SANOFI SYNTHELABO SA
Form 20-F
June 23, 2003
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As filed with the Securities and Exchange Commission on June 23, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 20-F

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year ended December 31, 2002

Commission File Number: 001-31368

Sanofi-Synthélabo

(exact name of registrant as specified in its charter)

N/A

(translation of registrant s name into English)

France

(jurisdiction of incorporation)

174, avenue de France, 75013 Paris, France

(address of principal executive offices)

Securities registered pursuant to Section 12(b) of the Act:

Title of Securities:	**Name of each exchange on which registered:**
American Depositary Shares, each representing one-half of one ordinary share, nominal value 2 per share	New York Stock Exchange
Ordinary shares, nominal value 2 per share	New York Stock Exchange (for listing purposes only)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

The number of outstanding shares of each of the issuer s classes of capital or common stock as of December 31, 2002 was:

ordinary shares: 732,367,507

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 12 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 x No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18 x

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PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

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Item 3. Key Information

A. Selected Financial Data

Introduction

Our company is the result of the 1999 merger of two French companies, Sanofi and Synthélabo. While we have prepared consolidated financial statements for 2000, 2001 and 2002 and a consolidated balance sheet as of December 31, 1999, we did not prepare a consolidated statement of income or statement of cash flows for 1999, the year of the merger. Instead, each of Sanofi and Synthélabo prepared consolidated statements of income and cash flows for the first half of 1999, and we prepared consolidated statements of income and cash flows for the second half of 1999. We have presented those statements of income and cash flows below, but they do not provide information that is comparable to the information in our 2000, 2001 and 2002 statements of income and cash flows.

We have also prepared a pro forma income statement for the year ended December 31, 1999, based on the assumption that the merger of Sanofi and Synthélabo occurred on January 1, 1999 and that the sale of Sanofi s beauty division occurred on December 31, 1998. The pro forma income statement data was prepared under French accounting rules applicable to pro forma financial information, and not in accordance with the regulations of the Securities and Exchange Commission applicable to pro forma financial statements. We have included certain data from the pro forma information below in order to reflect trends in our business during the period from 1999 to 2002. The methodology used to calculate our pro forma financial information is described in our registration statement on Form 20-F dated June 25, 2002 (SEC File No. 001-31368).

Our consolidated financial statements and those of our predecessor companies have been prepared in accordance with French generally accepted accounting principles, or French GAAP, and applicable French laws, which differ in certain significant respects from generally accepted accounting principles in the United States, or U.S. GAAP. These differences include, among other things:

- the treatment of the merger under U.S. GAAP as a purchase of Synthélabo by Sanofi and related subsequent accounting consequences;
- the treatment of certain provisions for restructuring;
- revenue recognition of a U.S. alliance under the operational management of Bristol-Myers Squibb; and
- the deferred income tax effect of our U.S. GAAP adjustments.

We have reconciled our net income and shareholders equity to U.S. GAAP. You should read Note F to our consolidated financial statements, which sets out the details of the reconciliation.

Unless otherwise indicated, U.S. dollar amounts in this annual report are translated using the December 31, 2002 Noon Buying Rate of $1.00 = 0.95.

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Selected Financial Data

The selected financial data set forth below have been derived from:

- our audited consolidated financial statements as of and for the years ended December 31, 2000, 2001 and 2002;
- our audited consolidated statement of income for the second half of 1999;
- our unaudited pro forma statement of income for the year ended December 31, 1999;
- the audited consolidated financial statements of Sanofi for the year ended December 31, 1998 and the six months ended June 30, 1999; and
- the audited consolidated financial statements of Synthélabo for the year ended December 31, 1998 and the six months ended June 30, 1999 (gross profit and operating profit data are unaudited as they are derived from management accounts and reflect classification differences to conform to the presentation of selected financial data for Sanofi for such periods).

The data derived from our pro forma statement of income are presented for illustration only, and do not necessarily reflect the actual results that would have been realized had Sanofi and Synthélabo operated on a combined basis for all of 1999. Due to the merger, the selected financial data for Sanofi and Synthélabo, as well as our selected financial data for the second half of 1999, are not comparable to our selected financial data for 2000, 2001 and 2002.

The first table below presents selected financial data for our company for the second half of 1999, and all of 2000, 2001 and 2002, as well as selected pro forma financial data for 1999. The second table presents selected financial data for Sanofi and Synthélabo for 1998 and the first half of 1999.

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	Six months ended December 31, 1999	As of and for the year ended December 31, 1999 (pro forma unaudited)	2000	2001	2002	2002 U.S. $
		(millions of , except per share data)				
Income statement data:						
French GAAP						
Net sales	2,658	5,350	5,963	6,488	7,448	7,840
Gross profit	1,889	3,744	4,521	5,235	6,070	6,389
Operating profit	531	971	1,577	2,106	2,614	2,752
Net income	342	625	985	1,585	1,759	1,852
Earnings per share (basic and diluted)[a]	0.47	0.85	1.35	2.17	2.42	2.55
Balance sheet data:[c]						
French GAAP						
Property, plant and equipment, net	1,143		1,217	1,229	1,395	1,468
Total assets	6,824		7,845	9,967	9,459	9,957
Long-term debt	137		121	119	65	68
Total shareholders equity	3,578		4,304	5,768	6,035	6,353
U.S. GAAP Data:[d]						
French GAAP Net income			985	1,585	1,759	1,852
Purchase accounting adjustments			(606)	(445)	(311)	(327)
Provisions and other liabilities			(99)	(23)		
Revenue recognition U.S. BMS alliance[b]			(8)	(136)	117	123
Other			99	(50)	23	24
Income tax effects			221	167	52	54
U.S. GAAP Net income[b]			592	1,098	1,640	1,726
French GAAP Shareholders equity			4,304	5,768	6,035	6,353
Purchase accounting adjustments			9,479	8,927	8,576	9,027
Provisions and other liabilities			110	35		
Revenue recognition U.S. BMS alliance[b]			(21)	(160)	(35)	(37)
Other			(168)	(456)	(695)	(732)
Income tax effects			(1,563)	(1,365)	(1,282)	(1,349)
U.S. GAAP Shareholders equity[b]			12,141	12,749	12,599	13,262
U.S. GAAP Earnings per share[b]						
basic[a]			0.82	1.52	2.30	2.42
diluted[a]			0.82	1.51	2.28	2.40

(a) Based on the weighted average number of shares outstanding in each year, equal to 731,143,218 shares in 1999, 731,441,746 shares in 2000, 732,005,084 shares in 2001 and 732,367,507 shares in 2002. Each ADS represents one-half of one share.

(b) The columns for 2000 and 2001 are restated to reflect our U.S. GAAP net income and shareholders equity taking into account the restatements of the financial statements of certain alliance entities under the operational management of Bristol-Myers Squibb. The restatements, which are set forth under the heading revenue recognition U.S. BMS alliance, for U.S. GAAP net income and shareholders equity, respectively, affected our share of the operating profits relating to the alliance entities. For additional information regarding these restatements, see Item 5 Operating and Financial Review and Prospects Overview Alliances Bristol-Myers Squibb.

(c) As discussed in Note B.2 to our consolidated financial statements included under Item 18, we changed our method of accounting for liabilities as of January 1, 2002. The impact of this change on shareholders equity was 24 million.

(d) As discussed in Note F.3.1 to our consolidated financial statements included under Item 18, we applied Statement of Financial Accounting Standard 142, Goodwill and Other Intangible Assets, as of January 1, 2002.

Sanofi **Synthélabo**

	Year ended December 31, 1998[b]	Six months ended June 30, 1999	Year ended December 31, 1998[b]	Six months ended June 30, 1999
			(unaudited)[c]	
	(millions of , except per share data)			
Income statement data:				
French GAAP				
Net sales	3,936	1,880	1,914	995
Gross profit	2,774	1,264	1,406	734
Operating profit	597	272	336	180
Net income	323	146	193	109
Earnings per share (basic and diluted)[a]	2.88	0.30	4.04	2.26
Balance sheet data:				
French GAAP				
Property, plant and equipment, net	759	753	282	281
Total assets	6,136	6,197	1,870	2,021
Long-term debt	402	39	61	58
Total shareholders equity	3,822	4,331	1,095	1,155

(a) Due to the merger, per share data for Sanofi and Synthélabo are not meaningful.
(b) Originally in French francs; amounts converted at the official rate of exchange, 1.00 = FF6.55957.
(c) Gross profit and operating profit data are unaudited. All other data is audited.

