UTSTARCOM INC
Form 10-K
October 10, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2006

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: 000-29661

UTSTARCOM, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**52-1782500** (I.R.S. Employer Identification No.)
1275 Harbor Bay Parkway **Alameda, California** (Address of principal executive offices)	**94502** (Zip Code)

(510) 864-8800

(Registrant s telephone number, including area code)

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

Common Stock, $0.00125 par value

(Title of class)

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes o No x

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-Ko

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

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last business day of the registrant s most recently completed second fiscal quarter (June 30, 2007) was approximately $580,658,573 based upon the closing price of $5.61 reported for such date on The NASDAQ Stock Market, LLC. As of June 30, 2006, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $769,074,909 based upon the closing price of $7.79 reported for such date on The NASDAQ Stock Market, LLC. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 10% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant, have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive for other purposes.

As of September 30, 2007, the registrant had 121,294,645 outstanding shares of Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

None

UTSTARCOM, INC.

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ADDITIONAL INFORMATION

UTStarcom (which may be referred to as the Company, we, us, or our) means UTStarcom, Inc. or UTStarcom, Inc. and its subsidiaries, as the context requires. The name UTStarcom is a registered trademark of UTStarcom, Inc.

In this Annual Report on Form 10-K, references to and statements regarding China refer to mainland China, references to U.S. dollars or $ are to United States Dollars, and references to Renminbi are to Renminbi, the legal currency of China.

Unless specifically stated, information in this Annual Report on Form 10-K assumes an exchange rate of $7.80 Renminbi for one U.S. dollar, the exchange rate in effect as of December 31, 2006.

Throughout this Annual Report on Form 10-K we incorporate by reference certain information from other documents filed with the Securities and Exchange Commission (the SEC). Please refer to such information at *www.sec.gov*.

UTStarcom s public filings, including our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, and any amendments to such reports, are available free of charge at our website, *www.utstar.com*. The information contained on our website is not being incorporated herein.

This Annual Report on Form 10-K contains forward-looking statements. Beginning on page 28 we discuss some of the risk factors that could cause our actual results to differ materially from those provided in the forward-looking statements.

EXPLANATORY NOTE

Our consolidated financial statements and financial information in this Annual Report on Form 10-K for accounting periods prior to the third quarter of 2006 have been restated.

Summary

In July 2007, the Company announced the Audit Committee was conducting an independent investigation of historical sales with certain customers in China and stated that it could not rule out the possibility that the outcome of the investigation could impact revenue recognized for certain of such contracts as recorded in previously issued financial statements. In September 2007, the Company announced the investigative phase of the Audit Committee s investigation had been completed. After consultation with and upon the recommendation of management, the Audit Committee determined revenue in the Company s Western Region of China was recognized earlier than it should have been and that the financial statements for the affected periods should be restated. The Company also announced that its previously issued financial statements for each of the fiscal years ended December 31 in the period 2000 through 2005, the financial statements for the interim periods contained in the Quarterly Reports on Form 10-Q filed with respect to each of these years, and the quarterly reports on Form 10-Q filed with respect to each of the quarterly periods ended March 31 and June 30, 2006 should not be relied upon. In this Annual Report we have corrected for the effects of net sales and related costs of net sales that were recorded earlier than they should have been. The net effect at December 31, 2005 was to reduce and defer previously recognized revenue and gross profit of $278.6 million and $97.7 million, respectively.

We also conducted a voluntary review of historical stock option practices under the direction of the Nominating and Corporate Governance Committee of our Board of Directors (Governance Committee). This review considered all option grant awards made in the period from February 29, 2000, shortly before the initial public offering of our Common Stock, through August 2006 for compliance with the various stock-based compensation accounting standards applicable during this period as well as the rules of our stock option plans. We found that in a number of instances we did not use the proper date as the measurement date in determining whether stock options had been issued with exercise prices below the fair value of our common stock. Therefore, we have restated our previously issued financial statements for the years ended December 31, 1998 through 2005 to account for an additional $25.5 million of stock compensation expense that should have been recognized over the period together with an equal increase in additional paid-in capital to recognize the intrinsic value assigned to these issuances of equity securities. Related adjustments of payroll and income taxes resulted in an additional $0.5 million of expense being recognized for the 1998 through 2005 period and total stockholders equity being reduced by a total of $2.1 million at December 31, 2005. During the first six months of 2006 an additional $1.2 million of stock compensation expense was recognized, which reduces our previously reported operating results for this period.

In restating our previously issued financial statements for the investigations described above, we also corrected other previously reported amounts. We corrected our reporting for $80.3 million of net sales to certain third party resellers and $41.2 million of associated cost of net sales in 2005 to classify these amounts as related party net sales and related party cost of net sales classifications, respectively, because in 2006 we determined that sales to these entities were, in substance, sales to one of our significant shareholders, SOFTBANK CORP. The accounts receivable from these sales was similarly reclassified into accounts receivable from related parties in our 2005 balance sheets. We also corrected our reporting of $6.3 million of time deposits at March 31 and June 30, 2006 because they did not mature within three months. Formerly the time deposits had been reported in error as cash equivalents, but now these amounts are included in short-term investments in these balance sheets and in the statements of cash flows for the March and June 2006 reporting periods. The corrections for all 2006 and 2005 interim periods have been recorded in the condensed consolidated financial statements included in Exhibit 99.1 of this Annual Report.

None of these restatements has any effect on any of our December 31 cash balances; however, cash equivalents were reduced in the March and June 2006 periods due to the reclassifications described above.

Additional information about these restatements and their effects on our financial statements is presented below as well as in the Notes to Consolidated Financial Statements.

China Sales Investigation

The Audit Committee of the Company s Board of Directors (Audit Committee) engaged independent counsel to conduct an investigation of sales in China following a determination by the Internal Audit group that allegations of improper activities in a sales office in the Western Region were credible. The allegations were made by a Company employee using the Company s whistle blower program. The independent counsel engaged forensic accountants, and this group is collectively referred to as the Investigating Team in the rest of this discussion.

In conducting its procedures, the Investigating Team found instances where the customer contracts that evidenced the arrangement contained obligations for the Company to deliver software upgrades when and if made available for the equipment sold for no additional consideration and for an unspecified period that could extend over the term of the contract. This additional contract obligation is an element of post contract support. In these cases, the Investigating Team found that the contract documentation for the same transaction submitted by the sales office to the Company s China headquarters for accounting purposes and utilized by the Company in determining the amount of revenue recognized did not include evidence of such post contract support obligations.

Accounting standards governing revenue recognition for system sales require all revenue to be deferred while there are undelivered elements under the arrangement unless the seller has established vendor specific objective evidence (VSOE) of fair value for such contract elements. Because these arrangements included such undelivered elements, revenue should be deferred based on the VSOE of the fair value of the underlying elements. VSOE of fair value represents the price charged when the same element is sold separately. Since the Company does not sell this element separately, it has not established VSOE for such undelivered elements, and as such the revenue from such contracts is required to be deferred and recognized over the period the Company is obligated to provide the post contract support.

The China sales investigation covered each of the seven years in the period ended December 31, 2006 and included: investigating approximately 1,200 contracts in all of our five regions in China; reviews of the electronic files of 45 employees; and formal interviews of 96 employees in China. Additionally, the China sales investigation included reviewing contract files, performing various financial analyses including comparison of payments received per our accounting records to the contract terms, and computer forensic procedures where destruction of electronic documents was suspected. In the aggregate, the Investigating Team expended approximately 25,000 hours in conducting this investigation, which commenced in February 2007 and was completed in September 2007 when the independent counsel and forensic accountants presented their final report to the Audit Committee. In July 2007, we announced the Audit Committee was conducting an independent investigation of historical sales with certain customers in China and we stated that we could not rule out the possibility that the outcome of the investigation could impact revenue recognized for certain of such contracts as recorded in our previously issued financial statements.

Upon completion of the investigative phase of the independent investigation by the Audit Committee, our management:

- conducted follow-up procedures to attempt to locate any additional relevant information to ensure the Company considered all available information and documents;

- evaluated the accounting for identified system sales using the contract template and documentation found in the sales contract files from the Western Region offices. This included calculating the financial statement effects of correcting the accounting for all system sales where the contract template found at our sales offices contained post contract support obligations to recognize revenue and cost of net sales over estimated period of post contract support;

- concluded that as a result of the existence of this undelivered post contract support obligation our previously issued financial statements should be restated to defer system sales contract revenue and the related cost of net sales over the estimated period of post contract support when a contract contained unspecified software upgrade rights.

The Audit Committee concurred with management s decisions.

