Starent Networks, Corp.
Form 10-Q
August 08, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008

or

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

For the transition period from to

Commission File Number: 001-33511

STARENT NETWORKS, CORP.

(Exact name of registrant as specified in its charter)

Delaware	**04-3527533**
(State or other jurisdiction of incorporation or organization)	(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. x Yes o No

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of August 4, 2008, there were 69,973,251 shares of the registrant s $0.001 par value per share common stock outstanding.

Table of Contents

STARENT NETWORKS, CORP.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008

Table of Contents

Item		Page
PART I. FINANCIAL INFORMATION		3
ITEM 1.	Condensed Consolidated Financial Statements (unaudited)	3
	Condensed Consolidated Balance Sheets as of June 30, 2008 and December 31, 2007	3
	Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2008 and 2007	4
	Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2008 and 2007	5
	Notes to Condensed Consolidated Financial Statements	6
ITEM 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	12
ITEM 3.	Quantitative and Qualitative Disclosures About Market Risk	24
ITEM 4T.	Controls and Procedures	24
PART II. OTHER INFORMATION		25
ITEM 1.	Legal Proceedings	25
ITEM 1A.	Risk Factors	26
ITEM 2.	Unregistered Sales of Equity Securities and Use of Proceeds	36
ITEM 4.	Submission of Matters to a Vote of Security Holders	37
ITEM 6.	Exhibits	37

Table of Contents

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)

	June 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 321,147	$ 223,987
Short-term investments		9,612
Accounts receivable	39,304	56,363
Inventories	41,519	29,638
Prepaid expenses and other current assets	6,291	6,656
Total current assets	408,261	326,256
Property and equipment, net	26,620	20,452
Other assets	2,035	1,955
Restricted cash	832	716
Total assets	$ 437,748	$ 349,379
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 9,800	$ 7,448
Accrued expenses	7,286	6,163
Accrued payroll and related expenses	11,936	15,568
Income taxes payable	1,545	1,075
Current portion of deferred revenue	109,874	52,733
Total current liabilities	140,441	82,987
Deferred revenue, net of current portion	8,056	10,670
Refundable purchase price of restricted common stock	645	783
Commitments and contingencies (Note 7)		
Stockholders equity:		
Preferred stock, $0.001 par value, 5,000,000 shares authorized and no shares outstanding		
	70	68

Common stock, $0.001 par value, 250,000,000 shares authorized, 69,557,678 and 68,252,858 shares issued and outstanding at June 30, 2008 and December 31, 2007, respectively				
Additional paid-in capital		359,155		348,917
Accumulated other comprehensive income				2
Accumulated deficit		(70,619)		(94,048)
Total stockholders equity		288,606		254,939
Total liabilities and stockholders equity	$	437,748	$	349,379

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

Table of Contents

STARENT NETWORKS, CORP.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited and in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Revenues:				
Product	$ 52,160	$ 25,121	$ 101,047	$ 49,573
Service	9,008	5,733	16,349	8,923
Total revenues	61,168	30,854	117,396	58,496
Cost of revenues:				
Product	9,497	6,316	18,546	10,754
Service	3,806	1,942	7,716	3,329
Total cost of revenues	13,303	8,258	26,262	14,083
Gross profit	47,865	22,596	91,134	44,413
Operating expenses:				
Research and development	12,500	7,585	24,843	17,651
Sales and marketing	16,173	8,867	35,024	15,936
General and administrative	5,931	3,398	11,087	6,242
Total operating expenses	34,604	19,850	70,954	39,829
Income from operations	13,261	2,746	20,180	4,584
Interest income	2,009	890	4,293	1,598
Foreign currency exchange gain (loss)	(148)	(91)	751	(89)
Income before income tax expense	15,122	3,545	25,224	6,093
Income tax expense	(1,346)	(164)	(1,795)	(407)
Net income	13,776	3,381	23,429	5,686
Accretion of redeemable convertible preferred stock		(1,448)		(3,445)
Income allocated to preferred stockholders		(1,108)		(1,583)
Net income applicable to common stockholders	$ 13,776	$ 825	$ 23,429	$ 658
Net income per share applicable to common stockholders (Note 3):				
Basic	$ 0.20	$ 0.03	$ 0.34	$ 0.04
Diluted	$ 0.19	$ 0.03	$ 0.32	$ 0.03
Weighted-average shares used in computing net income per common share (Note 3):				
Basic	69,379	23,919	69,105	15,864
Diluted	74,407	30,197	74,372	21,769

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

Table of Contents

STARENT NETWORKS, CORP.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited and in thousands)

	Six Months Ended June 30,	
	2008	**2007**
Cash flows from operating activities:		
Net income	$ 23,429	$ 5,686
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation and amortization expense	5,018	2,238
Share-based compensation	7,888	4,754
Foreign currency gains	(737)	(26)
Changes in operating assets and liabilities:		
Accounts receivable	17,146	(3,066)
Inventories	(11,875)	(3,385)
Prepaid expenses and other current assets	293	(878)
Other assets	(71)	(240)
Accounts payable	2,373	3,780
Accrued expenses	(2,368)	897
Income taxes payable	493	327
Deferred revenue	54,527	(22,727)
Net cash provided by (used in) operating activities	96,116	(12,640)
Cash flows from investing activities:		
Purchases of property and equipment	(11,215)	(8,474)
Purchases of short-term investments		(11,208)
Proceeds from maturities of short-term investments	9,610	26,580
Change in restricted cash	(130)	452
Net cash provided by (used in) investing activities	(1,735)	7,350
Cash flows from financing activities:		
Proceeds from public offerings, net of expenses	(87)	116,037
Proceeds from exercises of stock options	2,301	1,208
Proceeds from issuance of restricted common stock		347
Net cash provided by financing activities	2,214	117,592
Effect of exchange rate changes on cash and cash equivalents	565	88
Net increase in cash and cash equivalents	97,160	112,390
Cash and cash equivalents, beginning of period	223,987	24,010
Cash and cash equivalents, end of period	$ 321,147	$ 136,400

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

Table of Contents

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 the Company, 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 June 30, 2008, results of operations for the three and six months ended June 30, 2008 and 2007 and cash flows for the six months ended June 30, 2008 and 2007 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, 2007 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 Annual Report on Form 10-K for the year ended December 31, 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 two customers for the three and six months ended June 30, 2008, respectively, that each accounted for more than 10% of revenues and in the aggregate accounted for 85% and 83% of revenues for each of the respective periods. The Company had three customers for the three months ended June 30, 2007 that accounted for more than 10% of revenues and in the aggregate accounted for 89% of revenues. The Company had four customers for the six months ended June 30, 2007 that accounted for more than 10% of revenues and in the aggregate accounted for 90% of revenues.

At June 30, 2008, the Company had two customers that accounted for 60% of accounts receivable. At December 31, 2007, the Company had two customers that accounted for 74% of accounts receivable.

Table of Contents

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. Share-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.

The fair value of options granted for the three and six months ended June 30, 2008 and 2007 was estimated at the date of grant using the following assumptions:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Risk-free interest rates	3.26%	4.76%	3.01 - 3.26%	4.61 - 4.76%
Expected dividend yield	0%	0%	0%	0%
Expected life	6.25 years	6.25 years	6.25 years	6.25 years
Expected volatility	54%	64%	54 - 56%	64 - 68%

The expected life was calculated based on the simplified method as permitted by the SEC s Staff Accounting Bulletin 110, *Share-Based Payment*. 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 U.S. 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 June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Share-based compensation included in:				
Cost of revenues	$ 381	$ 130	694	$ 198
Total share-based compensation in cost of revenues	381	130	694	198
Research and development	1,803	1,660	3,107	2,141
Sales and marketing	1,366	644	2,293	993
General and administrative	968	847	1,794	1,422
Total share-based compensation in operating expenses	4,137	3,151	7,194	4,556
Total share-based compensation	$ 4,518	$ 3,281	$ 7,888	$ 4,754

3. Net Income per Share

Basic and diluted net income 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 per share applicable to common stockholders is computed by dividing net income 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

Table of Contents

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 stock. Diluted net income 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 per share (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income	$ 13,776	$ 3,381	$ 23,429	$ 5,686
Accretion of redeemable convertible preferred stock		(1,448)		(3,445)
Income allocated to preferred stockholders		(1,108)		(1,583)
Net income applicable to common stockholders	$ 13,776	$ 825	$ 23,429	$ 658
Weighted-average common shares outstanding basic	69,379	23,919	69,105	15,864
Dilutive effect of stock options and restricted stock	5,028	6,278	5,267	5,905
Weighted-average common shares outstanding dilutive	74,407	30,197	74,372	21,769
Net income per share:				
Basic	$ 0.20	$ 0.03	$ 0.34	$ 0.04
Diluted	$ 0.19	$ 0.03	$ 0.32	$ 0.03

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Options to purchase common stock and common stock subject to repurchase	2,913	66	2,151	66
Convertible preferred stock (as converted basis)		32,121		38,171

4. Fair Value Measurements

On January 1, 2008, the Company adopted the provisions of SFAS 157 (SFAS 157), *Fair Value Measurements,* for its financial assets and liabilities. As permitted by FASB Staff Position No. SFAS 157-2, *Effective Date of FASB Statement No. 157*, the Company elected to defer until

January 1, 2009 the adoption of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of this accounting pronouncement did not have a material effect on the Company s consolidated financial statements for financial assets and liabilities and any other assets and liabilities carried at fair value. The Company is currently in the process of evaluating the impact of adopting this pronouncement for other non-financial assets or liabilities. SFAS 157 provides a framework for measuring fair value under generally accepted accounting principles in the United States and requires expanded disclosures regarding fair value measurements. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities. At June 30, 2008, the Company s Level 1 assets and liabilities included the Company s money market funds included in cash and cash equivalents.

Table of Contents

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. At June 30, 2008, the Company had no Level 2 assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. At June 30, 2008, the Company had no Level 3 assets or liabilities.

At June 30, 2008, the Company s financial assets and liabilities that were measured at fair value on a recurring basis included money market funds of $291.3 million, which were level 1 financial assets. The Company did not have any non-financial assets or liabilities that were measured or disclosed at fair value on a recurring basis at June 30, 2008. As required by SFAS 157, assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

5. 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):

	June 30, 2008	December 31, 2007
Raw materials	$ 3,341	$ 4,632
Work in process	7,759	5,551
Finished goods	30,419	19,455
	$ 41,519	$ 29,638

6. Income Taxes

The Company s income tax provisions for the three and six months ended June 30, 2008 and 2007 are primarily attributable to federal and state income taxes in the U.S. and taxes related to foreign jurisdictions. The federal and state tax provisions for those periods included amounts in relation to the Company s income generated in the U.S., partially reduced by the utilization of available net operating loss (NOL) carryforwards and tax credits that were recorded on its balance sheet with a full valuation allowance prior to their utilization.

As of June 30, 2008, a full valuation allowance was recorded against the Company s net deferred tax assets in the U.S. As of December 31, 2007, the Company had U.S. federal NOL carryforwards of $27.6 million, state NOL carryforwards of $28.0 million, U.S. federal tax credits of $4.4 million and state research and development credits of $0.6 million.

The Company concluded that as of June 30, 2008 it was more likely than not that its net deferred tax assets in the U.S. would not be realized. While the Company has realized operating profits over the past three years and in the first six months of 2008, those profits of the prior years have been marginal in relation to the size of the Company s total deferred tax assets, which could increase in size based upon future stock option exercises by its employees. Management judgment is required to determine when the realization of the Company s deferred tax assets in the future is considered more likely than not. If and when the Company concludes that realization is more likely than not, it will record a reduction to its valuation allowance that will result in increases to net income and additional paid-in capital in the period such determination is made. It is reasonably possible that this determination could occur later in 2008 or early 2009.

7. Litigation

The Company is presently defending two patent infringement lawsuits brought against it by UTStarcom, Inc. In February 2005, UTStarcom filed a complaint against the Company in the United States District Court for the Northern District of California seeking unspecified damages and injunctive relief. The complaint alleges infringement by the Company of UTStarcom s U.S. Patent No. 6,829,473, entitled Roaming and Hand-Off Support for Prepaid Billing for Wireless Data Networks, which the Company refers to as the 473 patent. In May 2005, the Company answered the complaint, denied the infringement allegations contained in the complaint, and filed counterclaims against UTStarcom seeking a declaratory judgment that the Company did not infringe the 473 patent and that the 473 patent was invalid and unenforceable. In July 2005, the Company filed an amended answer and counterclaims to the 473 patent complaint. In December 2006, UTStarcom filed a reissue patent application relating to the 473 patent. In January 2007, by agreement of the parties, the District Court stayed the case pending the outcome of UTStarcom s reissue application relating to the 473 patent. In June 2007, the Company filed a request for *inter partes* re-examination of all claims of the 473 patent with the

Table of Contents

United States Patent and Trademark Office on sixteen different grounds. In August 2007, the Patent and Trademark Office granted the Company s request for *inter partes* re-examination of all claims on all sixteen grounds. In November 2007, the Patent and Trademark Office merged the reissue and re-examination proceedings. A first office action has not yet been issued. The Company believes that it

has meritorious defenses against any resulting reissued patent, and the Company is prepared to vigorously defend the 473 patent case through trial.

