ADTRAN INC
Form 10-Q
August 02, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended June 30, 2011

OR

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

Commission File Number 0-24612

ADTRAN, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**63-0918200**
(State of Incorporation)	*(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 þ No o

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 þ No o

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 þ	Accelerated Filer o	Non-accelerated Filer o	Smaller Reporting Company o

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

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

Class	Outstanding at July 21, 2011
Common Stock, $.01 Par Value	64,435,328 shares

ADTRAN, INC.
Quarterly Report on Form 10-Q
For the Three and Six Months Ended June 30, 2011
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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. W 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, 2010 filed on February 25, 2011 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.

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ADTRAN, INC.
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(In thousands, except per share amounts)

	June 30, 2011	December 31, 2010
ASSETS		
Current Assets		
Cash and cash equivalents	$ 23,787	$ 31,677
Short-term investments	138,690	157,479
Accounts receivable, less allowance for doubtful accounts of $21 and $162 at June 30, 2011 and December 31, 2010, respectively	83,266	70,893
Other receivables	10,425	3,962
Income tax receivable, net	805	2,741
Inventory	86,676	74,274
Prepaid expenses	3,362	3,270
Deferred tax assets, net	12,150	10,617
Total Current Assets	**359,161**	**354,913**
Property, plant and equipment, net	74,961	73,986
Other assets	1,825	1,915
Long-term investments	372,432	261,160
Total Assets	**$ 808,379**	**$ 691,974**
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 38,488	$ 22,785
Unearned revenue	9,312	10,138
Accrued expenses	5,957	4,913
Accrued wages and benefits	10,551	12,125
Total Current Liabilities	**64,308**	**49,961**
Deferred tax liabilities, net	8,802	10,350
Other non-current liabilities	15,086	11,841
Bonds payable	46,500	47,500
Total Liabilities	**134,696**	**119,652**
Commitments and contingencies (see Note 11)		
Stockholders Equity		
	797	797

Common stock, par value $0.01 per share; 200,000 shares authorized; 79,652 shares issued and 64,722 shares outstanding at June 30, 2011 and 79,652 shares issued and 63,010 shares outstanding at December 31, 2010		
Additional paid-in capital	208,349	193,866
Accumulated other comprehensive income	21,218	26,948
Retained earnings	785,493	731,962
Less treasury stock at cost: 14,930 and 16,642 shares at June 30, 2011 and December 31, 2010, respectively	(342,174)	(381,251)
Total Stockholders Equity	**673,683**	**572,322**
Total Liabilities and Stockholders Equity	**$ 808,379**	**$ 691,974**

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 June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Sales	$ 184,227	$ 150,361	$ 349,749	$ 277,388
Cost of sales	77,400	61,032	144,127	112,731
Gross Profit	**106,827**	**89,329**	**205,622**	**164,657**
Selling, general and administrative expenses	30,898	28,455	60,450	55,659
Research and development expenses	24,619	22,257	48,256	45,036
Operating Income	**51,310**	**38,617**	**96,916**	**63,962**
Interest and dividend income	2,003	1,654	3,792	3,181
Interest expense	(594)	(595)	(1,196)	(1,198)
Net realized investment gain	3,372	2,464	6,139	4,656
Other expense, net	(117)	(188)	(242)	(375)
Income before provision for income taxes	**55,974**	**41,952**	**105,409**	**70,226**
Provision for income taxes	(19,031)	(14,201)	(34,208)	(24,281)
Net Income	**$ 36,943**	**$ 27,751**	**$ 71,201**	**$ 45,945**
Weighted average shares outstanding basic	64,690	62,172	64,441	62,086
Weighted average shares outstanding diluted	66,135	63,488	66,044	63,281
Earnings per common share basic	$ 0.57	$ 0.45	$ 1.10	$ 0.74
Earnings per common share diluted	$ 0.56	$ 0.44	$ 1.08	$ 0.73
Dividend per share	$ 0.09	$ 0.09	$ 0.18	$ 0.18

See notes to consolidated financial statements

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ADTRAN, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Cash flows from operating activities:		
Net income	$ 71,201	$ 45,945
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,469	5,218
Amortization of net premium on available-for-sale investments	2,992	2,211
Net realized gain on long-term investments	(6,139)	(4,656)
Net loss on disposal of property, plant and equipment	17	12
Stock-based compensation expense	4,165	3,497
Deferred income taxes	(192)	(2,183)
Tax benefit from stock option exercises	10,318	1,757
Excess tax benefits from stock-based compensation arrangements	(9,180)	(1,579)
Changes in operating assets and liabilities:		
Accounts receivable, net	(12,373)	(3,596)
Other receivables	(6,463)	(3,929)
Income tax receivable, net	1,936	
Inventory	(12,402)	(18,273)
Prepaid expenses and other assets	(176)	(647)
Accounts payable	14,703	18,512
Accrued expenses and other liabilities	1,870	5,798
Income tax payable, net		892
Net cash provided by operating activities	**65,746**	**48,979**
Cash flows from investing activities:		
Purchases of property, plant and equipment	(6,287)	(4,789)
Proceeds from sales and maturities of available-for-sale investments	237,459	111,985
Purchases of available-for-sale investments	(335,870)	(137,688)
Net cash used in investing activities	**(104,698)**	**(30,492)**
Cash flows from financing activities:		
Proceeds from stock option exercises	33,022	7,409
Purchases of treasury stock		(10,330)
Dividend payments	(11,596)	(11,171)
Excess tax benefits from stock-based compensation arrangements	9,180	1,579
Net cash provided by (used in) financing activities	**30,606**	**(12,513)**

Net increase (decrease) in cash and cash equivalents		(8,346)		5,974
Effect of exchange rate changes		456		(602)
Cash and cash equivalents, beginning of period		**31,677**		**24,135**
Cash and cash equivalents, end of period	**$**	**23,787**	**$**	**29,507**

See notes to consolidated financial statements

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, 2010 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, 2010, filed on February 25, 2011 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, estimated income tax contingencies, the fair value of stock-based compensation, and the evaluation of other-than-temporary declines in the value of investments. Actual amounts could differ significantly from these estimates.

Recent Accounting Pronouncements

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. Since ASU 2011-05 affects presentation only, it will have no effect on our consolidated results of operations or financial condition.

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

During the six months ended June 30, 2011, we adopted the following accounting standards, which had no material effect on our consolidated results of operations or financial condition:

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

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

We adopted this amendment during the first quarter of 2011. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the three or six months ended June 30, 2011.

