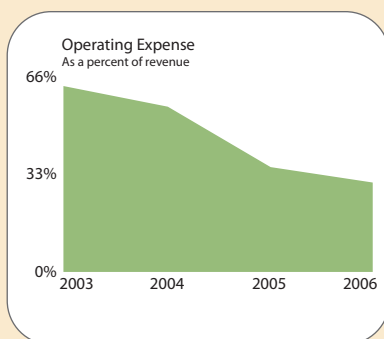
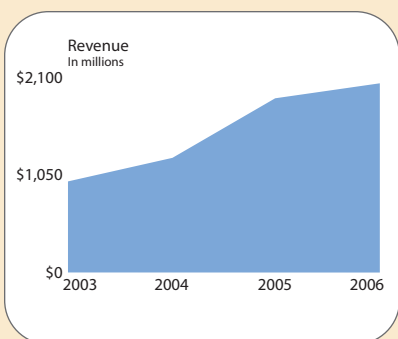


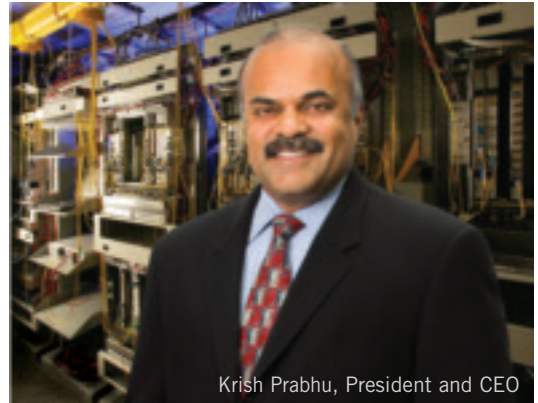
## Financial Highlights

Tellabs fiscal years ended December 29, 2006, and December 30, 2005.

In millions, except per-share and employee data	2006	2005	Change
Revenue	\$ 2,041	\$ 1,883	8%
Gross profit	\$ 934	\$ 855	9%
Operating earnings	\$ 247	\$ 189	31%
Earnings before income taxes	\$ 285	\$ 213	34%
Net earnings	\$ 194	\$ 176	10%
Net earnings per share	\$ 0.43	\$ 0.39	10%
Total cash, cash equivalents and marketable securities	\$ 1,300	\$ 1,190	9%
Total assets	\$ 3,922	\$ 3,515	12%
Total liabilities	\$ 984	\$ 700	41%
Stockholders' equity	\$ 2,938	\$ 2,815	4%
Net cash provided by operating activities	\$ 318	\$ 258	23%
Working capital	\$ 1,470	\$ 1,348	9%
Research and development expense	\$ 357	\$ 344	4%
Return on average stockholders' equity	6.7%	6.3%	8%
Weighted average shares outstanding	454	455	—
Number of employees	3,713	3,609	3%



Tellabs' revenue doubled since 2003, while operating expense shrank as a percent of revenue.



Krish Prabhu, President and CEO

## Dear Stockholders, Customers and Employees:

**More. I can't think of a better word** to describe what's happening in communications today. All across the world, people want to see more. Do more. Interact more. Learn more. And everywhere we look, the world's communications providers are rushing to respond.

This transition to tomorrow's networks represents a unique growth opportunity for Tellabs. That's because making more possible is what this company is all about. We do it by supplying the solutions that providers need to make their networks smarter, faster and better-suited to the kinds of high-bandwidth applications that will define the future of communications.

In fact, that future is already with us. As I write this, YouTube, the immensely popular video-sharing Web site, is already one of the top 15 Web sites in the world, even though it has yet to celebrate its second birthday. YouTube originates an average of 100 million video streams each day. And thanks to a partnership with Verizon, those videos are now accessible even when we're away from our computers.

The YouTube success story is merely one illustration of the remarkable changes that are taking place in the way we communicate and entertain ourselves.

As broadband Internet access has become increasingly available and affordable — at year-end, more than 250 million people around the world subscribed to a high-speed Internet service — it has fueled an insatiable hunger for video and other multimedia applications. And as more of us begin to consume this content — as we use the Internet to watch TV, listen to music, download full-length movies and play multiplayer games — the need for additional bandwidth is only going to grow.