In May 2007, UTStarcom filed an additional complaint against the Company and a number of its employees and former employees in the United States District Court for the Northern District of Illinois alleging violations of the Illinois trade secrets act, infringement of five patents assigned to UTStarcom, intentional interference with UTStarcom s business relations and declarations of ownership relating to one of the Company s patents and three of its patent applications. The complaint contains allegations, among others, that a number of former employees of a business unit UTStarcom acquired, who subsequently worked for the Company, took UTStarcom s trade secrets with them and improperly used those trade secrets to develop, manufacture and market the Company s 3G wireless products, and that such products incorporate various UTStarcom confidential technical information, including UTStarcom s proprietary virtual private network and EV-DO features. UTStarcom further alleges that the Company has disclosed UTStarcom s trade secrets in one of its patents and three of its patent applications, and that this patent and these patent applications legally belong to UTStarcom based on the inventors previous work at the business unit acquired by UTStarcom. In August 2007, the Company and the current and former employee defendants filed their answers to the complaint. The Company also filed counterclaims for tortious interference with prospective economic advantage, malicious prosecution, a declaration that the patents-in-suit are invalid and not infringed, and a declaration that one of the patents-in-suit is unenforceable due to inequitable conduct. In December 2007, UTStarcom filed an amendment to the complaint, which added new claims for declaration of ownership of four more of the Company s patent applications, copyright infringement, breach of restrictive covenants against the employee and former employee defendants, and aiding and abetting the employee and former employee defendants breaches of the duty of loyalty and the employment agreements. The amendment to the complaint also added another employee as a defendant. On January 4, 2008, the Company filed a motion to dismiss, or in the alternative for a more definite statement regarding, the trade secret, copyright, breaches of restrictive covenants, and aiding and abetting claims of the amendment to the complaint. UTStarcom filed its opposition to this motion on January 22, 2008, and the Company filed its reply on January 29, 2008. On May 20, 2008 the Court granted the Company s motion, in-part, and ordered UTStarcom to provide a more definite statement of its claims. On May 30, 2008, UTStarcom filed a Third Amended Complaint. On June 9, 2008, the Company moved to dismiss the trade secret, copyright, breaches of restrictive covenants, and aiding and abetting claims (Counts I, VI, and VIII-XV) of the Third Amended Complaint, for failure to comply with the Court s Order to provide a more definite statement of those claims. On July 23, 2008, the Court granted the Company s motion and dismissed those claims. On August 1, 2008, UTStarcom filed a Motion for Leave to Amend the Complaint to Provide a More Definite Statement and Clarification of the 7/23 Order. Following dismissal of the claims, UTStarcom s patent infringement and declaration of ownership claims remain. Discovery is proceeding. No trial date has been set. In this lawsuit, UTStarcom seeks unspecified monetary damages, punitive damages, injunctive relief, declarations of ownership relating to the specified patent and patent applications owned by the Company, findings of misappropriation of trade secrets, patent infringement and copyright infringement, costs and attorneys fees. The Company believes it has meritorious defenses to each of UTStarcom s claims in this lawsuit and it is prepared to vigorously defend the lawsuit.

In addition, the Company is subject to other legal proceedings, claims and litigation arising in the ordinary course of business. Defending lawsuits requires significant management attention and financial resources and the outcome of any litigation, including the matters described above, is inherently uncertain. The Company does not, however, currently expect that the ultimate costs to resolve pending matters will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

8. Business Segments

SFAS 131, *Disclosures About Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments in annual financial statements and requires selected information of segments to be presented in financial reports issued to stockholders. Operating segments are defined as components of an enterprise about which separate financial information is available and that is

evaluated regularly by the chief operating decision maker, or decision making group, in determining how to allocate resources and assess performance. The Company s chief operating decision maker, as defined under SFAS 131, is the chief executive officer. The Company views its operations and manages its business as one operating segment.

Revenue by geography is based on the billing address of the customer. The following tables set forth revenue and long-lived assets by geographic area (in thousands):

Revenues

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	**2007**	**2008**	**2007**
United States and Canada	$ 55,707	$ 16,317	$ 109,642	$ 36,936
Japan	3,999	12,828	5,139	13,524
Korea	1,111	539	2,074	6,273
Rest of world	351	1,170	541	1,763
Total	$ 61,168	$ 30,854	$ 117,396	$ 58,496

Table of Contents

Long-lived Assets

	June 30, 2008	December 31, 2007
United States	$ 19,050	$ 15,614
India	7,216	4,676
Rest of world	354	162
Total	$ 26,620	$ 20,452

9. Comprehensive Income

Comprehensive income consists of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income	$ 13,776	$ 3,381	$ 23,429	$ 5,686
Change in unrealized loss on short-term investments	(5)	(3)	(2)	(8)
Comprehensive income	$ 13,771	$ 3,378	$ 23,427	$ 5,678

10. Recent Accounting Pronouncements

The Company adopted the provisions of SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115,* on January 1, 2008. SFAS 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the fair value option). Under this pronouncement, a business entity must report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. The Company has not elected the fair value option for any items on its balance sheet.

In June 2008, the FASB issued FASB Staff Position (FSP) EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.* This FSP provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. This FSP will be effective for the Company on January 1, 2009. The Company has not yet determined the impact, if any, of this FSP on its consolidated financial statements.

In May 2008, the FASB released SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles.* SFAS 162 establishes the GAAP hierarchy and identifies the sources of accounting principles and the framework for selecting principles used in the preparation of financial statements. SFAS 162 is effective 60 days following the Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles.* The Company has not yet determined the impact, if any, of this statement on its consolidated financial statements.

In December 2007, the FASB released SFAS 141 (revised 2007), *Business Combinations*. This statement will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in process research and development and restructuring costs. In addition, under this statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. This statement will be effective for the Company on January 1, 2009 and will change its accounting treatment for business combinations on a prospective basis.

In December 2007, the FASB released SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. This statement will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. This statement will be effective for the Company on January 1, 2009. The Company has not yet determined the impact, if any, of this statement on its consolidated financial statements.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement

This Quarterly Report on Form 10-Q, including the information incorporated by reference herein, contains, in addition to historical information, forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based on our current expectations, assumptions, estimates and projections regarding our business and industry, and we do not undertake an obligation to update our forward-looking statements to reflect future events or circumstances. We may, in some cases, use words such as project, believe, anticipate, plan, expect, estimate, intend, continue, should, would, could, potentially, will, may or similar words and expressions that convey uncertainty of future events or outcomes to identify these forward-looking statements. Forward-looking statements in this Quarterly Report on Form 10-Q may include statements about:

- *our ability to attract and retain customers;*
- *our financial performance;*
- *our development activities;*
- *the advantages of our technology as compared to that of others;*
- *our ability to establish and maintain intellectual property rights;*
- *our ability to retain and hire necessary employees and appropriately staff our operations;*
- *the spending of our proceeds from public offerings of our common stock; and*
- *our cash needs.*

The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties and other factors, including the factors set forth in Part II Item 1A Risk Factors in this Quarterly Report on Form 10-Q, that could cause actual results to differ materially from the results anticipated by these forward-looking statements. You should read these factors and the risks described in other documents that we file from time to time with the SEC in conjunction with the unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2007.

Overview

Starent Networks is a leading provider of infrastructure hardware and software products and services that enable mobile operators to deliver multimedia services to their subscribers. We have created hardware and software products that provide network functions and services, including access from a wide range of radio networks to the operator s packet core network. Our products and services also provide management of subscriber sessions moving between networks and application of billing and other session policies. Our products and services provide high performance and system intelligence by combining significant computing power, memory and traffic handling capabilities with a flexible, high availability operating system and other proprietary software. Our products 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.

Our products consist of both hardware and software and can be configured to meet a number of customer needs. We sell our products and services to mobile operators around the world both directly and indirectly through our relationships with original equipment manufacturers, or OEMs, system integrators and distributors.

In June 2007, we completed an initial public offering of our common stock in which we sold and issued 10,580,226 shares of our common stock at a price of $12.00 per share. We raised a total of $127.0 million in gross proceeds from the initial public offering, or $116.0 million in net proceeds after deducting underwriting discounts and commissions of $8.9 million and other offering expenses of approximately $2.1 million. In connection with the initial public offering, all outstanding shares of our convertible preferred stock automatically converted into an aggregate of 44,287,985 shares of our common stock.

In November 2007, we completed an underwritten public offering of 8,000,000 shares of our common stock at a price to the

Table of Contents

public of $24.00 per share. We received total net proceeds from the November 2007 public offering of approximately $88.1 million, after deducting underwriting discounts and commissions and estimated offering expenses.

We maintain our corporate headquarters in Tewksbury, Massachusetts, and have sales and development offices in various locations worldwide. We conduct our research and development activities at two locations in India and two locations in the United States. As of June 30, 2008, we had 676 employees worldwide. Our revenues for the year ended December 31, 2007 were $145.8 million, and $61.2 million and $117.4 million for the three and six months ended June 30, 2008, respectively. Our net income for the year ended December 31, 2007 was $11.5 million, and $13.8 million and $23.4 million for the three and six months ended June 30, 2008, respectively.

Revenues

Our revenues consist of both product revenues and service revenues. We derive product revenues from the sale of our hardware products and the licensing of our software. Service revenues are generated from:

- maintenance and technical support associated with our software;

- hardware repair and maintenance services; and

- implementation, training and professional services.

We recognize revenue in accordance with Statement of Position, or SOP, 97-2, *Software Revenue Recognition* and SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*. Accordingly, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collection is probable.

Mobile operators can purchase our products and license our software in various configurations, depending on their requirements for capacity, features and protocols. Typically, a mobile operator purchases a small amount of equipment for testing and trial purposes and, once testing is complete, purchases the necessary products to meet their initial capacity and feature requirements. As their capacity requirements increase, operators may purchase additional hardware or license additional software. The level of our sales is significantly influenced by the extent to which mobile operators make capital investments to enhance and expand their networks to provide multimedia services. Mobile operators capital investments will be influenced by the demand for multimedia services by their customers.

We offer our products and services through our direct sales force to mobile operators and indirectly through relationships with OEMs, system integrators and distributors. The OEMs, system integrators and distributors generally purchase our products after they have received a purchase order from their customers and do not maintain an inventory of our products in anticipation of sales to their customers.

In 2004, we entered into OEM agreements with Nortel Networks relating to the CDMA and GSM/UMTS markets. Sales to Nortel Networks, all of which were made under the CDMA agreement, accounted for more than 40% of our revenues in 2006. In December 2006, we terminated both OEM agreements. Under the terms of the CDMA agreement, Nortel Networks has a right to continue to purchase our CDMA products for delivery through December 2008. Although the termination of the CDMA agreement could disrupt our relationships with CDMA mobile operators formerly serviced by Nortel Networks, we have established and will continue to seek to establish additional direct sales relationships with some of the CDMA operators formerly serviced by Nortel Networks. In addition, in May 2008, we established a new reseller relationship with Nortel Networks. As a result, we do not believe that the termination of the Nortel Networks OEM agreements will significantly impact our revenues.

We believe our revenues will vary significantly from period-to-period as a result of the following:

• *Fluctuations in the timing of customer orders.* Mobile operators require significant lead times to incorporate changes and enhancements into their networks to ensure the various network components are interoperable. These lead times and interoperability testing requirements result in an extended sales cycle and can lead to uneven purchasing patterns. In addition, our reliance on a relatively small number of customers contributes to the variability of our revenues.

• *The timing of revenue recognition in relation to the shipment of products.* Our products contain software which is not incidental to our products. Therefore, we recognize revenue pursuant to the requirements of SOP 97-2. Those requirements often cause us to defer recognition of revenue for a significant period of time after shipment, as a consequence of certain features of our customer arrangements (such as customer acceptance provisions) as well as the requirement that we establish company-specific evidence of the fair values of our products and services.

The variability of our revenues directly impacts our operating performance in any particular period since a significant portion of

Table of Contents

our operating costs, such as personnel costs, depreciation expense and sales commissions, are either fixed in the short-term or may not vary proportionately with recorded revenues.

Cost of Revenues

Cost of revenues consists of costs of products sold and services provided. Cost of products consists primarily of payments to a third party manufacturer for purchased materials and services and internal costs, such as salaries and benefits related to personnel, provision for inventory obsolescence and related overhead. The use of an outsourced manufacturer enables us to conserve working capital, adjust to fluctuations in demand and provide for timely delivery to our customers. Cost of services consists primarily of salaries and benefits related to professional services and technical support personnel, product repair costs, depreciation and related overhead.

Gross Profit

Our gross profit has been, and will be, affected by many factors, including the demand for our products and services, the average selling price of our products, which in turn depends on the mix of product configurations sold, new product introductions, the region of the world in which our customers are located and the volume and costs of manufacturing our hardware products.

Operating Expenses

Our operating expenses consist primarily of personnel costs, including salaries, commissions, bonuses, share-based compensation and related benefits and taxes; prototype costs related to the design and development of new products and enhancement of existing products; and consulting, travel and depreciation expenses. The expenses are classified into the following categories for reporting purposes: research and development, sales and marketing and general and administrative. The following is a brief description of the key types of expenses in each of these categories:

• Research and development expense consists primarily of personnel costs, prototype costs, consulting services and depreciation. Research and development activities, including hardware and software development and quality assurance testing, primarily occur at two locations in the United States and two locations in India.

• Sales and marketing expense consists primarily of personnel costs, travel and marketing programs such as trade shows. Commissions are a significant component of our sales personnel costs and are recorded as expense when earned, which is not necessarily directly proportionate to the amount of revenues recorded.

• General and administrative expense consists primarily of personnel costs related to our executive, finance, human resource and information technology organizations, professional fees, insurance and other related overhead.

Other Income (Expense)

Other income (expense) primarily consists of interest income earned on cash and short-term investments. We have historically invested our cash in money market funds and other short-term, high-grade investments.

Other income (expense) also includes gains (losses) from foreign currency transactions of our foreign subsidiaries. The functional currency of our foreign operations is the U.S. dollar. Accordingly, all assets and liabilities, except certain long-term assets, of these international subsidiaries are remeasured into U.S. dollars using the exchange rates in effect at the balance sheet date. Revenues and expenses of these international subsidiaries are generally remeasured into U.S. dollars at the average rates in effect during the year.