In October 2009, the FASB issued Accounting Standards Update No. 2009-14, *Certain Revenue Arrangements that Include Software Arrangements.* ASU 2009-14 changes the accounting model for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and non-software components that function together to deliver the tangible product s essential functionality are no longer within the scope of the software revenue guidance in Subtopic 985-605 of the ASC. In addition, ASU 2009-14 requires that hardware components of a tangible product containing software components always be excluded from the software revenue guidance. In that regard, ASU 2009-14 provides additional guidance on how to determine which software, if any, relating to the tangible product also would be excluded from the scope of the software revenue guidance. ASU 2009-14 also provides guidance on how a vendor should allocate arrangement consideration to deliverables in an arrangement that includes both tangible products and software. ASU 2009-14 also provides further guidance on how to allocate arrangement consideration when an arrangement includes deliverables both included and excluded from the scope of the software revenue guidance. We adopted this amendment during the first quarter of 2011. The adoption of this amendment had no effect on our consolidated results of operations and financial condition for the three or six months ended June 30, 2011.

2. INCOME TAXES

Our effective tax rate decreased from 34.6% in the six months ended June 30, 2010 to 32.5% in the six months ended June 30, 2011. The decrease is primarily attributable to the research tax credit and increased tax benefits from a higher volume of stock option exercises during the six months ended June 30, 2011. The inclusion of the benefit for the research tax credit in the six months ended June 30, 2011 resulted in a 2.2 percentage point decrease in our tax rate. In addition, increased benefits from a higher volume of stock option exercises during the six months ended June 30, 2011 resulted in a 1.6 percentage point decrease in our tax rate.

The tax provision rate in 2010 was affected by a benefit related to the completion of an audit for the years 2006 and 2007 by the Internal Revenue Service and a larger manufacturer's deduction. The completion of the audit provided a 1.0 percentage point benefit during the six months ended June 30, 2010. The higher manufacturer's deduction resulted in a 0.7 percentage point benefit in our effective tax rate for the six months ended June 30, 2010. Also, the tax provision rate in the first six months of 2010 did not include the benefit of the research tax credit, which expired on

December 31, 2009. The credit was reinstated during the fourth quarter of 2010.

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3. STOCK-BASED COMPENSATION

The following table summarizes the stock-based compensation expense related to stock options, restricted stock units (RSUs) and restricted stock under the Stock Compensation Topic of the FASB Accounting Standards Codification (ASC) for the three and six months ended June 30, 2011 and 2010, which was recognized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2011	2010	2011	2010
Stock-based compensation expense included in cost of sales	**$ 89**	**$ 73**	**$ 180**	**$ 141**
Selling, general and administrative expense	999	835	2,006	1,585
Research and development expense	988	900	1,979	1,771
Stock-based compensation expense included in operating expenses	**1,987**	**1,735**	**3,985**	**3,356**
Total stock-based compensation expense	**2,076**	**1,808**	**4,165**	**3,497**
Tax benefit for expense associated with non-qualified options	(276)	(195)	(716)	(372)
Total stock-based compensation expense, net of tax	**$ 1,800**	**$ 1,613**	**$ 3,449**	**$ 3,125**

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.

The weighted-average assumptions and value of options granted for the three and six months ended June 30, 2011 and 2010 are summarized as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Expected volatility	37.68%	39.94%	37.68%	41.00%
Risk-free interest rate	2.18%	2.45%	2.18%	2.50%
Expected dividend yield	0.86%	1.31%	0.86%	1.53%
Expected life (in years)	4.94	5.04	4.94	5.18
Weighted-average estimated value	$ 13.93	$ 9.39	$ 13.93	$ 8.19

The fair value of our RSUs is calculated using a Monte Carlo Simulation valuation method. There were no RSU grants during the six months ended June 30, 2011 or 2010.

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 six months ended June 30, 2011 or 2010.

Stock-based compensation expense recognized in our Consolidated Statements of Income for the three and six months ended June 30, 2011 and 2010 is based on 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 2% 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.

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As of June 30, 2011, total compensation expense related to non-vested stock options, RSUs and restricted stock not yet recognized was approximately $16.0 million, which is expected to be recognized over an average remaining recognition period of 2.7 years.

The following table is a summary of our stock options outstanding as of December 31, 2010 and June 30, 2011 and the changes that occurred during the six months ended June 30, 2011:

(In thousands, except per share amounts)	**Number of Options**		**Weighted Avg. Exercise Price**	**Weighted Avg. Remaining Contractual Life In Years**		**Aggregate Intrinsic Value**
Options outstanding, December 31, 2010	**6,234**	**$**	**23.09**	**6.21**	**$**	**81,561**
Options granted	5	$	41.92			
Options cancelled/forfeited	(40)	$	25.15			
Options exercised	(1,719)	$	19.39			
Options outstanding, June 30, 2011	**4,480**	**$**	**24.51**	**6.59**	**$**	**63,635**
Options exercisable, June 30, 2011	**2,256**	**$**	**23.22**	**4.85**	**$**	**34,947**

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 June 30, 2011. 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 and six month periods ended June 30, 2011 was $1.5 million and $38.9 million, respectively.

The following table is a summary of our RSUs and restricted stock outstanding as of December 31, 2010 and June 30, 2011 and the changes that occurred during the six months ended June 30, 2011:

(In thousands, except per share amounts)	**Number of Shares**		**Weighted Average Grant Date Fair Value**
RSUs and restricted stock outstanding, December 31, 2010	**87**	**$**	**28.46**
RSUs and restricted stock granted		$	
RSUs and restricted stock vested		$	
RSUs and restricted stock cancelled/forfeited		$	
Unvested RSUs and restricted stock, June 30, 2011	**87**	**$**	**28.46**

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4. INVESTMENTS

At June 30, 2011, we held the following securities and investments, recorded at either fair value or cost.

	Amortized	Gross Unrealized		Carrying
(In thousands)	Cost	Gains	Losses	Value
Deferred compensation plan assets	$ 6,438	$ 351	$	$ 6,789
Corporate bonds	200,280	971	(362)	200,889
Municipal fixed-rate bonds	117,262	597	(5)	117,854
Municipal variable rate demand notes	94,870			94,870
Fixed income bond fund	526	225		751
Marketable equity securities	12,119	27,516	(212)	39,423
Available-for-sale securities held at fair value	**$ 431,495**	**$ 29,660**	**$ (579)**	**$ 460,576**
Restricted investment held at cost				**48,250**
Other investments held at cost				**2,296**
Total carrying value of available-for-sale investments				**$ 511,122**

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

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

At June 30, 2011, we held $6.8 million of deferred compensation plan assets, carried at fair value.