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DIVIDENDS

We paid annual dividends for the years ended December 31, 1999, 2000, 2001 and 2002. Sanofi paid annual dividends for the year ended December 31, 1998. We expect that we will continue to pay regular dividends based on our financial condition and results of operations.

The following table sets forth information with respect to the dividends paid by Sanofi in respect of the year 1998 and by our company in respect of the years 1999, 2000, 2001 and 2002.

	1998	1999[2]	2000	2001	2002
Net Dividend per Share (in euro)	1.12[1]	0.32	0.44	0.66	0.84
Net Dividend per Share (in U.S. $)	1.00	0.28	0.39	0.59	0.88

(1) The net dividend per share was converted into euro using the rate of exchange of 1.00 = FF 6.55957 fixed on December 31, 1998.

(2) The lower dividend per share is a direct result of the increase in the number of shares outstanding as a result of the merger.

The declaration, amount and payment of any future dividends will be determined by majority vote of the holders of our shares at an ordinary general meeting, following the recommendation of our board of directors. Any declaration will depend on our results of operations, financial condition, cash requirements, future prospects and other factors deemed relevant by our shareholders. Accordingly, we cannot assure you that we will pay dividends in the future on a continuous and regular basis. Under French law, we are required to pay dividends approved by an ordinary general meeting of shareholders within nine months following the meeting where they are approved. The shares registered hereby are eligible for all dividends (if any) declared and approved.

In France, dividends are paid out of after-tax income. However, subject to possible changes in French law that are described in Item 10 under Additional Information Taxation, French residents are entitled to a tax credit, known as the *avoir fiscal*, in respect of dividends they receive from French companies. Individuals are entitled to an *avoir fiscal* equal to 50% of the dividend. The *avoir fiscal* applicable to corporate investors generally is equal to 10% of the dividend. Dividends paid to non-residents normally are subject to a 25% French withholding tax and are not eligible for the benefit of the *avoir fiscal*. However, non-resident holders that are entitled to and comply with the procedures for claiming benefits under an applicable tax treaty may be subject to a reduced rate of withholding tax, and may be entitled to benefit from a refund of the *avoir fiscal*. See Item 10 Additional Information Taxation. The information in the table above represents the net dividend paid, without regard to the *avoir fiscal*.

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EXCHANGE RATE INFORMATION

AND THE EUROPEAN MONETARY SYSTEM

The European Monetary System

Under the provisions of the Treaty on European Union negotiated at Maastricht in 1991 and signed by the then 11 member states of the European Union in early 1992, a European Monetary Union, known as EMU, was implemented on January 1, 1999 and a single European currency, known as the euro, was introduced. As of December 31, 2002, the following 12 member states have adopted the euro as their national currency: Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. The legal rate of conversion between the French franc and the euro was fixed on December 31, 1998 at 1.00 = FF 6.55957, and we have translated French francs into euros at that rate for periods before we adopted the euro for purposes of preparing our consolidated financial statements.

Exchange Rates

The following table sets forth, for the periods and dates indicated, certain information concerning the exchange rates for the French franc in 1998, expressed in French francs per U.S. dollar, and for the euro from 1999 through June 13, 2003, expressed in U.S. dollar per euro. The information concerning the U.S. dollar exchange rate is based on the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the Noon Buying Rate). We provide the exchange rates below solely for your convenience. We do not represent that French francs or euros were, could have been, or could be, converted into U.S. dollars at these rates or at any other rate. The Federal Reserve Bank of New York has ceased publishing the Noon Buying Rates for French francs and other constituent currencies of the euro. For information regarding the effect of currency fluctuations on our results of operations, see Item 5 Operating and Financial Review and Prospects.

	Period-end Rate	Average Rate[1]	High	Low
	(French francs per U.S. dollar)			
1998	5.59	5.90	6.21	5.39

(1) The average of the Noon Buying Rates on the last business day of each month (or portion thereof) during the relevant period.

	Period-end Rate	Average Rate[1]	High	Low
	(U.S. dollar per euro)			
1999	1.01	1.06	1.18	1.00
2000	0.94	0.92	1.03	0.83
2001	0.89	0.89	0.95	0.84
2002	1.05	0.95	1.05	0.86
2003 (through June 13, 2003)	1.18	1.11	1.19	1.04
2002				
December	1.05	1.02	1.05	0.99
2003				

January	1.07	1.06	1.09	1.04
February	1.08	1.08	1.09	1.07
March	1.09	1.08	1.10	1.05
April	1.12	1.09	1.12	1.06
May	1.18	1.15	1.18	1.12
June (through June 13, 2003)	1.18	1.18	1.19	1.17

(1) The average of the Noon Buying Rates on the last business day of each month (or portion thereof) during the relevant period for year average; on each business day of the month (or portion thereof) for monthly average. On June 13, 2003, the Noon Buying Rate was $1 = 0.85 ($1.18 per 1).

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B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

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D. Risk Factors

Risks Relating to Our Company

We may not be able to expand our presence profitably in the United States, a market that is a key to our growth strategy, and where we are investing substantial resources.

We may not achieve our growth strategy if we do not profitably expand our presence in the United States, the world s largest pharmaceuticals market. We have identified the United States, which accounted for 22.7% of our consolidated sales in 2002, as a potential major source of future growth and plan to expand significantly our direct presence in the United States in the coming years. For example, in April 2002, we purchased Pharmacia s interest in the joint venture that sold Stilnox® (under the name Ambien®) and Kerlone® in the United States. We face a number of potential obstacles to profitable growth in the United States, including:

A need to structure effectively our U.S. organization in relation to the size of the market.

The targeting of new markets.

The fact that the United States market is dominated by major U.S. pharmaceutical companies.

Potential changes in health care reimbursement policies and possible cost control regulations in the United States.

We depend on third parties for the marketing of some of our products outside Europe. These third parties may act in ways that could harm our business.

We commercialize some of our products outside Europe in collaboration with other pharmaceutical companies. We currently have major collaborative arrangements with Bristol-Myers Squibb for the marketing of Plavix® and Aprovel® and with Organon, a subsidiary of Akzo Nobel, for the marketing of Arixtra®. We also have alliances with several Japanese companies for the marketing of our products in Japan. See Item 4 Information on the Company Business Overview Marketing and Distribution. When we commercialize our products through collaboration arrangements, we are subject to the risks that certain decisions, such as the establishment of budgets and promotion strategies, are subject to the control of our collaboration partners, and that deadlocks may adversely affect the activities conducted through the collaboration arrangements. For example, our alliances with Bristol-Myers Squibb are subject to the operational management of Bristol-Myers Squibb in some countries, including the United States. In March 2002, Bristol-Myers Squibb began a program to reduce inventory levels of Plavix® and Aprovel® at wholesalers in the United States, which had a negative impact on U.S. sales of Plavix® and Aprovel®. For additional information regarding the impact of the inventory reduction program on our results of operations, see Item 5 Operating and Financial Review and Prospects. In addition to these types of actions, we cannot be certain that our partners will perform their obligations as expected. Further, our partners might pursue their own existing or alternative technologies or product candidates in preference to those being developed or marketed in collaboration with us.

We depend on third parties for the manufacturing of the active ingredients for some of our products, including Stilnox®, Eloxatin® and Xatral®, three of our strategic products.

Although our general policy is to manufacture the active ingredients for our products ourselves, we subcontract the manufacture of some of our active ingredients to third parties, which exposes us to the risk of a supply interruption in the event that our suppliers experience financial difficulties or are unable to manufacture a sufficient supply of our products. The manufacture of the active ingredients for Stilnox®, Eloxatin® and Xatral®, which are three of our six strategic products, is currently done by third parties. See Item 4 Information on the Company Business Overview Production and Raw Materials for a description of these outsourcing arrangements. Although we have not experienced any problems in the past, if disruptions were to arise from problems with our manufacturers, this would impact our ability to sell our products in the quantities demanded by the market, and could damage our reputation and relationships with our customers. Even though we try to have backup sources of supply whenever possible, including by manufacturing backup supplies of our principle active ingredients at a second or third facility, we cannot be certain they will be sufficient if our principal sources become unavailable.

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Our collaborations with third parties expose us to risks that they will assert intellectual property rights on our inventions or fail to keep our unpatented technology confidential.

We occasionally provide information and materials to research collaborators in academic institutions or other public or private entities, or request them to conduct tests to investigate certain materials. In all cases we enter into appropriate confidentiality agreements with such entities. However, those entities might assert intellectual property rights with regard to the results of the tests conducted by their collaborators, and might not grant licenses to us regarding their intellectual property rights on acceptable terms.