Application of Critical Accounting Policies and Use of Estimates

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements and related disclosures require us to make estimates, assumptions and judgments that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ significantly from these estimates under different assumptions or conditions.

We believe that of our significant accounting policies, which are described in note 2 to the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2007, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, we believe these are the most critical to fully understand and evaluate our financial condition and results of operations.

Table of Contents

Revenue Recognition

Generally, our revenues are generated through fulfillment of contractual arrangements that contain multiple elements, including equipment with embedded software and services, such as installation, training, consulting and maintenance and support, or M&S. We recognize revenue in accordance with SOP 97-2 and SOP 98-9. Accordingly, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collection is probable. Certain of these requirements, most notably the customer acceptance terms generally included in our contracts and our need to establish fair values of our products and services based on facts specific to our operations, are critical to the timing and extent of our revenue recognition. As a result of these factors, a significant majority of our contractual arrangements result in the deferral of revenue and the time period for deferral may be significant. In addition, in certain circumstances, pricing considerations must be assessed to determine whether the price is fixed or determinable.

Product revenues consist of revenues from sales of our hardware and licensing of our software. Product sales generally include a perpetual license to our software. Product revenues are generally recognized at shipment or upon customer acceptance, if contractually required, assuming all other revenue recognition criteria are met. Substantially all of our products have been sold in conjunction with product support services, which consist of software updates and product support. Software updates provide customers with rights to unspecified software product upgrades and to maintenance releases and patches released during the term of the support period. Revenues for support services are recognized on a straight-line basis over the service contract term, which is generally 12 to 15 months.

Pursuant to SOP 97-2, revenue is allocated to deliverables based on vendor specific objective evidence of fair value, or VSOE, when VSOE exists. Generally, all revenue for an arrangement is initially deferred when VSOE does not exist for any undelivered element and is subsequently recognized ratably over the contractual M&S period when M&S is the only undelivered element. If VSOE exists for the undelivered elements, but not the delivered elements, revenue is recognized under the residual method set forth in SOP 98-9, which provides that revenue is recognized based on the difference between the total arrangement fee and the VSOE of the undelivered elements. Revenue for the undelivered elements is then recorded as those elements are delivered. When we defer revenue in an arrangement, the related product costs are also deferred, subject to their realizability, and recognized in or over the same period as the related revenue.

The determination of VSOE is highly judgmental and is a key factor in determining whether revenue may be recognized or must be deferred and the extent to which it may be recognized once the various elements of an arrangement are delivered. We assess VSOE based on previous sales of products and services, the type and size of customer, renewal rates in contracts and the geographic location of the customer. We monitor VSOE on an ongoing basis. As noted above, most of our arrangements include multiple elements, some of which are delivered in or over future periods. Therefore, a change in our assessment of, or our inability to establish, VSOE for products or services may result in significant variation in our revenues and operating results.

In arrangements where cash consideration is paid to a customer, the payments are recorded in accordance with Emerging Issues Task Force, or EITF, 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*, which generally requires the consideration be recorded as a reduction of revenues.

Share-Based Compensation

Prior to January 1, 2006, we accounted for our stock-based awards to employees using the intrinsic value method prescribed in Accounting Principles Board, or APB, Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations. Under the intrinsic value method, compensation expense is measured on the date of the grant as the difference between the deemed fair value of our common stock and the exercise or purchase price multiplied by the number of stock options or restricted stock awards granted. In addition, through December 31, 2005, we accounted for share-based compensation expense for non-employees using the fair value method prescribed by Statement of Financial Accounting Standards, or SFAS, 123, *Accounting for Stock-Based Compensation,* applying the Black-Scholes option-pricing model, and recorded the fair value, for financial reporting purposes, of non-employee stock options as an expense over either the vesting term of the option or the service period.

In December 2004, the Financial Accounting Standards Board, or FASB, issued SFAS 123R, *Share-Based Payment*, which requires companies to expense the fair value of employee stock options and other forms of share-based compensation. We adopted SFAS 123R effective January 1, 2006. SFAS 123R requires nonpublic companies that used the minimum value method in SFAS 123 for either recognition or pro forma disclosures to apply SFAS 123R using the prospective-transition method. As such, we will continue to apply APB Opinion 25 in future periods to equity awards outstanding prior to the date of our adoption of SFAS 123R. In accordance with SFAS 123R, we will recognize the compensation cost of share-based awards on a graded-vesting basis over the vesting period of the award. Effective with the adoption of SFAS 123R, we elected to use the Black-Scholes option pricing model to determine the weighted average fair value of stock options granted or modified.

Since January 1, 2006, we account for equity instruments issued to nonemployees in accordance with the provisions of SFAS 123R (the requirements of which are consistent with those previously utilized under SFAS 123) and EITF Issue 96-18,

Table of Contents

Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services .

Several key assumptions are made in determining the grant date fair value of our stock options, including: the grant date market value of our common stock, the rate of volatility, the risk-free interest rate and the rate of expected forfeitures. As there was no public market for our common stock prior to our initial public offering, the determination of the fair market value of our common stock was determined by our board of directors. Due to the limited trading history of our common stock, we have determined the volatility for options granted after January 1, 2006 based on an analysis of reported data for a peer group of companies that issued options with substantially similar terms. The expected volatility of options granted has been determined using an average of the historical volatility measures of this peer group of companies. The expected life of options has been determined utilizing the simplified method as prescribed by the SEC s Staff Accounting Bulletin No. 110, *Share-Based Payment*, resulting in an expected life for the three and six months ended June 30, 2008 and 2007 of 6.25 years. The risk-free interest rate is based on a U.S. treasury instrument whose term is consistent with the expected life of the stock options. We have not paid, and do not anticipate paying, cash dividends on our shares of common stock; therefore, the expected dividend yield was assumed to be zero. In addition, SFAS 123R requires companies to utilize an estimated forfeiture rate when calculating the expense for the period. As a result, we applied an estimated forfeiture rate of 3%, based on a review of our historical forfeitures, to determine the expense recorded in our consolidated statements of operations. Significant changes in these assumptions, especially the expected life of options, forfeiture rate and volatility could have a significant impact on our results of operations.

For the three and six months ended June 30, 2008, we recorded expense of $4.5 million and $7.9 million in connection with share-based awards. As of June 30, 2008, we had $24.3 million of unrecognized expense related to non-vested options that is expected to be recognized over a weighted average period of 1.6 years.

Inventory

We carry our inventory at the lower of historical cost or net realizable value assuming inventory items are consumed on a first-in, first-out basis. We recognize inventory losses based on obsolescence and levels in excess of forecasted demand. In these cases, inventory is written down to estimated realizable value based on historical usage and expected demand. Inherent in our estimates of market value in determining inventory valuation are estimates related to economic trends, future demand for our products and technical obsolescence of our products. If future demand or market conditions are less favorable than our projections, additional inventory write-downs could be required and would be reflected in the cost of revenues in the period the revision is made. To date, we have not been required to revise any of our assumptions or estimates used to determine our inventory valuations.

When products have been delivered, but the product revenues associated with the arrangement have been deferred as a result of not meeting the revenue recognition criteria required by SOP 97-2, we defer the related inventory costs for the delivered items.

Income Taxes

We are subject to income taxes in both the United States and foreign jurisdictions and we use estimates in determining our provisions for income taxes. We account for income taxes in accordance with SFAS 109, *Accounting for Income Taxes*, which is the asset and liability method for accounting and reporting for income taxes. Under SFAS 109, deferred tax assets and liabilities are recognized based on temporary differences

between the financial reporting and income tax bases of assets and liabilities using statutory rates. We provide for income taxes during interim periods based on the estimated effective tax rate for the full fiscal year, and record a cumulative adjustment to the tax provision in an interim period in which a change in the estimated annual effective tax rate is determined.

For the three and six months ended June 30, 2008, our effective tax rates were 8.9% and 7.1%, respectively. For the three and six months ended June 30, 2007, our effective tax rates were 4.6% and 6.7%, respectively. Those effective tax rates were lower than the statutory federal income tax rate of 35% due primarily to our use of net operating loss carryforwards, or NOLs, to offset our U.S. taxable income (which reduced the valuation allowance we had previously recorded against those NOLs), partially offset by the impact of taxes owed in relation to the income generated by our foreign subsidiaries.

As of June 30, 2008, a full valuation allowance was recorded against our net deferred tax assets in the U.S. As of December 31, 2007, we had U.S. federal NOL carryforwards of $27.6 million, state NOL carryforwards of $28.0 million, U.S. federal tax credits of $4.4 million, and state research and development credits of $0.6 million. Management judgment is required to determine when the realization of our deferred tax assets in the future is considered more likely than not. While we have realized operating profits over the past three years and in the first six months of 2008, those profits of the prior years have been marginal in relation to the size of our total deferred tax assets, which could increase in size based upon future stock option exercises by our employees. Accordingly, we have not yet concluded that realization of our U.S. deferred tax assets in the future is more likely than not. For the remainder of 2008, we will continue to review our operating results to determine if it becomes more likely than not that our deferred tax assets will be realized in the future, at which time we would reduce some or all of the valuation allowance. It is reasonably possible that this

Table of Contents

determination could occur later in 2008 or early 2009. Any reduction in our valuation allowance in the future would result in an income tax benefit and higher stockholders equity in the period such determination is made and could have a negative impact on our reported net income in future fiscal years as we would expect to begin recording a higher provision for income taxes. Any reduction in our valuation allowance would not impact our cash flows.

Income tax expense related to our international subsidiaries generally results from taxable income generated by the subsidiary pursuant to intercompany service agreements. We believe the compensation associated with these service agreements is reasonable in light of the level and nature of services performed by our subsidiaries. However, if a foreign tax jurisdiction or the Internal Revenue Service were to challenge these arrangements, we could be subject to additional income tax expense either in the United States or the foreign jurisdiction.

On January 1, 2007, we adopted the provisions of FASB Interpretation, or FIN, No. 48, *Accounting for Uncertainty in Income Taxes*, *an interpretation of SFAS 109*. The new standard defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authorities based solely on the technical merits of the position. If the recognition threshold is met, the tax benefit is measured and recognized as the largest amount of tax benefit, in our judgment, which is greater than 50% likely to be realized. We did not recognize any change in our reserves for uncertain tax positions as a result of the adoption of this standard. At the adoption date of January 1, 2007, we had approximately $0.1 million of unrecognized tax benefits, the benefit of which, if recognized, would favorably affect the income tax rate in future periods. At June 30, 2008, we had a liability of approximately $0.3 million related to unrecognized tax benefits.

We recognize interest and penalties related to uncertain tax positions in income tax expense. Upon our adoption of FIN 48 and at June 30, 2008, we had an immaterial amount of accrued interest and penalties associated with our uncertain tax positions.

We have accumulated significant losses from our inception in August 2000. Since the net operating losses may potentially be utilized in future years to reduce taxable income, all of our tax years remain open to examination by the major taxing jurisdictions to which we are subject.

Research and Development Expense

Research and development expense includes costs incurred to develop intellectual property. Research and development costs are charged to operations as incurred. The costs to develop new software and substantial enhancements to existing software are expensed as incurred until technological feasibility has been established, at which time any additional costs would be capitalized. We have determined technological feasibility is established at the time a working model of software is completed. The time period during which costs could be capitalized, from the point of reaching technological feasibility until the time of general product release, is short. Consequently, the amounts that could be capitalized are not material to our financial position or results of operations and therefore have been charged to expense as incurred.

Results of Operations

Revenues

The following table sets forth our revenues by type and geographic location of our customers.

	Three Months Ended June 30,					
	2008		2007		Period-to-Period Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	Percentage
	(dollars in thousands)					
Revenues:						
Product	$ 52,160	85%	$ 25,121	81%	$ 27,039	108%
Service	9,008	15	5,733	19	3,275	57
Total revenues	$ 61,168	100%	$ 30,854	100%	$ 30,314	98%
Revenues by Customer Type:						
Direct	$ 55,604	91%	$ 11,111	36%	$ 44,493	400%
Indirect	5,564	9	19,743	64	(14,179)	(72)
Total revenues	$ 61,168	100%	$ 30,854	100%	$ 30,314	98%
Revenues by Geography:						
United States and Canada	$ 55,707	91%	$ 16,317	53%	$ 39,390	241%
Japan	3,999	7	12,828	42	(8,829)	(69)
Korea	1,111	2	539	2	572	106
Rest of world	351		1,170	3	(819)	(70)
Total revenues	$ 61,168	100%	$ 30,854	100%	$ 30,314	98%

Table of Contents

Revenues increased $30.3 million, or 98%, in the quarter ended June 30, 2008 compared to the same quarter in 2007, primarily due to increased product revenues of $27.0 million. Product revenues increased primarily due to product shipments in the United States and Canada for which we received customer acceptances and recognized revenue in the second quarter of 2008 versus the same period of 2007 and to a lesser extent due to the higher sales price of our ST40 platform as compared to our ST16 platform. Japan revenues decreased $8.8 million, or 69%, in the quarter ended June 30, 2008 compared to the same quarter in 2007, primarily due to lower acceptances received in the current quarter due to the timing of product and software delivery.

The $3.3 million increase in service revenues in the second quarter of 2008 compared to the same period in 2007 was due to an increased amount of our products installed at mobile operators, which is generally the basis of maintenance and service fees, as compared to the same period in 2007.

Indirect revenue decreased in the second quarter of 2008 compared to the second quarter of 2007 due primarily to the conversion of indirect customers formerly serviced by Nortel Networks to direct sales relationships.