At June 30, 2011, we held $200.9 million of corporate bonds. These bonds are classified as available-for-sale and had an average duration of 2.2 years at June 30, 2011. At June 30, 2011, approximately 1% of our corporate bond portfolio had a credit rating of AAA, 14% had a credit rating of AA, 55% had a credit rating of A, and 30% had a credit rating of BBB. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

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At June 30, 2011, we held $117.9 million of municipal fixed-rate bonds. These bonds are classified as available-for-sale and had an average duration of 1.3 years at June 30, 2011. At June 30, 2011, approximately 24% of our municipal fixed-rate bond portfolio had a credit rating of AAA, 58% had a credit rating of AA, and 18% had a credit rating of A. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

At June 30, 2011, we held $94.9 million of municipal variable rate demand notes, all of which were classified as available-for-sale. At June 30, 2011, 27% of our municipal variable rate demand notes had a credit rating of AAA, 63% had a credit rating of AA, 10% had a credit rating of A, and all contained put options of seven days. Despite the long-term nature of their stated contractual maturities, we routinely buy and sell these securities and we believe that we have the ability to quickly liquidate them. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. We believe we have the ability to sell our variable rate demand notes to the remarketing agent, tender agent or issuer at par value plus accrued interest in the event we decide to liquidate our investment in a particular variable rate demand note. At June 30, 2011, approximately 24% of our variable rate demand notes were supported by letters of credit from banks that we believe to be in good financial condition. The remaining 76% of our variable rate demand notes were supported by standby purchase agreements. As a result of these factors, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments. All income generated from these investments was recorded as interest income. We have not recorded any losses relating to municipal variable rate demand notes.

At June 30, 2011, we held $0.8 million of a fixed income bond fund.

At June 30, 2011, we held $39.4 million of marketable equity securities, including a single security, of which we held 1.3 million shares, carried at a fair value of $24.3 million. We sold 0.2 million shares of this security during the six months ended June 30, 2011. The sale of this security resulted in proceeds of $4.2 million and a realized gain of $4.1 million. This single security traded approximately 0.9 million shares per day in the first six months of 2011 in an active market on a European stock exchange. This single security comprises $23.8 million of the gross unrealized gains included in the fair value of our marketable equity securities at June 30, 2011. The remaining $3.7 million of gross unrealized gains and $0.2 million of gross unrealized losses at June 30, 2011 were spread amongst more than 400 equity securities.

At June 30, 2011, we held a $48.3 million restricted certificate of deposit, which is carried at cost. This investment serves as a collateral deposit against the principal amount outstanding under loans made to ADTRAN pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond). At June 30, 2011, the estimated fair value of the Bond was approximately $46.0 million, based on a debt security with a comparable interest rate and maturity and a Standard and Poor s credit rating of A+. We have the right to set-off the balance of the Bond with the collateral deposit in order to reduce the balance of the indebtedness. For more information on the Bond, see Debt under Liquidity and Capital Resources in the Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Item 2 of Part I of this report.

At June 30, 2011, we held $2.3 million of other investments carried at cost, consisting of interests in two private equity funds and an investment in a privately held telecommunications equipment manufacturer. The fair value of these investments was estimated to be approximately $10.5 million at June 30, 2011, based on unobservable inputs including information supplied by the company and the fund managers. We have committed to invest up to an aggregate of $7.9 million in the two private equity funds, and we have contributed $8.4 million as of June 30, 2011, of which $7.7 million has been applied toward these commitments. As of June 30, 2011, we have received distributions related to these two private equity funds of $7.9 million, of which $1.4 million was recorded as investment income. These investments are carried at cost, net of distributions, with distributions in excess of our investment recorded as investment income. The remaining commitment under the funds is $0.2 million, which expires in 2013. We have not been required to record any impairment losses related to these investments during the six months ended June 30, 2011.

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 $12 thousand during the six months ended June 30, 2011 related to three marketable equity securities. For the six months ended June 30, 2010, we recorded an other-than-temporary impairment charge of $42 thousand related to three marketable equity securities.

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

		Fair Value Measurements at June 30, 2011 Using		
(In thousands)	**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	$ 10,737	$ 10,737	$	$
Available-for-sale securities				
Deferred compensation plan assets	6,789	6,789		
Available-for-sale debt securities				
Corporate bonds	200,889		200,889	
Municipal fixed-rate bonds	117,854		117,854	
Municipal variable rate demand notes	94,870		94,870	
Fixed income bond fund	751	751		
Available-for-sale marketable equity securities				
Equity securities technology industry	25,591	25,591		
Equity securities other	13,832	13,832		
Available-for-sale securities	**460,576**	**46,963**	**413,613**	
Total	**$ 471,313**	**$ 57,700**	**$ 413,613**	**$**

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	Fair Value Measurements at December 31, 2010 Using			
(In thousands)	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	$ 14,532	$ 14,532	$	$
Available-for-sale securities				
Deferred compensation plan assets	4,246	4,246		
Available-for-sale debt securities				
Corporate bonds	127,072		127,072	
Municipal fixed-rate bonds	71,467		71,467	
Municipal variable rate demand notes	116,745		116,745	
Fixed income bond fund	746	746		
Available-for-sale marketable equity securities				
Equity securities technology industry	35,596	35,596		
Equity securities other	12,414	12,414		
Available-for-sale securities	**368,286**	**53,002**	**315,284**	
Total	**$ 382,818**	**$ 67,534**	**$ 315,284**	**$**

As of June 30, 2011 and December 31, 2010, the fair value of the investments in available-for-sale Level 2 corporate bonds and municipal fixed-rate bonds was $318.7 million and $198.5 million, respectively. The fair value of these securities is calculated using a weighted average market price for each security. Market prices are obtained from a variety of industry standard data providers, security master files from large financial institutions, and other third-party sources. These multiple market prices are used as inputs into a distribution-curve-based algorithm to determine the daily market value of each security.

As of June 30, 2011 and December 31, 2010, the fair value of the investments in available-for-sale Level 2 municipal variable rate demand notes was $94.9 million and $116.7 million, respectively. These securities have a structure that implies a standard expected market price. The frequent interest rate resets make it reasonable to expect the price to stay at par. These securities are priced at the expected market price.

