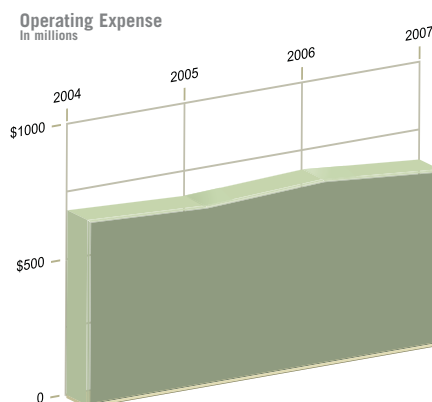
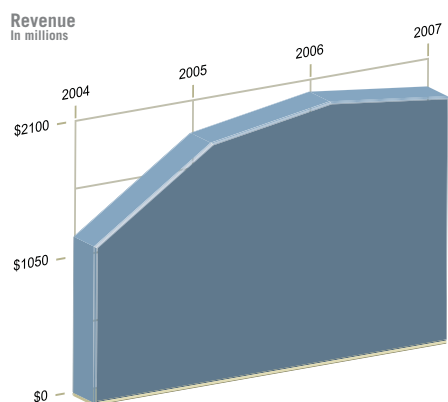


Tellabs Financial Highlights

# 2007

Tellabs fiscal years ended December 28, 2007, and December 29, 2006.

In millions, except per-share and employee data	2007	2006	Change
Revenue	\$ 1,913	\$ 2,041	-6%
Gross profit	\$ 674	\$ 934	-28%
Operating earnings	\$ 27	\$ 247	-89%
Earnings before income taxes	\$ 70	\$ 285	-75%
Net earnings	\$ 65	\$ 194	-66%
Net earnings per share	\$ 0.15	\$ 0.43	-65%
Total cash, cash equivalents and marketable securities	\$ 1,219	\$ 1,300	-6%
Total assets	\$ 3,747	\$ 3,922	-4%
Total liabilities	\$ 833	\$ 984	-15%
Stockholders' equity	\$ 2,913	\$ 2,938	-1%
Net cash provided by operating activities	\$ 131	\$ 318	-58%
Working capital	\$ 1,439	\$ 1,470	-2%
Research and development expense	\$ 343	\$ 357	-4%
Return on average stockholders' equity	2.2%	6.7%	-67%
Weighted average shares outstanding	441	454	-3%
Number of shares outstanding at year-end	419	439	-5%
Number of employees	3,716	3,713	-



Tellabs revenue fell 6% to \$1.9 billion in 2007. Operating expense declined \$16 million, down 2%.



Michael J. Birck  
Chairman of the Board

## As our industry goes through a sea change, Tellabs is moving forward.

### Dear Stockholders, Customers, Employees and Friends,

For Tellabs and other telecom equipment vendors, 2007 brought choppy waters.

Some of our customers, the telecom service providers, delayed network expansions and upgrades in the wake of recent mergers. The spending slowdown was most pronounced among North American wireless carriers. Tellabs' 2007 revenue of \$1.9 billion fell 6% from a year ago.

### Customers are choosing Tellabs' new products

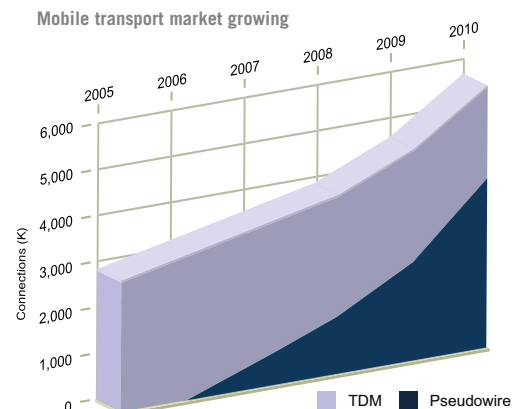
While overall revenue was disappointing, Tellabs' new products performed better than expected:

- Almost half, or 48%, of our 2007 revenue came from products we added since 2003.
- Revenue from fiber-access systems rose to a record level.
- Data revenue grew 50% on rising sales of the Tellabs® 8800 system. And the recently launched Tellabs® 8600 system won 35 out of 36 competitions for customers in 2007.
- Services revenue increased 22%, as customers chose Tellabs for existing and new consulting services.