	Six Months Ended June 30,					
	2008		2007		Period-to-Period Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	Percentage
	(dollars in thousands)					
Revenues:						
Product	$ 101,047	86%	$ 49,573	85%	$ 51,474	104%
Service	16,349	14	8,923	15	7,426	83
Total revenues	$ 117,396	100%	$ 58,496	100%	$ 58,900	101%
Revenues by Type:						
Direct	$ 109,322	93%	$ 29,094	50%	$ 80,228	276%
Indirect	8,074	7	29,402	50	(21,328)	(73)
Total revenues	$ 117,396	100%	$ 58,496	100%	$ 58,900	101%
Revenues by Geography:						
United States and Canada	$ 109,642	93%	$ 36,936	63%	$ 72,706	197%
Japan	5,139	4	13,524	23	(8,385)	(62)
Korea	2,074	2	6,273	11	(4,199)	(67)
Rest of world	541		1,763	3	(1,222)	(69)
Total revenues	$ 117,396	100%	$ 58,496	100%	$ 58,900	101%

Revenues increased $58.9 million, or 101%, in the six months ended June 30, 2008 as compared to the same period in 2007, primarily due to increased product sales to existing customers. Product revenues, which include hardware and software sales, increased $51.5 million in the first half of 2008 as compared to the same period in 2007 due primarily to increased sales to major mobile operators in the United States and Canada. The increase in revenues was partially offset by the decrease in revenues in Korea, related primarily to the recognition of approximately $5.5 million due to the delivery of specific software functionality during the first quarter of 2007 and decreased revenues in Japan, as discussed above.

Table of Contents

Cost of Revenues and Gross Profit

	Three Months Ended June 30,					
	2008		2007		Period-to-Period Change	
	Amount	% of Related Revenues	Amount	% of Related Revenues	Amount	Percentage
	(dollars in thousands)					
Cost of revenues:						
Product	$ 9,497	18%	$ 6,316	25%	$ 3,181	50%
Services	3,806	42	1,942	34	1,864	96
Total cost of revenues	$ 13,303	22%	$ 8,258	27%	$ 5,045	61%
Gross Profit:						
Product	$ 42,663	82%	$ 18,805	75%	$ 23,858	127%
Services	5,202	58	3,791	66	1,411	37
Total gross profit	$ 47,865	78%	$ 22,596	73%	$ 25,269	112%

Product gross margin increased 7 percentage points to 82% in the second quarter of 2008 as compared to the same period in 2007. Both periods included higher levels of software-only transactions, resulting in gross margins higher than our historical amounts. We anticipate that our gross margins will decrease somewhat in subsequent quarters of 2008 based on the anticipated mix of products sold.

During the second quarter of 2008, the $1.9 million increase in cost of services was primarily due to higher personnel and overhead costs associated with additional customer support and training personnel that were added since the second quarter of 2007. We anticipate cost of services will increase in future periods as we continue to expand our customer support organization geographically during the remainder of 2008.

	Six Months Ended June 30,					
	2008		2007		Period-to-Period Change	
	Amount	% of Related Revenues	Amount	% of Related Revenues	Amount	Percentage
	(dollars in thousands)					
Cost of revenues:						
Product	$ 18,546	18%	$ 10,754	22%	$ 7,792	72%
Services	7,716	47	3,329	37	4,387	132
Total cost of revenues	$ 26,262	22%	$ 14,083	24%	$ 12,179	86%
Gross Profit:						
Product	$ 82,501	82%	$ 38,819	78%	$ 43,682	113%
Services	8,633	53	5,594	63	3,039	54
Total gross profit	$ 91,134	78%	$ 44,413	76%	$ 46,721	105%

Product gross margin increased 4 percentage points as a percentage of revenue in the first six months of 2008 as compared to the same period in 2007 due primarily to a higher proportion of software revenue and to a lesser extent the higher average sales price of our ST40.

The $4.4 million increase in cost of services was primarily due to higher personnel costs, depreciation expense and overhead costs associated with additional customer support and training personnel that were added during 2008 and in the second half of 2007. We anticipate cost of services will increase in future periods as we continue to increase the number of customer support personnel we employ and continue to expand our customer support testing facilities.

Gross profit on services increased 54% during the first six months of 2008 as a result of the increase in our installed base though the increase was at a lower rate than the growth in service revenue due to the increased costs of services described above.

We believe our overall gross margin for the remainder of 2008 will decrease somewhat from the 78% achieved in the first half of 2008, as we expect to incur implementation costs related to installations of our solutions at new customers during the second half of 2008.

Table of Contents

Operating Expenses

	Three Months Ended June 30,					
	2008		2007		Period-to-Period Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	Percentage
	(dollars in thousands)					
Research and development	$ 12,500	20%	$ 7,585	25%	$ 4,915	65%
Sales and marketing	16,173	26	8,867	29	7,306	82
General and administrative	5,931	10	3,398	11	2,533	75
Total operating expenses	$ 34,604	57%	$ 19,850	64%	$ 14,754	74%

	Six Months Ended June 30,					
	2008		2007		Period-to-Period Change	
	Amount	% of Revenues	Amount	% of Revenues	Amount	Percentage
	(dollars in thousands)					
Research and development	$ 24,843	21%	$ 17,651	30%	$ 7,192	41%
Sales and marketing	35,024	30	15,936	27	19,088	120
General and administrative	11,087	9	6,242	11	4,845	78
Total operating expenses	$ 70,954	60%	$ 39,829	68%	$ 31,125	78%

Personnel Costs. Personnel costs are our largest expense, representing 62% and 64% of our total operating expenses for the three and six months ended June 30, 2008. These costs consist of cash and stock components. The cash component of compensation included in each expense category is set forth below.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
	(dollars in thousands)					
Research and development	$ 6,053	$ 4,890	$ 1,163	$ 12,584	$ 9,468	$ 3,116
Sales and marketing	9,507	5,471	4,036	22,045	9,535	12,510
General and administrative	1,799	1,305	494	3,664	2,266	1,398
Total cash-based compensation in operating expenses	$ 17,359	$ 11,666	$ 5,693	$ 38,293	$ 21,269	$ 17,024

The increase in personnel costs above were due primarily to a higher number of employees and higher sales commissions in the three and six months ended June 30, 2008 compared to the same periods of 2007. We added 175 employees since June 30, 2007, 106 in research and development, 15 in sales and marketing, 30 in support, 18 in general and administrative and the remainder in operations, resulting in total employees of 676 at June 30, 2008. The increase in commissions was due to our high sales volume in the latter half of 2007 for which commissions were earned during the first half of 2008 and those commissions being at a higher rate in 2008 than in 2007. We anticipate sales commissions as a percentage of revenues to decrease in subsequent periods of 2008.

In addition to cash compensation, we grant equity instruments to our employees, resulting in the recognition of share-based compensation in accordance with SFAS 123R, which is a significant portion of our personnel costs. The share-based compensation included in each expense category is set forth below.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2008	2007	Change	2008	2007	Change
	(dollars in thousands)					
Research and development	$ 1,803	$ 1,660	$ 143	$ 3,107	$ 2,141	$ 966
Sales and marketing	1,366	644	722	2,293	993	1,300
General and administrative	968	847	121	1,794	1,422	372
Total share-based compensation in operating expenses	$ 4,137	$ 3,151	$ 986	$ 7,194	$ 4,556	$ 2,638

These charges amounted to 7% and 6% of revenues for the three and six months ended June 30, 2008, respectively. The increase in the share-based compensation expense in the 2008 period as compared to the same period of 2007 was due primarily to the increase in the fair value of our common stock at the time the share-based awards were granted and our higher number of employees.

Research and development. Research and development expenses increased $4.9 million, or 65%, in the second quarter of 2008

Table of Contents

compared to the same quarter in 2007. The increase was due to increases in cash and share-based compensation of $1.2 million and $0.1 million, respectively, higher depreciation expense of $1.4 million, higher consulting expense of $0.6 million and a $1.2 million decrease related to reimbursements for non-recurring engineering projects which are recorded as a reduction of operating expense, partially offset by lower prototype and related equipment expenses of $0.1 million. Research and development expenses increased $7.2 million, or 41%, for the six months ended June 30, 2008 compared to the same period in 2007. The increase was due to increases in cash and share-based compensation of $3.1 million and $1.0 million, respectively, higher depreciation expense of $2.5 million, higher consulting expense of $1.0 million and a $1.2 million decrease related to reimbursements for non-recurring engineering projects referred to above, partially offset by lower prototype and related equipment expenses of $2.6 million.

We intend to continue to invest significantly in our research and development efforts, which we believe are essential to maintaining our competitive position. Accordingly, we anticipate personnel costs and depreciation expense will increase during the remainder of 2008 as we continue to add product development and quality assurance personnel and to increase our test lab facilities.

Sales and marketing. Sales and marketing expenses increased $7.3 million, or 82%, in the second quarter of 2008 as compared to the same period in 2007 and decreased as a percentage of revenues. This increase was due primarily to higher cash compensation of $4.0 million and share-based compensation of $0.7 million, discussed above, consulting expense of $1.0 million and travel expenses of $0.3 million. Sales and marketing expenses increased $19.1 million, or 120%, for the six months ended June 30, 2008 as compared to the same period in 2007 and increased as a percentage of revenues. This increase was due primarily to higher cash compensation of $12.5 million and share-based compensation of $1.3 million, discussed above, consulting expense of $2.1 million and travel expenses of $0.7 million. Consulting expenses increased due to arrangements we have with third party consultants whose fees are earned as we receive orders from specific customers, and the increase in travel expense was due primarily to our employee additions.

We anticipate continuing to increase the number of sales and marketing personnel we employ in future periods to expand our geographic presence, to address specific customer opportunities and to increase our revenues. The commission portion of sales personnel costs may vary significantly if our customer orders differ materially from the quotas established for our sales personnel. In addition, we expect to continue to incur additional expenses such as demonstration and interoperability testing associated with our ST40 platform in existing and new markets.

General and administrative. General and administrative expenses increased $2.5 million, or 75%, in the second quarter of 2008 as compared to the same period in 2007 due primarily to higher cash compensation of $0.5 million and share-based compensation of $0.1 million, discussed above, and professional fees of $1.7 million. General and administrative expenses increased $4.8 million, or 78%, for the six months ended June 30, 2008 as compared to the same period in 2007 due primarily to higher cash compensation of $1.4 million and share-based compensation of $0.4 million, discussed above, and professional fees of $2.6 million. The increase in professional fees was due primarily to costs associated with our defense in the UTStarcom litigation.

We expect general and administrative expense to increase in future periods as we invest in infrastructure to support continued growth and incur additional costs related to operating as a publicly traded company, including increased audit and legal fees, costs of compliance with securities and other regulations, investor relations and higher insurance premiums. In addition, we expect to continue to incur costs associated with patent

litigation discussed in Part II Item 1 Legal Proceedings .

Interest income. Interest income consisted of income generated from the investment of our cash balances and short-term investments. Interest income increased $1.1 million and $2.7 million for the three and six months ended June 30, 2008, respectively, due to higher average cash and investment balances in the first half of 2008 partially offset by lower rates of return as compared to the same periods in 2007. The increase in our cash and short-term investment balances was due primarily to the receipt of approximately $204.1 million of net proceeds from public offerings of our common stock in 2007 and cash generated from operations.

Income tax expense. For the three and six months ended June 30, 2008, we recorded income tax expense of $1.3 million and $1.8 million, respectively, compared to $0.2 million and $0.4 million in the same periods of 2007. The increase in the 2008 period was due primarily to our higher level of income. We anticipate that we will be subject to state and foreign income taxes and federal alternative minimum tax for 2008. We have significant net operating loss carryforwards and other deferred tax assets, but have applied a full valuation allowance to them due to the uncertainty surrounding the timing and extent of realization of these tax attributes. We continually assess the level of valuation allowance required and should more positive than negative evidence regarding the realizability of these tax attributes exist at a future point in time, the valuation allowance may be reduced or eliminated altogether. Reduction of the valuation allowance, in whole or in part, would result in a non-cash reduction in income tax expense during the period of reduction. It is reasonably possible that this determination could occur later in 2008 or early 2009.

Foreign Currency Exchange Gain (Losses). For the three months ended June 30, 2008, we recorded foreign currency losses of $148,000, compared to a foreign currency loss of $91,000 in the same period of 2007. For the six months ended June 30, 2008, we recorded foreign currency gains of $751,000, compared to a foreign currency loss of $89,000 in the same period of 2007. The difference in the 2008 period was due to an increase in the amount of our assets, primarily cash and accounts receivable, denominated in foreign currencies, primarily Euros, which are translated at the end of the reporting period and to the weakening of the US dollar that occurred in the three and six months ended June 30, 2008.

Net income. Net income increased approximately $10.4 million and $17.7 million for the three and six months ended June 30,

Table of Contents

2008, respectively, compared to the same period of 2007 due to the items discussed above.

Liquidity and Capital Resources

Resources

We funded our operations from 2000 through 2004 primarily with net proceeds of issuances of convertible preferred stock of approximately $100.0 million. Since 2005, we have funded our operations principally with cash provided by operating activities, which was driven mainly by our revenue growth.

In June and November 2007, we completed public offerings of our common stock which raised approximately $204.1 million in net proceeds.

Cash, cash equivalents and short-term investments. Our cash and cash equivalents at June 30, 2008 of $321.1 million were held for working capital purposes and were invested primarily in money market funds. We do not enter into investments for trading or speculative purposes. Restricted cash, which totaled $0.8 million at June 30, 2008 and $0.7 million at December 31, 2007, was not included in cash and cash equivalents and was held as collateral for letters of credit related to vendor and lease agreements.