The effect of correcting improperly recognized revenue and cost of net sales is to (reduce) increase previously reported net sales, gross profit and net income by the following amounts (in thousands of dollars):

Year ended December 31,	**Net sales**	**Gross profit**	**Net income**
2000	$ (12,408)	$ (5,294)	$ (4,781)
2001	(17,154)	(6,330)	(5,779)
2002	(64,732)	(22,924)	(19,697)
2003	(21,060)	(8,014)	(6,382)
Totals through December 31, 2003	(115,354)	(42,562)	(36,639)
2004	(104,965)	(27,241)	(18,594)
2005	(58,232)	(27,863)	(42,433)
2000 - 2005 Total	(278,551)	(97,666)	(97,666)
2006 quarter ended			
March 31	5,410	1,360	1,360
June 30	2,380	(371)	(371)
Total China Sales Restatement	$ (270,761)	$ (96,677)	$ (96,677)

The cumulative effect of all of the China sales restatement adjustments to our consolidated balance sheet as of December 31, 2003 resulted in a decrease in retained earnings of $36.6 million, an increase in deferred revenue of $115.4 million to account for previously recognized sales, an increase in deferred costs of $75.7 million to account for previously recognized cost of net sales, and an increase in deferred tax assets of $3.0 million. In our consolidated balance sheet at December 31, 2006, deferred revenue is $275.7 million, of which $35.6 million is classified as current and $240.1 million as non-current, and the deferred costs balance is $176.6 million. These amounts will be recognized in our consolidated statements of operations over the estimated remaining period of post contract support.

Upon completing its investigation, the Audit Committee concluded that the conditions and practices relating to systems contracts prevalent in the Western Region resulted primarily from the failure to prevent or detect instances of override related to controls in China over customer agreements, lack of proper management oversight, unclear record retention policies and procedures relating to systems contracts, and inadequate employee training. The Investigating Team and the Audit Committee also concluded that with respect to four regions other than the Western Region there was no evidence of fraud or misconduct or reason to suspect such occurred. The Investigating Team and the Audit Committee also concluded that there was no credible evidence of knowledge by senior management in China or the United States of the conditions and practices related to the Western Region of China that were discovered in the investigation. The Audit Committee concluded that local management in several of the sales offices in the Western Region of China did not submit appropriate information to the Company s senior management in China and the United States. Therefore, in prior years, neither the Company s management nor the Company s independent registered accounting firm were able to properly evaluate the effect of that information on revenue recognition. The Audit Committee also concluded that certain members of management in China bear varying degrees of responsibility for inadequate oversight of activities. As a result, certain employees in China have either been terminated or placed on suspension for failure to provide adequate oversight of activities.

We have restructured the management of the Western Region sales organization and are working to identify and implement changes to our policies and procedures and enhance employee training to improve internal control consciousness and lessen the possibility of accounting errors occurring in the future.

Stock Option Accounting

In November 2006, we announced we had commenced a voluntary review of historical stock option practices under the leadership of the Governance Committee following a preliminary review by management which identified potential deficiencies and discrepancies in the documentation of stock option grants. The review considered all option grant awards made in the period from February 29, 2000, shortly before the initial public offering of our Common Stock, through August 2006 (Review Period) for compliance with the various stock-based compensation accounting standards applicable during the Review Period as well as the rules of our stock option plans. The Governance Committee engaged independent outside legal counsel to assist in the review who, in turn, engaged forensic accountants. (Separate law firms and separate forensic accounting firms were engaged by the Audit Committee and the Governance Committee for the China sales investigation and the stock option accounting review.) In the rest of this discussion, this group collectively is referred to as the Stock Option Review Team and their actions and activities are referred to as the Stock Option Review. The Stock Option Review Team members spent over 11,000 hours in this review, and the Governance Committee met with the Stock Option Review Team on more than a dozen occasions to receive, discuss, and consider the Stock Option Review Team s information and findings.

At the time the review commenced, the Governance Committee consisted of three members of the Board of Directors, all of whom are independent directors. The Committee decided to delegate supervision of the review to Mr. Jeff Clarke, its Chairman, who joined our Board in 2005 and had not

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served on the Compensation Committee of the Board of Directors (Compensation Committee) during the period under review. The Governance Committee also consisted of two other independent directors, Mr. Larry D. Horner and Mr. Thomas Toy, who also serve on the Board s Compensation Committee. Mr. Allen Lenzmeier was appointed to the Governance Committee on April 27, 2007.

Review procedures included:

- interviews of individuals involved with granting, advising, administering, or accounting for stock options, including current and former: management, members of the Board of Directors, employees, and non-employee professionals;
- review of relevant stock administration, human resource, legal, and finance department files and records;
- review of stock option grant information in select employee personnel files;
- review by at least 30 attorneys and 15 forensic accountants of approximately 250,000 potentially relevant e-mails and documents in electronic format selected through electronic discovery techniques from over 1.8 million electronic documents processed;
- review of the electronic database of the Company s stock option activity maintained by a third party along with communications to and from this service provider;
- reconciliation of grant activity from approval documents executed by the Compensation Committee with the electronic database;
- reconciliation of stock option grant, exercise, and cancellation information from SEC filings with select employee personnel files and the electronic database;
- statistical and judgmental pattern analysis;
- follow-up on matters raising questions about the option granting process and its history, conduct of those involved with granting, advising, administering, or accounting for stock options, or the accounting treatment for stock options; and
- follow-up on items or issues requested or identified by management or the Company s independent registered public accounting firm.

The Stock Option Review Team, management, and the Governance Committee decided to group stock option grants into six award categories based on differences in what constituted substantive approval for each category under our stock option granting practices as well as giving consideration to the risk of intentional misstatement of the grant date. Guidance in a September 19, 2006 letter publicly issued by the SEC s Chief Accountant focuses on the concept that a measurement date under Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* (APB 25), the accounting standard governing our stock option accounting through 2005, does not occur until the number of shares an individual employee is entitled to receive and the exercise price is determined with finality (i.e., no longer subject to change). This is the date on which substantive approval occurred, and depending on a company s facts and circumstances the guidance from the SEC discussed above recognizes a company may determine that the measurement date for some stock option grants may occur before all required granting actions have occurred such as final approval by the Compensation Committee. This alternative is available only when a review of all facts and circumstances supports a conclusion that substantive approval occurs earlier than when all required granting actions have occurred and there is no evidence of fraudulent or manipulative conduct in the company s option granting practices.

In determining the measurement date to be used, the Stock Option Review Team, management, and the Governance Committee agreed to use the following definitions as constituting the proper measurement date, and generally these dates were used in testing the stated grant dates or establishing corrected measurement dates:

Discretionary Director and Officer Grants	The date of a Compensation Committee meeting where the grant was approved or the date the final Compensation Committee signer approved the grant when approval occurred through unanimous written consent documents (UWC).
Automatic Director Grants	The date specified in the relevant stock option plan.
Broadbase	The date the grantee list, including the allocation of shares to individual grantees, was complete. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
Acquisition	The first Compensation Committee meeting following the acquisition, provided grantees had received employment offer letters stating the number of stock options to be granted before such date, because this was the date at which the option exercise price was established. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
New Hire	The first scheduled Compensation Committee meeting following the first day of employment, because this was the date at which the option exercise price was established. The number of options was based on either grant amounts specified in an employment offer letter or, in some cases, on a matrix that assigned grant amounts based on position and level within the Company. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
Other Merit	The date the grantee list, including the allocation of shares to grantees, was substantially complete. Compensation Committee approval was considered perfunctory due to delegation of authority to management.

For 12 tested grant dates where a corrected measurement date was required, the Stock Option Review Team and management were unable to locate sufficient evidence to establish a corrected measurement date using our established criteria for the applicable option grant type. In these situations alternative available evidence was used to establish the corrected measurement date.

During the period covered by the Stock Option Review, we granted stock options on approximately 34 million shares of our Common Stock at 197 grant dates. The review specifically examined the appropriateness of the stated grant date for approximately 90% of the stock options granted, including all stock option grants made to directors and officers, all broadbase grants and all option grants made in connection with business acquisitions.

The findings of this review are summarized as follows:

				Measurement date changed	
	Number of	Grants	No change	additional compensation	no additional compensation
Grant Type	**grants**	**tested**	**required**	**expense required**	**expense required (1)**
Discretionary Director & Officer	16	16	8	4	4
Automatic Director	5	5	5		
Broadbase	8	8		6	2
Acquisition	10	10	10		
New Hire	166	48	48		
Other Merit	96	41	4	21	16
Total	301 (2)	128	75	31	22

(1) Under APB 25 there is no expense adjustment arising from using the corrected measurement date for these grants because the amount the employee would have to pay to exercise these stock option grants exceeded the quoted market price of our Common Stock at the corrected measurement date, and therefore, these stock option grants contained no intrinsic value at the corrected measurement date.

(2) The number of grants exceeds the number of grant dates because on certain grant dates more than one category of stock option grants were approved.