We also rely upon unpatented proprietary technology, processes, know-how and data that we regard as trade secrets and protect them in part by entering into confidentiality agreements with our employees, consultants and certain contractors. We cannot be sure that these agreements or other trade secret protection will provide meaningful protection, or if they are breached, that we will have adequate remedies. You should read Item 4 Information on the Company Business Overview Patents and Intellectual Property Rights for more information about our patents and licenses.

We have two principal shareholders who continue to maintain a significant degree of influence.

Our two principal shareholders, L Oréal and Total, owned 19.5% and 24.5% of our share capital, respectively, as of April 30, 2003. Our bylaws provide that our fully paid up shares that have been held in registered form for at least two years under the name of the same shareholder acquire double voting rights. As a result, as of April 30, 2003, L Oréal and Total held shares representing 27.9% and 35.0%, respectively, of our voting rights, and are in a position to exert significant influence in the election of our directors and officers and other corporate actions that require shareholder approval. The ownership of a large percentage of our capital and voting rights by our two principal shareholders, who are also members of our board of directors, may have the effect of delaying, deferring or preventing a change in our control and may discourage bids for our shares.

Fluctuations in currency exchange rates could adversely affect our financial condition and results of operations.

Because we sell our products in numerous countries, our results of operations and financial condition could be adversely affected by fluctuations in currency exchange rates. We are particularly sensitive to movements in exchange rates between the euro and the U.S. dollar and, to a lesser extent, the Japanese yen. In 2002, approximately 22.7% of our consolidated sales were realized in the United States, and 4.2% were realized in Japan (the United States also represented 45.2% of our 2002 operating profit excluding unallocated costs). While we incur expenses in those currencies, the impact of these expenses does not fully offset the impact of currency exchange rates on our revenues. As a result, currency exchange rate movements can have a considerable impact on our earnings. When deemed appropriate, we enter into transactions to hedge our exposure to foreign exchange risks. These efforts, when undertaken, may fail to offset the effect of adverse currency exchange rate fluctuations on our results of operations. For more information concerning our exchange rate exposure, see Item 11 Quantitative and Qualitative Disclosures About Market Risk.

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Risks Relating to Our Industry

We invest substantial sums in research and development in order to remain competitive, and we may not recover these sums if our products are unsuccessful in clinical trials or fail to receive regulatory approval.

We need to invest heavily in research and development to remain competitive.

To be successful in the highly competitive pharmaceutical industry, we must commit substantial resources each year to research and development in order to develop new products. Even if our research and development efforts are fruitful, our competitors may develop more effective products or a greater number of successful new products. In 2002, we spent 1,218 million on research and development, amounting to approximately 16.4% of our consolidated net sales. Our ongoing investments in new product launches and research and development for future products could produce higher costs without a proportionate increase in revenues.

The research and development process is lengthy and carries a substantial risk of product failure.

The research and development process typically takes from 10 to 15 years from discovery to commercial product launch. This process is conducted in various stages, and during each stage there is a substantial risk that we will not achieve our goals and will have to abandon a product in which we have invested substantial amounts. For example, in order to develop a commercially viable product, we must demonstrate, through extensive pre-clinical and human clinical trials, that the compounds are safe and effective for use in humans. There is also no assurance that favorable results obtained in pre-clinical trials will be confirmed by later clinical trials, or that the clinical trials will establish sufficient safety and efficacy data necessary for regulatory approval. As of January 31, 2003, we had 52 compounds in pre-clinical and clinical development in our four targeted therapeutic areas, of which 23 were in phase II or phase III clinical trials. For additional information regarding clinical trials and the definition of the phases of clinical trials, see Item 4 Information on the Company Business Overview Research and Development. There can be no guarantee that any of these compounds will be proven safe or effective, or that they will produce commercially successful products.

After completing the research and development process, we must invest substantial additional resources seeking to obtain government approval in multiple jurisdictions, with no guarantee that approval will be obtained.

We must obtain and maintain regulatory approval for our pharmaceutical products from the European Union, United States and other regulatory authorities before the product may be sold in its markets. The submission of an application to a regulatory authority in a particular country or the European Union does not guarantee that it will grant a license to market the product. Each authority may impose its own requirements, including requiring local clinical studies, and may delay or refuse to grant approval, even though a product has already been approved in another country.

In our principal markets, the approval process for one or more indications of a new product is complex and lengthy, and typically takes from six months to two years from the date of application depending on the country. Moreover, if regulatory approval of a product is granted, the approval entails limitations on the indicated uses for which it may be marketed. A marketed product is also subject to continual review even after regulatory approval. Later discovery of previously unknown problems or failure to comply with the applicable regulatory requirements may result in marketing restrictions or withdrawal of the product, as well as possible legal sanctions. In addition, we are subject to strict government controls on the manufacture, labeling, distribution and marketing of our products. All of these factors can increase our costs of developing new

products and the risk that we will not succeed in selling them successfully.

If we are unable to protect our proprietary rights, we may not compete effectively or operate profitably.

It is important for our success that we be able effectively to obtain, maintain and enforce our patents and other proprietary rights. Patent law relating to the scope of claims in the pharmaceutical field in which we

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operate is a continually evolving field of law and can be subject to some uncertainty. Accordingly, we cannot be sure that:

- new additional inventions will be patentable,
- patents for which applications are now pending will be issued to us, or
- the scope of any patent protection will be sufficiently broad to exclude competitors.

Additionally, third parties may challenge the validity of the patents issued or licensed to us, which may result in the invalidation of these rights. We currently have over 9,000 patents and patent applications worldwide, and we license-in more than 30 additional patents. We cannot be sure how much protection, if any, will be given to our patents if we attempt to enforce them and they are challenged in court or in other proceedings.

In the first half of 2002, two pharmaceutical companies, Apotex and Dr. Reddy s Laboratories, each filed an Abbreviated New Drug Application, or ANDA, with the U.S. Food and Drug Administration, or FDA, seeking to market a generic form of Plavix® in the United States and challenging certain U.S. patents relating to Plavix®. In March 2003, Apotex instituted a similar challenge in Canada. For additional information regarding ANDAs, see Item 4 Information on the Company Business Overview Regulation. We have filed suit against Apotex and against Dr. Reddy s Laboratories for infringement of our patent rights. See Item 8 Financial Information Legal Proceedings. The Plavix® patent rights are material to our company s business, and if we were unsuccessful in asserting them or they were deemed invalid, any resulting introduction of a generic prescription version of Plavix® in the U.S. would reduce the price that we receive for this product and the volume of the product that we would be able to sell.

In recent years, governments faced with national crises have used pressure to obtain substantial concessions from pharmaceutical companies, including threatening compulsory licensing of products that they consider essential. While we support the efforts of national governments to combat major health care crises, if those efforts come at the expense of effective patent protection, the ability of our company and other pharmaceutical manufacturers to recover amounts spent on research and development will be adversely affected. In such event, we and other manufacturers might curtail our research and development expenditures, and as a result might not develop as many new products.

Our patents may be infringed, or we may infringe the patents of others.

Our competitors may infringe our patents or successfully avoid them through design innovation. To prevent infringement, we may file infringement claims, which are expensive and time consuming. Policing unauthorized use of our intellectual property is difficult, and we may not be able to prevent misappropriation of our proprietary rights. This risk is increased by the growth in the number of patent applications filed and patents granted in the pharmaceutical industry.

Product liability claims could adversely affect our business and results of operations.

Product liability is a significant commercial risk for us, and could become a more significant risk as we expand in the United States (where product liability claims can be particularly costly). Substantial damage awards have been made in certain jurisdictions against pharmaceutical

companies based upon claims for injuries allegedly caused by the use of their products. In addition, some pharmaceutical companies have recently withdrawn products from the market in the wake of significant product liability claims. Although we are not currently involved in any significant product liability cases claiming damages as a result of the use of our products, it is possible that such cases will be brought in the future. Further, there is a general trend in the insurance industry to exclude certain products from coverage. Although we maintain insurance to cover this risk, we cannot be certain that our insurance will be sufficient to cover all potential liabilities.

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We face uncertainties over pricing of pharmaceutical products.

The commercial success of our products depends in part on the extent to which the cost of our products are reimbursed. Price pressure is strong due to:

- a tendency of governments and private health care providers to favor generic pharmaceuticals;
- price controls imposed by governments in many countries; and
- parallel imports, in particular in the European Economic Area, a practice by which traders exploit price differentials among markets by purchasing in lower-priced markets for resale in higher-priced markets.

Price pressure is considerable in our two largest markets, Europe and the United States, which represented 57.7% and 22.7%, respectively, of our consolidated sales in 2002 (the United States also accounted for 45.2% of our 2002 operating profit excluding unallocated costs). Changes in the pricing environments in the United States or Europe (on an individual country basis) could have a significant impact on our revenues and operating profits. See Item 4 Information on the Company Business Overview Pricing for a description of certain regulatory pricing systems that impact our company.