5. INVENTORY

At June 30, 2011 and December 31, 2010, inventory consisted of the following:

(In thousands)	June 30, 2011	December 31, 2010
Raw materials	$ 44,177	$ 43,897
Work in process	6,327	2,871
Finished goods	36,172	27,506
Total	**$ 86,676**	**$ 74,274**

We establish reserves for estimated excess, obsolete, or unmarketable inventory equal to the difference between the cost of the inventory and the estimated fair value of the inventory based upon assumptions about future demand and market conditions. At June 30, 2011 and December 31, 2010, raw materials reserves totaled $7.8 million and $7.3 million, respectively, and finished goods inventory reserves totaled $2.0 million and $1.6 million, respectively.

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6. STOCKHOLDERS EQUITY

A summary of the changes in stockholders equity for the six months ended June 30, 2011 is as follows:

(In thousands)		Stockholders Equity
Balance, December 31, 2010	**$**	**572,322**
Net income		71,201
Dividend payments		(11,596)
Dividends accrued for unvested restricted stock units		(19)
Net change in unrealized gains and losses on marketable securities (net of deferred taxes)		(5,791)
Reclassification adjustment for amounts included in net income (net of deferred taxes)		(395)
Foreign currency translation adjustment		456
Proceeds from stock option exercises		33,022
Tax benefits from stock option exercises		10,318
Stock-based compensation expense		4,165
Balance, June 30, 2011	**$**	**673,683**

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 30 million shares of our common stock. During the six months ended June 30, 2011, we did not repurchase any shares of our common stock. We have the authority to purchase an additional 2.0 million shares of our common stock under the plan approved by the Board of Directors on April 14, 2008.

Stock Option Exercises

We issued 1.7 million shares of treasury stock during the six months ended June 30, 2011 to accommodate employee stock option exercises. The stock options had exercise prices ranging from $10.50 to $36.64. We received proceeds totaling $33.0 million from the exercise of these stock options during the six months ended June 30, 2011.

Dividend Payments

During the six months ended June 30, 2011, we paid cash dividends as follows (in thousands except per share amount):

Record Date	Payment Date		Per Share Amount		Total Dividend Paid
February 3, 2011	February 17, 2011	$	0.09	$	5,775
April 28, 2011	May 12, 2011	$	0.09	$	5,821

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Comprehensive Income

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

(In thousands)	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Net income	$ 36,943	$ 27,751	$ 71,201	$ 45,945
Net change in unrealized gains and losses related to marketable securities, net of deferred tax benefit of $2,029 and $3,404 for the three months ended June 30, 2011 and 2010, respectively, and $2,702 and $631 for the six months ended June 30, 2011 and 2010, respectively	(3,140)	(5,678)	(5,791)	(1,056)
Reclassification adjustment for amounts included in net income, net of deferred tax benefit of $146 and $96 for the three months ended June 30, 2011 and 2010, respectively, and $186 and $127 for the six months ended June 30, 2011 and 2010, respectively	(236)	(160)	(395)	(212)
Foreign currency translation adjustment	369	(770)	456	(602)
Total comprehensive income	**$ 33,936**	**$ 21,143**	**$ 65,471**	**$ 44,075**

7. EARNINGS PER SHARE

A summary of the calculation of basic and diluted earnings per share for the three and six months ended June 30, 2011 and 2010 is as follows:

(In thousands, except per share amounts)	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Numerator				
Net income	$ 36,943	$ 27,751	$ 71,201	$ 45,945
Denominator				
Weighted average number of shares basic	64,690	62,172	64,441	62,086
Effect of dilutive securities				
Stock options	1,387	1,281	1,547	1,169
Restricted stock and restricted stock units	58	35	56	26
Weighted average number of shares diluted	66,135	63,488	66,044	63,281
Net income per share basic	$ 0.57	$ 0.45	$ 1.10	$ 0.74
Net income per share diluted	$ 0.56	$ 0.44	$ 1.08	$ 0.73

Anti-dilutive options to purchase common stock outstanding were excluded from the above calculations. Anti-dilutive options totaled 0.9 million and 2.1 million for the three months ended June 30, 2011 and 2010, respectively, and

0.9 million and 2.8 million for the six months ended June 30, 2011 and 2010, respectively.

8. 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 expenses, research and development expenses, interest and dividend income, interest expense, net realized investment gain/loss, other expense, net and provision for income taxes are reported on an entity-wide basis only. There are no inter-segment revenues.

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The following table presents information about the reported sales and gross profit of our reportable segments for the three and six months ended June 30, 2011 and 2010. Asset information by reportable segment is not reported, since we do not produce such information internally.

	Three Months Ended			
	June 30, 2011		June 30, 2010	
(In thousands)	Sales	Gross Profit	Sales	Gross Profit
Carrier Networks	$ 150,492	$ 87,465	$ 117,579	$ 70,273
Enterprise Networks	33,735	19,362	32,782	19,056
Total	**$ 184,227**	**$ 106,827**	**$ 150,361**	**$ 89,329**

	Six Months Ended			
	June 30, 2011		June 30, 2010	
(In thousands)	Sales	Gross Profit	Sales	Gross Profit
Carrier Networks	$ 282,852	$ 166,963	$ 217,103	$ 129,539
Enterprise Networks	66,897	38,659	60,285	35,118
Total	**$ 349,749**	**$ 205,622**	**$ 277,388**	**$ 164,657**

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, and Digital Subscriber Line Access Multiplexer (DSLAM) products. Our broadband access products are used by service providers to deliver high-speed Internet access, Voice over Internet Protocol (VoIP), IP Television (IPTV), and/or Ethernet services from the central office or remote terminal locations to customer premises. The Carrier Systems category also includes our optical access products. These products consist of optical access multiplexers including our family of OPTI products and our Optical Networking Edge (ONE) products. Optical access products are used to deliver higher bandwidth services, or to aggregate large numbers of low bandwidth services for transportation across fiber optic infrastructure. Total Access 1500 products, 303 concentrator products, M13 multiplexer products, and a number of mobile backhaul products are also included in the Carrier Systems product category.

Business Networking products provide access to telecommunication services, facilitating the delivery of converged services and Unified Communications to the 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), 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.