In late January 2007 the Governance Committee reported its interim findings concerning the use of incorrect measurement dates in our stock option accounting under APB 25 to our Board of Directors. On February 1, 2007, the Audit Committee of the Board of Directors then concluded, in consultation with and upon the recommendation of management, that we should correct for errors in previously reported stock-based compensation expense through restatement of our previously issued financial statements and that our previously issued financial statements for all periods should no longer be relied upon. We communicated this decision in a February 1, 2007 public announcement.

A non-cash compensation charge, to be recognized as an expense over a grantee s service period, arises under APB 25 if a stock option has intrinsic value at its measurement date. This intrinsic value is measured by the excess, if any, of the fair value at the date of grant of the underlying common stock over the stock option s exercise price. Our practice has been to grant stock options with exercise prices equal to the closing price of our Common Stock at each grant date, to use the grant date as the measurement date for stock-based compensation purposes, and as such previously we had determined the granted stock options had no intrinsic value at their grant dates and no compensation expense was recognized. However, APB 25 states the measurement date does not occur until all essential actions necessary to grant the option are completed, including the final determination of both the number of shares to be granted to each employee or director and the exercise price, and the option grant is approved by those with requisite authority. This is reinforced by the September 19, 2006 letter issued by the SEC s Chief Accountant which focuses on the need for the number of shares and exercise price of an award to an individual to be finalized to have a measurement date. This letter clarifies the SEC staff s view that if it is possible that those terms could change, a measurement date has not occurred, even if the award s terms are not actually changed.

Based on the available evidence, the review found that the number of shares an individual employee was entitled to receive and/or the exercise price was not determined with finality at the stated grant date on 53 tested grant dates, and we should have used a later date as the measurement date. The principal reasons for the stated grant date not qualifying as the measurement date under APB 25 include:

- certain listings of grantees, below officer level, were incomplete and added to or modified by stock option administration personnel after the grant was approved by the Compensation Committee;

- for certain grants where Compensation Committee approval was not considered perfunctory, the date a UWC document was sent to Compensation Committee members for approval was used as the stated grant date for some discretionary officer and director grants rather than the date the UWC was signed by all Compensation Committee members and therefore became effective;

- the Stock Option Review Team was unable to locate contemporaneous documentation of some director and officer, broadbase, new hire, and other merit grants.

During the review the Company also discovered a stock option grant to a former officer that was modified in 1998 in connection with his termination of employment. This change was never included in the Company s stock option grant records and the additional compensation expense resulting from the change in the option s terms (approximately $1.2 million) was not recorded previously. This discovery is consistent with the Stock Option Review Team s finding that in certain instances there was a lack of formal documentation in the stock option granting process and/or expected documentation is missing from the stock option administration files. In addition, the Stock Option Review Team found that, in many instances, there was a lack of self-authenticating evidence to corroborate that cash exercises were contemporaneous. As a result, the findings on the issue of backdating of cash exercises were inconclusive.

We are restating our consolidated financial statements to recognize additional non-cash stock-based compensation expense arising from using corrected measurement dates for certain stock option grants made during the years 2000 through 2005 and to reflect the modification of the 1998 grant described above. Consistent with our historical accounting policy this additional stock-based compensation expense is being recognized on an accelerated basis by treating each vesting tranche as a separate stock option grant (graded vesting).

Our accounting for stock-based compensation changed to a fair value based method in 2006 when, as required by accounting standards, we ceased accounting for stock-based compensation under the intrinsic value method pursuant to APB 25 and began accounting for stock-based compensation under Statement of Financial Accounting Standards 123(R) *Share-Based Payments* (SFAS 123(R)). Under this method all stock option grants have a fair value determined using an option pricing model, and such fair value is used to recognize non-cash stock-based compensation expense. We are restating our unaudited condensed consolidated financial statements for the first and second fiscal quarters of 2006, included in Exhibit 99.1, to recognize changes in non-cash stock-based compensation expense that arose from a re-determination of the fair value of stock options granted in 2005 and prior where the Governance Committee s review resulted in a corrected measurement date. By January 1, 2006, of the 17.9 million options granted in 2000 - 2005 where corrections were made to the measurement dates in the Stock Option Review, 4.4 million options with corrected measurement dates granted in 2000 and 2001 had fully vested. Therefore, the fair values of the outstanding and unvested portion of the remaining 13.5 million stock options granted in 2002 - 2005 with incorrect measurement dates were recalculated. We are also recording additional non-cash stock-based compensation expense in the first two quarters of 2006 arising from correcting the measurement date for stock option grants to three individuals in this period. We recognize stock compensation expense on a straight-line basis under SFAS 123(R).

Those stock option grants with corrected measurement dates have also been restated using the fair value based measurement principles of Statement of Financial Accounting Standards 123 *Accounting for Stock-Based Compensation* (SFAS 123) to present, in Note 2, Restatement of Financial Statements of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report, the pro forma effect on stock-based compensation expense, net income (loss), and earnings (loss) per share amounts in 2004 and 2005 of using the fair value based method to determine stock-based compensation expense rather than using APB 25 s intrinsic value method. Such disclosure is required in financial statements for periods prior to the adoption of SFAS 123(R).

In addition to restating the consolidated financial statements in response to the Governance Committee s findings, we are recording additional non-cash adjustments to account for the modification in 1998 of a stock option grant to a former officer in connection with his termination of employment and to record in the first two quarters of 2006 corrections relating to accounting for performance related stock options and restricted stock grants, all of which were previously identified and considered immaterial.

Correcting the measurement date for previously granted stock options in some cases results in additional taxable income to employees on which additional payroll taxes are due from the employees as well as us. We have provided for all additional payroll taxes plus related penalties and interest arising from the restatement of stock-based compensation, including amounts otherwise payable by stock option recipients, and our restated financial statements include an accrual in all affected years of approximately $1.5 million for all estimated payroll tax related expenses.

The corrections for the stock option restatement are to increase (reduce) previously reported non-cash compensation expense, payroll taxes, income taxes and net income by the following amounts (in thousands of dollars):

Year ended December 31,	**Non-cash stock compensation**	**Payroll taxes**	**Income taxes**	**Net income**
1998	$ 1,244	$	$ (448)	$ (796)
1999				
2000	556		(104)	(452)
2001	4,870		(942)	(3,928)
2002	8,110		(1,550)	(6,560)
2003	12,470	900	(2,281)	(11,089)
Totals through December 31, 2003	27,250	900	(5,325)	(22,825)
2004	(410)	541	250	(381)
2005	(1,290)	60	4,083	(2,853)
2000 - 2005 Total	25,550	1,501	(992)	(26,059)
2006 quarter ended				
March 31	662	9		(671)
June 30	504	6		(510)
	$ 26,716	$ 1,516	$ (992)	$ (27,240)

The Governance Committee s review found 17.9 million stock options of the 28.8 million options granted on our Common Stock during 2000 through 2005 had incorrect measurement dates. Using the corrected measurement dates, 7.6 million stock options had exercise prices that exceeded the closing price of our Common Stock and therefore had no intrinsic value to be accounted for under APB 25, and 10.3 million stock options had intrinsic value because their exercise prices were below the closing price of our Common Stock. These 10.3 million stock options resulted in an increase in additional non-cash stock-based compensation expense of $24.3 million, and an additional $1.5 million of payroll tax related expenses during 2000 - 2005 partially offset by $0.5 million of income tax benefit as shown in the above table. Of the 10.3 million stock options resulting in additional non-cash stock-based compensation expense, 2.0 million options were granted to officers and directors and resulted in $6.1 million of additional non-cash stock-based compensation expense.

Upon completing its review, the Governance Committee concluded it found no evidence of intent to manipulate the Company s operating results or financial statements. A key finding of the Governance Committee was that there were deficiencies with the process by which stock options were granted during the period from our initial public offering in 2000 through at least 2005, which resulted in accounting errors. The Governance Committee concluded that certain members of management bear varying degrees of responsibility for the deficiencies in the process by which options were granted. The Governance Committee s review also concluded that none of the current or former employees or directors of the Company engaged in intentional wrongdoing.

In determining the above restatement amounts, management used all reasonably available relevant information to form conclusions it believes are reasonable as to the most likely option granting actions that occurred, the dates when such actions occurred, and the determination of grant dates for financial accounting purposes based on when the requirements of the accounting standards were met. In light of significant judgment used in establishing revised measurement dates, alternative approaches to those used by the Stock Option Review Team and management could have resulted in different compensation charges than those recorded in the restatement. The Stock Option Review Team and management considered various alternatives throughout the course of the review and restatement, and management believes the adjustments to measurement dates used in our review of stock option grant accounting and restatement of our financial statements are reasonable and appropriate in our circumstances.