Risks from the handling of hazardous materials could harm our operating results.

Pharmaceutical manufacturing activities, such as the chemical manufacturing of the active ingredients in our products and the related storage and transportation of raw materials, products and wastes exposes us to various risks, including:

- fires from inflammable substances;
- storage tank leaks and ruptures; and
- discharges or releases of toxic or hazardous substances.

These operating risks can cause personal injury, property damage and environmental contamination, and may result in:

- the shutdown of affected facilities and
- the imposition of civil or criminal penalties.

The occurrence of any of these events may significantly reduce the productivity and profitability of a particular manufacturing facility and harm our operating results.

Although we maintain property, business interruption and casualty insurance that we believe is in accordance with customary industry practices, we cannot assure you that this insurance will be adequate to cover fully all potential hazards incident to our business. For more detailed information on environmental issues, see Item 4 Information on the Company Business Overview Health, Safety and Environment.

Environmental liabilities and compliance costs may have a significant negative effect on our operating results.

The environmental laws of various jurisdictions impose actual and potential obligations on our company to remediate contaminated sites. These obligations may relate to sites:

that we currently own or operate,

that we formerly owned or operated, or

where waste from our operations was disposed.

These environmental remediation obligations could significantly reduce our operating results. In particular, our accruals for these obligations may be insufficient if the assumptions underlying these accruals prove incorrect or if we are held responsible for additional, currently undiscovered contamination. Any shortfalls could have a material impact on our operating profits. See Item 4 Information on the Company Business Overview Health, Safety and Environment and Regulation for additional information regarding our environmental policies.

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Furthermore, we are or may become involved in claims, lawsuits and administrative proceedings relating to environmental matters. An adverse outcome in any of these might have a significant negative impact on our operating results. Stricter environmental, safety and health laws and enforcement policies could result in substantial costs and liabilities to our company and could subject our handling, manufacture, use, reuse or disposal of substances or pollutants to more rigorous scrutiny than is currently the case. Consequently, compliance with these laws could result in significant capital expenditures as well as other costs and liabilities, thereby harming our business and operating results.

Risks Relating to an Investment in our Shares or ADSs

Foreign exchange fluctuations may adversely affect the U.S. dollar value of our ADSs and dividends (if any).

As a holder of ADSs, you may face some exchange rate risk. Our ADSs will trade in U.S. dollars and our shares will trade in euro. The value of the ADSs and our shares could fluctuate as the exchange rates between these currencies fluctuate. If and when we do pay dividends, they would be denominated in euro. Fluctuations in the exchange rate between the euro and the U.S. dollar will affect the U.S. dollar amounts received by owners of ADSs upon conversion by the depositary of cash dividends, if any. Moreover, these fluctuations may affect the U.S. dollar price of the ADSs on the New York Stock Exchange, whether or not we pay dividends in addition to the amounts, if any, that you would receive upon our liquidation or upon the sale of assets, merger, tender offer or similar transactions denominated in euro or any other foreign currency other than U.S. dollars.

If you hold ADSs rather than shares it may be difficult for you to exercise some of your rights as a shareholder.

As a holder of ADSs, it may be more difficult for you to exercise your rights as a shareholder than it would be if you directly held shares. For example, if we offer new shares and you have the right to subscribe for a portion of them, the depositary is allowed, in its own discretion, to sell for your benefit that right to subscribe for new shares instead of making it available to you. Also, to exercise your voting rights, ADS holders must instruct the depositary how to vote their shares. Because of this extra procedural step involving the depositary, the process for exercising voting rights will take longer for you, as a holder of ADSs, than for holders of shares. ADSs for which the depositary does not receive timely voting instructions will not be voted at any meeting. For a detailed description of your rights as a holder of ADSs, you should read Item 12 Description of Securities other than Equity Securities Description of American Depositary Shares.

Sales of our shares that will be eligible for sale in the near future may cause the market price of our shares or ADSs to decline.

At April 30, 2003, we had 732,450,981shares outstanding, approximately 44.05% of which are held by our two largest shareholders, Total and L Oréal. Of the shares held by these shareholders on April 30, 2003, 38,157,539 shares are available for sale in the public market, and the remainder will become available for sale in the public market on December 1, 2004 when the shareholders agreement between those shareholders expires. Since the merger, and including in 2002, Total has gradually been reducing its shareholding in our company.

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Sales of a substantial number of our shares, or a perception that such sales may occur, could adversely affect the market price for our shares and ADSs. See Item 10 Additional Information Share Capital Shares Eligible for Future Sale for a more detailed description of the eligibility of our shares for future sale.

Because all of our directors and officers reside outside of the United States and a substantial portion of our assets are located in France, you may have difficulty enforcing certain rights.

All of our directors and officers reside outside the United States and a substantial portion of our assets is located in France. As a result, it may be difficult for you to effect service of process within the United States on such persons and to enforce against them, either inside or outside the United States, judgments obtained against them in U.S. courts, or to enforce in U.S. courts, judgments obtained against them in courts in jurisdictions outside the United States, in any action based on civil liabilities under the U.S. federal securities laws. Additionally, awards of punitive damages in actions brought in the United States or elsewhere may be unenforceable in France. For additional information see Item 10 Additional Information Memorandum and Articles of Association Enforceability of Civil Liabilities.

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FORWARD-LOOKING STATEMENTS

This annual report contains forward-looking statements. We may also make written or oral forward-looking statements in our periodic reports to the Securities and Exchange Commission on Form 6-K, in our annual report to shareholders, in our proxy statements, in our offering circulars and prospectuses, in press releases and other written materials and in oral statements made by our officers, directors or employees to third parties. Examples of such forward-looking statements include:

- projections of operating revenues, net income, net earnings per share, capital expenditures, dividends, capital structure or other financial items or ratios;
- statements of our plans, objectives or goals, including those relating to products, clinical trials, regulatory approvals and competition;
- statements about our future economic performance or that of France, the United States or any other countries in which we operate; and
- statements of assumptions underlying such statements.

Words such as believe, anticipate, plan, expect, intend, target, estimate, project, predict, forecast, guideline, should and intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve inherent risks and uncertainties. We caution you that a number of important factors could cause actual results to differ materially from those contained in any forward-looking statements. Such factors, some of which are discussed under Item 3 Key Information Risk Factors beginning on page 10, include but are not limited to:

- our ability to continue to expand our presence profitably in the United States;
- the success of our research and development programs;
- our ability to protect our intellectual property rights; and
- the risks associated with reimbursement of healthcare costs and pricing reforms, particularly in the United States and Europe.

We caution you that the foregoing list of factors is not exclusive and that other risks and uncertainties may cause actual results to differ materially from those in forward-looking statements.

Forward-looking statements speak only as of the date they are made. We do not undertake any obligation to update them in light of new information or future developments.

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Item 4. Information on the Company

Introduction

We are an international pharmaceutical group engaged in the research, development, manufacture and marketing of pharmaceutical products for sale principally in the prescription market. In 2002, our consolidated net sales were 7,448 million ($7,840 million), our operating profit was 2,614 million ($2,752 million) and our net income was 1,759 million ($1,852 million). On the basis of 2002 sales, we are the second largest pharmaceutical group in France, the seventh largest pharmaceutical group in Europe and among the twenty largest pharmaceutical groups in the world (IMS data).

In our prescription pharmaceuticals business, we specialize in four therapeutic areas:

Cardiovascular/Thrombosis. Our Cardiovascular/Thrombosis products include two of the fastest-growing products on the Cardiovascular/Thrombosis market today: the blood pressure medication Aprovel® and the anti-clotting agent Plavix®, as well as one of our newest products, the anti-thrombotic Arixtra®.

Central Nervous System, or CNS. Our CNS medicines include Stilnox®, the world s leading prescription insomnia medication, and Depakine®, one of the leading treatments for epilepsy.

Internal Medicine. Our Internal Medicine products include Xatral®, a leading treatment for benign prostatic hypertrophy.

Oncology. Our lead product in this strategic market is the cancer drug Eloxatin®, which is marketed in Europe as a first-line treatment against colorectal cancer and, since August 2002, in the United States as a second line treatment in combination with 5-FU/LV.

Our three leading products are Aprovel®, Plavix® and Stilnox®, which together accounted for 39.9% of our total consolidated net sales, or 2,973 million, in 2002.

We have a strong commitment to research and development. We have 14 research centers and have over 6,700 employees devoted to research and development. At January 31, 2003, we had 52 compounds in development in the four therapeutic areas, 23 of which were in phase II or phase III clinical trials.