Our net cash flows from operating, investing and financing activities for the periods indicated in the table below were as follows (in thousands):

	Six Months Ended June 30,	
	2008	**2007**
Net cash provided by (used in) operating activities	$ 96,116	$ (12,640)
Net cash provided by (used in) investing activities	$ (1,735)	$ 7,350
Net cash provided by financing activities	$ 2,214	$ 117,592

Operating activities. Cash from operating activities consists of significant components of the statements of operations adjusted for changes in various working capital items including deferred revenues, accounts receivable, inventories, accounts payable, prepaid expenses and various accrued expenses.

Six months ended June 30, 2008 compared to six months ended June 30, 2007.

For the six months ended June 30, 2008, net cash provided by operating activities was $96.1 million as compared to cash used in operating activities of $12.6 million for the same period in 2007. Cash received from customers increased $154.8 million in the first six months of 2008 to $189.2 million from $34.4 million in the same period of 2007. This increase was due primarily to the timing of billing and collections of the higher level of customer orders that were received in the latter half of 2007 and in early 2008. This increase was partially offset by an increase in cash paid for payroll and related expenses of $25.9 million, which totaled $47.4 million in the first six months of 2008 compared to $21.5 million for the same period in 2007, and higher cash paid for inventories of $23.5 million, which totaled $37.3 million in the first six months of 2008 compared to $13.8 million for the same period in 2007. The increase in payroll and related expenses was due primarily to our increased headcount and sales commissions, as discussed above. The increase in cash paid for inventories was due primarily to our purchases to meet our higher level of customer orders.

Investing activities. Cash from investing activities consisted primarily of capital expenditures and purchases and sales of short-term investments associated with our investment balances. The $1.7 million of cash used in investing activities during the first six months of 2008 consisted primarily of capital expenditures of $11.2 million partially offset by maturities of short-term investments of $9.6 million. The $7.4 million of cash provided by investing activities in the six months ended June 30, 2007 was due primarily to proceeds from maturities of short-term investments of $26.6 million partially offset by capital expenditures of $8.5 million and $11.2 million of net purchases of short-term investments.

Financing activities. Cash from financing activities for the six months ended June 30, 2008 consisted primarily of $2.3 million of cash received from the exercise of stock options. The $117.6 million of cash from financing activities for the six months ended June 30, 2007 was due primarily to the net proceeds from our initial public offering of $116.0 million.

At June 30, 2008 and December 31, 2007, we had no long-term debt outstanding and our restricted cash was our only asset pledged as collateral.

We believe our existing cash and cash equivalents, and cash flows from operating activities will be sufficient to finance our planned growth, enhance our products and fund anticipated capital expenditures for the foreseeable future.

We may use the net proceeds from our public offerings for working capital and other general corporate purposes, to finance

Table of Contents

accelerated growth, develop new product lines and fund acquisitions and strategic investments. These future working capital requirements will depend on many factors, including the rate of our revenues growth, our introduction of new products and enhancements and our expansion of sales and marketing and product development activities. To the extent our existing resources are insufficient to fund these activities we may need to raise additional funds through bank credit arrangements or public or private equity or debt financings. We also may need to raise additional funds in the event we determine in the future to effect one or more acquisitions of businesses, technologies and products that complement our existing operations. In the event additional funding is required, we may not be able to obtain bank credit arrangements or complete an equity or debt financing on terms acceptable to us or at all.

Requirements

Capital expenditures. We have made capital expenditures primarily for testing and evaluation systems and equipment to support product development and customer service, as well as for leasehold improvements and other general purposes to support our growth. Our capital expenditures totaled $11.2 million in the six months ended June 30, 2008. We expect capital expenditures to be approximately $20-25 million for the full year of 2008, primarily related to purchases of test equipment, equipment to support product development and customer service, leasehold improvements and other general purposes to support our growth.

Contractual obligations and requirements. As of June 30, 2008, our commitments under operating leases and purchase obligations were as set forth below. For purposes of the table below, purchase obligations are defined as agreements to purchase goods or services that are enforceable and legally binding and that specify all significant terms, including fixed or minimum quantities to be purchased, fixed, minimum or variable pricing provisions, and the approximate timing of transactions.

	Total	Remainder of 2008	1-3 Years	4-5 Years	More than 5 Years
			(dollars in thousands)		
Operating leases	$ 6,141	$ 1,356	$ 4,454	$ 331	$
Purchase obligations	15,438	14,401	1,037		
Total	$ 21,579	$ 15,757	$ 5,491	$ 331	$

The table above does not reflect unrecognized tax benefits of $0.3 million, the timing of which is uncertain.

Off-Balance-Sheet Arrangements

We do not engage in any off balance sheet financing activities. We do not have any interest in entities referred to as variable interest entities, which includes special purpose entities and other structured finance entities.

Recent Accounting Pronouncements

We have adopted the provisions of SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115,* on January 1, 2008. SFAS 159 permits entities to choose, at specified election dates, to measure eligible items at fair value (the fair value option). Under this pronouncement, a business entity must report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting period. We have not elected the fair value option for any items on its balance sheet.

In June 2008, the FASB issued FASB Staff Position (FSP) EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.* This FSP provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. This FSP will be effective for us on January 1, 2009. We have not yet determined the impact, if any, of this FSP on our consolidated financial statements.

In May 2008, the FASB released SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles.* SFAS 162 establishes the GAAP hierarchy and identifies the sources of accounting principles and the framework for selecting principles used in the preparation of financial statements. SFAS 162 is effective 60 days following the Securities and Exchange Commission s approval of the Public Company Accounting Oversight Board amendments to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles.* We have not yet determined the impact, if any, of this statement on our consolidated financial statements.

In December 2007, the FASB released SFAS 141 (revised 2007), *Business Combinations*. This statement will significantly

Table of Contents

change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in process research and development and restructuring costs. In addition, under this statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. This statement will be effective for us on January 1, 2009 and will change our accounting treatment for business combinations on a prospective basis.

In December 2007, the FASB released SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. This statement will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. This statement will be effective for us on January 1, 2009. We have not yet determined the impact, if any, of this statement on our consolidated financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily a result of fluctuations in foreign exchange rates and interest rates. We do not hold or issue financial instruments for trading purposes.

Foreign Currency Exchange Risk

Our international customer transactions are predominantly denominated in either U.S. dollars or Euro. Accordingly, we have exposure to changes between the U.S. Dollar and the Euro. We currently do not enter into foreign currency hedging transactions. In addition, the functional currency of our foreign operations in Europe, Asia and South America is the U.S. dollar. Accordingly, all assets and liabilities of these foreign subsidiaries are remeasured into U.S. dollars using the exchange rates in effect at the balance sheet date with the exception of certain non-monetary items which are remeasured at historical rates. Revenues and expenses of these foreign subsidiaries are remeasured into U.S. dollars at the average rates in effect during the year. Any differences resulting from the remeasurement of assets, liabilities and operations of these subsidiaries are recorded within other income (expense) in our consolidated statements of operations. If the foreign currency exchange rates had fluctuated by 10% as of June 30, 2008 and December 31, 2007, our foreign exchange gain or loss would have fluctuated by approximately $2.1 million and $0.2 million, respectively.

Interest Rate Risk

At June 30, 2008, we had unrestricted cash and cash equivalents totaling $321.1 million. At December 31, 2007, we had unrestricted cash and cash equivalents and short-term investments totaling $233.6 million. These amounts were invested primarily in money market funds and high quality corporate and government securities. The unrestricted cash and cash equivalents were held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, would reduce future investment income.

ITEM 4T. CONTROLS AND PROCEDURES

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2008. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2008, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended June 30, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are presently defending two patent infringement lawsuits brought against us by UTStarcom, Inc. In February 2005, UTStarcom filed a complaint against us in the United States District Court for the Northern District of California seeking unspecified damages and injunctive relief. The complaint alleges infringement by us of UTStarcom s U.S. Patent No. 6,829,473, entitled Roaming and Hand-Off Support for Prepaid Billing for Wireless Data Networks, which we refer to as the 473 patent. In May 2005, we answered the complaint, denied the infringement allegations contained in the complaint, and filed counterclaims against UTStarcom seeking a declaratory judgment that we did not infringe the 473 patent and that the 473 patent was invalid and unenforceable. In July 2005, we filed an amended answer and counterclaims to the 473 patent complaint. In December 2006, UTStarcom filed a reissue patent application relating to the 473 patent. In January 2007, by agreement of the parties, the District Court stayed the case pending the outcome of UTStarcom s reissue application relating to the 473 patent. In June 2007, we filed a request for *inter partes* re-examination of all claims of the 473 patent with the United States Patent and Trademark Office on sixteen different grounds. In August 2007, the Patent and Trademark Office granted our request for *inter partes* re-examination of all claims on all sixteen grounds. In November 2007, the Patent and Trademark Office merged the reissue and re-examination proceedings. A first office action has not yet been issued. We believe that we have meritorious defenses against any resulting reissued patent, and we are prepared to vigorously defend the 473 patent case through trial.

In May 2007, UTStarcom filed an additional complaint against us and a number of our employees and former employees in the United States District Court for the Northern District of Illinois alleging violations of the Illinois trade secrets act, infringement of five patents assigned to UTStarcom, intentional interference with UTStarcom s business relations and declarations of ownership relating to one of our patents and three of our patent applications. The complaint contains allegations, among others, that a number of former employees of a business unit UTStarcom acquired, who subsequently worked for us, took UTStarcom s trade secrets with them and improperly used those trade secrets to develop, manufacture and market our 3G wireless products, and that such products incorporate various UTStarcom confidential technical information, including UTStarcom s proprietary virtual private network and EV-DO features. UTStarcom further alleges that we have disclosed UTStarcom s trade secrets in one of our patents and three of our patent applications, and that this patent and these patent applications legally belong to UTStarcom based on the inventors previous work at the business unit acquired by UTStarcom. In August 2007, we and the current and former employee defendants filed our answers to the complaint. We also filed counterclaims for tortious interference with prospective economic advantage, malicious prosecution, a declaration that the patents-in-suit are invalid and not infringed, and a declaration that one of the patents-in-suit is unenforceable due to inequitable conduct. In December 2007, UTStarcom filed an amendment to the complaint, which added new claims for declaration of ownership of four more of our patent applications, copyright infringement, breach of restrictive covenants against the employee and former employee defendants, and aiding and abetting the employee and former employee defendants breaches of the duty of loyalty and the employment agreements. The amendment to the complaint also added another employee as a defendant. On January 4, 2008, we filed a motion to dismiss, or in the alternative for a more definite statement regarding, the trade secret, copyright, breaches of restrictive covenants, and aiding and abetting claims of the amendment to the complaint. UTStarcom filed its opposition to our motion on January 22, 2008, and we filed our reply on January 29, 2008. On May 20, 2008, the Court granted our motion, in-part, and ordered UTStarcom to provide a more definite statement of its claims. On May 30, 2008, UTStarcom filed a Third Amended Complaint. On June 9, 2008, we moved to dismiss the trade secret, copyright, breaches of restrictive covenants, and aiding and abetting claims (Counts I, VI, and VIII-XV) of the Third Amended Complaint, for failure to comply with the Court s Order to provide a more definite statement of those claims. On July 23, 2008, the Court granted our motion and dismissed those claims all claims that were the subject of the motion. On August 1, 2008, UTStarcom filed a Motion for Leave to Amend the Complaint to Provide a More Definite Statement and Clarification of the 7/23 Order. Following dismissal of the claims, UTStarcom s patent infringement and declaration of ownership claims remain. Discovery is proceeding. No trial date has been set. In this lawsuit, UTStarcom seeks unspecified monetary damages, punitive damages, injunctive relief, declarations of ownership relating to the specified patent and patent applications owned by us, findings of misappropriation of trade secrets, patent infringement and copyright infringement, costs and attorneys fees. We believe we have meritorious defenses to each of UTStarcom s claims in this lawsuit and we are prepared to vigorously defend the lawsuit.

In addition, we are subject to other legal proceedings, claims and litigation arising in the ordinary course of business. Defending lawsuits requires significant management attention and financial resources and the outcome of any litigation, including the matters described above, is inherently uncertain. We do not, however, currently expect that the ultimate costs to resolve pending matters will have a material adverse effect on our consolidated financial position, results of operations or cash flows.

Table of Contents

ITEM 1A. RISK FACTORS

These are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this Quarterly Report on Form 10-Q. Because of the these factors, as well as other variables affecting our operating results, past financial performance should not be considered as a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods. These risks are not the only ones facing the Company. Please also see Cautionary Statement in Part I, Item 2 of this Quarterly Report on Form 10-Q.

Risks Related to Our Business and Industry

We compete in new and rapidly evolving markets and have a limited operating history, which makes it difficult to predict our future operating results.

We were incorporated in August 2000, and deployed our first commercial product in the first quarter of 2003. We have a limited operating history in an industry characterized by rapid technological change, changing customer needs, evolving industry standards and frequent introductions of new products and services. We believe our limited operating history and the characteristics of our industry make it difficult to forecast our future operating results. You should consider and evaluate our prospects in light of risks faced by companies such as ours, which include challenges in accurate financial planning as a result of limited historical data and the uncertainties resulting from a relatively limited time period in which to implement and evaluate our business strategies, as compared to companies with longer operating histories.

Our past operating results have fluctuated significantly, and likely will continue to fluctuate significantly, which makes it difficult to predict our operating results and could cause our operating results to fall below expectations.

Our operating results have historically fluctuated significantly from period to period and we expect our operating results to continue to fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may not be meaningful. You should not rely on our past results as an indication of our future performance. If our revenues or operating results fall below the expectations of investors or securities analysts or below any guidance we may provide to the market, the price of our common stock could decline.