Summary of Restatement Amounts

The following table presents the decrease in net earnings from the restatement for each restated year:

Year ended December 31,	Net income (loss), as previously reported	Restatement adjustments China Sales	Stock Options	Total	Net income (loss), as restated
		(Decrease) Increase (in thousands)			
1998		$	$ (796)	$ (796)	
1999					
2000		(4,781)	(452)	(5,233)	
2001		(5,779)	(3,928)	(9,707)	
2002	$ 107,862	(19,697)	(6,560)	(26,257)	$ 81,605
2003	$ 209,856	(6,382)	(11,089)	(17,471)	$ 192,385
Totals through December 31, 2003		(36,639)	(22,825)	(59,464)	
2004	$ 69,824	(18,594)	(381)	(18,975)	$ 50,849
2005	$ (487,359)	(42,433)	(2,853)	(45,286)	$ (532,645)
2000 - 2005 Total		(97,666)	(26,059)	(123,725)	
2006 quarter ended					
2006 Q1		1,360	(671)	689	
2006 Q2		(371)	(510)	(881)	
		$ (96,677)	$ (27,240)	$ (123,917)	

The effect these corrections on diluted earnings (loss) per share for 2002 to 2005 are as follows:

Year ended December 31,	Diluted earnings (loss) per share, as previously reported	Restatement amounts China sales	Stock options	Total restatement	Diluted earnings (loss) per share, as restated
2002	0.94	(0.17)	(0.06)	(0.23)	0.71
2003	1.70	(0.05)	(0.09)	(0.14)	1.56
2004	0.54	(0.14)	(0.00)	(0.14)	0.40
2005	(4.16)	(0.36)	(0.03)	(0.39)	(4.55)

The cumulative effect on stockholders equity at December 31, 2003 from the above corrections is as follows (in thousands):

Increase (decrease) in additional paid-in capital and deferred stock compensation:	
Values assigned to stock options	$ 27,250
Reduction of previously recorded income tax benefits from stock options	(1,278)
Net increase in additional paid-in capital and deferred stock compensation	25,972
(Increase) decrease in retained earnings:	
Revenue and related cost of sales deferral for China system sales	(36,639)
Additional non-cash compensation expense from stock options	(27,250)
Payroll taxes for values assigned to stock options	(900)
Income tax benefit from additional compensation and payroll tax expense	5,325
Net increase in retained earnings	(59,464)
Net decrease in stockholders equity at December 31, 2003	$ (33,492)

SEC Filings to Report Restatements

This Annual Report includes restatements of the following previously filed financial statements and related information: (1) our consolidated financial statements as of December 31, 2005 and for the fiscal years ended December 31, 2004 and 2005; (2) unaudited Quarterly Financial Data for the first two quarters in the fiscal year ended December 31, 2006 and for all quarters in the fiscal year ended December 31, 2005; (3) Segment Data and Management s Discussion and Analysis of Financial Condition and Results of Operations for these periods; and (4) Selected Consolidated Financial Data as of and for the years ended December 31, 2005, 2004, 2003 and 2002. All financial information in this Annual Report also gives effect to prior restatements of our financial statements reported in our Annual Reports for 2003 and 2005.

Concurrently with the delayed filing of this Annual Report with the SEC, we are also filing our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 which has not been filed previously. We expect to file our currently delinquent Quarterly Reports on Form 10-Q for the quarters ended March 31, 2007 and June 30, 2007 shortly. These Form 10-Q quarterly reports will include complete restated financial statements for the three and nine month periods ended September 30, 2005; the three month period ended March 31, 2006, and the three and six month periods ended June 30, 2006, respectively. Additionally, Exhibit 99.1 of this Annual Report contains restated condensed consolidated balance sheets and statements of operations as of and for the three month and year to date periods ended June 30, 2006, March 31, 2006, September 30, 2005, June 30, 2005 and March 31, 2005. Exhibit 99.1 also contains restated condensed consolidated statements of cash flows for the three months ended March 31, 2006 and the six months ended June 30, 2006, which give effect to the corrections for the aforementioned 2006 error in the classification of certain time deposits, the restated condensed consolidated statement of operations for the three month period ended December 31, 2005, and the restated condensed consolidated balance sheet at December 31, 2004. This follows guidance issued by the SEC concerning presenting information about the effects of restating previously issued financial statements for the effects of correcting errors in prior stock option accounting. Pursuant to this guidance we do not intend to amend any of our previously filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for the periods affected by the restatements and such reports should not be relied upon.

PART I

ITEM 1 BUSINESS

OVERVIEW

We design, manufacture and sell telecommunications infrastructure, handsets and customer premise equipment and provide services associated with their installation, operation, and maintenance. Our products are sold primarily to telecommunications service providers or operators. We sell an extensive range of products that are designed to enable voice, data and video services for our operator customers and their subscribers around the world. While historically the vast majority of our sales have been to service providers in China, we have expanded our focus to build a significant presence in many global markets and currently sell our products in several established and emerging growth markets, which include North America, Japan, India, Central and Latin America, Europe, the Middle East, Africa and Southeast and North Asia.

UTStarcom was incorporated in Delaware in 1991. Our headquarters are based in Alameda, California, with research and design operations in the United States, Canada, China, India and Korea. Our primary mailing address is 1275 Harbor Bay Parkway, Alameda, California, 94502. We can be reached by telephone at (510) 864-8800 and our website address is *www.utstar.com*. All of our SEC filings can be found under the Investor Relations section of our website or at the SEC s website at www.sec.gov and are available free of charge.

OUR OBJECTIVE

Our objective is to be a leading global provider of Internet Protocol (IP) -based communications products and services. We seek to differentiate ourselves by developing innovative, first-to-market products that are designed to integrate multiple functionalities and deliver multiple revenue-generating services on a single technology platform, reduce network complexity, and enable a migration to a new generation of network technologies. Our products and software are designed to make carrier deployments, maintenance and upgrades both economical and efficient, allowing operators to earn a high return on their investment.

OUR STRATEGY

Because our products are IP-based, our customers can more easily integrate our products with other industry standard hardware and software. Additionally, we believe we can introduce new features and enhancements that can be cost effectively added to our customers existing networks. IP-based devices can be changed or upgraded in modules, saving our customers the expense of replacing their entire system installation. Our strategy is built upon the following key concepts:

- identify key technology shifts and trends before our competitors;
- develop differentiated products, which are designed to offer new and innovative revenue-generating features and enhanced functionality for our customers;
- reduce overall operational and deployment costs of our customers networks, enabling them to meet the demands of a greater number of consumers by expanding their addressable markets; and
- develop tailored products and services to suit customers current needs and to anticipate future needs.

KEY STRENGTHS

Our key strengths in the implementation of our strategy include the following factors:

A History of Technology Innovation

Since our inception, we have focused on the development of new innovative communications technologies and products that are designed to differentiate us from our peers and create new market opportunities for our carrier customers. For example, we helped create a new market for wireless telephony in China based upon the development of our Personal Access Service and IP-based Personal Access Service (collectively PAS) products offering a low-power, low-cost alternative to traditional mobile telephony. We believe PAS became successful with traditional wireline carriers because it enabled them to build upon their existing fixed-line networks to offer their consumers wireless mobile services. This service, while limited in range to each specific city or region in which it was offered, afforded a low-cost alternative to more expensive traditional cellular services. The rapid rate of adoption for PAS positioned us as one of the leading wireless infrastructure and handset providers in China and to date over 52 million subscribers are using services supported by our technology.

A Significant Customer Base and Leverage in China

Over the course of several years, we have built an extensive administrative, research and development, manufacturing, and sales and support infrastructure in China. We believe this infrastructure allows us to focus our engineering, product development and sales and marketing efforts to quickly identify and address our customers needs. In addition, our low-cost research and development and manufacturing capabilities in China allow us to be competitive on a cost and pricing basis for our products. Finally, by virtue of its large population and low teledensity, or the number of telephones per person in a region, and our significant customer deployments, the China market provides a highly conducive platform for us to deploy our most advanced technology in substantial volume. We believe that our infrastructure, cost efficiencies, and research and development advances in China provide a significant platform and strategic advantage for our global success.

A Commitment to Carrier Value

We believe we have been able to develop strong relationships with our customers by delivering complete product lines that are designed to enable carriers to capitalize on economies of scale and to easily customize and extend their service offerings. To ensure our products deliver the most value, the UTStarcom product architecture is designed to allow carriers to offer a full range of services over multiple access networks, whether wireless or wireline. Our wireless products support a broad range of frequencies for cost-effective deployment worldwide and our broadband products support both copper- and fiber-based access. To help ensure we offer high value solutions at a low cost, we leverage our design, development, and manufacturing facilities in China.

A Focused Global Market Diversification Initiative

In 2006, we continued to focus on the diversification of our global customer base and market penetration. Our diversification strategy involves a combination of internal efforts and strategic acquisitions. In order to better address new markets outside of China we introduced a number of new products including our Continuity solutions for the Fixed Mobile Convergence market; the F3000 portable WiFi handset; and Evolution Voice Data Only rev A capability for MovingMedia 2000.