The legal and commercial name of our company is Sanofi-Synthélabo. We are a French *société anonyme*, a form of limited liability stock company, formed in 1994 pursuant to the French commercial code for a term of 99 years. Our registered office is located at 174, avenue de France, 75013 Paris, France. Our telephone number is +33 (0)1 53 77 40 00.

A. History and Development of the Company

Our company is the result of the 1999 merger of Sanofi and Synthélabo, two major French pharmaceutical companies. Since the merger, we have combined the resources of the two companies to expand our global presence, particularly in the United States, and to increase our focus on research and development for products with strong future potential. This year we are celebrating the thirtieth anniversary of our group worldwide.

Sanofi was founded in 1973 by Elf Aquitaine, a French oil company, when it took control of the Labaz Group (a pharmaceutical company) for diversification purposes. Sanofi launched its first major product on the market, Ticlid®, in 1978. At the time of the merger in 1999, Sanofi was the second largest pharmaceutical group in France in terms of sales. A majority of its share capital was owned by Elf Aquitaine, which was acquired by Total. Sanofi made a significant venture into the United States market in 1994, when it acquired the prescription pharmaceuticals business of Sterling Winthrop, an affiliate of Eastman Kodak.

Sanofi launched its first major product on the U.S. market, Aprovel®, in 1997, followed by Plavix® in 1998.

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Synthélabo was founded in 1970 through the merger of two French pharmaceutical laboratories, Laboratoires Dausse (founded in 1834) and Laboratoires Robert & Carrière (founded in 1899). In 1973, L Oréal acquired the majority of its share capital and in 1988, Synthélabo launched two major products on the French market: Stilnox® and Xatral®. At the time of the merger, Synthélabo was the third largest pharmaceutical group in France in terms of sales. A majority of its share capital was still owned by the French cosmetics group L Oréal. In 1993, Synthélabo launched Stilnox® in the United States under the brand name Ambien®. By 1994, Stilnox® had become the leading insomnia prescription medication worldwide according to IMS data.

Sanofi and Synthélabo agreed to merge at the end of 1998, and the merger became effective in the second quarter of 1999. Following the merger, Total and L Oréal were the largest shareholders of the new group, although neither held a majority of the share capital. The two principal shareholders entered into a shareholders agreement that lasts until 2004. The terms of the shareholders agreement are described under Item 7 Major Shareholders and Related Party Transactions Major Shareholders.

Part of our strategy following the merger was to concentrate on our core prescription pharmaceuticals business. To implement this strategy, we divested non-core businesses, including:

- in 1999, Sanofi s beauty business, our diagnostics business, our animal health and nutrition business and an equity affiliate in the cheese business; and
- in 2001, our custom chemicals business and two medical equipment businesses, as well as our direct shareholding in Laboratoires de Biologie Végétale Yves Rocher.

For a description of our principal capital expenditures and divestitures since 1999, our expectations as to future capital expenditures and divestitures and the impact of the merger and these divestitures on our results of operations and financial condition, see Item 5 Operating and Financial Review and Prospects. We currently have no material capital expenditures or divestitures in progress.

B. Business Overview

Strategy

We believe we have the potential to grow profitably by taking advantage of our focused portfolio of current and potential drugs centered around four targeted therapeutic areas. The key elements of our strategy to achieve these goals are to:

- *Capitalize on our direct presence in the United States.* We intend to continue to capitalize on our potential for growth in the U.S. market. We have increased our interest in the promotional activities and profitability of our alliance with Bristol-Myers Squibb that markets Aprovel® (under the name Avapro®) in the United States, and in April 2002 we purchased Pharmacia s interest in the joint venture that markets Stilnox® (under the name Ambien®) in the U.S. and regained full U.S. marketing rights to Ambien®. We have also more than doubled our U.S. sales force in the past three years to 2,259 employees as at December 31, 2002, reducing our need to use third parties to market our products in the United States. We intend to use our increased sales force as a platform for the introduction and promotion of additional products in the U.S. market, such as oxaliplatin, which we have marketed under the brand name Eloxatin® since August 2002, and alfuzosin, which we expect to begin marketing in the second half of 2003.

Capitalize on the sales potential of our six strategic products. We believe that each of Aprovel®, Plavix®, Stilnox® and Eloxatin® will continue to have strong growth potential and that Xatral® and Arixtra® have the potential to become leading products. We intend to make the necessary investment of marketing and other resources to fully promote these six strategic products.

Continue our strong commitment to research and development. As at January 31, 2003, we had 52 compounds in our research and development pipeline, of which 23 were in phase II or III clinical trials. We believe that the number of compounds in later stage development in our pipeline, together with our

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capabilities in the high technology areas of genomics, proteomics, high throughput screening, combinatorial chemistry and bioinformatics, gives us a solid foundation for developing future products. We intend to continue to focus our efforts on developing products to meet unmet medical needs in our four targeted therapeutic areas and to maintain our current high level of research and development spending as a percentage of revenues.

Continue to improve operating margins. Since the merger in 1999, we have streamlined operations by divesting non-core businesses such as our beauty, diagnostics and animal health divisions. We believe that our new, focused structure gives us the opportunity to improve our profitability, and we intend to take advantage of this opportunity by targeting our promotional efforts on our higher margin products.

Continue to enhance our presence worldwide. Over time, we intend to build progressively our presence in Japan and other targeted countries. Our strategy is to establish local subsidiaries and a local sales force, when possible. In Japan, due to market particularities, we may increase our marketing presence either through external growth or by transforming certain of our drug-specific joint ventures into broader partnership relationships for a variety of products.

Seize appropriate opportunities for growth through selective mergers, acquisitions and strategic alliances. Where appropriate, we intend to continue to seize appropriate external growth opportunities for growth through selective mergers, acquisitions and strategic alliances.

Principal Products

Our principal products are prescription pharmaceuticals, which we group into four main therapeutic categories: Cardiovascular/Thrombosis, Central Nervous System, Internal Medicine and Oncology. The following table outlines our consolidated net sales by therapeutic area for the year ended December 31, 2002.

Consolidated Sales by Therapeutic Area

	Year Ended December 31, 2002	
	(millions of)	*% of Net Sales*
Prescription Pharmaceuticals*		
Cardiovascular/Thrombosis		
Aprovel®	562	7.5%
Plavix®	987	13.3%
Other	1,355	18.2%
Total	2,904	39.0%
Central Nervous System		
Stilnox®/Ambien®/Myslee®	1,424	19.1%
Other	985	13.2%

Total	2,409	32.3%
Internal Medicine		
Xatral®	182	2.4%
Other	1,245	16.7%
Total	1,427	19.1%
Oncology		
Eloxatin®	389	5.2%
Other	15	0.2%
Total	404	5.4%
Other Pharmaceuticals	304	4.2%
Total consolidated net sales	**7,448**	**100.0%**

* Our products include over 160 Cardiovascular/Thrombosis products, over 130 Central Nervous System products, over 500 Internal Medicine products and over 15 Oncology products worldwide. Other Pharmaceuticals includes all of our other pharmaceutical products that cannot be classified in our main therapeutic areas, such as our dental hygiene products.

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A number of our products, including four of our six strategic products (Plavix®, Aprovel®, Stilnox® and Arixtra®), are sold in certain countries through alliances that we have entered into with other pharmaceutical companies, or through licensees. Our consolidated revenues only reflect a portion of the total revenues realized by the alliances and licensees. In some cases, our revenue shares from the alliances are based on formulas that make our consolidated revenues grow at a different rate than the overall growth in sales of the products. In this annual report, we present both our consolidated revenues from products sold through alliances, and developed sales, which represent the overall sales of these products, including sales by our alliance partners and licensees. We believe that developed sales are a useful measurement tool because they demonstrate trends in the overall sales of our products in the market, without regard to the formulas under which our revenue shares are determined.

A drug can be referred to either by its international non-proprietary name, or INN, or by its brand name, which is normally exclusive to the company that markets it. In most cases, our brand names, which may vary from country to country, are protected by trademark registrations. In the description that follows, our products are generally referred to by the brand names that we use in France.

