long-term investments at March 31, 2012 also include \$11.2 million related to our deferred compensation plans; \$2.1 million of other investments carried at cost, consisting of interests in two private equity funds and an investment in a privately held telecommunications equipment manufacturer; and \$0.7 million of a fixed income bond fund.

We review our investment portfolio for potential other-than-temporary declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. As a result of our review, we recorded an other-than-temporary impairment charge of \$33 thousand during the three months ended March 31, 2012 related to seven marketable equity securities. For the three months ended March 31, 2011, we recorded an other-than-temporary impairment charge of \$4 thousand related to one marketable equity security.

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Financing Activities

Dividends

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 three months ended March 31, 2012, we paid dividends totaling \$5.7 million.

Debt

We have amounts outstanding under loans made pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond) which totaled \$47.0 million at March 31, 2012 and December 31, 2011. At March 31, 2012, the estimated fair value of the Bond was approximately \$48.3 million, based on a debt security with a comparable interest rate and maturity and a Standard & Poor's credit rating of A+. Included in long-term investments are restricted funds in the amount of \$48.3 million at March 31, 2012 and December 31, 2011, which is a collateral deposit against the principal amount of the 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. The Bond matures on January 1, 2020, and bears interest at the rate of 5% per annum. 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 we are required to remit to the state for those employment positions that qualify under this program.

We are required to make payments in the amounts necessary to pay the principal and interest on the amounts currently outstanding. Based on positive cash flow from operating activities, we have decided to continue early partial redemptions 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 classified as a current liability in accounts payable in the Consolidated Balance Sheet at March 31, 2012.

Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions of up to 35 million shares of our common stock. During the three months ended March 31, 2012, we did not repurchase any shares of our common stock. We have the authority to purchase an additional 5.9 million shares of our common stock under plans approved by the Board of Directors on April 14, 2008 and October 11, 2011.

Stock Option Exercises

To accommodate employee stock option exercises, we issued 0.2 million shares of treasury stock for \$3.6 million during the three months ended March 31, 2012. During the three months ended March 31, 2011, we issued 1.7 million shares of treasury stock for \$31.8 million.

Off-Balance Sheet Arrangements and Contractual Obligations

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. During the three months ended March 31, 2012, there have been no material changes in contractual obligations and commercial commitments from those discussed in our most recent Annual Report on Form 10-K for the year ended December 31, 2011 filed on February 29, 2012 with the SEC.

We have committed to invest up to an aggregate of \$7.9 million in two private equity funds, and we have contributed \$8.4 million as of March 31, 2012, of which \$7.7 million has been applied to these commitments.

FACTORS THAT COULD AFFECT OUR FUTURE RESULTS

The following are some of the risks that could affect our financial performance or could cause actual results to differ materially from those expressed or implied in our forward-looking statements:

Our operating results may fluctuate in future periods, which may adversely affect our stock price.

Our revenue for a particular period can be difficult to predict, and a shortfall in revenue may harm our operating results.

The failure to complete the integration of the Nokia Siemens Networks fixed line Broadband Access business as soon as we expect or the failure to realize benefits from this acquisition as significant as we expect may affect our future results of operations and financial condition, and could affect our stock price.

General economic conditions may reduce our revenues and harm our operating results.

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Our exposure to the credit risks of our customers and distributors may make it difficult to collect accounts receivable and could adversely affect our operating results and financial condition.

We expect gross margin to vary over time, and our level of product gross margin may not be sustainable.

We must continue to update and improve our products and develop new products in order to compete and to keep pace with improvements in telecommunications technology.

Our products may not continue to comply with the regulations governing their sale, which may harm our business.

Our failure or the failure of our contract manufacturers to comply with applicable environmental regulations could adversely impact our results of operations.

If our products do not interoperate with our customers' networks, installations may be delayed or cancelled, which could harm our business.

The lengthy approval process required by major and other service providers for new products could result in fluctuations in our revenue.

We engage in research and development activities to improve the application of developed technologies, and as a consequence may miss certain market opportunities enjoyed by larger companies with substantially greater research and development efforts who may focus on more leading edge development.

We depend heavily on sales to certain customers; the loss of any of these customers would significantly reduce our revenues and net income.

Our strategy of outsourcing a portion of our manufacturing requirements to subcontractors located in Asia or other international regions may result in us not meeting our cost, quality or performance standards.

Our dependence on a limited number of suppliers may prevent us from delivering our products on a timely basis, which could have a material adverse effect on customer relations and operating results.

We compete in markets that have become increasingly competitive, which may result in reduced gross profit margins and market share.

Our estimates regarding future warranty obligations may change due to product failure rates, shipment volumes, field service obligations and other rework costs incurred in correcting product failures. If our estimates change, the liability for warranty obligations may be increased or decreased, impacting future cost of goods sold.

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Managing our inventory is complex and may include write-downs of excess or obsolete inventory.

The anticipated growth of our international operations could expose us to additional risks, increase our costs and adversely affect our operating results and financial condition.