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The table below presents sales information by product category for the three and six months ended June 30, 2011 and 2010.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2011	2010	2011	2010
Carrier Systems	$ 112,289	$ 73,148	$ 199,039	$ 131,241
Business Networking	35,699	32,165	72,062	58,622
Loop Access	36,239	45,048	78,648	87,525
Total	**$ 184,227**	**$ 150,361**	**$ 349,749**	**$ 277,388**

In addition, we identify subcategories of product revenues, which we divide into growth products, representing our primary growth areas, and traditional products. Our growth products consist of Broadband Access and Optical Access products (included in Carrier Systems) and Internetworking products (included in Business Networking) and our traditional products include HDSL products (included in Loop Access) and other products not included in the aforementioned growth products.
Subcategory revenues included in the above are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2011	2010	2011	2010
Growth Products				
Broadband Access (included in Carrier Systems)	$ 77,062	$ 44,971	$ 128,844	$ 81,333
Optical Access (included in Carrier Systems)	22,008	16,128	42,924	27,387
Internetworking (NetVanta & Multi-service Access Gateways) (included in Business Networking)	33,029	27,902	65,912	50,085
Total	**132,099**	**89,001**	**237,680**	**158,805**
Traditional Products				
HDSL (does not include T1) (included in Loop Access)	34,049	42,174	74,994	82,104
Other products (excluding HDSL)	18,079	19,186	37,075	36,479
Total	**52,128**	**61,360**	**112,069**	**118,583**
Total	**$ 184,227**	**$ 150,361**	**$ 349,749**	**$ 277,388**

Sales by Geographic Region

The table below presents sales information by geographic area for the three and six months ended June 30, 2011 and 2010. International sales correlate to shipments with a non-U.S. destination.

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands)	2011	2010	2011	2010
United States	$ 160,804	$ 142,046	$ 313,917	$ 262,346

International		23,423		8,315		35,832		15,042
Total	**$**	**184,227**	**$**	**150,361**	**$**	**349,749**	**$**	**277,388**

9. LIABILITY FOR WARRANTY RETURNS

Our products generally include warranties of one to ten years for product defects. We accrue for warranty returns at the time revenue is recognized based on our estimate of the cost to repair or replace the defective products. We engage in extensive product quality programs and processes, including actively monitoring and evaluating the quality of our component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. The increasing complexity of our products will cause warranty incidences, when they arise, to be more costly. Our estimates regarding future warranty obligations may change due to product failure rates, material usage, and other rework costs incurred in correcting a product failure. In addition, from time to time, specific warranty accruals may be recorded if unforeseen problems arise. Should our actual experience relative to these factors be worse than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods. The liability for warranty obligations totaled $3.6 million at June 30, 2011 and $3.3 million at December 31, 2010. These liabilities are included in accrued expenses in the accompanying Consolidated Balance Sheets.

A summary of warranty expense and write-off activity for the six months ended June 30, 2011 and 2010 is as follows:

Six Months Ended June 30, *(In thousands)*	**2011**	**2010**
Balance at beginning of period	$ 3,304	$ 2,833
Plus: Amounts charged to cost and expenses	1,525	1,377
Less: Deductions	(1,183)	(1,050)
Balance at end of period	**$ 3,646**	**$ 3,160**

10. 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 and six month periods ended June 30, 2011 and 2010, we incurred fees of $10 thousand per month for these legal services.

11. COMMITMENTS AND CONTINGENCIES

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

We 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 June 30, 2011, of which $7.7 million has been applied to these commitments. See Note 4 of Notes to Consolidated Financial Statements for additional information.

12. SUBSEQUENT EVENTS

On July 12, 2011, 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 July 28, 2011. The payment date will be August 11, 2011. The quarterly dividend payment will be approximately $5.8 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.

During the third quarter of 2011 and as of August 2, 2011, we repurchased 0.6 million shares of our common stock through open market purchases at an average cost of $34.25 per share. We have the authority to purchase an additional 1.4 million shares of our common stock under the plan approved by the Board of Directors on April 14, 2008.

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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 growth products, representing our primary growth areas, and traditional products. Our growth products consist of Broadband Access and Optical Access products (included in Carrier Systems) and Internetworking products (included in Business Networking) and our traditional products include HDSL products (included in Loop Access) and other products not included in the aforementioned growth 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 primary growth areas position us well for this migration. We anticipate that revenues of many of our traditional 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 8 of Notes to Consolidated Financial Statements in this report for further information regarding these product categories.

Sales were $184.2 million and $349.7 million for the three and six months ended June 30, 2011 compared to $150.4 million and $277.4 million for the three and six months ended June 30, 2010. Product revenues for our three primary growth areas, Broadband Access, Optical Access and Internetworking, were $132.1 million and $237.7 million for the three and six months ended June 30, 2011 compared to $89.0 million and $158.8 million for the three and six months ended June 30, 2010. Our gross margin decreased to 58.0% and 58.8% for the three and six months ended June 30, 2011 from 59.4% for the three and six months ended June 30, 2010. Our operating income margin increased to 27.9% and 27.7% for the three and six months ended June 30, 2011 from 25.7% and 23.1% for the three and six months ended June 30, 2010. Net income was $36.9 million and $71.2 million for the three and six months ended June 30, 2011 compared to $27.8 million and $45.9 million for the three and six months ended June 30, 2010. Our effective tax rate increased to 34.0% for the three months ended June 30, 2011 from 33.9% for the three months ended June 30, 2010 and decreased to 32.5% for the six months ended June 30, 2011 from 34.6% for the six months ended June 30, 2010. Earnings per share, assuming dilution, were $0.56 and $1.08 for the three and six months ended June 30, 2011 compared to $0.44 and $0.73 for the three and six months ended June 30, 2010.

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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, 2010, filed on February 25, 2011 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, 2010, filed on February 25, 2011 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.

RESULTS OF OPERATIONS THREE AND SIX MONTHS ENDED JUNE 30, 2011 COMPARED TO THREE AND SIX MONTHS ENDED JUNE 30, 2010

SALES

ADTRAN s sales increased 22.5% from $150.4 million in the three months ended June 30, 2010 to $184.2 million in the three months ended June 30, 2011, and increased 26.1% from $277.4 million in the six months ended June 30, 2010 to $349.7 million in the six months ended June 30, 2011. The increase in sales for the three months ended June 30, 2011 is primarily attributable to a $32.1 million increase in our Broadband Access products, a $5.9 million increase in sales of our Optical Access products, and a $5.1 million increase in sales of our Internetworking products, partially offset by an $8.1 million decrease in sales of our HDSL products. The increase in sales for the six months ended June 30, 2011 is primarily attributable to a $47.5 million increase in sales of our Broadband Access products, a $15.8 million increase in sales of our Internetworking products, and a $15.5 million increase in sales of our Optical Access products, partially offset by a $7.1 million decrease in sales of our HDSL products.