Prescription Pharmaceuticals

Our portfolio of prescription pharmaceuticals includes a range of innovative products with strong market positions in our four targeted therapeutic areas. In Thrombosis, we are the leader in the European and U.S. markets for anti-platelet agents based on total consolidated sales of our anti-atherothrombotic agent Plavix® (clopidogrel) and rank second in the European market for heparins with products including Fraxiparine® and Arixtra®28,602

Optical Access (included in Carrier Systems)

10,652 11,166

Internetworking (NetVanta & Multi-service Access Gateways) (included in Business Networking)

15,315 14,913

Total

48,186 54,681

Traditional Products

HDSL (does not include T1) (included in Loop Access)

42,921 41,950

Other products (included in the preceding table)

19,257 23,254

Total

62,178 65,204

Total

$110,364	**$119,885**

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

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component suppliers. Our products continue to become more complex in both size and functionality as many of our product offerings migrate from line card applications to systems products. These products will require more warranty repairs to be completed at the installed location due to their size and complexity, rather than at a manufacturing site or repair depot. This field service obligation, as well as 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 higher than our estimates, we will be required to record additional warranty expense. Alternatively, if we provide for more reserves than we require, we will reverse a portion of such provisions in future periods.

The liability for warranty obligations totaled $2.8 million at March 31, 2009 and December 31, 2008. These liabilities are included in accrued expenses in the accompanying Condensed Consolidated Balance Sheets.

Three Months Ended March 31, *(In thousands)*	**2009**	**2008**
Balance at beginning of period	$ 2,812	$ 2,944
Plus: amounts charged to cost and expenses	615	714
Less: deductions	(637)	(636)
Balance at end of period	**$ 2,790**	**$ 3,022**

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. We paid $10,000 during the three month period ended March 31, 2009 and $30,000 during the three month period ended March 31, 2008 for legal services rendered.

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

We have committed to invest up to an aggregate of $7.9 million in two private equity funds, and we have contributed $7.9 million as of March 31, 2009, of which $7.4 million has been applied to these commitments. See Note 4 of Notes to Condensed Consolidated Financial Statements for additional information.

12. SUBSEQUENT EVENTS

On April 14, 2009, we announced that our Board of Directors declared a quarterly cash dividend of $0.09 per common share to be paid to stockholders of record at the close of business on April 30, 2009. The payment date will be May 14, 2009. The quarterly dividend payment will be approximately $5.6 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.

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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 Condensed Consolidated Financial Statements and the related notes that appear elsewhere in this document.

OVERVIEW

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

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

Our three major product categories are Carrier Systems, Business Networking and Loop Access. Carrier Systems products are used by telecommunications service providers to provide last mile access in support of data, voice and video services to consumers and enterprises. Business Networking products provide enterprises access to telecommunication networks and facilitate networking capabilities for voice, data and video networks. Loop Access products are used by carrier and enterprise customers for access to copper-based telecommunications networks.

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

See Note 8 of Notes to Condensed Consolidated Financial Statements in this report for further information regarding these product categories.

Sales were $110.4 million for the three months ended March 31, 2009 compared to $119.9 million for the three months ended March 31, 2008. Product revenues for our three primary growth areas, including Broadband Access, Optical Access and Internetworking, were $48.2 million for the three months ended March 31, 2009 compared to $54.7 million for the three months ended March 31, 2008. Our gross margin increased for the three months ended March 31, 2009 to 61.1% from 58.6% for the three months ended March 31, 2008, while our operating income margin decreased to 20.7% for the three months ended March 31, 2009 from 21.0% for the three months ended March 31, 2008. Net income was $15.2 million for the three months ended March 31, 2009 compared to $17.0 million for the three months ended March 31, 2008. Our effective tax rate decreased from 36.5% for the three months ended March 31, 2008 to 26.3% for the three

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months ended March 31, 2009. Earnings per share, assuming dilution, were $0.24 for the three months ended March 31, 2009 compared to $0.26 for the three months ended March 31, 2008. The earnings per share for the three months ended March 31, 2009 compared to the same period in 2008 reflects a lower weighted average number of shares outstanding in 2009 due to stock repurchases under the share repurchase plans approved by our Board of Directors.

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

Beginning in the latter part of the third quarter of 2008 and extending through the first quarter of 2009, we experienced an overall decline in order rates across most of our product categories. We believe this decline in order rates was the result of slowing macroeconomic conditions, coupled with fact that our sales in the fourth and first quarters of each year have typically been lower than sales in the preceding second and third quarters due to seasonality. If the macroeconomic conditions experienced in the first quarter of 2009 remain constant, we believe that it is likely that ADTRAN will experience lower revenue levels in the second quarter of 2009 than we realized in the second quarter of 2008.

Our operating results may also fluctuate as a result of a number of other factors, including increased competition, customer order patterns, changes in product mix, timing differences between price decreases and product cost reductions, product warranty returns, and announcements of new products by us or our competitors. 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 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, 2008, filed on February 27, 2009 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, 2008, filed on February 27, 2009 with the SEC.

EFFECT OF RECENT ACCOUNTING PRONOUNCEMENTS

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

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RESULTS OF OPERATIONS THREE MONTHS ENDED MARCH 31, 2009 COMPARED TO THREE MONTHS ENDED MARCH 31, 2008

SALES

ADTRAN s sales decreased 7.9% from $119.9 million in the three months ended March 31, 2008 to $110.4 million in the three months ended March 31, 2009. The decrease in sales is primarily attributable to a $6.4 million decrease in sales of our Broadband Access products, a $4.0 million decrease in sales of other traditional products, and a $0.5 million decrease in sales of our Optical Access products.

Carrier Networks sales decreased 7.8% from $94.5 million in the three months ended March 31, 2008 to $87.1 million in the three months ended March 31, 2009. The decrease is primarily attributable to decreases in Broadband Access, traditional TDM products and Optical Access product sales, partially offset by an increase in HDSL product sales.

Enterprise Networks sales decreased 8.4% from $25.4 million in the three months ended March 31, 2008 to $23.3 million in the three months ended March 31, 2009. The decrease is attributable to declines in sales of traditional IAD products and Enterprise T1 products, partially offset by an increase in Internetworking product sales. Internetworking product sales were 63.2% of Enterprise Network sales in the three months ended March 31, 2009 compared with 57.7% in the three months ended March 31, 2008. Traditional products primarily comprise the remainder of Enterprise Networks sales. Enterprise Networks sales as a percentage of total sales decreased from 21.2% for the three months ended March 31, 2008 to 21.1% for the three months ended March 31, 2009.

International sales, which are included in the Carrier Networks and Enterprise Networks amounts discussed above, increased 7.8% from $6.4 million in the three months ended March 31, 2008 to $6.9 million in the three months ended March 31, 2009. International sales, as a percentage of total sales, increased from 5.4% for the three months ended March 31, 2008 to 6.3% for the three months ended March 31, 2009. International sales increased in the three months ended March 31, 2009 compared to the three months ended March 31, 2008 primarily due to an increase in product shipments to customers in the Asia Pacific region.

Carrier System product sales decreased $8.5 million in the three months ended March 31, 2009 compared to the three months ended March 31, 2008 due primarily to a $6.4 million decrease in Broadband Access product sales and a $0.5 million decrease in Optical Access products sales. The decrease in Broadband Access and Optical Access products sales is primarily attributable to lower carrier capital expenditures due to general economic conditions. Additionally, Carrier System product sales decreased $1.7 million due to decreases in shipments of traditional TDM products as customers shifted emphasis to newer technologies. Many of these newer technologies are integral to our Broadband Access and Optical Access product areas.

Business Networking product sales decreased $1.0 million in the three months ended March 31, 2009 compared to the three months ended March 31, 2008 due to a $1.4 million decrease in sales of traditional IAD products as customers shifted to newer technologies. Many of these newer technologies are integral to our Internetworking product area. Partially offsetting this decline was a $0.4 million increase in Internetworking product sales, primarily as a result of market share gains due to our efforts to improve our focus on addressing traditional enterprise channels and leveraging our carrier distribution channels.

Loop Access product sales decreased $0.1 million in the three months ended March 31, 2009 compared to the three months ended March 31, 2008 primarily due to a $0.7 million decrease in Enterprise T1 product sales and a $0.4 million decrease in sales of other traditional products, partially offset by a 2.3% or $1.0 million increase in HDSL product revenues.

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COST OF SALES

As a percentage of sales, cost of sales decreased from 41.4% in the three months ended March 31, 2008 to 38.9% in the three months ended March 31, 2009. The decrease in cost of sales as a percentage of sales is primarily due to lower freight costs, reduced expediting costs and lower product costs.

Carrier Networks cost of sales, as a percent of division sales, decreased from 41.0% in the three months ended March 31, 2008 to 37.7% in the three months ended March 31, 2009, primarily as a result of the lower cost elements noted above.