Our acquisition of selected assets of the wireless handset division of Audiovox Corporation in November of 2004 enhanced our ability to gain access to some of the largest and most stable operators worldwide, particularly in the United States. As a result of this acquisition, the United States has become our largest market, representing 55% of net sales in 2006.

In addition to the large telecommunications service providers in well-established markets, we also target carriers in emerging markets, such as Philippines Long Distance Telephone Company in the Philippines, Vonage Holdings Corporation in the United States, Reliance Infocomm Ltd. in India and Brazil Telecom in Brazil, which have all focused their network deployments on IP-based voice, data and video services.

We believe emerging markets present significant opportunities for growth. We believe that many developing regions see a correlation between increased teledensity and improved economic growth, recognizing the need to invest in a telecommunications infrastructure in order to compete globally and overcome economic disparities. Our strategy is to develop products and design services to meet the needs and level of affordability of these emerging-market service providers and their customers. In addition, we recognize that to be successful in emerging markets, it is often important to commit to establishing a local presence in areas such as research and development, manufacturing, sales and support. We continue to explore major growth potential in global markets outside of China and believe that many of these markets are ideal candidates for our products and services.

MARKETS AND CUSTOMERS

Our products and services are being deployed and implemented in regions throughout the world in markets including China, Japan, India, Central and Latin America, Europe, Africa, North America, Asia and the Middle East. Historically, China has been our largest market, representing 32%, 30%, and 79% of our net sales in 2006, 2005 and 2004, respectively. With the acquisition of selected assets from Audiovox Corporation in November 2004, sales in the United States have grown to 55% of net sales in 2006 compared to 46% and 13% in 2005 and 2004, respectively. Additional markets and customer information is included in the discussion of business segments below.

Global Customers

Our customers, typically telecommunications service providers, enable delivery of wireless and broadband access services including data, voice, and/or video to their subscribers. They include, but are not limited to, local, regional, national and international telecommunications carriers, including broadband, cable, Internet, wireline and wireless providers. Telecommunications service providers typically require extensive proposal review, product certification, test and evaluation, network design, and, in most cases, are associated with long sales cycles. Our customers networking requirements are influenced by numerous variables, including their size, the number and types of subscribers that they serve, the relative teledensity of the geography served, their subscriber demand for wireless and wireline communications, and access services in the served geography.

Global Sales and Service

Our worldwide sales organization consists of managers, sales representatives, network consultants and technical support personnel. We have field sales offices in various locations including China, Japan, India, Central and Latin America, Europe, Africa, North America, Asia and the Middle East. We operate six retail facilities for end-user devices under the name Quintex® and license the trade name Quintex® to six outlets in selected markets in the United States. We continue to increase our penetration of these markets in several ways:

- through direct sales offices located in key market regions;
- by licensing our technology to local manufacturers;
- by developing local sales agency and distributor relationships within specific market regions; and
- by establishing sales relationships with original equipment manufacturers.

We continue to aggressively build regional in-country sales offices with local direct sales staff in order to provide support for our expanding global operations.

In addition to our product offerings, we provide a broad range of service offerings, including technical support services. Our service offerings complement our products with a range of consulting, technical, project, quality and maintenance support-level services including 24-hour support through technical assistance centers. Technical support services are designed to help ensure that our products operate efficiently, remain highly available, and benefit from the most up-to-date system software. These services enable customers to protect their network investments and minimize downtime for systems running mission-critical applications.

Competition

We compete in the telecommunications equipment market, providing infrastructure products, consumer products and services for transporting data, voice and video traffic across traditional and IP-based networks.

As we expand into new markets, we will face competition from both existing and new competitors, including existing companies with strong technological, marketing and sales positions in those markets.

We believe our competitive strengths are derived from three main principles: our early entry and commitment to the development of all IP-based communications technologies; our experience in high-volume, low-cost manufacturing and large-scale technology deployments in China; and our commitment to developing comprehensive, complete product offerings for our carrier customers that allow them to capitalize on economies of scale and differentiate their service offerings.

By contrast, our competitive disadvantages include our relatively smaller size in terms of revenues and working capital, and number of employees as compared to many of our competitors, our lack of history and experience in selling to many of the largest carriers in well-established markets and our lack of consumer brand recognition in markets outside of China.

TECHNOLOGY AND PRODUCTS

Our technology focus centers on an IP-based softswitch core network architecture that creates a single platform for delivering multiple services to the end user of the telecommunications network. A softswitch is a software-based system for handling call management functionality that has historically been handled by a large hardware switch device in a traditional telephone network. Our IP-based softswitch is a technological approach to telephony networking where all of the capability for the delivery of telephone services resides in easily adaptable IP-based software. A softswitch is designed to reduce the cost of long distance and local exchange switching and to create new differentiated voice, data and video services. In contrast, legacy networks are based on the delivery of a single service, such as voice or data. If a service provider operating a traditional network wanted to offer multiple services, it would have to build, run and maintain a separate network for each service, including separate billing, network management and support functionalities, adding significant costs to the carrier s operating model. A multi-service, IP-based core network is designed so that all services can be converged onto one platform with one billing, network management and support function for all services. In addition, because it is largely software-based, an IP network is by design more cost-effective to run and maintain than traditional infrastructure technologies. All of our products are interoperable and can be integrated into a single IP-based network. We intend to continue to support our IP-based wireless and broadband services and enhance their functionality for deployment in all global markets. We also intend to continue our research and development efforts on future IP-based access services.

Our IP-based softswitch architecture (mSwitch) is a diverse assembly of software and hardware-based networking elements designed to replace traditional central office telephone switches. Our mSwitch enables the delivery of a common set of features and services over a variety of access networks, whether wireless or wireline. Our products are designed to support a variety of services, including broadband and narrowband access, call control of telephone and data communications and delivery of next generation features not offered by the traditional fixed line switching infrastructure, including IP-based television (IPTV).

mSwitch Platform

Our mSwitch® is a flexible IP-based platform designed to provide voice communications over an IP network. The mSwitch® product family supports three primary solutions:

- IP-based Personal Access System (iPAS) Wireless Local Service;
- Next Generation Network (NGN) Voice over Internet Protocol (VoIP); and
- Fixed Mobile Convergence.

mSwitch® enables service providers to migrate from existing circuit platforms to a next generation IP-based packet switch architecture, or to launch new applications in a greenfield environment. Our mSwitch® portfolio is a carrier-class next generation switching product family that enables service providers to:

- Deploy a converged core switching network that supports both wireline and wireless endpoints;
- Enable application delivery across diverse access points;
- Maintain consistent end user experience regardless of method of access to the applications;
- Protect investment in their core infrastructure;
- Deploy a scalable, modular system; and
- Enjoy the benefits of an Operation Support System /Network Management System suite designed to integrate seamlessly with the service provider s existing network.

Business Segments

In organizing our extensive product portfolio, we have created four individual operating units: Network Solutions, Personal Communication Division (PCD), Handsets and Global Services & Support International (Services).

- Network Solutions: Our Network Solutions operating unit provides is products and services through two reporting segments; Broadband Infrastructure and Wireless Infrastructure. Our Wireless Infrastructure segment designs, builds and sells software and hardware products that enable end users to send and receive voice and data communication in either a fixed or mobile environment. Our Broadband Infrastructure segment designs, builds and sells software and hardware products that enable end users to access high-speed, cost effective wireline data, voice and media communication.

- Personal Communications Division: Our Personal Communications Division markets, sells and supports handsets other than PAS handsets for markets other than China. Most of our handset sales in 2005 and 2004 were designed and built by other manufacturers, however, in 2005 we began shipping handsets designed and manufactured by us and for the 2006 fiscal year handsets manufactured by us made up approximately 36% of the total unit sales.

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- Handsets: Our Handset segment designs, builds and sells consumer devices that allow customers to access wireless services. All handset revenues within China are included in this segment.

- Services: Our Services segment provides service and support for Wireless Infrastructure and Broadband Infrastructure customers in the areas of planning, deployment, operations and ongoing maintenance.

Our products within each of these categories, excluding services, include multiple hardware and software subsystems that can be offered in various combinations to suit individual carrier needs. Our system products are based on widely adopted global communications standards and are designed to allow service providers to quickly and cost-efficiently integrate our systems into their existing networks and deploy our systems in new broadband, IP and wireless network rollouts. Our products are also designed for quick and cost-effective transition to future network technologies, enabling our customers to make the best use of their existing infrastructure. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Net Sales, for a discussion of our net sales by business segment.

NETWORK SOLUTIONS

Wireless Infrastructure

The products in our Wireless Infrastructure segment are based on a variety of leading worldwide mobile interface standards, including: Personal Handyphone System (PHS) and CDMA2000. Our Wireless Infrastructure business accounted for approximately 17%, 15% and 49% of revenues in 2006, 2005 and 2004, respectively. All of our wireless products are designed to offer a full suite of integrated, customizable, voice and value-added services, including text messaging services, web browsing, e-mail, voice mail, and Internet access.