We are encouraged by the acceptance of our new products and services, some of which are selling in substantial quantities. While we see real opportunities to extend these offerings into more customer networks, we need to continue to make our new products more profitable. We are hard at work doing just that.

Some of our competitors, the telecom equipment vendors, responded to customer consolidation and aggressive purchasing tactics with mergers of their own. Still, dozens of vendors compete for virtually every opportunity, creating hypercompetition in the marketplace. To win, some vendors resort to price cutting, often to levels that leave little or no room for profit.

As a result of such competition, many equipment vendors, Tellabs among them, saw profit margins shrink last year. Tellabs' 2007 gross profit margins fell 10.5 percentage points. While we were among the handful of competitors to produce a profit in 2007, our net earnings declined 65% to 15 cents per share. We have our work cut out for us in 2008.



As the mobile carriers move to new pseudo-wire technology, the Tellabs 8600 system has become a leading contender, winning 35 out of 36 competitions in 2007.

(Source: Infonetics Research)

# 50

**Tellabs Fact:** Tellabs customers deliver Internet service as fast as 50 megabits per second, 1,000 times faster than dial-up service, via our fiber-access equipment.

**Market Fact:** More than 50% of U.S. households, or about 56 million homes, use high-speed Internet services.

# 50



## **User demand continues to grow**

The good news for our industry is that strong demand for telecom services will continue to shape our future. Growth will spring from recent innovations:

- More than one out of three people in the world, or 2.5 billion people, used a mobile phone in 2007. New users are signing up for mobile phones at the rate of 1,000 per minute. Mobile voice, Internet, video and commercial services will propel industry growth.
- More than half of U.S. households now use high-speed Internet. And those users demand even faster Internet speeds, driven largely by the need to download and upload videos and photos. Service providers are responding to that demand by embarking on multi-year network upgrades.
- YouTube,<sup>TM</sup> a video sharing Web site, consumed more bandwidth in 2007 than the entire Internet used in the year 2000. As more people watch video via the Internet, this growth will continue.

User demand is driving service providers to transform their traditional voice networks into Internet and video networks. Both services can use up to 25 times more bandwidth than voice.

At the same time, competition is forcing service providers to reduce network costs. So our customers are embarking on major infrastructure upgrades that will take years and years to fully complete.

Tellabs enables customers to quickly upgrade and expand their networks to meet changing user needs. Network operators need:

- fiber access to increase bandwidth to homes
- more capacity to carry new mobile services on wireless networks
- multiservice routers to interconnect existing and new services with high reliability
- converged transport solutions to meet bandwidth needs deep inside the network
- specialized services to optimize networks, speed revenue and lower expenses.

Tellabs products and services address exactly these needs.

## **We are making headway on profitability**

We clearly understand the challenges before us. Tellabs' leadership and people are working to meet our customers' needs as we improve our financial performance. We must increase gross profit margins, reduce operating expenses and expand revenue opportunities. We also must aggressively pursue new products and perhaps new product categories through internal development and, possibly, acquisition.

We are working to improve gross profit margins across the board, especially on products early in their life cycles, when margins tend to be slim or even negative. In the second half of 2007, we began to eke out margin improvements on the Tellabs<sup>®</sup> 7100 optical transport system (OTS) and Tellabs<sup>®</sup> 1600 optical network terminals (ONTs). Still, we have much more to do here.

In 2007, we cut Tellabs' operating expenses by \$16 million or 2%. To keep Tellabs shipshape, we plan to lower annual operating expenses and overhead costs for products and services by \$100 million, with these savings fully realized in 2009. Unfortunately, that means we will need to lay off about 225 people this year.