**Clearly, this shift poses a major challenge for traditional networks.** If you download one minute of video to your iPod, you're using four times the network capacity that's required to download one minute of music. If you upload a video clip from your mobile phone, that takes five times the network capacity of one minute of talk. And if you use the Internet to stream a movie in high definition, that requires five times the network capacity needed to watch that same movie in standard definition.



Networks are adding capacity to handle more video. Compared with standard TV, HDTV (high-definition television) uses five times more bandwidth, while DVDs in HD format use 10 times more bandwidth.

Then consider that hundreds of millions of us around the world do some combination of those things every single day. Add it all up, and it's no surprise networks are feeling the strain.

This hunger for bandwidth shows no signs of slowing down. If anything, the trendlines are accelerating. It seems that every day brings another announcement of a new online TV channel, an easier way to post user-generated video or a faster way to download the latest Hollywood blockbuster. At the same time, this multimedia content is no longer confined to our laptops or desktops. Increasingly, it is available through our mobile phones, our PDAs, our TVs, our digital video recorders ... even our electronic games.

**Tellabs is ideally positioned in this new environment.** As our customers upgrade their networks, Tellabs has carved out strong positions in markets with high-growth potential: fiber access, next-generation transport and the migration toward services based on IP (Internet Protocol).

Tellabs enables companies like Verizon to respond instantly to the need for greater bandwidth and deliver the Internet at speeds of 50 megabits per second, almost 1,000 times faster than dial-up Internet service. Carriers like Telecom Italia depend on Tellabs to converge their fixed and mobile networks. And our Tellabs® IntegratedMobile<sup>SM</sup> solution enables wireless providers to dramatically reduce the costs of their backhaul networks, which connect antennas and switching offices.

**Tellabs revenue grew 8% in 2006,** driven by solid performance across our Broadband, Transport and Services segments. Late in 2006 and early in 2007, uncertainty surrounding our industry's consolidation slowed customer spending and led to lower than expected revenue in North America. Since our customers continue to see growing user demand for bandwidth, Tellabs remains well-positioned to benefit from this growth.

By moving from stand-alone products to highly targeted solutions, we have transformed ourselves into a more strategic partner for our customers. And we believe the opportunities for future growth are substantial.

For example, the worldwide market for ROADM (reconfigurable optical add-drop multiplexer) is expected to nearly double by 2009. The worldwide multiservice router market is forecast to increase 39% in the same period — growing much faster than the communications market as a whole. And experts predict that the market for fiber access will expand 53% through the end of the decade.

These are all markets in which Tellabs has both the experience and expertise to excel.

**Tellabs continues to lead the North American fiber-access market**, a vital and growing business. As more providers drive fiber closer to people's homes and businesses, we believe we are positioned to further expand our presence.

Today, Tellabs offers the first generation of fiber access, called BPON (broadband passive optical network). We recently became one of three companies chosen by Verizon to deploy the next generation, called GPON (gigabit passive optical network), which will deliver four times greater bandwidth. To sharpen our competitive edge in GPON, in 2007 we will introduce the Tellabs® 8865 service-aware optical line terminal, which uniquely combines fiber access with the intelligence to recognize and prioritize services as they are delivered to homes. This means better performance and a richer user experience on PCs and TVs.

Another new fiber-access platform, the Tellabs® 1150 multiservice access platform, will offer unparalleled flexibility. Service providers can use one platform to connect fiber where they need it — to zones within 6,000 feet (1,800 meters) of homes, to neighborhoods within 500 feet (150 meters) of homes or all the way home.

But our focus is not just on the technology of today or next year. We're planning many years ahead. To that end, we have engaged with experts at the University of Michigan and the Polytechnic University of Catalonia to help us develop the third generation of fiber access, called WDM PON (wavelength division multiplexing passive optical network). This third generation of fiber access will make it possible to deliver exponentially greater bandwidth directly to our homes and businesses.

**Tellabs data revenue grew 78% in 2006.** We made strong progress in the data market in 2006, continuing to push beyond our traditional customers. Today, Tellabs serves data customers in Europe, Asia, Australia, Latin America and North America. And we are positioned to build on our momentum in 2007.

As network traffic increases, so does the need for greater network intelligence. Some traffic, like video and gaming, needs a higher priority than sending an e-mail or opening a Web page. The Tellabs® 8800 multiservice router series provides that network intelligence, makes it possible to route traffic based on priority and assures a better user experience.