Personal Access System

Our Personal Access System family of wireless core infrastructure equipment, based on the PHS standards developed by The Association of Radio Industries and Telecommunication Technology Committee in Japan, is designed to help our customers create new revenue opportunities with high quality wireless voice and data services. Approximately 79% of our Wireless Infrastructure revenue is derived from our PAS product.

With the UTStarcom iPAS wireless access network, operators can migrate their current wireline network to an IP-based PHS wireless network that provides wireless voice and data services within a city or community. With this new system, service providers can offer new wireless services, such as citywide mobility, same-number wireless extension, email, mobile Internet access, text messaging and location-based services.

The iPAS wireless access network offers several advantages:

- Common platform for both wireline and wireless offers a complete set of wireline and wireless services: Plain Old Telephone Service, Integrated Services Digital Network, citywide mobility, text messaging, email, location-based services, mobile Internet access.

- Flexible deployments integrates iPAS into the existing public network or deploy it as an independent network over a unified IP-based core network with advanced softswitch architecture. As a result, service providers can cost-effectively deploy services to meet subscriber demands.

- High-performance softswitch platform scales an iPAS network to support from 10,000 to more than five million subscribers with a softswitch server cluster and multi protocol gateways. With its softswitch architecture, customers can migrate seamlessly to Third-Generation Cell-Phone Technology services over a unified IP-based core network.

- Centralized Web-based operations support system simplifies network operations by concentrating all supporting functions, such as subscriber management, service provisioning, network management, billing processing, and customer care, into one centralized network operation center. With the Web-based interface, maintenance personnel or subscribers can access the service remotely over the Internet.

- Wide selection of subscriber devices allows customers to choose the easiest access: a PHS handset or personal station for citywide mobility, a fixed subscriber unit for fixed wireless access, a Personal Handyphone System Internet Access Forum Standard data suite device for high-speed Internet access, or any combination of these.

CDMA 2000 Wireless Voice and Data Products

CDMA stands for Code Division Multiple Access and is one of the main technologies currently used in digital wireless communications networks. CDMA 2000 is popularly referred to as the third-generation (3G) technology for CDMA and has greater voice capacity, data capacity and data speed than CDMA. Additionally, CDMA 2000 technology enables a range of new features including broadband Internet access, music downloads, push-to-talk communications, streaming video and remote corporate access.

In the fall of 2004, we introduced MovingMedia 2000, the first IP-based infrastructure product for CDMA 2000 designed to offer cost effective CDMA coverage in urban, rural and campus environments. The MovingMedia 2000 product line provides mobile operators with end-to-end IP-based infrastructure enabling voice and data services to end-users. Based on Third Generation Partnership Project (3GPP2) standards specifications, we believe our MovingMedia 2000 is an ideal solution for both incumbent and greenfield CDMA operators. MovingMedia 2000 allows CDMA operators to transition to an all IP-based network, resulting in significant backhaul cost savings and the ability to offer new value-add services.

Fixed Mobile Convergence

Our Continuity Fixed Mobile Convergence product provides a way for users to inter-connect to either a wireline or cellular network regardless of which network they are currently on. With our Continuity solution, users can access their services seamlessly regardless of their location, device, or network access method.

Continuity has been designed for all types of carriers but in particular, for wireline carriers that want to provide mobility services by utilizing their lower cost wireline assets. Continuity allows wireline operators to enter the mobile service market using Wireless Fidelity (WiFi) as a complementary alternative to a traditional cellular network. Continuity is also intended for mobile operators to provide their users with the same value-added features as wireline providers and to further improve their cellular coverage by using lower cost WiFi technology.

Markets and Customers

In 2006, our largest market for Wireless Infrastructure products was China, which equaled approximately 80% of revenues for the segment. We believe that China continues to be one of the largest and most important wireless markets in the world with GDP growth of more than 9% over the past several years and a relatively low fixed and mobile teledensity rate of just 28% and 35%, respectively. China is currently undergoing an evolution of wireless technology, as their regulatory authority, the Ministry of Information Industry, is preparing to issue new 3G operating licenses. As such, wireless infrastructure spending is expected to shift from traditional PAS and other second generation technologies to new 3G technology over the next several years. This caused a decline in spending for our PAS products which led to an overall decline in Wireless Infrastructure product revenues by 2% and 66% in 2006 and 2005, respectively. In 2006, sales in the Jiangsu Province and in the Zhejiang Province accounted for approximately 15% and 10%, respectively, of sales for the Wireless Infrastructure segment.

Outside of China, key markets we are targeting for Wireless Infrastructure include India, Japan, Latin America, Europe and the United States. Combined sales to these regions were approximately 20% of total wireless infrastructure sales in 2006, but are expected to increase over time as we put more focus in these regions. In 2006, we continued to expand our presence in Europe, the Middle East and Africa, with both orders from new customers and additional sales and service operations.

Southeastern Asia is another region with a large population base and relatively low teledensity rate. We have established an office for sales and services operations to support various countries in this region including, but not limited to, Vietnam, Thailand and Taiwan. At the close of 2006, our customers had over 1.2 million PAS subscribers in Vietnam and Taiwan utilizing our network infrastructure. Key customers in the region include FITEL and Chunghwa Telecom Co. Ltd. in Taiwan, and Vietnam Post and Telecommunications Corporation in Vietnam.

Competition

The Wireless Infrastructure market is marked by intense competition worldwide from numerous global and regional competitors, including some of the world s largest companies. Pricing, payment terms and brand recognition are key considerations for our customers. Specific competitors in this segment include: Alcatel-Lucent, LM Ericsson Telephone Company, Huawei Technology Co., Ltd., InterDigital Communications Corp, Motorola, Inc., Nokia Corporation, Nortel Networks Corporation, Samsung Electronics Co. Ltd., Siemens AG and Zhongxing Telecommunications Equipment Corporation, Inc.

Broadband Infrastructure

Our Broadband Infrastructure products are designed to satisfy customer demand for high speed and cost effective wireline-based data, voice and multimedia services. Revenues from this segment accounted for approximately 9%, 18% and 9% of total sales in 2006, 2005 and 2004, respectively. Our wireline technology enables high-speed voice, video and data transmissions over broadband IP-based networks. Our Broadband Infrastructure segment includes digital subscriber line products, multi-service access node products, fiber optics products and IPTV.

Digital Subscriber Line Products

Digital subscriber line (DSL) technology allows high-speed data and content transfer while providing simultaneous telephone communications over the same fixed copper line. Our IP-based DSL Access Multiplexers (IP-DSLAMs) incorporate the latest DSL technologies combined with a range of form factors to enable high-speed access and deliver services to residential and commercial subscribers using broadband networks.

Our AN-2000 product is intended for operators with an existing copper telephone network seeking to expand into offering broadband data to their customers. An all-IP network allows our customers to more easily add features such as video streaming and IP multicast in addition to traditional broadband services. To date, we have deployed more than seven million IP-DSLAM lines globally.

Our DSL products include customer premise equipment (CPE) such as various DSL modems, set-top boxes and voice over the internet devices that allow residential and business customers to access voice, data and video services. Our products are designed to be rich in functionality, simple to set up, easy to install and easy to manage. The diversity and flexibility of our CPE offerings allows them to work with both our own infrastructure equipment as well as with other vendors infrastructure equipment.

Multi-Service Access Node

A Multi-Service Access Node (MSAN) is a single device which delivers a mix of broadband, traditional voice and data services, and media gateway functionality via copper or fiber. The iAN8K Multimedia Network Edge product line embodies our commitment to providing end-to-end IP connectivity. The iAN8K product family is our next generation access platform that integrates the feature sets of the iAN-8000 MSAN platform with the Broadband Data Access functionality provided by the AN-2000 B820 IP-DSLAM product line which allows service providers to converge seamlessly from legacy Time Division Multiplexing based networks to IP-based Next Generation Networks. The iAN-8000 MSAN integrates the standalone functionalities of a traditional Digital Loop Carrier, a next-generation VoIP Media Gateway and an IP-DSLAM in a single convenient, multi-service access platform.

Optical Products

Our optical products include transport products based upon internationally defined optical transmission standards and access products. Our products convert and translate data, video, voice, or other traffic into an optical signal which is transmitted over glass fiber. The product platform includes a multi-service management system which simultaneously processes multiple speeds ranging from 155 Megabits per second for traditional voice service to 10 Gigabits per second for data intensive services.

Gigabit Ethernet Passive Optical Network (GEPON)

In 2004, we introduced our GEPON product. A passive optical network is a system configuration that brings optical fiber all the way to the end user using unpowered optical splitters that enable a single optical fiber to serve multiple premises. Our GEPON platform is designed to provide high subscriber density and low cost of entry, making it a compelling alternative to traditional telephone or broadband solutions.