## **We serve the world's largest telecom service providers**

In 2007, Tellabs provided equipment to 30 of the world's 35 largest service providers. Yet we need to cast a wider net to diversify our revenue opportunities.

Three-fourths of Tellabs' revenue comes from North American customers, including the top U.S. wireless providers and the wireline side of Verizon and AT&T. To expand sources of U.S. revenue, we are stepping up sales activities with independent operating companies (IOCs) and national local exchange carriers (NLECs). These customers are deploying new networks to deliver Internet Protocol television (IPTV) and business services.

# 1000:1

**Market Fact:** Worldwide, more than 1,000 new users sign up for mobile phones every minute.



**Market Fact:**

80% of U.S. adults use the Internet weekly, up from 9% in 1995.

Although most of Tellabs' revenue comes from North America today, capital spending is increasingly stronger in other markets. Our data products have opened the door to new relationships with Tier One service providers, such as NTT of Japan, Telstra of Australia and Telecom Italia.

We are expanding and pursuing further opportunities around the globe. To augment our opportunities, we are launching an international version of the Tellabs 7100 OTS and the new Tellabs® 7100 Nano OTS.

### **We extended our share repurchase program**

In November, the Board of Directors authorized an additional \$600 million share repurchase program to return excess capital to stockholders. In 2007, we repurchased 25.1 million shares, or almost 6% of Tellabs shares outstanding. Since 2005, we have bought back 14% of shares outstanding. This program signals our confidence in Tellabs' future as a stand-alone company, while assuring adequate resources to fund our future. At year-end, Tellabs held more than \$1.2 billion in cash and equivalents.

### **Introducing Rob Pullen, Tellabs' new CEO**

In November, Tellabs chief executive officer Krish A. Prabhu announced his plan to step down after four years at the helm. We appreciate his contributions and leadership.

Setting Tellabs' course for the future is our new chief executive officer, Robert W. Pullen, who has served Tellabs in a variety of leadership roles over the past 23 years, including services, sales, and research and development. Rob has a deep understanding of our industry's issues and is well-qualified to navigate our company through the current industry environment. He brings strong continuity to his new position as Tellabs' CEO, and he has demonstrated the leadership skills that made him the Board's obvious choice.

Most recently, Rob served Tellabs as vice president of global services, a segment that produced 22% revenue growth in 2007, in part as a result of innovative professional services we recently introduced. Rob served Tellabs as vice president of sales in North America, more than doubling revenue in our largest market between 2002 and 2005. Before that, he was vice president of optical networking, a role in which he successfully integrated two acquisitions while leading a key R&D team.



Michael J. Birck presented new Tellabs CEO Robert W. Pullen to employees.

Stockholders who attend our annual meeting in April will have an opportunity to meet Rob and talk with him face to face. I intend to stay active in the business as Chairman of the Board.

I am grateful to our stockholders for their support as we move forward in a challenging and sometimes frustrating industry environment. I appreciate and sincerely thank Tellabs people for their work each day to make our customers and company successful.

Times like these test our resilience. Tellabs' track record shows that we can come through them strengthened by the challenges. As we go forward, I am confident that we have the right plan, the right products and the right people to steer Tellabs back to profitable growth.

Sincerely,

**Michael J. Birck**

Chairman of the Board

February 26, 2008

# 30

**Tellabs Fact:** 30 of the world's largest 35 telecom service providers use Tellabs products in their networks.

# 35

**Market Fact:** Mobile phone penetration is 100% in Europe.

# 100%





Timothy J. Wiggins  
Executive Vice President and  
Chief Financial Officer

**Q. What's happening in the telecom equipment industry?**

A. *Michael J. Birck, chairman of the board:* The industry is feeling the aftershock of consolidation, which has reduced the number of service-provider customers and increased the purchasing power of the largest among them. For example, four of our largest customers in 2005 are now one customer with considerable leverage over vendors.