Carrier Networks sales increased 28.0% from $117.6 million in the three months ended June 30, 2010 to $150.5 million in the three months ended June 30, 2011, and increased 30.3% from $217.1 million in the six months ended June 30, 2010 to $282.9 in the six months ended June 30, 2011. The increase in sales for the three and six months ended June 30, 2011 is primarily attributable to increases in Broadband Access, Optical Access and Internetworking NTE products sales, partially offset by a decrease in HDSL and other traditional product sales.

Enterprise Networks sales increased 2.9% from $32.8 million in the three months ended June 30, 2010 to $33.7 million in the three months ended June 30, 2011, and increased 11.0% from $60.3 million in the six months ended June 30, 2010 to $66.9 million in the six months ended June 30, 2011. The increase for the three and six months ended June 30, 2011 is primarily attributable to an increase in sales of Internetworking products, partially offset by a decrease in sales of traditional products. Internetworking product sales attributable to Enterprise Networks were 85.4% and 85.2% of the division s sales in the three and six months ended June 30, 2011, compared to 75.7% and 74.7% in the three and six months ended June 30, 2010. Traditional products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales decreased from 21.8% for the three months ended June 30, 2010 to 18.3% for the three months ended June 30, 2011 and decreased from 21.7% for the six months ended June 30, 2010 to 19.1% for the six months ended June 30, 2011.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 181.7% from $8.3 million in the three months ended June 30, 2010 to $23.4 million in the three months ended June 30, 2011, and increased 138.2% from $15.0 million in the six months ended June 30, 2010 to $35.8 million in the six months ended June 30, 2011. International sales, as a percentage of total sales, increased from 5.5% for the three months ended June 30, 2010 to 12.7% for the three months ended June 30, 2011, and increased from 5.4% for the six months ended June 30, 2010 to 10.2% for the six ended June 30, 2011. International sales increased in the three and six months ended June 30, 2011 compared to the three and six months ended June 30, 2010 primarily due to an increase in sales to Latin America and Europe, partially offset by a decrease in sales to Australia and Asia.

Carrier System product sales increased $39.1 million and $67.8 million in the three and six months ended June 30, 2011 compared to the three and six months ended June 30, 2010. The increase for the three months ended June 30, 2011 is primarily due to a $32.1 million increase in Broadband Access product sales and a $5.9 million increase in Optical Access product sales. The increase for the six months ended June 30, 2011 is primarily due to a $47.5 million increase in Broadband Access product sales and a $15.5 million increase in Optical Access product sales. The increase in Broadband Access product sales is primarily attributable to continued growth in deployments of our Total Access 5000 and Fiber-to-the-Node platforms.

Business Networking product sales increased $3.5 million and $13.4 million in the three and six months ended June 30, 2011 compared to the three and six months ended June 30, 2010. The increase for the three months ended June 30, 2011 is primarily due to a $5.1 million increase in Internetworking product sales across both divisions, partially offset by a $1.6 million decrease in other traditional product sales. The increase for the six months ended June 30, 2011 is primarily due to a $15.8 million increase in Internetworking product sales across both divisions, partially offset by a $2.4 million decrease in other traditional product sales. The decrease in sales of traditional 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 $8.8 million and $8.9 million in the three and six months ended June 30, 2011 compared to the three and six months ended June 30, 2010. The decrease for the three months ended June 30, 2011 is primarily due to an $8.1 million decrease in HDSL product sales. The decrease for the six months ended June 30, 2011 is primarily due to a $7.1 million decrease in HDSL product sales.

COST OF SALES

As a percentage of sales, cost of sales increased from 40.6% in the three months ended June 30, 2010 to 42.0% in the three months ended June 30, 2011 and increased from 40.6% in the six months ended June 30, 2010 to 41.2% in the six months ended June 30, 2011. This increase is primarily the result of a higher mix of lower gross margin professional services revenue and cabinet revenue, and expediting costs of production materials related to a specific customer project.

Carrier Networks cost of sales, as a percent of division sales, increased from 40.2% in the three months ended June 30, 2010 to 41.9% in the three months ended June 30, 2011 and increased from 40.3% in the six months ended June 30, 2010 to 41.0% in the six months ended June 30, 2011. The increase in Carrier Networks cost of sales as a percentage of sales is primarily attributable to the impact of changes in sales mix and cost elements discussed above.

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Enterprise Networks cost of sales, as a percent of division sales, increased from 41.9% in the three months ended June 30, 2010 to 42.6% in the three months ended June 30, 2011 and increased from 41.7% in the six months ended June 30, 2010 to 42.2% in the six months ended June 30, 2011. The increase is primarily attributable to a higher cost product mix.

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

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased 8.6% from $28.5 million in the three months ended June 30, 2010 to $30.9 million in the three months ended June 30, 2011 and increased 8.6% from $55.7 million in the six months ended June 30, 2010 to $60.5 million in the six months ended June 30, 2011. The increase in selling, general and administrative expenses for the three and six month periods ended June 30, 2011 is primarily related to increased staffing and fringe benefit costs due to increased headcount, and increases in incentive compensation, contract services and recruiting expenses.

Selling, general and administrative expenses as a percentage of sales decreased from 18.9% in the three months ended June 30, 2010 to 16.8% in the three months ended June 30, 2011 and decreased from 20.1% in the six months ended June 30, 2011 to 17.3% in the six months ended June 30, 2011. 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 10.6% from $22.3 million in the three months ended June 30, 2010 to $24.6 million in the three months ended June 30, 2011 and increased 7.1% from $45.0 million in the six months ended June 30, 2010 to $48.3 million in the six months ended June 30, 2011. The increase in research and development expenses for the three and six months ended June 30, 2011 reflects increased staffing and fringe benefit costs due to increased headcount, and an increase in customer specific testing expenses. As a percentage of sales, research and development expenses decreased from 14.8% in the three months ended June 30, 2010 to 13.4% in the three months ended June 30, 2011 and decreased from 16.2% in the six months ended June 30, 2010 to 13.8% in the six months ended June 30, 2011. Research and development expenses as a percentage of sales will fluctuate whenever there are incremental product development activities or a significant fluctuation in revenues for the periods being compared.

