

Starent Networks, Corp.  
Form 10-Q  
November 08, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2007

Or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number: 001-33511

**STARENT NETWORKS, CORP.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**04-3527533**  
(I.R.S. Employer Identification No.)

**30 International Place  
Tewksbury, MA 01876**  
(Address of principal executive offices) (zip code)

**(978) 851-1100**  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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 ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒

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

As of November 8, 2007, there were 68,668,709 shares of the registrant's \$0.001 par value per share common stock outstanding.

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**STARENT NETWORKS, CORP.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2007**

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## PART I. FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## STARENT NETWORKS, CORP.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited and in thousands, except share and per share data)

	September 30, 2007	December 31, 2006
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 135,942	\$ 24,010
Short-term investments	14,656	36,144
Accounts receivable	34,859	13,619
Inventories	23,088	14,578
Prepaid expenses and other current assets	5,727	3,193
Total current assets	214,272	91,544
Property and equipment, net	19,792	10,839
Other assets	1,154	845
Restricted cash	594	1,039
Total assets	\$ 235,812	\$ 104,267
<b>Liabilities, redeemable convertible preferred stock and stockholders' equity (deficit)</b>		
Current liabilities		
Accounts payable	\$ 9,668	\$ 4,249
Accrued expenses	6,052	2,675
Accrued payroll and related expenses	10,880	7,977
Income taxes payable	536	232
Current portion of deferred revenue	43,466	57,106
Total current liabilities	70,602	72,239
Deferred revenue, net of current portion	6,303	6,562
Refundable exercise price of restricted common stock	1,042	707
Commitments and contingencies (Note 7)		
Redeemable convertible preferred stock		130,270
Stockholders' equity (deficit)		
Common stock, \$0.001 par value, 250,000,000 and 120,000,000 shares authorized, 64,117,060 and 7,456,672 shares issued and outstanding at September 30, 2007 and December 31, 2006, respectively	64	7
Additional paid-in capital	256,014	
Accumulated other comprehensive loss	(5)	(1)
Accumulated deficit	(98,208)	(105,517)

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	September 30, 2007	December 31, 2006
Total stockholders' equity (deficit)	157,865	(105,511)
Total liabilities, redeemable convertible preferred stock and stockholders' equity (deficit)	\$ 235,812	\$ 104,267

The accompanying notes are an integral part of these condensed consolidated financial statements.

## STARENT NETWORKS, CORP.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited and in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Revenues:				
Product	\$ 31,588	\$ 31,642	\$ 81,160	\$ 61,108
Service	5,103	3,596	14,026	8,953
Total revenues	36,691	35,238	95,186	70,061
Cost of revenues:				
Product	7,422	13,240	18,176	20,534
Service	2,723	429	6,052	1,133
Total cost of revenues	10,145	13,669	24,228	21,667
Gross profit	26,546	21,569	70,958	48,394
Operating expenses:				
Research and development	10,612	7,421	28,263	17,126
Sales and marketing	11,940	8,983	27,876	21,728
General and administrative	4,164	2,317	10,405	5,816
Total operating expenses	26,716	18,721	66,544	44,670
Income (loss) from operations	(170)	2,848	4,414	3,724
Interest income	2,038	630	3,637	1,542
Foreign currency exchange gain (loss)	84	(23)	(6)	(46)
Other income (expenses)		38		(3)
Income before income tax expense	1,952	3,493	8,045	5,217
Income tax expense	(329)	(243)	(736)	(386)
Net income	\$ 1,623	\$ 3,250	\$ 7,309	\$ 4,831
Net income (loss) per share applicable to common stockholders (Note 3):				
Basic	\$ 0.03	\$ 0.02	\$ 0.07	\$ (0.17)
Diluted	\$ 0.02	\$ 0.02	\$ 0.06	\$ (0.17)
Weighted-average shares used in computing net income (loss) per common share (Note 3):				
Basic	64,039	7,133	32,108	6,938

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	Three Months Ended September 30,		Nine Months Ended September 30,	
Diluted	70,685	9,357	38,260	6,938

The accompanying notes are an integral part of these condensed consolidated financial statements.