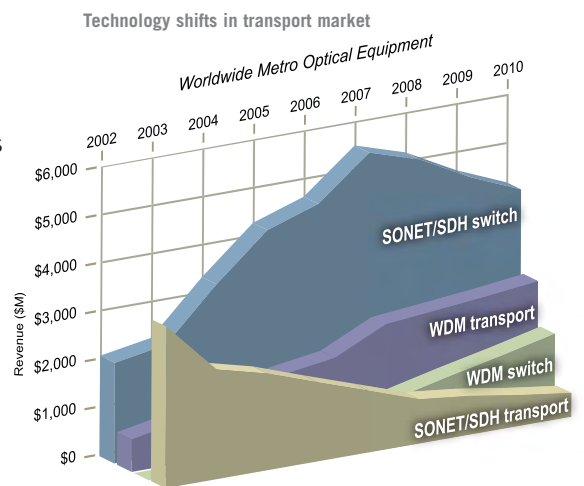
After customers consolidated, some delayed network expansion and upgrades, which was especially evident among North American mobile providers. Moreover, we have seen increasingly aggressive procurement contracting by both wireless and wireline service providers in North America, resulting in paper-thin profit margins for many vendors. Since three-quarters of Tellabs' revenue comes from North America, we were particularly hard hit during 2007.

Responding to service-provider consolidation, some of Tellabs' competitors have joined forces. Our markets have thus become hypercompetitive, with a few very large and dozens of smaller vendors fighting over less business. The inevitable result is increasing pricing pressure that drains profits out of our sector. Tellabs was one of a handful of companies whose network equipment business stayed in the black last year. That meager profit notwithstanding, we are far from satisfied with our 2007 results.

**Q. What happened to Tellabs' results in 2007?**

A. *Timothy J. Wiggins, executive vice president and chief financial officer:* Revenue of \$1.9 billion dropped by 6%, primarily due to lower spending by North American wireless carriers on Tellabs products. But buried in those results were encouraging trends for our future, including strong uptake of our data, access and services offerings.

- We achieved our highest sales of fiber-access equipment ever, and we rank #1 in fiber-access market share in North America.
- Data revenue grew 50% on the strength of our successful Tellabs 8600 and Tellabs 8800 systems.
- Tellabs® Global Services grew 22%, propelled by existing and new services.
- Nearly half of our 2007 revenue came from products and services we added to our portfolio since 2003, proof that our new offerings are winning customers over.



The transport market is shifting to new technologies built into the Tellabs 7100 OTS. Revenue from the Tellabs 7100 system quadrupled in 2007.

(Source: Infonetics Research)

# 1

**Market Fact:** Cell phones are now used by more than one out of three people around the world.

# 1

**Tellabs Fact:** One-half of the world's mobile calls go through networks owned by Tellabs customers.

# 3

# 2



## Management Answers Your Questions, continued



Daniel P. Kelly  
Executive Vice President –  
Global Products

However, as our product mix shifted toward new products faster than expected, Tellabs' gross profit margins declined 10.5 percentage points. Products that are early in their life cycles often carry lower margins than more established products. We sold fewer Tellabs® 5500 digital cross-connects, an established product; we sold more Tellabs 7100 OTSs, a new product; and we sold more Tellabs 1600 ONTs at negative margins. As a result, earnings fell 65% to 15 cents per share. As we begin 2008, we are aggressively focused on improving Tellabs' performance.