In addition to other risk factors listed in this Risk Factors section, factors that may affect our operating results include:

• fluctuations in demand, sales cycles and prices for our products and services;

• reductions in customers budgets for mobile network infrastructure purchases and delays in their purchasing decisions;

• the timing of recognizing revenue in any given period as a result of software revenue recognition rules;

• the sale of our products in the timeframes we anticipate, including the number and size of orders in each period;

• the level of our customer concentration and our ability to generate purchases in any particular period from large customers;

• our ability to develop, introduce and ship in a timely manner new products and product enhancements that meet customer requirements;

• the timing of product releases or upgrades by us or by our competitors;

• any significant changes in the competitive dynamics of our markets, including new entrants or substantial discounting of products;

• our ability to control costs, including our operating expenses and the costs of the components we purchase; and

• general economic conditions in our domestic and international markets.

We depend on a limited number of customers for a substantial portion of our revenues. The loss of a key customer or any significant adverse change in the size or terms of orders from a key customer could significantly reduce our revenues.

We derive a substantial portion of our revenues from a limited number of customers partly due to the nature of the mobile communications industry. For example, in the six months ended June 30, 2008 we had two customers that each accounted for more than 10% of our revenues and in the aggregate represented 83% of our revenues. In addition, we do not have long-term volume purchase contracts with our customers or other commitments that ensure future sales of our products to existing customers. The loss of any key customer, or our inability to generate anticipated revenue from them, would significantly and adversely affect our business, financial condition and results of operations. In addition, a

Table of Contents

change in the timing or size of a purchase by any one of our key customers can result in significant variations in our revenue and operating results from period to period. Our operating results for the foreseeable future will continue to depend on our ability to effect sales to a small number of customers. Any revenue growth will depend on our success selling additional products to our large customers and expanding our customer base to include additional customers that deploy our products in large-scale networks serving significant numbers of subscribers.

Moreover, many of our key customers are large mobile operators that have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers may require us to agree to terms and conditions that could result in increased costs and decreased revenues that could adversely affect our operating results.

We rely on a single line of products focused on a single market. If the market for those products does not develop as we anticipate, our revenues may decline or fail to grow, which would adversely affect our operating results.

We derive, and expect to continue to derive, all of our revenues from a single line of products that provide network functions and services to mobile operators packet core networks. The market for our products is relatively new and still evolving, and it is uncertain whether our products will achieve and sustain high levels of demand and market acceptance. Our success will depend to a substantial extent on the willingness of mobile operators to continue to implement packet-based, multimedia network infrastructure. Factors that could impair the rate of growth of multimedia networks include:

- lower than anticipated demand by subscribers for multimedia services;

- budgetary constraints of mobile operators;

- uncertainties on the part of mobile operators as to the particular 3G or 4G access technologies they select for deployment in their networks; and

- delays in the development or availability of all the network elements necessary for the mobile operator to deploy its next-generation multimedia network.

If mobile operators do not continue to implement packet core networks, the market for our products may not continue to develop or may develop more slowly than we expect, either of which would significantly adversely affect our revenues and profitability.

The market in which we compete is highly competitive and competitive pressures from existing and new companies may have a material adverse effect on our business, revenues, growth rates and market share.

We compete in a highly competitive industry that is influenced by many factors, including customer demands for:

- reliable, high performance products;
- system ability to handle increasing amounts of network traffic and service integration capabilities;
- system intelligence;
- breadth of network interoperability, access independence and standards support;
- high levels of customer support and customer interaction; and
- competitive pricing.

We expect competition in the mobile network infrastructure industry to intensify significantly in the future. Other companies may introduce new products in the markets we serve or intend to enter. This competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and failure to increase, or the loss of, market share, any of which would likely seriously harm our business, operating results or financial condition.

Competitive products may in the future have better performance, lower prices and broader acceptance than our products. Our primary competitors include Cisco Systems, Inc., Huawei Technologies Co., Ltd., LM Ericsson Telephone Co., Nokia Siemens Networks B.V. and UTStarcom, Inc., each of which has a longer operating history, greater name recognition, a larger customer base and significantly greater financial, technical, sales, marketing and other resources than we do. Potential customers may prefer to purchase from their existing suppliers rather than a new supplier regardless of product performance or features. In addition, many of our competitors have a broader range of products and may be able to offer concessions to potential customers on bundled purchases that we are not able to match because we currently offer only a single line of products. We also face competition from a number of companies with more limited market share either generally or by geography and newer market entrants.

Table of Contents

If our market continues to develop and expand, we could face increased competition from other established companies, as well as emerging companies. For example, OEMs, system integrators and distributors currently selling our products could market products and services that compete with our products and services. In addition, some of our competitors have made acquisitions or entered into partnerships or other strategic relationships with one another to offer a more comprehensive solution than they individually had offered. We expect this trend to continue as companies attempt to strengthen or maintain their market positions in an evolving industry and as companies enter into partnerships, or are acquired. Many of the companies driving this consolidation trend have significantly greater financial, technical and other resources than we do and are better positioned to acquire and offer complementary products and technologies. The companies resulting from these possible consolidations may create more compelling product offerings and be able to offer greater pricing flexibility, making it more difficult for us to compete effectively, including on the basis of price, sales and marketing programs, technology or product functionality. Continued industry consolidation may adversely impact customers perceptions of the viability of smaller and even medium-sized technology companies and consequently customers willingness to purchase from such companies. These pressures could materially adversely affect our business, operating results and financial condition.

Our sales cycles can be long and unpredictable, and our sales efforts require considerable time and expense.

Our sales cycles typically are long and unpredictable, and our sales efforts require considerable time and expense. Our sales efforts involve educating our customers about the use and benefit of our products, including their technical capabilities and potential cost savings. Customers typically undertake a significant evaluation process before making a purchase, in some cases over twelve months. We spend substantial time and resources in our sales efforts without any assurance that our efforts will produce any sales. In addition, product purchases are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. Our long sales cycle may cause our revenues and operating results to fluctuate significantly.

Demand for our products depends on the rate that mobile operators expand and enhance their mobile networks in order to provide multimedia services.

Our future success as a provider of network infrastructure products and services for mobile operators ultimately depends on the continued growth of the mobile communications industry and, in particular, the continued deployment and expansion of mobile multimedia services. Increased demand by mobile subscribers for voice communications and multimedia services delivered over mobile network systems will be necessary to justify capital expenditure commitments by mobile operators to invest in the improvement and expansion of their networks. Demand for multimedia services might not continue to increase if there is limited availability or market acceptance of mobile devices designed for such services, the multimedia content offered through mobile networks does not attract widespread interest or the quality of service available through mobile networks does not meet customer expectations. If long-term expectations for mobile multimedia services are not realized or do not support a sustainable business model, operators may not commit significant capital expenditures to upgrade their networks to provide these services, the demand for our products and services will decrease, and we may not be able to sustain or increase our levels of revenues or profitability in the future.

A significant portion of our future revenues depends on our ability to further penetrate the GSM/UMTS market and our failure to do so could significantly interfere with our future growth.

The two principal radio access interfaces in use today for mobile communications are Code Division Multiple Access, or CDMA, and Global System for Mobile Communications/Universal Mobile Telecommunications System, or GSM/UMTS. To date, we have achieved our highest number of deployments in the CDMA market, which has transitioned faster to high-bandwidth networks. However, significantly more operators

worldwide currently utilize GSM/UMTS than CDMA technologies. In order to continue our growth, we believe it is important that we continue to expand into the GSM/UMTS market. To date, we have established a relationship with a major GSM/UMTS operator, and we intend to devote significant sales and marketing resources to further penetrate the GSM/UMTS market. If GSM/UMTS operators do not transition or delay their transition to high-bandwidth networks, or if we are unable to establish relationships with additional GSM/UMTS operators, we may not be able to grow our business as expected and our results of operations will be adversely affected.

We rely on OEMs, system integrators and distributors to sell some of our products, and our failure to develop and manage our distribution channels could adversely affect our business.

For our sales to mobile operators, we rely in part on establishing and maintaining successful relationships with original equipment manufacturers, or OEMs, system integrators and distributors. A significant amount of our revenues is derived through these indirect sales. Accordingly, our revenues depend in part on the effective performance of these distribution relationships. By utilizing these indirect sales channels we may have less contact with the end users of our products, thereby potentially making it more difficult for us to establish brand awareness, ensure proper delivery and installation of our products, service ongoing customer requirements and respond to evolving customer needs. Developing relationships with qualified OEMs, system integrators and distributors and training them in our technology and product offerings requires significant time and resources. In order to develop and expand our distribution channels, we must continue to scale and improve our processes and procedures that support our OEM, system integrator

Table of Contents

and distributor relationships, including investment in systems and training. We have no minimum purchase commitments with any of our OEMs, system integrators or distributors, and our contracts with them do not prohibit them from offering products or services that compete with ours. Our competitors may be effective in providing incentives to existing and potential OEMs, system integrators and distributors to favor their products or to prevent or reduce sales of our products. Our OEMs, system integrators and distributors may choose not to offer our products exclusively or at all. Our failure to establish and maintain successful relationships with our OEMs, system integrators and distributors would likely materially adversely affect our business, operating results and financial condition.

We have a significant accumulated deficit, and we may not be able to maintain profitability.

As a result of our net losses in years prior to 2005 we had an accumulated deficit of $70.6 million as of June 30, 2008. We will need to generate significant revenues and control our operating expenses and other expenditures to maintain profitability. If we are unable to remain profitable, the market price of our common stock could decline.

If network functions and services similar to those offered by our products are incorporated into existing or new mobile network infrastructure products, demand by mobile operators for our products may diminish.

Mobile network infrastructures are continually evolving with changing industry standards and the introduction of new technologies and network elements. Network functions and services provided by our products located on the packet core network may be provided by different network elements within these networks. Other providers of mobile network infrastructure products may add network functions and services provided by our products to their existing products or offer new products with similar characteristics for different parts of the network infrastructure.

The inclusion of, or the announcement of an intent to include, functionality and services perceived to be similar to those offered by our products in competitor products within or outside the packet core network could have an adverse effect on our ability to market and sell our products. Furthermore, even if the network functions and services offered by our competitors are more limited than those provided by our products, a significant number of customers may elect to accept limited functionality or services in lieu of adding our products to their network. The adoption of these competitive products or different approaches to their network infrastructure by mobile operators could have an adverse effect on our business, operating results and financial condition.

The applications of existing or future accounting standards could result in significant fluctuations in our operating results.

We recognize our product software license revenue in accordance with AICPA Statement of Position, or SOP, 97-2, *Software Revenue Recognition*, and related amendments and interpretations and SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions*. Under these accounting standards, even if we deliver products to, and collect cash from, a customer in a given fiscal period, we may be required to defer recognizing revenue from the sale of such product until a future period when all the conditions necessary for revenue recognition have been satisfied. Conditions that can cause delays in revenue recognition include software arrangements that have undelivered elements for which we have not yet established vendor specific objective evidence of fair value; requirements that we deliver services for significant enhancements or modifications to customize our software for a particular customer; or material customer acceptance criteria. Our customer contracts typically include one or more of these types of conditions. Therefore, we often must defer revenue recognition for a period of time after our products are delivered and billed to a customer, and such deferral may extend over one or more fiscal quarters. The

period of deferral, if any, depends on the specific terms and conditions of each customer contract, and therefore it is difficult for us to predict with accuracy at the beginning of any fiscal period the amount of revenues that we will be able to recognize from anticipated customer shipments in that period. Moreover, any changes in interpretations and guidance as to SOP 97-2 could have a significant effect on our reported financial results.

We may have difficulty acquiring new customers due to the high costs of switching mobile network infrastructure providers or equipment.

Mobile network operators typically make substantial investments when deploying a mobile network infrastructure. Once a mobile network operator has deployed a mobile network infrastructure for a particular portion of their network, it is often difficult and costly to switch to another vendor s infrastructure. Unless we are able to persuasively demonstrate that our products offer performance, functionality or cost advantages that materially outweigh a customer s expense of switching from a competitor s product, it will be difficult for us to generate sales once that competitor s equipment has been deployed. Accordingly, if a customer has already deployed a competitor s product for their network infrastructure, it may be difficult for us to sell our products to that customer.

Our ability to sell our products is highly dependent on the quality of our support and services offerings, and our failure to offer high quality support and services would have a material adverse effect on our sales and results of operations.

Once our products are deployed within our customers networks, our customers depend on our support organization to resolve issues relating to our products. A high level of support is critical for the successful marketing and sale of our products and future enhancements. If we, or our OEMs, system integrators or distributors, do not effectively assist our customers in deploying our products, help our customers quickly resolve post-deployment issues, and provide effective ongoing support, it would adversely affect

Table of Contents

our ability to sell our products to existing customers and could harm our reputation with potential customers. In addition, as we expand our operations internationally, our support organization will face additional challenges, including those associated with delivering support, training and documentation in languages other than English. As a result, our failure to maintain high quality support and services could have a material adverse effect on our business, operating results and financial condition.

The mobile network infrastructure industry is, and likely will continue to be, characterized by rapid technological changes in networks and standards, which will require us to develop new products and product enhancements, and could render our existing products obsolete.

Mobile operators have been aggressively upgrading their networks, and new industry standards for access technologies, such as third generation, or 3G, and more advanced fourth generation, or 4G, technologies continue to evolve. Continuing technological changes in the mobile communications industry and in the mobile network infrastructure industry could undermine our competitive position or make our products obsolete, either generally or for particular types of services. Our future success will depend upon our ability to accurately predict and respond to new technology standards. We must develop and introduce a variety of new capabilities and enhancements to our existing product offerings, as well as introduce new product offerings, to address the changing standards and technological needs of the network infrastructure market. A failure to accurately predict and respond to evolving technologies, to introduce on a timely basis new products and enhancements in response to evolving technologies and standards, or to address changing needs in our current markets or expand into new markets may cause existing and potential customers to forego purchases of our products or purchase from our competitors. The introduction of new products embodying new technologies or the emergence of new industry standards could render our existing products uncompetitive from a pricing standpoint, obsolete or unmarketable.