Enterprise Networks cost of sales, as a percent of division sales, increased from 43.0% in the three months ended March 31, 2008 to 43.3% in the three months ended March 31, 2009. The increase was primarily related to a higher cost product mix.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses decreased 7.2% from $25.5 million in the three months ended March 31, 2008 to $23.7 million in the three months ended March 31, 2009. The decrease in selling, general and administrative expenses is primarily related to a reduction in discretionary expenditures including temporary labor, travel and various promotional expenses.

Selling, general, and administrative expenses as a percentage of sales increased from 21.3% in the three months ended March 31, 2008 to 21.5% in the three months ended March 31, 2009.

RESEARCH AND DEVELOPMENT EXPENSES

Research and development expenses increased 6.6% from $19.6 million in the three months ended March 31, 2008 to $20.9 million in the three months ended March 31, 2009. The increase in research and development expenses reflects increased staffing, engineering and testing expense primarily related to customer specific product development activities, as well as costs related to product approvals primarily for one or more of the top three U.S. carriers. As a percentage of sales, research and development expenses increased from 16.3% in the three months ended March 31, 2008 to 18.9% in the three months ended March 31, 2009.

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

INTEREST AND DIVIDEND INCOME

Interest and dividend income decreased 30.4% from $2.3 million in the three months ended March 31, 2008 to $1.6 million in the three months ended March 31, 2009. This decrease is primarily driven by a 56% reduction in the average rate of return on these investments as a result of lower interest rates, partially offset by a 7% increase in our average investment balances.

INTEREST EXPENSE

Interest expense, which is primarily related to our taxable revenue bond, remained relatively constant at $0.6 million in each of the three months ended March 31, 2009 and 2008. See Liquidity and Capital Resources below for additional information on our revenue bond.

NET REALIZED INVESTMENT LOSS

Net realized investment loss increased from a $0.1 million loss in the three months ended March 31, 2008 to $3.2 million loss in the three months ended March 31, 2009. This change is primarily a result of the other-than-temporary impairment of certain securities in our equity portfolio. See Investing Activities in Liquidity and Capital Resources below for additional information.

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OTHER INCOME (EXPENSE), NET

Other income (expense), net, comprised primarily of miscellaneous income, gains and losses on foreign currency transactions, investment account management fees and scrap raw material sales, decreased from $0.1 million of income in the three months ended March 31, 2008 to ($0.1) million of expense in the three months ended March 31, 2009.

INCOME TAXES

Our effective tax rate decreased from 36.5% in the three months ended March 31, 2008 to 26.3% in the three months ended March 31, 2009. During the first quarter of 2009, we completed a review of our estimated tax deductions for the years 2005, 2006 and 2007 relating to the deduction for manufacturer s domestic production activities concerning the domestic content of the products that we manufacture, under Internal Revenue Code Section 199. This review resulted in a $1.7 million benefit being recorded in the first quarter of 2009, or an 8.3 percentage point decrease in our effective tax rate. Amended income tax returns have been filed during the first quarter of 2009 in association with this benefit. The tax provision for the first quarter of 2009 also included the benefit from the research and development tax credit. The tax provision rate for the first quarter of 2008 did not include the benefit from the research and development tax credit which had expired as of December 31, 2007. Legislation to extend the research and development tax credits to the tax years 2008 and 2009 was signed into law October 3, 2008. The exclusion of the benefit from the research and development tax credits resulted in approximately a 1.8 percentage point increase in our effective tax rate in the first quarter of 2008.

NET INCOME

As a result of the above factors, net income decreased $1.9 million from $17.0 million in the three months ended March 31, 2008 to $15.2 million in the three months ended March 31, 2009.

As a percentage of sales, net income decreased from 14.2% in the three months ended March 31, 2008 to 13.8% in the three months ended March 31, 2009.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

At March 31, 2009, cash on hand was $54.0 million and short-term investments were $77.9 million, which resulted in available short-term liquidity of $131.9 million. At December 31, 2008, our cash on hand of $41.9 million and short-term investments of $96.3 million resulted in available short-term liquidity of $138.2 million. The decrease in liquidity from December 31, 2008 to March 31, 2009 primarily reflects a realignment of our investment portfolio whereby long-term investments increased $20.8 million in the first quarter of 2009 compared to December 31, 2008.

Operating Activities

Our working capital, which consists of current assets less current liabilities, decreased 3.8% from $212.7 million as of December 31, 2008 to $204.6 million as of March 31, 2009. The quick ratio, defined as cash, cash equivalents, short-term investments, and net accounts receivable, divided by current liabilities, decreased from 4.76 as of December 31, 2008 to 3.90 as of March 31, 2009. The current ratio, defined as current assets divided by current liabilities, decreased from 6.30 as of December 31, 2008 to 5.23 as of March 31, 2009. The quick ratio and the current ratio decreased mainly due to a realignment of our investment portfolio whereby long-term investments increased $20.8 million in the first quarter of 2009 and to a $6.2 million increase in income taxes payable during the first quarter of 2009.

Net accounts receivable increased from $52.7 million at December 31, 2008 to $56.8 million at March 31, 2009. Our allowance for doubtful accounts was $38,000 at December 31, 2008 and $58,000 at March 31, 2009. Quarterly accounts receivable days sales outstanding (DSO) increased from 43 days as of December 31, 2008 to 46 days as of March 31, 2009.

Quarterly inventory turnover decreased from 3.8 turns as of December 31, 2008 to 3.5 turns as of March 31, 2009. Inventory increased 4.8% from December 31, 2008 to March 31, 2009, primarily in anticipation of orders for new VDSL2-based products. We expect inventory levels to fluctuate as we attempt to maintain sufficient inventory to ensure competitive lead times while managing the risk of inventory obsolescence that may occur due to rapidly changing technology and customer demand.

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Accounts payable increased 14.4% from $20.3 million at December 31, 2008 to $23.2 million at March 31, 2009. Generally, the change in accounts payable is due to variations in the timing of the receipt of supplies, inventory and services and our subsequent payments for these purchases.

Investing Activities

Capital expenditures totaled approximately $2.4 million and $1.9 million for the three months ended March 31, 2009 and 2008, 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 $2.5 million from $237.5 million at December 31, 2008 to $240.0 million at March 31, 2009.

We invest all available cash not required for immediate use in operations primarily in securities that we believe bear minimal risk of loss. At March 31, 2009 these investments included municipal variable rate demand notes of $26.7 million, municipal fixed-rate bonds of $122.6 million and corporate bonds issued by various banks that are guaranteed by the Federal Deposit Insurance Corporation (FDIC) of $25.3 million. At December 31, 2008, these investments included municipal variable rate demand notes of $52.6 million, municipal fixed-rate bonds of $116.9 million and a government agency security of $2.0 million.

Our municipal variable rate demand notes are classified as available-for-sale short-term investments and had a credit rating of A-1+ or VMIG-1 at March 31, 2009. Despite the long-term nature of their stated contractual maturities, we believe that we have the ability to quickly liquidate these securities. Our investments in these securities are recorded at fair value and the interest rates reset every seven days. As a result, we had no cumulative gross unrealized holding gains (losses) or gross realized gains (losses) from these investments. All income generated from these investments was recorded as interest income. We have not been required to record any losses relating to municipal variable rate demand notes.

At March 31, 2009, approximately 66% of our municipal fixed-rate bond portfolio had a credit rating of AAA and 34% had a credit rating of AA. These bonds are classified as available-for-sale investments and had an average duration of 1.0 years at March 31, 2009. Because our bond portfolio has a high quality rating and contractual maturities of a short duration, we are able to obtain prices for these bonds derived from observable market inputs, or for similar securities traded in an active market, on a daily basis.

At March 31, 2009, we held $25.3 million of corporate bonds issued by various banks that are guaranteed by the FDIC. These bonds are classified as available-for-sale and had an average duration of 2.9 years at March 31, 2009. All of these bonds had a credit rating of AAA at March 31, 2009. Because of the high quality and short duration of these issues, we are able to obtain prices for these bonds derived from observable market inputs on a daily basis.

Our long-term investments increased 14.8% from $141.2 million at December 31, 2008 to $162.1 million at March 31, 2009. The primary reason for the increase in our long-term investments during the first quarter of 2009 was the purchase of $25.3 million of corporate bonds issued by various banks, which are guaranteed by the FDIC. The primary reason for our investment in the corporate bonds was to increase the yield on our fixed rate portfolio. Long-term investments at March 31, 2009 and December 31, 2008 included an investment in a certificate of deposit of $48.8 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 $9.6 million and $12.0 million, and with a fair value of $11.1 million and $11.6 million, at March 31, 2009 and December 31, 2008, respectively, including a single equity security, of which we held 2.5 million shares, carried at $3.7 million and $2.5 million of fair value at March 31, 2009 and December 31, 2008, respectively. The single security traded approximately 65,000 shares per day in the first quarter of 2009, in an active market on a European stock exchange. Of the gross unrealized gains included in the fair value of our marketable securities at March 31, 2009, this single security carried $2.8 million of this unrealized gain. Long-term investments at March 31, 2009 and December 31, 2008 also include $2.5 million related to our deferred compensation plan; $2.2 million of other investments carried at cost, consisting of two private equity funds and a direct investment in a privately held telecommunications equipment manufacturer; and $0.9 million of a fixed income bond fund. This bond fund had no unrealized losses at March 31, 2009 and had $0.4 million at December 31, 2008.