Our GEPON family includes both the telecommunications provider s central office and CPE which handle speeds of up to one Gigabit per second of bandwidth to residential and business customers. By integrating more functionality into the product, we have eliminated the need for carriers to deploy additional switching and routing equipment.

Multi-Service Transport Product (MSTP)

We introduced our NetRing MSTP optical product line in December 2003. While our GEPON product is designed to provide services to individual customers, our NetRing products are designed for the high bandwidth needs of a service area. Our NetRing 600 products provide voice and data services for multi-tenant buildings, office buildings, and enterprise campus applications. Our mid-range NetRing 2500 products offer voice and data transport when more bandwidth and greater capacity is required. Our high-end NetRing 10000 products provide service for regional transport applications, when maximum bandwidth and capacity is required. In each application, the optical fiber is looped through the service area and connected back upon itself, providing full redundancy in the event that the fiber is severed. NetRing provides a broad range of functions for carriers to manage voice, data and video traffic with network management functions previously available only on multiple independent platforms.

Video content is increasingly being viewed by telecommunications providers as a new source of revenue. Our IPTV system, RollingStream (formerly mVision), includes both central office and customer premises equipment for delivering television and multimedia over carrier networks based on IP technology. Our RollingStream products and services enable a service provider to deliver broadcast television and on-demand video services to residential and commercial premises over a switched network architecture. It is a carrier-class product that is designed to scale to support millions of users and hundreds of thousands of content hours. We believe RollingStream is the first solution designed to enable carriers to deploy very-large-scale streaming video content over a switched network.

The RollingStream product family includes a storage and streaming device (MediaSwitch); a device for combining different video signals onto a unified distribution system (Content Engine); a device residing at the user s home or place of business; and a network management system that enables system wide operation. The current version of the RollingStream products has been designed to function over standard copper telephone lines. Future versions may operate over cable or optical transmission lines.

RollingStream is designed to allow carriers to offer new, revenue-generating television and multi-media services. The system is also designed to help providers attract customers of cable and satellite operators by offering a more comprehensive and interactive suite of services. We continue to see industry and customer enthusiasm with key customer deployments announced at Softbank in Japan; China Telecom and China Netcom in China; MTNL in India; and over 40 trial networks deployed globally.

Markets and Customers

Our Broadband Infrastructure segment also targets several large markets and customers worldwide. In 2006, our largest broadband infrastructure customer was Softbank Corp. and affiliates in Japan (SBB), representing approximately 54% of total broadband sales. SBB, which is a related party to UTStarcom, is a parent company to several of our key service provider customers in Japan, including Yahoo! BB and Japan Telecom. According to the Japan Ministry of Public Management, Yahoo! BB is the leading provider of broadband service in Japan with over 5 million IP-based DSL lines as of December 31, 2006. Yahoo! BB continues to expand and deploy our AN-2000 and iAN-8000 equipment in support of their Voice over Broadband and varying speed DSL services. Additionally, Yahoo! BB and UTStarcom officially launched the UTStarcom RollingStream IPTV products in July of 2005.

In addition to the Japanese market, we have targeted other key markets such as China, India, Europe, the Middle East, Africa, Central America and Latin America for the deployment of our Broadband Infrastructure products. In 2006, those markets contributed approximately 46% to total Broadband Infrastructure revenues. We believe these markets provide a significant amount of opportunity going forward given their relatively low broadband penetration rates and strong consumer demand for new broadband services.

For example, according to the Department of Telecommunications of India as of November 2006, India had a population of 1.1 billion and a low fixed line teledensity of approximately 16.3%. We currently offer our AN-2000, iAN8K, IPTV and NetRing products and services in India. With over one million access lines deployed today, we anticipate that we will continue to implement and deploy our products and conduct trials with several operators, including Reliance Infocomm Ltd. and Bharat Sanchar Nigam Ltd.

We also saw significant growth in 2006 in Central America and Latin America. Our target markets in Central and Latin America include, but are not limited to, countries like Brazil, Mexico, Panama, Haiti, Honduras and Guatemala. We have shipped our AN-2000 to service providers and continue to perform extensive testing and certification for telecommunications carriers for other key products such as RollingStream within these regions. In 2006, key customers in Central and Latin America included Telefonos de Mexico, S.A. in Mexico, Brazil Telecom in Brazil and Telefonica del Sur in Chile.

Competition

The Broadband Infrastructure market is marked by intense competition worldwide from numerous global and regional competitors, including some of the world s largest companies. The principal methods of competition include pricing, payment terms and pre-existing relationships. Specific competitors in this segment include Alcatel-Lucent, Datang Telecom Technology Co. Ltd, LM Ericsson Telephone Company, Huawei Technology Co., Ltd., Motorola, Inc., Siemens AG, Tellabs, Inc., and Zhongxing Telecommunications Equipment Corporation, Inc.

HANDSETS

We design and sell a variety of handsets to support our business in China, primarily our sales of PAS products. Our Handsets business accounted for approximately 16%, 16% and 29% of revenues in 2006, 2005 and 2004, respectively. The products range from basic, low-cost units to high-functionality, higher-cost models. Today we feature handsets with cameras, video recorders and players, high-resolution color displays, multiple ring tones, text messaging service and high speed Internet access and email capability.

PAS Handsets

We currently offer a wide variety of PAS handset models from high-end, data-capable and feature-rich models to low-cost value models. According to a December 2006 report by the industry research firm GfK Ltd., we have a 48% market share and are the market leader for PAS handsets in China, which is the largest handset market in the world according to its Ministry of Information Industry. We shipped more than 7.8 million PAS handsets in 2006.

CDMA, WiFi and Multi-Mode Handsets

In 2004, we announced our entry into the CDMA and WiFi handset markets in China. We offer carriers a wide selection of price ranges and handset features by providing a broad range of models supporting each of these technologies.

Markets and Customers

In 2006, our primary market for the Handsets segment was in China with approximately 98% of revenue in 2006 attributed to the China market. In 2006, sales in the Jiangsu Province, the Zhejiang Province and in the Guangdong Province accounted for approximately 20%, 15% and 13%, respectively, of sales for the Handsets segment.

Competition

The Handset business segment faces significant competition from numerous global competitors. The principal methods of competition include pricing and brand recognition. Specific competitors in this segment include: Alcatel-Lucent; China PTIC Information Industry Corporation; Zhongxing Telecommunications Equipment Corporation, Inc.; Amoi Electronics Company, Ltd.; Huawei Technologies Co, Ltd; Kyocera Corporation; Nippon Electric Corporation and Sanyo Electric Company, Ltd.

PERSONAL COMMUNICATIONS DIVISION

We acquired the Personal Communications Division (PCD) from Audiovox Corporation in November 2004. Revenues from this segment represented approximately 55%, 48% and 11% of our total sales in 2006, 2005 and 2004, respectively. Our PCD segment markets wireless handsets and accessories through international wireless carriers and their agents, independent distributors and retailers. We sell an array of digital handsets, hand-held computing devices and accessories in a variety of technologies, principally utilizing the CDMA radio air interface. We generally market our wireless products under the UTStarcom brand name or co-brand our products with our carrier customers. In addition to handsets, we sell a complete line of accessories that includes batteries, hands-free kits, battery eliminators, cases and data cables. In 2007, we intend to continue to broaden our digital product offerings by supplying handsets with enhanced features such as two and three megapixel resolution for video and camera products, music on demand, MP3 music players and improved internet capabilities.

Product Development, Warranty and Customer Service

Although the PCD segment does not have its own manufacturing facilities, it works closely with both customers and suppliers in feature design, development and testing of products. In particular, PCD:

- with its wireless customers, determines future market feature requirements;
- works with its suppliers to develop products containing those features;
- participates in the design of the features and aesthetics of its wireless products;
- tests products in its own facilities to ensure compliance with PCD standards;
- supervises testing of the products in its carrier markets to ensure compliance with carrier specifications.

We believe customer service is an important tool for enhancing our brand name and relationship with carriers. In order to provide full service to our customers, we provide a warranty on our handset products for periods ranging from twelve to fifteen months. To support our warranties, we work with approximately 2,800 independent warranty centers throughout North and South America and have experienced technicians in our warranty repair stations at our PCD headquarters facility. We have experienced customer service representatives who interact directly with both end-users and our customers. These representatives are trained to respond to questions on handset operation and warranty and repair issues.

Suppliers

Our PCD segment purchases its wireless products from several manufacturers located in Pacific rim countries, including Japan, China, South Korea and Taiwan. In selecting suppliers, we consider quality, price, service, market conditions and reputation. We generally purchase our products under short-term purchase orders and do not enter into long-term contracts. During 2006 and 2005, three vendors accounted for approximately 88% and 97% of purchases, respectively. In September 2006, we entered into a Strategic Alliance Agreement with one of these vendors whereby we were appointed exclusive distributor in certain territories. Additionally, we plan to extend our supplier base by introducing more models of our own design and expanding our relationships with other manufacturers.