We may be adversely affected by fluctuations in currency exchange rates.

Our success depends on our ability to reduce the selling prices of succeeding generations of our products.

Our failure to maintain rights to intellectual property used in our business could adversely affect the development, functionality, and commercial value of our products.

Software under license from third parties for use in certain of our products may not continue to be available to us on commercially reasonable terms.

We may incur liabilities or become subject to litigation that would have a material effect on our business.

Consolidation and deterioration in the competitive service provider market could result in a significant decrease in our revenue.

We depend on distributors who maintain inventories of our products. If the distributors reduce their inventories of these products, our sales could be adversely affected.

If we are unable to successfully develop relationships with system integrators, service providers, and enterprise value added resellers, our sales may be negatively affected.

If we fail to manage our exposure to worldwide financial and securities markets successfully, our operating results and financial statements could be materially impacted.

Changes in our effective tax rate or assessments arising from tax audits may have an adverse impact on our results.

We are required to periodically evaluate the value of our long-lived assets, including the value of intangibles acquired and goodwill resulting from business acquisitions. Any future impairment charges required may adversely affect our operating results.

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Our success depends on attracting and retaining key personnel.

Regulatory and potential physical impacts of climate change and other natural events may affect our customers and our production operations, resulting in adverse effects on our operating results.

While we believe our internal control over financial reporting is adequate, a failure to maintain effective internal control over financial reporting as our business expands could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

The price of our common stock has been volatile and may continue to fluctuate significantly.

The foregoing list of risks is not exclusive. For a more detailed description of the risk factors associated with our business, see Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011, filed on February 29, 2012 with the SEC.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates and prices of marketable equity and fixed-income securities. The primary objective of the large majority of our investment activities is to preserve principal while at the same time achieving appropriate yields without significantly increasing risk. To achieve this objective, a majority of our marketable securities are investment grade, municipal, fixed-rate bonds, municipal variable rate demand notes and municipal money market instruments denominated in United States dollars. Our investment policy provides limitations for issuer concentration, which limits, at the time of purchase, the concentration in any one issuer to 5% of the market value of our total investment portfolio.

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of March 31, 2012, \$23.9 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

As of March 31, 2012, approximately \$433.8 million of our cash and investments may be directly affected by changes in interest rates. We have performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps) for an entire year, while all other variables remain constant. At March 31, 2012, we held \$163.9 million of cash and investments where a change in interest rates would impact our interest income. A hypothetical 50 bps decline in interest rates as of March 31, 2012 would reduce annualized interest income in these investments by approximately \$0.7 million. In addition, we held \$361.3 million of fixed-rate municipal bonds and corporate bonds whose fair values may be directly affected by a change in interest rates. A hypothetical 50 bps increase in interest rates as of March 31, 2012 would reduce the fair value of our municipal fixed-rate bonds and corporate bonds by approximately \$2.1 million.

As of March 31, 2011, approximately \$393.0 million of our cash and investments was subject to being directly affected by changes in interest rates. We have performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 bps for the entire year, while all other variables remain constant. A hypothetical 50 bps decline in interest rates as of March 31, 2011 would have reduced annualized interest income on our cash and investments by approximately \$0.3 million. In addition, a hypothetical 50 bps increase in interest rates as of March 31, 2011 would have reduced the fair value of our cash and investments by approximately \$2.1 million.

For further information about the fair value of our available-for-sale investments as of March 31, 2012 see Note 5 of Notes to Consolidated Financial Statements.

Table of Contents**ITEM 4. CONTROLS AND PROCEDURES**

(a) *Evaluation of disclosure controls and procedures.* Our Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) for ADTRAN. Our Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report, have concluded that our disclosure controls and procedures are effective.

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

PART II. OTHER INFORMATION**ITEM 1A. RISK FACTORS**

A list of factors that could materially affect our business, financial condition or operating results is included under *Factors That Could Affect Our Future Results* in *Management's Discussion and Analysis of Financial Condition and Results of Operations* contained in Item 2 of Part I of this report. There have been no material changes to the risk factors as disclosed in Item 1A of Part I of our most recent Annual Report on Form 10-K for the year ended December 31, 2011, filed on February 29, 2012 with the SEC.

ITEM 6. EXHIBITS

Exhibits.

| Exhibit No. | Description |
|-------------|--|
| 31 | Rule 13a-14(a)/15d-14(a) Certifications |
| 32 | Section 1350 Certifications |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Labels Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |

* Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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SIGNATURE

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

ADTRAN, INC.

(Registrant)

Date: May 9, 2012

/s/ James E. Matthews
James E. Matthews
Senior Vice President Finance,
Chief Financial Officer, Treasurer,
Secretary and Director
(Principal Accounting Officer)

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EXHIBIT INDEX

| Exhibit No. | Description |
|--------------------|--|
| 31 | Rule 13a-14(a)/15d-14(a) Certifications |
| 32 | Section 1350 Certifications |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Labels Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |

* Pursuant to Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.