Our products are complex and may take longer to develop than anticipated and we may not recognize revenues from new products or product enhancements until after we have incurred significant development costs.

Some of our products must be tailored to meet customer specifications. As a result, we often develop new features and enhancements to our products. These product enhancements often take substantial time to develop because of their complexity and because customer specifications sometimes change during the development cycle. We often do not recognize revenue from our new products or enhancements until we have incurred significant development costs, and our operating results will suffer if sales of new products or enhancements fail to meet our expectations.

There is no assurance that our research and development investments will lead to successful new products or enhancements.

We will continue to invest in research and development for the introduction of new products and enhancements to existing products designed to improve the capacity, data processing rates and features of our products and services. We must also continue to develop new features and functionality for our products based on specific customer requests and anticipated market needs. However, research and development in the mobile network infrastructure industry is complex, expensive and subject to uncertainty. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. If we continue to expend a significant amount of resources on research and development and our efforts do not lead to the successful introduction of products or product enhancements that are competitive in the marketplace, there could be a material adverse effect on our business, operating results, financial condition and market share. We may not be able to anticipate market needs and develop products and product enhancements that meet those needs, and any new products or product enhancements that we introduce may not achieve any significant degree of market acceptance.

If our products do not interoperate with our customers networks, installations will be delayed or cancelled, which would harm our business.

Our products must interoperate with our customers existing networks, which often have different specifications, utilize multiple protocol standards and products from multiple vendors and contain multiple generations of products that have been added over time. If we find errors in the existing software or defects in the hardware used in our customers networks or problematic network configurations or settings, as we have in the past, we may have to modify our software or hardware so that our products will interoperate with our customers networks. This could cause longer installation times for our products or order cancellations and could harm our relationship with existing and future customers, any of which would adversely affect our business, operating results and financial condition.

In addition, our customers may require that we demonstrate that our products interoperate with network elements offered by our competitors, and we may need our competitors cooperation to conduct such testing and validation. Any unwillingness of our competitors to cooperate with us in performing these interoperability tests or our inability to demonstrate interoperability would likely have an adverse effect on our ability to market our products.

Table of Contents

Our products are highly technical and may contain undetected software or hardware errors, which could cause harm to our reputation and adversely affect our business.

Our products are highly technical and complex. When deployed, they are critical to the mobile operator networks. Our products have contained and may contain undetected errors, defects or security vulnerabilities. Some errors in our products may only be discovered after a product has been installed and used by mobile operators. Any errors, defects or security vulnerabilities discovered in our products after commercial release could result in loss of revenues or delay in revenue recognition, loss of customers and increased service cost, any of which could adversely affect our business, operating results and financial condition. In addition, we could face claims for product liability, tort or breach of warranty, including claims relating to changes to our products made by our OEMs, system integrators or distributors. Our contracts with customers generally contain provisions relating to warranty disclaimers and liability limitations, which may be ineffective. Defending a lawsuit, regardless of its merit, is costly and may divert management s attention away from the business and adversely affect the market s perception of us and our products. In addition, if our business liability insurance coverage is inadequate or future coverage is unavailable on acceptable terms or at all, our operating results and financial condition could be adversely impacted.

We are susceptible to shortages or price fluctuations in our supply chain. Any shortages or price fluctuations in components used in our products could delay shipment of our products, which could materially adversely affect our business.

Shortages in components that we use in our products are possible and our ability to predict the availability of such components may be limited. Some of these components are available only from single or limited sources of supply. The process of qualifying alternate sources for components, if available at all, may be time consuming, difficult and costly. In addition, the lead times associated with certain components are lengthy and preclude rapid changes in quantity requirements and delivery schedules. Any growth in our business or the economy is likely to create greater pressures on us and our suppliers to project overall component demand accurately and to establish appropriate component inventory levels. In addition, increased demand by third parties for the components we use in our products may lead to decreased availability and higher prices for those components. We carry very little inventory of our products and product components, and we rely on our suppliers to deliver necessary components to our contract manufacturer in a timely manner based on forecasts we provide. We generally rely on purchase orders rather than long-term contracts with our suppliers. As a result, even if available, we may not be able to secure sufficient components at reasonable prices or of acceptable quality to build products in a timely manner, which would seriously impact our ability to deliver products to our customers, and our business, operating results and financial condition would be adversely affected.

We depend on a single contract manufacturer with whom we do not have a long-term supply contract, and changes to this relationship may result in delays or disruptions that could harm our business.

We depend on Plexus Corp., an independent contract manufacturer, to manufacture and assemble our products. We rely on purchase orders with our contract manufacturer and do not have long-term supply arrangements in place. As a result, our contract manufacturer is not obligated to supply products to us for any specific period, quantity or price. Our orders may represent a relatively small percentage of the overall orders received by our contract manufacturer from its customers. As a result, fulfilling our orders may not be considered a priority by our contract manufacturer in the event the contract manufacturer is constrained in its ability to fulfill all of its customer obligations in a timely manner.

It is time consuming and costly to qualify and implement a contract manufacturer relationship. Therefore, if our contract manufacturer suffers an interruption in its business, or experiences delays, disruptions or quality control problems in its manufacturing operations, or we have to change or add additional contract manufacturers, our ability to ship products to our customers would be delayed and our business, operating results and financial condition would be adversely affected.

If we fail to predict accurately our manufacturing requirements, we could incur additional costs or experience manufacturing delays that could harm our business.

We provide demand forecasts to our contract manufacturer. If we overestimate our requirements, our contract manufacturer may assess charges or we may have liabilities for excess inventory, each of which could negatively affect our gross margins. Conversely, because lead times for required materials and components vary significantly and depend on factors such as the specific supplier, contract terms and the demand for each component at a given time, if we underestimate our requirements, our contract manufacturer may have inadequate materials and components required to produce our products, which could interrupt manufacturing of our products and result in delays in shipments and deferral or loss of revenues.

If we fail to retain our key personnel, we may not be able to achieve our anticipated level of growth and our business could suffer.

Our future depends, in part, on our ability to attract and retain key personnel, including the continued contributions of our executive officers and other key technical personnel, each of whom would be difficult to replace. In particular, Ashraf M. Dahod, our president, chief executive officer and chairman is critical to the management of our business and operations, as well as the development of our strategic direction. The loss of services of Mr. Dahod or other executive officers or key personnel or the inability to continue to attract qualified personnel could have a material adverse effect on our business. Mr. Dahod is not a party to an employment agreement with us and, therefore, may terminate his employment with us at any time, with no advance notice. The replacement of Mr. Dahod would involve significant time and expense and may significantly delay or prevent the achievement of our

Table of Contents

business objectives.

Competition for our employees is intense, and we may not be able to attract and retain the highly skilled employees that we need to support our business.

Competition for highly skilled technical personnel is extremely intense and we continue to face difficulty identifying and hiring qualified personnel in many areas of our business. In particular, we face significant challenges hiring and retaining personnel in India for research and development activities because the market for such personnel is increasingly competitive. We may not be able to hire and retain such personnel at compensation levels consistent with our existing compensation and salary structure. Many of the companies with which we compete for hiring experienced employees have greater resources than we have and may be able to offer more attractive terms of employment. In addition, we invest significant time and expense in training our employees, which increases their value to competitors who may seek to recruit them. If we fail to retain our employees, we could incur significant expenses replacing employees and the quality of our products and services and our ability to provide such products and services could diminish, resulting in a material adverse affect on our business. Furthermore, in making employment decisions, particularly in high-technology industries, candidates often consider the value of the equity they are to receive in connection with their employment. Therefore, significant volatility in the price of our stock may adversely affect our ability to attract or retain personnel.

Our international sales and operations subject us to additional risks that may adversely affect our operating results.

Over the last several years, we derived a significant portion of our revenues from customers outside the United States, and we continue to expand our international operations. As of June 30, 2008, approximately 61% of our employees were located outside of the United States, including 358 employees located in India. In addition, we have sales and technical support personnel in numerous countries worldwide. We expect to continue to add personnel in additional countries. Any continued expansion into international markets will require significant resources and management attention and will subject us to new regulatory, economic and political risks, and we cannot be sure that any further international expansion will be successful. Among the risks we believe are most likely to affect us with respect to our international operations are:

- the difficulty of managing and staffing international offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;

- difficulties in enforcing contracts and collecting accounts receivable and longer payment cycles, especially in emerging markets;

- our ability to comply with differing technical standards and certification requirements outside North America;

- unexpected changes in regulatory requirements;

• reduced protection for intellectual property rights in some countries;

• new and different sources of competition;

• fluctuations in exchange rates; and

• tariffs and trade barriers, import/export controls and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks successfully could harm our international operations and reduce our international sales, adversely affecting our business, operating results and financial condition.

We may need additional capital in the future, which may not be available to us on favorable terms, or at all, and may dilute your ownership of our common stock.

We have historically relied on outside financing and cash from operations to fund our operations, capital expenditures and expansion. We may require additional capital from equity or debt financing in the future to:

• take advantage of strategic opportunities including more rapid expansion of our business or the acquisition of complementary products, technologies or businesses; and

• develop new products or enhancements to existing products.

Table of Contents

We may not be able to secure timely additional financing on favorable terms, or at all. The terms of any additional financing may place limits on our financial and operating flexibility. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, if and when we require it, our ability to grow or support our business and to respond to business challenges could be significantly limited.

We may engage in future acquisitions that could disrupt our business, cause dilution to our stockholders and harm our business, operating results or financial condition.

While we currently have no acquisitions of other businesses pending or planned, we have, from time to time, evaluated acquisition opportunities and may pursue acquisition opportunities in the future. We have very little experience consummating acquisitions, and therefore our ability as an organization to make acquisitions is unproven. We may not be able to find suitable acquisition candidates and we may not be able to complete acquisitions on favorable terms, if at all. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or such acquisitions may be viewed negatively by customers, financial markets or investors. In addition, any acquisitions that we make could lead to difficulties in integrating personnel and operations from the acquired businesses and in retaining and motivating key personnel from these businesses. Acquisitions may disrupt our ongoing operations, divert management from day-to-day responsibilities, increase our expenses or adversely impact our business, operating results and financial condition. Future acquisitions may reduce our cash available for operations and other uses and could result in an increase in amortization expense related to identifiable assets acquired, potentially dilutive issuances of equity securities or the incurrence of debt, which could harm our business, operating results and financial condition.

If we fail to manage future growth effectively, our business could be harmed.

We have expanded our operations significantly since inception and anticipate that further significant expansion will be required. For example, our revenues increased from $59.7 million in 2005 to $145.8 million in 2007, and $117.4 million for the six months ended June 30, 2008, and the number of our employees increased from 200 at the beginning of 2005 to 676 as of June 30, 2008. This growth has placed significant demands on our management, as well as our financial and operational resources. If we do not effectively manage our future growth, the efficiency of our operations and the quality of our products could suffer, which could adversely affect our business and operating results. To effectively manage this growth, we will need to continue to:

- implement appropriate operational, financial and management controls, systems and procedures, including continued implementation of our enterprise-wide financial system;

- expand our manufacturing capacity and scale of production;

- expand our sales, marketing and distribution infrastructure and capabilities; and

• provide adequate training and supervision to maintain high quality standards.

We have incurred, and will continue to incur, significant increased costs as a result of operating as a public company, and our management will be required to devote substantial time to new compliance initiatives.

As a public company, we have incurred, and will continue to incur, significant legal, accounting and other expenses that we did not incur as a private company. In addition, the Sarbanes-Oxley Act of 2002, and rules subsequently implemented by the Securities and Exchange Commission and the NASDAQ Stock Market, impose additional requirements on public companies, including requiring changes in corporate governance practices. Our management and other personnel will need to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations will increase our legal and financial compliance costs and will make some activities more time-consuming and costly. For example, we expect these rules and regulations to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantial additional costs to maintain the same or similar coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

In addition, the Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, for the year ending December 31, 2008, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our testing, or the subsequent testing by our independent registered public accounting firm, may reveal deficiencies in our internal control over financial reporting that are deemed to be material weaknesses. Our compliance with Section 404 will require that we incur substantial expense and expend significant management time on compliance-related issues. We will need to hire additional accounting and financial staff with appropriate public company experience and technical accounting

Table of Contents

knowledge. Moreover, if we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to sanctions or investigations by the NASDAQ Stock Market, the Securities and Exchange Commission or other regulatory authorities, which would require additional financial and management resources.

We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.

Our products are subject to United States export controls and may be exported outside the United States only with the required level of export license or through an export license exception, because we incorporate encryption technology into our products. In addition, various countries regulate the import of certain encryption technology and have enacted laws that could limit our ability to distribute our products or could limit our customers ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their networks or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import laws and regulations, shifts in approach to the enforcement or scope of existing laws and regulations, or change in the countries, persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, operating results and financial condition.

Compliance with environmental matters and worker health and safety laws could be costly, and noncompliance with these laws could have a material adverse effect on our results of operations, expenses and financial condition.

Some of our operations use substances regulated under various federal, state, local and international laws governing the environment and worker health and safety, including those governing the discharge of pollutants into the ground, air and water, the management and disposal of hazardous substances and wastes, and the cleanup of contaminated sites. Some of our products are subject to various federal, state, local and international laws governing chemical substances in electronic products. We could be subject to increased costs, fines, civil or criminal sanctions, third-party property damage or personal injury claims if we violate or become liable under environmental and/or worker health and safety laws.