### **Q. What does Tellabs need to do to get its performance back on track?**

A. *Timothy J. Wiggins, executive vice president and chief financial officer:* We are implementing a plan to increase gross profit margins and reduce our annual operating expenses and overhead costs. Under this plan, together with the restructuring announced in September 2007, Tellabs expects our 2009 costs to be \$100 million lower than our 2007 costs. We are working to:

- Reduce our operating expenses by \$75 million a year.
- Cut overhead costs of products and services by \$25 million a year.
- Increase gross profit margins on new products by reducing costs and winning more customers.
- Increase revenue from customers in Europe, Africa, Asia, Australia and Latin America, and from IOCs and NLECs in North America.
- Return excess capital to stockholders through our stock repurchase programs, including \$600 million authorized in November by our Board of Directors.

### **Q. How are Tellabs' new products doing?**

A. *Daniel P. Kelly, executive vice president, global products:* Our products are performing well in the marketplace and in customers' networks. Today, nearly half of our revenue comes from products we added since 2003, proof positive that we've chosen the right products and targeted the right markets. We are focused on network applications that are growing faster than service providers' overall capital spending, such as consumer broadband services, business services and mobile transport. In 2007, Tellabs invested 18% of sales in research and development.

Our engineers have proven time and again that we can move faster than large competitors to solve customers' problems quickly. For example, we developed the current version of the Tellabs 7100 system

# >100

**Market Fact:** More than 100 service providers around the world use Tellabs data solutions.



**Tellabs Fact:** Tellabs data revenue grew 50% in 2007.

# 50

## Management Answers Your Questions, continued



Carl A. DeWilde  
Executive Vice President –  
Global Sales, Services and Strategy

on a compressed schedule that enabled us to earn Verizon's business. As a result, revenue from the Tellabs 7100 system quadrupled last year, beating our plans.

To further expand the addressable markets for the Tellabs 7100 system, in 2008 we are:

- Adding international interfaces to meet customer needs outside of North America.
- Launching a smaller version, the Tellabs 7100 Nano system, to address customer needs in smaller networks around the world.
- Integrating Ethernet switching capabilities into the Tellabs 7100 system to converge optical and data functionality into a single platform.

We continue to improve our flagship transport product for North American providers, the Tellabs 5500 system. During 2008, our new high-density shelf will increase optical density sixfold, which reduces our customers' operating expenses.

And we're making strong headway with new data products around the world. Data revenue grew 50% in 2007. Dozens of customers have chosen the Tellabs 8600 system to migrate wireless backhaul networks to Ethernet, reducing operating expenses as much as 90% compared with existing leased lines. Thanks to its highly integrated and cost-effective architecture, the Tellabs 8600 system is delivering solid gross profit margins, early in its life.

The Tellabs 8800 multiservice router (MSR) series addresses our customers' need to continue delivering more profitable existing services, such as ATM and Frame Relay, along with new Ethernet and IP/MPLS services. More than 100 customers have chosen Tellabs' data products for networks around the world.

### **Q. How is Tellabs doing with customers?**

A. *Carl A. DeWilde, executive vice president, global sales, services and strategy:* I'm encouraged. Tellabs products are competitive and our customer relationships are expanding.

We are focusing on specific network applications such as mobile transport. When mobile carriers needed a new way to haul traffic in wireless networks, our Tellabs 8600 system fit that need. During 2007, the Tellabs 8600 system won 35 of the 36 competitions that we participated in, which contributed to our 50% growth in data revenue.

Such strong new products enable Tellabs to make headway with new customers. For example, our Tellabs 8800 series has brought us new customers such as Telstra in Australia and Telecom Italia.



44

**Market Fact:** 44% of U.S. home broadband users have generated their own content, which creates demand for higher uploading speeds.

48%

**Tellabs Fact:** Almost half, or 48%, of Tellabs' revenue is generated by products we added since 2003.

'03

## Management Answers Your Questions, continued



John M. Brots  
Executive Vice President –  
Global Operations



Jean K. Holley  
Executive Vice President and  
Chief Information Officer

In fact, during 2007 Tellabs earned business from 30 of the top 35 service providers in the world. Our successful partnership with Verizon to build the FiOS fiber-access network has propelled Tellabs to a #1 market share in North American fiber access.