## STARENT NETWORKS, CORP.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited and in thousands)

	Nine Months Ended September 30,	
	2007	2006
<b>Cash flows from operating activities:</b>		
Net income	\$ 7,309	\$ 4,831
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation expense	5,093	2,188
Share-based compensation	8,520	492
Foreign currency losses	(118)	19
Changes in operating assets and liabilities		
Accounts receivable	(21,227)	(8,505)
Inventories	(8,504)	5,763
Prepaid expenses and other current assets	(2,433)	(1,103)
Other assets	(307)	(201)
Accounts payable	5,375	901
Accrued expenses	6,081	1,778
Income taxes payable	306	91
Deferred revenue	(13,900)	18,342
Net cash provided by (used in) operating activities	(13,805)	24,596
<b>Cash flows from investing activities:</b>		
Purchases of property and equipment	(14,003)	(5,904)
Purchases of short-term investments	(18,896)	(48,048)
Proceeds from maturities of short-term investments	40,380	31,045
Change in restricted cash	451	24
Net cash provided by (used in) investing activities	7,932	(22,883)
<b>Cash flows from financing activities:</b>		
Proceeds from Initial Public Offering, net of expenses	115,955	
Repayment of long-term debt		(33)
Proceeds from exercise of stock options	1,314	138
Proceeds from issuance of restricted common stock	347	
Net cash provided by financing activities	117,616	105
Effect of exchange rate changes on cash and cash equivalents	189	16
Net increase (decrease) in cash and cash equivalents	111,932	1,834
Cash and cash equivalents, beginning of period	24,010	20,036
Cash and cash equivalents, end of period	\$ 135,942	\$ 21,870



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Nine Months Ended  
September 30,

The accompanying notes are an integral part of these condensed consolidated financial statements.

**STARENT NETWORKS, CORP.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Overview**

***Business Description***

Starent Networks, Corp. ("Starent" or the "Company") was incorporated in Delaware on August 11, 2000 and is a leading provider of infrastructure hardware and software products and services that enable mobile operators to deliver multimedia services to their subscribers. The Company's products and services integrate multiple network functions and services needed for the delivery of advanced multimedia services, such as video, Internet access, voice-over-IP, e-mail, mobile TV, photo sharing and gaming.

***Basis of Presentation***

The accompanying interim condensed consolidated financial statements presented herein have been prepared by Starent, are unaudited and, in the opinion of management, include all adjustments, consisting only of normal, recurring adjustments and accruals, necessary for a fair statement of the Company's financial position at September 30, 2007, results of operations for the three and nine month periods ended September 30, 2007 and September 30, 2006 and cash flows for the nine month periods ended September 30, 2007 and September 30, 2006 in accordance with accounting principles generally accepted in the United States. Interim results are not necessarily indicative of results for any other interim period or a full year. The condensed consolidated balance sheet presented as of December 31, 2006 has been derived from the audited consolidated financial statements as of that date.

The condensed consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain all of the information that is included in the annual financial statements and notes of the Company. The condensed consolidated financial statements and notes presented herein should be read in conjunction with the financial statements and notes included in the Company's Registration Statement on Form S-1 (File No. 333-141092) declared effective by the Securities and Exchange Commission, or SEC, on June 5, 2007.

***Significant Estimates and Assumptions***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. Management evaluates these estimates and assumptions on an ongoing basis. Significant estimates and assumptions relied upon by management in preparing these financial statements include revenue recognition, allowances for doubtful accounts, net realizable value of inventories, expensing and capitalization of research and development costs for software, the determination of fair value of share-based compensation and the recoverability of the Company's net deferred tax assets and related valuation allowance.

Although the Company regularly assesses these estimates, actual results could differ materially from these estimates. Changes in estimates are recorded in the period in which they become known. The Company bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances. Actual results could differ from management's estimates if past experience or other assumptions do not turn out to be substantially accurate.

***Concentrations of Risk and Off-Balance-Sheet Risk***

The Company has no significant off-balance-sheet risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements. Financial instruments that potentially subject the Company to concentrations of credit risk are principally cash and cash equivalents, short-term investments, accounts receivable and inventories. The Company's cash equivalents and its short-term investments are principally maintained with one commercial bank.

The Company had four customers for the three and nine months ended September 30, 2007 that each accounted for more than 10% of revenues and in the aggregate accounted for 88% of revenues for each of the respective periods. The Company had two customers for the three and nine months ended September 30, 2006 that each accounted for more than 10% of revenues and in the aggregate accounted for 94% and 83% of revenues for the respective periods.

At September 30, 2007, the Company had two customers that accounted for 75% of accounts receivable. At December 31, 2006, the Company had three customers that accounted for 76% of accounts receivable.

The Company relies on a single contract manufacturer to manufacture and assemble its products. The Company has no long-term supply arrangements with this manufacturer and accordingly no obligation exists for the manufacturer to supply products to the Company in specific quantities or within specific time frames.

In addition, certain of the components included in the Company's products are sourced from single or limited sources and lead times for some of these components may be significant. The Company has no long-term contracts to purchase these components.

**2. Stock-Based Compensation**

In December 2004, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standard, or SFAS, 123(Revised), *Share-Based Payment*, which is a revision of SFAS 123, *Accounting for Stock-Based Compensation*. SFAS 123R supersedes Accounting Principles Board, or APB, Opinion 25, *Accounting for Stock Issued to Employees* and SFAS 123 and amends SFAS 95, *Statement of Cash Flows*. Generally, the approach in SFAS 123R is similar to the approach described in SFAS 123. However, SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their grant date fair value. The Company adopted SFAS 123R effective January 1, 2006 utilizing the prospective transition method, which requires the Company to apply the provisions of SFAS 123R only to new awards granted, and to awards modified, repurchased or cancelled on or after January 1, 2006.