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

INTEREST AND DIVIDEND INCOME

Interest and dividend income increased 21.1% from $1.7 million in the three months ended June 30, 2010 to $2.0 million in the three months ended June 30, 2011 and increased 19.2% from $3.2 million in the six months ended June 30, 2010 to $3.8 million in the six months ended June 30, 2011. The increase for the three months ended June 30, 2011 is primarily driven by a 25.5% increase in our average investment balances, partially offset by a 26.3% reduction in the average rate of return on our investments as a result of lower interest rates. The increase for the six months ended June 30, 2011 is primarily driven by a 23.1% increase in our average investment balances, partially offset by a 20.0% reduction in the average rate of return on our 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 June 30, 2011 and 2010 and $1.2 million in each of the six months ended June 30, 2011 and 2010, respectively. See Liquidity and Capital Resources below for additional information on our revenue bond.

NET REALIZED INVESTMENT GAIN

Net realized investment gain increased 36.9% from $2.5 million in the three months ended June 30, 2010 to $3.4 million in the three months ended June 30, 2011 and increased 31.9% from $4.7 million in the six months ended

June 30, 2010 to a $6.1 million in the six months ended June 30, 2011. The increase for the three and six months ended June 30, 2011 is the result of realized gains from the realignment of our fixed income and deferred compensation portfolios. See Investing Activities in Liquidity and Capital Resources below for additional information.

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OTHER EXPENSE, NET

Other 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, decreased from $0.2 million in the three months ended June 30, 2010 to $0.1 million in the three months ended June 30, 2011 and decreased from $0.4 million in the six months ended June 30, 2010 to $0.2 million in the six months ended June 30, 2011.

INCOME TAXES

Our effective tax rate decreased from 34.6% in the six months ended June 30, 2010 to 32.5% in the six months ended June 30, 2011. The decrease is primarily attributable to the research tax credit and increased tax benefits from a higher volume of stock option exercises during the six months ended June 30, 2011. The inclusion of the benefit for the research tax credit in the six months ended June 30, 2011 resulted in a 2.2 percentage point decrease in our tax rate. In addition, increased benefits from a higher volume of stock option exercises during the six months ended June 30, 2011 resulted in a 1.6 percentage point decrease in our tax rate.

The tax provision rate in 2010 was affected by a benefit related to the completion of an audit for the years 2006 and 2007 by the Internal Revenue Service and a larger manufacturer's deduction. The completion of the audit provided a 1.0 percentage point benefit during the six months ended June 30, 2010. The higher manufacturer's deduction resulted in a 0.7 percentage point benefit in our effective tax rate for the six months ended June 30, 2010. Also, the tax provision rate in the first six months of 2010 did not include the benefit of the research tax credit, which expired on December 31, 2009. The credit was reinstated during the fourth quarter of 2010.

NET INCOME

As a result of the above factors, net income increased $9.2 million from $27.8 million in the three months ended June 30, 2010 to $36.9 million in the three months ended June 30, 2011 and increased $25.3 million from $45.9 million in the six months ended June 30, 2010 to $71.2 million in the six months ended June 30, 2011.

As a percentage of sales, net income increased from 18.5% in the three months ended June 30, 2010 to 20.1% in the three months ended June 30, 2011 and increased from 16.6% in the six months ended June 30, 2010 to 20.4% in the six months ended June 30, 2011.

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 June 30, 2011, cash on hand was $23.8 million and short-term investments were $138.7 million, which resulted in available short-term liquidity of $162.5 million. At December 31, 2010, our cash on hand of $31.7 million and short-term investments of $157.5 million resulted in available short-term liquidity of $189.2 million. The decrease in short-term liquidity from December 31, 2010 to June 30, 2011 primarily reflects a realignment of our fixed income portfolio from short-term to long-term, which increased long-term investments by $111.3 million during the six months ended June 30, 2011.

Operating Activities

Our working capital, which consists of current assets less current liabilities, decreased 3.3% from $305.0 million as of December 31, 2010 to $294.9 million as of June 30, 2011. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 5.21 as of December 31, 2010 to 3.82 as of June 30, 2011. The current ratio, defined as current assets divided by current liabilities, decreased from 7.10 as of December 31, 2010 to 5.59 as of June 30, 2011. Our working capital, the quick ratio, and the current ratio decreased due to a decrease in short-term investments of $18.8 million, which was a result of the realignment of our fixed income portfolio from short-term to long-term, and an increase in accounts payable of $15.7 million. 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.

Net accounts receivable increased 17.5% from $70.9 million at December 31, 2010 to $83.3 million at June 30, 2011. Our allowance for doubtful accounts was $0.2 million at December 31, 2010 and $21 thousand at June 30, 2011. Quarterly accounts receivable days sales outstanding (DSO) increased from 39 days as of December 31, 2010 to 41 days as of June 30, 2011. Net accounts receivable and DSO increased for the quarter ended June 30, 2011 due to the timing of sales and collections during the quarter. Other receivables increased from $4.0 million at December 31, 2010 to $10.4 million at June 30, 2011. Generally, the change in other receivables is due to the timing of shipments and payments received for materials supplied to our contract manufacturers.

Quarterly inventory turnover decreased from 3.8 turns as of December 31, 2010 to 3.7 turns as of June 30, 2011. Inventory increased 16.7% from December 31, 2010 to June 30, 2011. Our investment in inventory increased during the six months ended June 30, 2011 to support increasing customer demand, increases in inventories related to an increase in installation services activities, and to mitigate component supply constraints broadly affecting the industry. We expect inventory levels to fluctuate as we attempt to maintain sufficient inventory in response to seasonal cycles of our business; ensuring competitive lead times while managing the risk of inventory obsolescence that may occur due to rapidly changing technology and customer demand.

Accounts payable increased 68.9% from $22.8 million at December 31, 2010 to $38.5 million at June 30, 2011. Generally, the change in accounts payable is due to variations in the timing of the receipt of supplies, inventory and services and our subsequent payments for these purchases.

Investing Activities

Capital expenditures totaled approximately $6.3 million and $4.8 million for the six months ended June 30, 2011 and 2010, 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 $92.5 million from $418.6 million at December 31, 2010 to $511.1 million at June 30, 2011. This increase reflects the impact of additional funds available for investment provided by our operating activities and proceeds from stock option exercises by our employees, reduced by our cash needs for equipment acquisitions 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 June 30, 2011 these investments included municipal variable rate demand notes of $94.9 million, municipal fixed-rate bonds of $117.9 million and corporate bonds of $200.9 million. At December 31, 2010, these investments included municipal variable rate demand notes of $116.7 million, municipal fixed-rate bonds of $71.5 million and corporate bonds of $127.1 million.