In January 2003, the European Union, or EU, issued two directives relating to chemical substances in electronic products. The Waste Electrical and Electronic Equipment Directive, referred to as WEEE, requires producers of electrical goods to pay for specified collection, recycling, treatment and disposal of past and future covered products. The deadline for enacting and implementing the WEEE directive was August 13, 2004, although extensions were granted in some countries. Producers became financially responsible under WEEE related legislation beginning in August 2005. The other directive, the Restriction on the use of certain Hazardous Substances, referred to as RoHS, restricts lead and other hazardous substances in electronic equipment placed on the EU market after July 1, 2006. If we fail to comply with these directives, we may suffer a loss of revenues, be unable to sell our products in certain markets and countries, be subject to penalties and fines or suffer a competitive disadvantage. Similar legislation could be enacted in other jurisdictions, including in China, Japan or the United States, and the scope of new legislation with respect to currently unregulated substances is uncertain. Costs to comply with WEEE or RoHS related legislation or similar future legislation, if applicable, could include costs associated with modifying our products, recycling and other waste processing costs, legal and regulatory costs and insurance costs. We are currently in compliance with these directives; however, we have incurred significant costs related to compliance with current requirements. The costs to comply with current and future environmental and worker health and safety laws may have a material adverse effect on our results of operations, expenses and financial condition.

Risks Related to Our Intellectual Property

Our ability to compete and the success of our business could be jeopardized if we are unable to rely on our patent rights.

Our success and ability to compete depends in part upon our ability to obtain protection in the United States and other countries for our products by establishing and maintaining intellectual property rights relating to or incorporated into our technology and products. We own a variety of patents and patent applications in the United States and corresponding patents and patent applications in foreign jurisdictions. However, we have not obtained patent protection in each market in which we plan to compete. To date, our patent portfolio has not prevented other companies from competing against us, and we do not know how successful we would be if we sought to enforce our patent rights against suspected infringers. Our pending and future patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Even if issued, patents may be challenged, narrowed, invalidated or circumvented, which could limit our ability to stop competitors from marketing similar products or limit the length of term of patent protection we may have for our products. Changes in either patent laws or in interpretations of patent laws in the United States and other countries may diminish the value of our intellectual property or narrow the scope of our patent protection. Any circumstance or change that results in patent protection not being available for our products could adversely affect our business, financial condition and results of operations.

Table of Contents

If we are unable to protect the confidentiality of our unpatented proprietary information and know-how, the value of our technology and products could be adversely affected.

In addition to patented technology, we rely upon unpatented proprietary technology, processes and know-how. We generally seek to protect this information in part by confidentiality agreements with our employees, consultants and third parties. These agreements may be breached, and we may not have adequate remedies for any such breach. In addition, our trade secrets may otherwise become known or be independently developed by competitors. If we are unable to protect the confidentiality of our proprietary information and know-how, the value of our technology and products could be adversely affected, which could in turn adversely affect our business, financial condition and results of operations.

Claims by others that we infringe their proprietary technology could force us to incur significant costs.

Third parties have asserted, and may assert in the future, claims that our products infringe patents or patent applications under which we do not hold licenses or other rights. Third parties may own or control these patents and patent applications in the United States and abroad. These third parties have brought, and could in the future bring, claims against us that would cause us to incur substantial expenses and, if successfully asserted against us, could cause us to pay substantial damages. Further, if a patent infringement suit were brought against us, we could be forced to stop or delay manufacturing or sales of the product that is the subject of the suit. In addition, we could be forced to redesign the product that uses any allegedly infringing technology.

We are presently defending two patent infringement lawsuits brought by UTStarcom, Inc. In February 2005, UTStarcom filed a lawsuit asserting infringement of a patent in the United States District Court for the Northern District of California relating to a prepaid billing function we provided to one of our customers. This patent lawsuit by UTStarcom has been stayed pending a reissue proceeding of the patent asserted in the case. Such a reissue proceeding may take a year or longer to complete. After the reissue proceeding, the stay of the lawsuit likely will be lifted and the lawsuit may proceed. If this occurs, we will continue to defend ourselves in this litigation, which will require a significant investment of time and financial resources. A finding that we have infringed this patent may require us to pay damages based on our past sale of the prepaid billing function and, in addition, may force us to limit or cease development, manufacturing and sales of the prepaid billing function. This could adversely affect our business, financial condition and results of operations.

In May 2007, UTStarcom filed a lawsuit against us and a number of our employees and former employees in the United States District Court for the Northern District of Illinois alleging violations of the Illinois trade secrets act, infringement of five patents assigned to UTStarcom, intentional interference with UTStarcom s business relations and declarations of ownership relating to one of our patents and three of our patent applications. The complaint contains allegations, among others, that a number of former employees of a business unit UTStarcom acquired, who subsequently worked for us, took UTStarcom s trade secrets with them and improperly used those trade secrets to develop, manufacture and market our 3G wireless products, and that such products incorporate UTStarcom confidential technical information, including UTStarcom s proprietary virtual private network and EV-DO features. UTStarcom further alleges that we have disclosed UTStarcom s trade secrets in one of our patents and three of our patent applications, and that this patent and these patent applications legally belong to UTStarcom based on the inventors previous work at the business unit acquired by UTStarcom. In December 2007, UTStarcom filed an amendment to the complaint, which added new claims for declaration of ownership of four more of our patent applications, copyright infringement, breach of restrictive covenants against the employee and former employee defendants, and aiding and abetting the employee and former employee defendants breaches of the duty of loyalty and the employment agreements. The amendment to the complaint also added another employee as a defendant. In January 2008, we filed a motion to dismiss, or in the alternative for a more definite statement regarding, the trade secret, copyright, breaches of restrictive covenants, and aiding and abetting claims of the amendment to the complaint. In May 2008, the Court granted our motion, in-part, and ordered UTStarcom to provide a more definite statement of its claims. Also in May 2008, UTStarcom filed a Third Amended Complaint. In June 2008, we moved to dismiss the trade secret, copyright, breaches of restrictive covenants, and aiding and abetting claims (Counts I, VI, and VIII-XV) of the Third Amended Complaint, for failure to comply with the Court s Order to provide a more definite statement of those claims. In

July 2008, the Court granted our motion and dismissed those claims. On August 1, 2008, UTStarcom filed a Motion for Leave to Amend the Complaint to Provide a More Definite Statement and Clarification of the 7/23 Order. Following dismissal of the claims, UTStarcom s patent infringement and declaration of ownership claims remain. In this lawsuit, UTStarcom seeks unspecified monetary damages, punitive damages, injunctive relief, declarations of ownership relating to the specified patent and patent applications owned by us, findings of misappropriation of trade secrets, patent infringement and copyright infringement, costs and attorneys fees. We will vigorously defend ourselves in this litigation and we have filed counterclaims. The defense of this lawsuit and the prosecution of our counterclaims will require significant investment of time and financial resources. A finding in UTStarcom s favor in this lawsuit may require us to pay substantial damages based on the past sales of our ST16 product, may force us to pay royalties on past or future sales of our ST16 or ST40 products, may force us to limit or cease development, manufacturing and sales of the ST16 and ST40, which are our only product platforms, may require that key employees be transferred to other positions or functions, or temporarily prohibited from working for us, and may result in the loss or assignment of ownership of a specified patent and seven patent applications owned by us. This could adversely affect our business, financial condition and results of operations.

As a result of patent infringement claims, or in order to avoid potential claims, we may choose or be required to seek a license from the third party and be required to pay license fees or royalties or both. These licenses may not be available on acceptable terms,

Table of Contents

or at all. Even if we were able to obtain a license, the rights may be nonexclusive, which could result in our competitors gaining access to the same intellectual property. Ultimately, we could be forced to cease some aspect of our business operations if, as a result of actual or threatened patent infringement claims, we are unable to enter into licenses on acceptable terms. This could significantly and adversely affect our business, financial condition and results of operations.

In addition to infringement claims against us, we may become a party to other types of patent litigation and other proceedings, including interference proceedings declared by the United States Patent and Trademark Office and opposition proceedings in the European Patent Office, regarding intellectual property rights with respect to our products and technology. The cost to us of any patent litigation or other proceeding, even if resolved in our favor, could be substantial. Some of our competitors may be able to sustain the costs of such litigation or proceedings more effectively than we can because of their greater financial resources. Uncertainties resulting from the initiation and continuation of patent litigation or other proceedings could have a material adverse effect on our ability to compete in the marketplace. Patent litigation and other proceedings may also require significant commitments of time by our management.

Our use of open source could impose limitations on our ability to commercialize our products.

We incorporate open source software into our products. Although we monitor our use of open source software closely, the terms of many open source licenses to which we are subject have not been interpreted by United States or foreign courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to seek licenses from third parties in order to continue offering our products, to re-engineer our products or to discontinue sales of our products, any of which could materially adversely affect our business.

We rely on the availability of licenses for intellectual property from third parties, and if these licenses are not available to us on commercially reasonable terms, product sales and development may be delayed.

We incorporate certain third-party technologies, including software programs, into our products and may need to utilize additional third-party technologies in the future. However, licenses to relevant third-party technology may not continue to be available to us on commercially reasonable terms, or at all. Therefore, we could face delays in product releases until alternative technology can be identified, licensed or developed, and integrated into our current products. These delays, if they occur, could materially adversely affect our business.

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

(b) Use of Proceeds from Public Offerings of Common Stock

In June 2007, we completed an initial public offering of common stock pursuant to a Registration Statement on Form S-1 (Registration No. 333-141092) which the SEC declared effective on June 5, 2007. Pursuant to the registration statement, we registered the offering and sale of an aggregate of 12,115,067 shares of our common stock, of which 10,580,226 shares were sold by us including 1,580,226 shares sold in connection with the underwriters option described below, and 1,534,841 shares were sold by certain stockholders, at a price of $12.00 per share.

The underwriters exercised their option to purchase the additional 1,580,226 shares of our common stock at the initial public offering price of $12.00 per share on June 8, 2007 and the offering closed on June 11, 2007. The underwriters for the offering were Goldman, Sachs & Co., Lehman Brothers, JPMorgan and Thomas Weisel Partners LLC.

We raised a total of $127.0 million in gross proceeds from the initial public offering, or approximately $116.0 million in net proceeds after deducting underwriting discounts and commissions of $8.9 million and other estimated offering costs of approximately $2.1 million. The selling stockholders received a total of approximately $18.4 million in gross proceeds from the initial public offering or approximately $17.1 million of net proceeds after deducting the underwriting discounts. We have invested the remaining net proceeds in cash and cash equivalents, primarily money-market mutual funds. None of the remaining net proceeds were paid, directly or indirectly, to directors, officers, persons owning ten percent or more of our equity securities, or any of our other affiliates.

In October 2007, we completed a public offering of common stock pursuant to a Registration Statement on Form S-1 (Registration No. 333-146717) which the SEC declared effective on October 31, 2007. Pursuant to the registration statement, we registered the offering and sale of an aggregate of 8,000,000 shares of our common stock, of which 3,880,000 shares were sold by us and 4,120,000 shares were sold by certain stockholders, at a price of $24.00 per share. The underwriters for the offering were Goldman, Sachs & Co., Lehman Brothers, JPMorgan and Thomas Weisel Partners LLC.

We raised a total of $93.1 million in gross proceeds from the public offering, or approximately $88.1 million in net proceeds after deducting underwriting discounts and commissions of $4.4 million and other estimated offering costs. The selling stockholders received a total of approximately $98.9 million in gross proceeds from the public offering or approximately $94.2 million of net proceeds after deducting the underwriting discounts. We have invested the remaining net proceeds in cash and cash equivalents, primarily money-market mutual funds. None of the remaining net proceeds were paid, directly or indirectly, to directors, officers, persons owning ten percent or more of our equity securities, or any of our other affiliates.

Table of Contents

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

We held our 2008 Annual Meeting of Stockholders on May 22, 2008. At the 2008 Annual Meeting, our stockholders elected two director nominees and ratified the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2008.

At the 2008 Annual Meeting, our stockholders elected Sean M. Dalton and Matthew J. Desch to serve as Class I directors until our 2011 annual meeting of stockholders and until their successors are elected and qualified. In addition to the election of Mr. Dalton and Mr. Desch, our directors James A. Dolce, Jr. and Kenneth A. Goldman continue in office for terms ending in 2009 and our directors Edward T. Anderson, Timothy A. Barrows and Ashraf A. Dahod continue in office for terms ending in 2010, in each case, until his successor is elected and qualified.

The matters acted upon at the 2008 Annual Meeting, and the voting tabulation for each matter, are as follows:

(1) To elect two Class I directors to our board of directors, each to serve for a term ending in 2011, or until his respective successor has been duly elected and qualified:

Nominees for Election as a Class I Director:	Votes For	Votes Withheld
Sean M. Dalton	53,172,175	87,604
Matthew J. Desch	52,648,313	611,466

(2) To ratify the selection of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2008, which matter was approved by a vote of 53,209,242 shares voting for, 6,492 shares voting against and 44,045 shares abstaining.

ITEM 6. EXHIBITS

The following in an index of the exhibits included in this report:

Exhibit No.	Description
31.1	Certification of Chief Executive Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

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.

STARENT NETWORKS, CORP.
(Registrant)

Date: August 8, 2008

By: /s/ ASHRAF M. DAHOD
Ashraf M. Dahod
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 8, 2008

By: /s/ PAUL J. MILBURY
Paul J. Milbury
Vice President, Operations and Chief Financial Officer
(Principal Financial Officer)

Date: August 8, 2008

By: /s/ GEORGE W. HALE
George W. Hale
Vice President, Finance and Corporate Controller
(Principal Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
31.1	Certification of Chief Executive Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.