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The fair value of options granted for the three and nine months ended September 30, 2007 and 2006 was estimated at the date of grant using the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Risk-free interest rates	4.50%	4.84%	4.50-4.76%	4.55-4.99%
Expected dividend yield	0%	0%	0%	0%
Expected life	6.25 years	6.25 years	6.25 years	6.25 years
Expected volatility	62%	68%	62-68%	68%

The expected life was calculated based on the simplified method as permitted by the SEC's Staff Accounting Bulletin 107, *Share-Based Payments*. The computation of expected volatility was based on the historical volatility of comparable companies from a representative peer group selected based on industry and market capitalization. The risk free interest rate was based on a treasury instrument whose term is consistent with the expected life of the stock options. In addition to the assumptions above, as required under SFAS 123R, management made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

The results for the periods set forth below included share-based compensation expense in the following expense categories of the condensed consolidated statements of operations (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Share based compensation included in:				
Cost of revenue	\$ 221	\$ 10	\$ 419	\$ 18
Total share-based compensation in cost of revenue	221	10	419	18
Research and development	1,947	85	4,088	167
Sales and marketing	650	89	1,643	187
General and administrative	948	76	2,370	120
Total share-based compensation in operating expenses	3,545	250	8,101	474
Total share-based compensation	\$ 3,766	\$ 260	\$ 8,520	\$ 492

## 3. Net Income (Loss) per Share

Basic and diluted net income (loss) per share applicable to common stockholders is presented in conformity with SFAS 128, *Earnings per Share* and the related interpretation in Emerging Issues Task Force 03-06, *Participating Securities and the Two-Class Method under FASB Statement No. 128*. Basic net income (loss) per share applicable to common stockholders is computed by dividing net income (loss) applicable to common stockholders by the weighted-average number of common shares outstanding during the period, excluding the dilutive effects of common stock equivalents. Income applicable to common stockholders includes accretion of redeemable convertible preferred stock and earnings allocated to participating preferred stockholders. Common stock equivalents include stock options, restricted stock and, in certain circumstances, convertible securities such as the convertible preferred

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stock. Diluted net income (loss) per share assumes the conversion of the convertible preferred stock using the "if converted" method, if dilutive, and includes the dilutive effect of stock options and restricted stock under the treasury stock method. The following table presents the calculation of basic and diluted net income (loss) per share (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Net income	\$ 1,623	\$ 3,250	\$ 7,309	\$ 4,831
Accretion on redeemable convertible preferred stock		(1,997)	(3,445)	(5,991)
Income allocated to preferred stockholders		(1,079)	(1,703)	
Net income (loss) applicable to common stockholders	\$ 1,623	\$ 174	\$ 2,161	\$ (1,160)
Weighted-average common shares outstanding basic	64,039	7,133	32,108	6,938
Dilutive effect of stock options and restricted stock	6,646	2,224	6,152	
Weighted average common shares outstanding dilutive	70,685	9,357	38,260	6,938
Net income (loss) per share:				
Basic	\$ 0.03	\$ 0.02	\$ 0.07	\$ (0.17)
Diluted	\$ 0.02	\$ 0.02	\$ 0.06	\$ (0.17)

The following outstanding options, restricted common stock subject to repurchase and convertible preferred stock were excluded from the computation of diluted net income (loss) per common share for the periods presented because including them would have had an antidilutive effect (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Options to purchase common stock and common stock subject to repurchase	587	3,847	896	5,702
Convertible preferred stock (as converted basis)		44,288	25,308	44,288

## 4. Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market (net realizable value). Inventories principally included the cost of raw materials, subassemblies, the cost of third-party contract manufacturers and cost of sales related to deferred revenue which is included in finished goods. Inventories consisted of the following (in thousands):

	September 30, 2007	December 31, 2006
Raw materials	\$ 4,585	\$ 1,617
Work in process	5,432	2,950
Finished goods	13,071	10,011
	\$ 23,088	\$ 14,578

## 5. Redeemable Convertible Preferred Stock and Stockholders' Equity

### Redeemable Convertible Preferred Stock

The following table summarizes redeemable convertible preferred activity during the nine months ended September 30, 2007 (in thousands):

	Series A	Series B	Series C	Series D	Series E	Total
Balance at December 31, 2006	\$ 15,307	\$ 31,591	\$ 30,491	\$ 32,750	\$ 20,131	\$ 130,270
Accretion of dividends on preferred stock	350	759	794	921	621	3,445
Conversion of preferred stock	(15,657)	(32,350)	(31,285)	(33,671)		