In addition, the Tellabs® 8600 managed edge system, as part of Tellabs® IntegratedMobile<sup>SM</sup> solution, is meeting with great success as operators upgrade to 3G and 4G networks. It is now being used by customers in Latin America, Europe, Africa and Asia. And as the need for capacity and speed increases worldwide, we believe the Tellabs® 8600 system is poised for takeoff in 2007.

**Transport revenue increased 15% in 2006.** Our Transport segment remains solid, driven by the growing consumer demand for wireless data and video services. Every day, more than one-third of the world's wireless calls travel over networks owned by Tellabs customers. As those customers continue migrating to 3G and 4G wireless networks — networks that will enable even higher bandwidth video and data applications — the need for additional capacity will continue to ramp up. And Tellabs is ready to capture our share of that growth.

In 2006, our transport business was paced by strong sales of our Tellabs® 5500 digital cross-connect, which connects traffic between different carriers and networks, and by the Tellabs® 7100 optical transport system with ROADM, which enables carriers to respond to the need for greater bandwidth instantly.

**Global services revenue grew 9%** as we sharpened our focus on professional services that help customers transform networks. Our 2007 services growth will be driven by service providers that tap Tellabs' expertise to improve profitability, speed new services to market, cut costs and minimize network complexity.

**We see great opportunity to grow our international business.** In 2006, revenue from our international operations increased 6%, representing one-fourth of Tellabs' total revenue. Through our global data solutions, we established relationships with new customers like Telecom Italia and Australia's Telstra. Going forward, we believe there are tremendous opportunities to adapt our new North American solutions for use in global markets, especially in the areas of transport and access.

**We've built a solid financial foundation.** In 2006, we achieved 8% revenue growth and 31% growth in operating income. We will continue to focus on profitable growth in 2007.

More than ever, I believe that Tellabs is in an enviable position. We have targeted the right markets. We have the solutions our customers need to advance today's networks and build tomorrow's. And we have transformed our company to be a much more agile and strategic partner.

Our confidence in the future is reflected in the stock buyback authorized by Tellabs' board of directors, under which Tellabs repurchased \$465 million, or 46 million shares, since 2005.

Of course, the biggest part of our success remains our employees, whose drive, talent and commitment are second to none. They are the reason that Tellabs is able to make more possible. It is a daily privilege to lead them.

Sincerely,

A handwritten signature in blue ink that reads "Krish".

**Krish A. Prabhu**

President and CEO

February 23, 2007

## **Tellabs President and CEO Krish Prabhu answers investors' questions.**

### **Q. In light of 2006 results, what do you expect in 2007?**

A. We saw a slowdown in North American customer spending in late 2006, driven by uncertainty surrounding service provider consolidation. Since our customers continue to see growing user demand for bandwidth as we enter 2007, we expect customer spending to rebound.

As users demand more, telecom service providers need to spend more on their networks to deliver new services and add capacity. Tellabs grows with this spending because we're positioned where the action is — in the access, transport, metro and wireless networks.

As users watch more video on PCs and HDTVs, they require more capacity or bandwidth, which we help service providers address through fiber access. As more video traffic in backbone networks drives the need to add bandwidth, we enable service providers to do so quickly and flexibly through our next-generation transport platform. As businesses migrate to Ethernet and IP services, they still need to interoperate with businesses that use existing data services like ATM and Frame Relay, and we address this need through our data solutions. As mobile phone users choose data and video services, we enable the move to 3G mobile services.

### **Q. Can Tellabs achieve its stretch targets of 20% operating income and 15% revenue growth?**

A. Yes, we have the technology, the customers and the people to achieve our targets over the

long haul. In 2006 we achieved 8% revenue growth and 31% growth in operating income. We continue to set stretch targets for our growth, aiming at 20% operating income and 15% revenue growth.

### **Q. What gets you excited about Tellabs?**

A. We have the right people working on the right solutions for our customers. We are positioned exactly where customers need to spend to keep up with users' demands for new services and more capacity. Our service-provider customers see that more video, more wireless and more business data services add up to needs that Tellabs solutions address very competitively.

### **Q. How will you build your international business?**

A. Our international growth will come both from new products and new customers. We are transforming our fiber-access and ROADM products, first deployed in North America, into global platforms as new opportunities arise around the world. In 2006, we won business with new customers such as Telecom Italia and Australia's Telstra, and these successes extend our momentum with international customers.

In 2006, only one-fourth of our revenue came from customers outside North America, so there's plenty of room to grow our international business.