In 2008, we are sharpening our focus on making profitable sales. Our job is clear:

- Increase business with existing customers.
- Add channel partners to reach additional customers.
- Win more business from telecom service providers outside North America and customers such as IOCs and NLECs in the United States.
- Pass up potential deals that deny us the opportunity to realize a fair profit.

### **Q. How is Tellabs' supply chain contributing to profitability and customer satisfaction?**

A. *John M. Brots, executive vice president, global operations:* Tellabs' supply chain initiatives have reduced costs by more than \$100 million over the past three years, as we completed our conversion to outsourced manufacturing.

Our current supply chain initiatives focus on reducing costs by continuing to:

- Realize new efficiencies in sourcing components in low-cost geographic regions.
- Engineer products for better manufacturability.
- Reduce the costs of converting parts into finished products.
- Assure the quality of products before they ship.
- Optimize our highly efficient distribution network.

We are always working to improve customer satisfaction by meeting customer requirements more consistently. Since 2005, our key customer satisfaction measure has increased at double-digit rates. That said, with today's price pressure, our primary focus remains the job of making Tellabs' supply chain more efficient and more effective for customers.

### **Q. What is Tellabs doing to make business processes more efficient?**

A. *Jean K. Holley, executive vice president and chief information officer:* To improve our visibility of revenue and gross profit margins, last year we deployed a tool that enables us to forecast revenue and gross profit margins in a more granular way. Now we can manage the business more effectively.

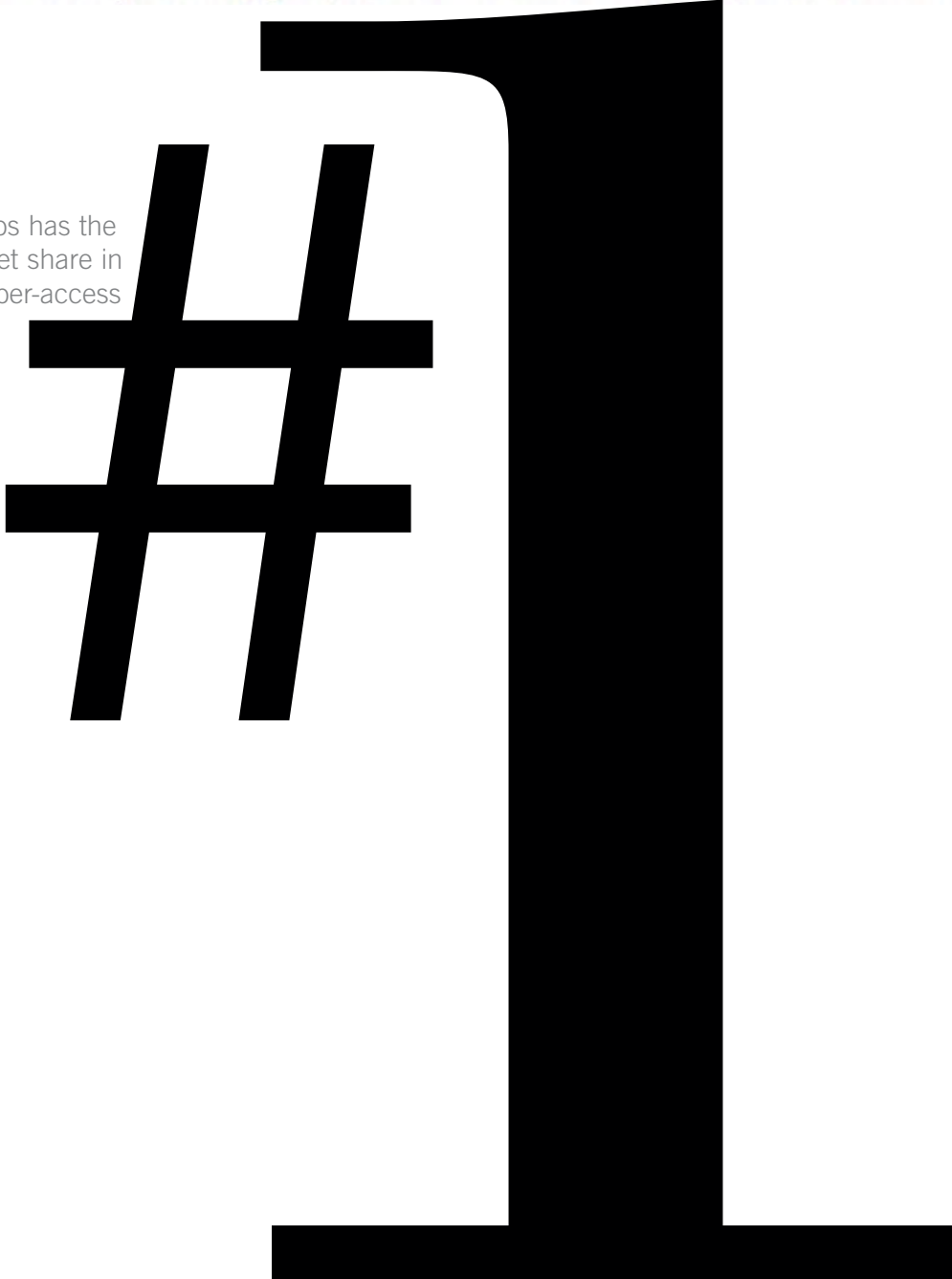
We are consolidating the primary engineering tools in our R&D and supply chain organizations. These tools lower our supply chain costs, simplify collaboration by employees around the world, and enable us to leverage consistent, global engineering practices as we move to low-cost geographies.