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We review our investment portfolio for potential other-than-temporary declines in value on an individual investment basis. We assess, on a quarterly basis, significant declines in value which may be considered other-than-temporary and, if necessary, recognize and record the appropriate charge to write-down the carrying value of such investments. In making this assessment, we take into consideration qualitative and quantitative information, including but not limited to the following: the magnitude and duration of historical declines in market prices, credit rating activity, assessments of liquidity, public filings, and statements made by the issuer. We generally begin our identification of potential other-than-temporary impairments by reviewing any security with a fair value that has declined from its original or adjusted cost basis by 25% or more for six or more consecutive months. We then evaluate the individual security based on the previously identified factors to determine the amount of the write-down, if any. Because of the strained credit markets and deterioration in the equity markets experienced beginning in the fourth quarter of 2008, we expanded the impairment review of our investments to assess the impact of these factors on our ability to recover our cost in every security whose value had declined from its original or adjusted cost by more than 25%, regardless of the historical duration of the decline. We then evaluated individual securities to determine the amount of the write-down, if any. As a result, we recorded an other-than-temporary impairment charge of $1.9 million during the first quarter of 2009 related to 99 marketable equity securities. In addition to the impairment charge we recorded on our marketable equity securities, we recorded an impairment of $0.4 million related to our investment in a fixed income bond fund and $0.5 million related to our deferred compensation plan during the first quarter of 2009 as a result of similar reviews. As long as current market conditions continue to exist, we will continue to complete a similar review of individual securities for impairment each quarter. For the three months ended March 31, 2008, we had a charge of $0.2 million related to the impairment of certain publicly traded equity securities.

Financing Activities

In July 2003, our Board of Directors elected to begin declaring quarterly dividends on our common stock considering the tax treatment of dividends and adequate levels of Company liquidity. During the three months ended March 31, 2009, ADTRAN paid dividends totaling $5.6 million.

Debt

We have amounts outstanding under loans made pursuant to an Alabama State Industrial Development Authority revenue bond (the Bond) which totaled $48.8 million at March 31, 2009 and December 31, 2008. Included in long-term investments are restricted funds in the amount of $48.8 million at March 31, 2009 and December 31, 2008, 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. Due to continued positive cash flow from operating activities, we made a business decision to begin an early partial redemption of the Bond. It is our intent to make annual principal payments in addition to the interest amounts that are due. In connection with this decision, $0.5 million of the Bond debt has been classified as a current liability in the Condensed Consolidated Balance Sheet.

Stock Repurchase Program

During the three months ended March 31, 2009, we repurchased 0.1 million shares of our common stock at an average price of $14.51 per share under the repurchase plans approved by our Board of Directors. Since 1997, our Board of Directors has approved multiple share repurchase programs that have authorized open market repurchase transactions. We have the authority to purchase an additional 3.4 million shares of our common stock under the plan approved by the Board of Directors on April 14, 2008.

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To accommodate employee stock option exercises, we issued 4,855 shares of treasury stock for $49,000 during the three months ended March 31, 2009. During the three months ended March 31, 2008, we issued 0.1 million shares of treasury stock for $0.6 million.

Off-Balance Sheet Arrangements and Contractual Obligations

We do not have off-balance sheet financing arrangements and have not engaged in any related party transactions or arrangements with unconsolidated entities or other persons that are reasonably likely to materially affect liquidity or the availability of or requirements for capital resources. During the three months ended March 31, 2009, 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, 2008 filed on February 27, 2009 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 $7.9 million as of March 31, 2009, of which $7.4 million has been applied to these commitments. See Note 4 of Notes to Condensed Consolidated Financial Statements for additional information.

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.

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 will be delayed or cancelled and could harm our business.

We primarily engage in research and development 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.

The lengthy approval process required by Incumbent Local Exchange Carriers (ILECs) and other service providers could result in fluctuations in our revenue.

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.

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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.

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.

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, 2008, filed on February 27, 2009 with the SEC.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates and prices of marketable equity and fixed-income securities. The primary objective of the large majority of our investment activities is to preserve principal while at the same time achieving appropriate yields without significantly increasing risk. To achieve this objective, a majority of our marketable securities are investment grade municipal fixed-rate bonds, municipal variable rate demand notes and municipal money market instruments denominated in United States dollars. At March 31, 2009, our municipal variable rate demand notes had a credit rating of A-1+ or VMIG-1. Approximately 66% of our municipal fixed-rate bonds had a credit rating of AAA and 34% had a credit rating of AA. We also held $25.3 million of corporate bonds issued by various banks that are guaranteed by the Federal Deposit Insurance Corporation. At March 31, 2009, our corporate bonds had a credit rating of AAA.

We maintain depository investments with certain financial institutions. Although these depository investments may exceed government insured depository limits, we have evaluated the credit worthiness of these applicable financial institutions, and determined the risk of material financial loss due to exposure of such credit risk to be minimal. As of March 31, 2009, $32.2 million of our cash and cash equivalents, primarily certain domestic money market funds and

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foreign depository accounts, were in excess of government provided insured depository limits. The Temporary Liquidity Guarantee Program adopted during 2008 by the Federal Deposit Insurance Corporation provides full coverage of our domestic depository accounts through December 2009.

As of March 31, 2009, approximately $215.7 million of our cash and investments may be directly affected by changes in interest rates. We have performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps), 100 bps and 150 bps for the entire year, while all other variables remain constant. At March 31, 2009, we held $73.8 million of money market instruments and municipal variable rate demand notes. Hypothetical 50 bps, 100 bps and 150 bps declines in interest rates as of March 31, 2009 would reduce annualized interest income on our money market instruments and municipal variable rate demand notes by approximately $0.4 million, $0.7 million and $1.1 million, respectively. In addition, we held $141.9 million of fixed-rate municipal bonds and corporate bonds whose fair value may be directly affected by a change in interest rates. Hypothetical 50 bps, 100 bps and 150 bps increases in interest rates as of March 31, 2009 would reduce the fair value of our municipal fixed-rate bonds and corporate bonds by approximately $0.9 million, $1.8 million and $2.7 million, respectively.

As of March 31, 2008, interest income on approximately $90.0 million of our cash and investments was subject to being directly affected by changes in interest rates. We performed a hypothetical sensitivity analysis assuming market interest rates increase or decrease by 50 basis points (bps), 100 bps and 150 bps, while all other variables remain constant. Hypothetical 50 bps, 100 bps and 150 bps declines in interest rates as of March 31, 2008 would have reduced annualized interest income on our money market instruments and municipal variable rate demand notes by approximately $0.4 million, $0.9 million and $1.3 million, respectively. In addition, hypothetical 50 bps, 100 bps and 150 bps increases in interest rates as of March 31, 2008 would have reduced the fair value of our municipal fixed-rate bonds by approximately $0.2 million, $0.5 million and $0.7 million, respectively.

For further information about the fair value of our available-for-sale investments as of March 31, 2009 see Note 4 of Notes to Condensed 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.

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, 2008, filed on February 27, 2009 with the SEC.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

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

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
January 1, 2009 January 31, 2009				3,453,571
February 1, 2009 February 28, 2009	98,580	$ 14.51	98,580	3,354,991
March 1, 2009 March 31, 2009				3,354,991
Total	98,580		98,580	

(1) On April 14, 2008, ADTRAN s Board of Directors approved additional repurchases of up to 5,000,000 shares of its common stock. This plan will be implemented through open market purchases from time to time as conditions warrant.

ITEM 6. EXHIBITS

Exhibits.

Exhibit No.	Description
31	Rule 13a-14(a)/15d-14(a) Certifications
32	Section 1350 Certifications

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SIGNATURE

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

ADTRAN, INC.

(Registrant)

Date: May 1, 2009

/s/ James E. Matthews
James E. Matthews

Senior Vice President Finance,

Chief Financial Officer, Treasurer,

Secretary and Director

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EXHIBIT INDEX

Exhibit No.	Description
31	Rule 13a-14(a)/15d-14(a) Certifications
32	Section 1350 Certifications