At June 30, 2011, we held $94.9 million of municipal variable rate demand notes, all of which were classified as available-for-sale. At June 30, 2011, 27% of our municipal variable rate demand notes had a credit rating of AAA, 63% had a credit rating of AA, 10% had a credit rating of A, and all contained put options of seven days. Despite the long-term nature of their stated contractual maturities, we routinely buy and sell these securities and we believe that we have the ability to quickly liquidate them. Our investments in these securities are recorded at fair value, and the interest rates reset every seven days. We believe we have the ability to sell our variable rate demand notes to the remarketing agent, tender agent or issuer at par value plus accrued interest in the event we decide to liquidate our investment in a particular variable rate demand note. At June 30, 2011, approximately 24% of our variable rate demand notes were supported by letters of credit from banks that we believe to be in good financial condition. The remaining 76% of our variable rate demand notes were supported by standby purchase agreements. As a result of these factors, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments. All income generated from these investments was recorded as interest income. We have not recorded any losses relating to municipal variable rate demand notes.

At June 30, 2011, we held $117.9 million of municipal fixed-rate bonds. These bonds are classified as available-for-sale and had an average duration of 1.3 years at June 30, 2011. At June 30, 2011, approximately 24% of our municipal fixed-rate bond portfolio had a credit rating of AAA, 58% had a credit rating of AA, and 18% had a credit rating of A. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

At June 30, 2011, we held $200.9 million of corporate bonds. These bonds are classified as available-for-sale and had an average duration of 2.2 years at June 30, 2011. At June 30, 2011, approximately 1% of our corporate bond portfolio had a credit rating of AAA, 14% had a credit rating of AA, 55% had a credit rating of A, and 30% had a credit rating of BBB. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

Our long-term investments increased 42.6% from $261.2 million at December 31, 2010 to $372.4 million at June 30, 2011. The primary reasons for the increase in our long-term investments were cash generated from operations and proceeds from stock option exercises by our employees. Long-term investments at June 30, 2011 and December 31, 2010 included an investment in a certificate of deposit of $48.3 million, which serves as collateral for our revenue bonds, as discussed below. We have various equity investments included in long-term investments at a cost of $12.1 million and $11.5 million, and with a fair value of $39.4 million and $48.0 million, at June 30, 2011 and December 31, 2010, respectively, including a single equity security, of which we held 1.3 million shares and 1.5 million shares, carried at $24.3 million and $34.2 million of fair value at June 30, 2011 and December 31, 2010, respectively. The single security traded approximately 0.9 million shares per day in the six months ended June 30, 2011 in an active market on a European stock exchange. Of the gross unrealized gains included in the fair value of our marketable securities at June 30, 2011, this single security comprised $23.8 million of this unrealized gain. Long-term investments at June 30, 2011 also include $6.8 million related to our deferred compensation plan; $2.3 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 $0.8 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 $12 thousand during the six months ended June 30, 2011 related to three marketable equity securities. For the six months ended June 30, 2010, we recorded an other-than-temporary impairment charge of $42 thousand related to three marketable equity securities.

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 six months ended June 30, 2011, we paid dividends totaling $11.6 million.

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Debt

We have amounts outstanding under loans made pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond) which totaled $48.0 million at June 30, 2011 and December 31, 2010. At June 30, 2011, the estimated fair value of the Bond was approximately $46.0 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 June 30, 2011 and December 31, 2010, 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, $1.5 million of the Bond debt has been classified as a current liability in the Consolidated Balance Sheet.

Stock Repurchase Program

Since 1997, our Board of Directors has approved multiple share repurchase programs authorizing open market repurchase transactions of up to 30 million shares of our common stock. During the six months ended June 30, 2011, we did not repurchase any shares of our common stock. We have the authority to purchase an additional 2.0 million shares of our common stock under the plan approved by the Board of Directors on April 14, 2008.

To accommodate employee stock option exercises, we issued 1.7 million shares of treasury stock for $33.0 million during the six months ended June 30, 2011. During the six months ended June 30, 2010, we issued 0.5 million shares of treasury stock for $7.4 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 six months ended June 30, 2011, 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, 2010 filed on February 25, 2011 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 June 30, 2011, of which $7.7 million has been applied to these commitments. See Note 4 of Notes to Consolidated Financial Statements for additional information.

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.
- General economic conditions may reduce our revenues and harm our operating results.
- 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 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.
- Managing our inventory is complex and may include write-downs of excess or obsolete inventory.
- We may pursue acquisitions, which may expose us to a number of risks. If we are unable to mitigate these risks, our business may be negatively impacted.
- Increased sales volume in international markets could result in increased costs or loss of revenue due to factors inherent in these markets.
- 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.
- Our success depends on attracting and retaining key personnel.
- Regulatory and potential physical impacts of climate change 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, 2010, filed on February 25, 2011 with the SEC.

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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. At June 30, 2011, 27% of our municipal variable rate demand notes had a credit rating of AAA, 63% had a rating of AA, and 10% had a credit rating of A, and all contained put options of seven days. At June 30, 2011, approximately 24% of our municipal fixed-rate bonds had a credit rating of AAA, 58% had a credit rating of AA, and the remaining 18% had a credit rating of A. At June 30, 2011, approximately 1% of our corporate bond portfolio had a credit rating of AAA, 14% had a credit rating of AA, 55% had a credit rating of A, and 30% had a credit rating of BBB.

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of June 30, 2011, $23.4 million of our cash and cash equivalents, primarily certain domestic money market funds and foreign depository accounts, were in excess of government provided insured depository limits.

As of June 30, 2011, approximately $437.9 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 June 30, 2011, we held $119.2 million of money market instruments and municipal variable rate demand notes where a change in interest rates would impact our interest income. A hypothetical 50 bps decline in interest rates as of June 30, 2011 would reduce annualized interest income on our money market instruments and municipal variable rate demand notes by approximately $0.2 million. In addition, we held $318.7 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 June 30, 2011 would reduce the fair value of our municipal fixed-rate bonds and corporate bonds by approximately $3.0 million.

As of June 30, 2010, approximately $285.0 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 June 30, 2010 would have reduced annualized interest income on our cash, money market instruments and municipal variable rate demand notes by approximately $0.5 million. In addition, a hypothetical 50 bps increase in interest rates as of June 30, 2010 would have reduced the fair value of our municipal fixed-rate bonds and corporate bonds by approximately $1.2 million.

For further information about the fair value of our available-for-sale investments as of June 30, 2011 see Note 4 of Notes to Consolidated Financial Statements.

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.

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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, 2010, filed on February 25, 2011 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: August 2, 2011

/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.