# >1,500,000

**Market Fact:** More than 1.5 million consumers use Internet service powered by Tellabs fiber access.



**Tellabs Fact:** Tellabs has the number one market share in North American fiber-access equipment.





James M. Sheehan  
Executive Vice President and  
Chief Administrative Officer

**Q. What is Tellabs doing to address its corporate social responsibility?**

*A. James M. Sheehan, executive vice president and chief administrative officer:* In keeping with our tradition, Tellabs continues to invest in the communities where we do business through programs to match employee gifts of time and money. Over the past decade, the Tellabs Foundation has given more than \$10 million to nonprofit organizations focused primarily on education, health and the environment.

Last year, Tellabs established a cross-functional team to open a dialogue with investors and customers about Tellabs' broader commitment to corporate social responsibility.

In 2008, we are taking steps to adopt a Supplier Code of Conduct and report regularly on Tellabs' corporate social responsibility performance. In keeping with the company's values, we want to ensure that, throughout our supply chain, workers are treated with respect, working conditions remain safe, and our vendors use environmentally responsible manufacturing processes.

**Q. Where is Tellabs going long-term? Can you survive as an independent entity?**

*A. Michael J. Birck, chairman of the board:* We run Tellabs for the long term, so Tellabs' Board of Directors and senior executives studied these issues and their ramifications throughout the year.

Our careful review of the industry and our business prospects convinces us that Tellabs has what it takes to survive independently. We have the right customers, products, people and financial resources to go it alone.

To do that, however, we will need to augment our current products and services to better position us for growth and profitability, and we are continually examining such opportunities.

The share repurchase program now in progress is evidence that we believe in our future as an independent organization. It enables Tellabs to return capital to stockholders and signals our confidence in our future as a stand-alone company, one with considerably better share price performance than was recently exhibited.

Yet, we are mindful that challenges abound and circumstances can change, just as they did during 2007. It would be unwise to rule out possible future business combinations. If we see clear opportunity to create value for customers and stockholders through either an acquisition or a merger, we will act accordingly.

This industry is much more difficult and complex than it was a few years ago, yet we still believe it holds ample future promise, enough to justify the hard work that will surely be needed.