Markets and Customers

We sell our wireless handsets and accessories to wireless carriers and the carrier s respective agents, distributors and retailers. Our largest market for the PCD segment is North America, which represents approximately 94% of PCD net sales during 2006. Our five largest wireless customers in 2006 were Verizon Wireless, T-Mobile USA, Sprint Spectrum, Virgin Mobile USA and Cricket Communications. Verizon Wireless, T-Mobile and Sprint Spectrum accounted for approximately 25%, 20% and 18%, respectively, of net sales for the segment during 2006. In addition, we promote our products through trade and consumer advertising, participation at trade shows and direct personal contact by our sales representatives. We also assist wireless carriers with their marketing campaigns by scripting telemarketing presentations, funding co-operative advertising campaigns, developing and printing custom sales literature, logistic services, conducting in-house training programs for wireless carriers and their agents and providing assistance in market development.

We operate six retail facilities under the name Quintex. Quintex also serves as an agent (in activating cell phone numbers) for the following carriers in selected areas: Boost, Nextel, Sprint Spectrum, and T-Mobile. For fiscal 2006, revenues from Quintex were approximately 2% of total PCD revenues.

Competition

The market for wireless handsets and accessories is highly competitive and is characterized by intense price competition, significant price erosion over the life of a product whose life cycle has continued to shorten, demand for value-added services, rapid technological development and industry consolidation of both customers and manufacturers. Currently, our primary competitors for wireless handsets include LG, Motorola, Samsung, Kyocera, Nokia and Sanyo.

We also compete with numerous established and new manufacturers and distributors, some of whom sell the same or similar products directly to our customers. Historically, our competitors have also included some of our own suppliers and customers. Many of our competitors offer more extensive advertising and promotional programs than we do. We compete for sales to carriers, agents and distributors on the basis of our products, services and price. As our customers are requiring greater value-added logistic services, we believe that competition will continually be required to support an infrastructure capable of providing these services. Our ability to continue to compete successfully will largely depend on our ability to perform these value-added services at a reasonable cost.

Our products compete primarily on the basis of price, features and reliability. There have been, and will continue to be, several periods of extreme price competition in the wireless industry, particularly when one or more of our competitors has sought to sell off excess inventory by lowering prices significantly or carriers canceling or modifying sales programs. As a result of global competitive pressures, there have been significant consolidations in the domestic wireless industry, which has caused extreme price competition. These consolidations may result in greater competition for a smaller number of large customers and may favor one or more of our competitors.

SERVICES

In addition to our product offerings, we provide a broad range of service offerings, including technical support services. Our service offerings complement our products with a range of consulting, technical, project, quality and maintenance support-level services including 24-hour support through technical assistance centers. Technical support services are designed to help ensure that our products operate efficiently, remain highly reliable, and benefit from the most up-to-date system software. These services enable customers to protect their network investments and minimize downtime for systems running mission-critical applications. Our Services segment accounted for approximately 3%, 3%, and 2% of revenues in 2006, 2005 and 2004, respectively.

OPERATIONS

Employees

As of December 31, 2006, we employed a total of approximately 6,000 full-time employees. We also from time to time employ part-time employees and hire contractors. Of the total number of full-time employees at December 31, 2006, approximately 2,600 were in research and development, approximately 800 were in manufacturing, approximately 1,400 were in marketing, sales and support, and approximately 1,200 were in administration. We had approximately 4,600 employees located in China, approximately 700 employees located in the United States, and approximately 700 employees in other countries. Our employees are not represented by any collective bargaining agreement, and we have never experienced a work stoppage. We believe that we have good employee relations.

Sales, Marketing and Customer Support

We pursue a direct sales and marketing strategy in China, targeting sales to telecommunication operators and equipment distributors with closely associated customers. We maintain sales and customer support sites in all major cities in China. Our customer service operation in Hangzhou, China, serves as both a technical resource and liaison to our product development organization. In China, customer service technicians are distributed in the regional sales and customer support sites to provide a local presence.

Our sales efforts in markets outside of China combine direct sales, original equipment manufacturers, distributors, resellers, agents and licensees. We maintain 43 sales and customer support offices in 25 countries covering the U.S., Canada, Latin America, the Caribbean, Europe, the Middle East, Africa, India, and the Asia-Pacific regions.

Manufacturing, Assembly and Testing

We manufacture or engage in the final assembly and testing of our mSwitch, PAS systems, handsets and AN-2000 products at our manufacturing facility in the Chinese province of Zhejiang. The manufacturing operations consist of circuit board assembly, final system assembly, software installation and testing. We assemble circuit boards primarily using surface mount technology. Assembled boards are individually tested prior to final assembly and tested again at the system level prior to system shipment. We use internally developed functional and parametric tests for quality management and process control and have developed an internal system to track quality statistics at a serial number level.

Our manufacturing facility is ISO 9001-2000 certified. ISO 9001-2000 certification requires that the certified entity establish, maintain and follow an auditable quality process including documentation requirements, development, training, testing and continuous improvement which is periodically audited by an independent external auditor.

We contract with third parties in China to perform high volume assembly and manufacturing of our handsets and some high volume single boards for AN-2000, PAS and mSwitch systems. We conduct final assembly, testing and packaging at our own facilities and generally use third parties for high volume assembly of circuit boards.

We have also contracted with various suppliers to provide PAS wireless base station components for distribution under the UTStarcom label. In China, we undertake final assembly and test our wireless infrastructure products at our own facilities and have started to manufacture some of these products ourselves.

Research and Development

We believe it is essential to continue to develop and introduce new and enhanced products if we are to maintain our competitive position. While we use competitive analyses and technology trends as factors in our product development plans, the primary input for new products and product enhancements comes from soliciting and analyzing information about service providers needs. Our relationships with China s Ministry of Information Industry and Telecommunications Administration and individual telecommunications bureaus and our full-service post-sale customer support in China provide our research and development organization with insight into trends and developments in the marketplace. The insights provided from these relationships allow us to develop market-driven products such as PAS, mSwitch and IP-DSLAM. We maintain a strong relationship between our research centers in the U.S. and China. We rotate engineers between the U.S. and China to further integrate our research and development operations. We have been able to cost-effectively hire highly skilled technical employees from a large pool of qualified candidates in China. We also have a development center in India to take advantage of the talent pool available there, and to support our operations in India. Our research and development centers are ISO 9001-2000 certified.

In the past we have made, and expect to continue to make, significant investments in research and development. Our research and development expenditures totaled $182.9 million in 2006, $246.8 million in 2005, and $219.1 million in 2004.

Intellectual Property

Our ability to compete is dependent in part on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. We hold U.S. and foreign patents for our existing products expiring between 2014 and 2023, and have patents pending in both the U.S. and in foreign countries. In addition, we have, from time to time, chosen to abandon previously filed applications. Patents may not be issued and any patents issued may not cover the scope of the claims sought in the applications. Additionally, issued patents may be found to be invalid or unenforceable in the courts of those countries where we hold or have filed for patents. Our U.S. patents do not afford any intellectual property protection in China or other international jurisdictions. Additionally, patents that we hold in countries other than the United States do not afford any intellectual property protection in the United States. Please refer to the discussion of risks associated with our intellectual property in Item 1A-Risk Factors Factors Affecting Future Operating Results.

Seasonality

Our revenues and earnings have not demonstrated consistent seasonal characteristics. While we experience some seasonality typical of the telecommunications industry, such as seasonally weak first quarters, that is often offset by other mitigating factors such as customer concentration and timing of revenue recognition.

ITEM 1A RISK FACTORS

FACTORS AFFECTING FUTURE OPERATING RESULTS

RISKS RELATED TO OUR COMPANY

The restatement of our consolidated financial statements following the Nominating and Corporate Governance Committee s and management s review of our past stock option granting practices and the Audit Committee s and management s review of certain sales in China has resulted in expanded litigation and regulatory proceedings and may result in future litigation which could harm our financial results

Our review of our historic option granting practices and certain sales in China has required us to incur substantial expenses for legal, accounting, tax and other professional services, has diverted our management s attention from our business, and could in the future harm our business, financial condition, results of operations and cash flows.

The Audit Committee of our Board of Directors (Audit Committee) engaged independent counsel to conduct an investigation of sales in China. The independent counsel engaged forensic accountants. The China sales investigation, which commenced in February 2007 and was completed in September 2007, covered each of the seven years in the period ended December 31, 2006. As a result of the review, management concluded and recommended to the Audit Committee that our previously issued financial statements should be restated to defer the system sales contract revenue and the related cost of net sales for certain sales arrangements in one region of China found to contain post-contract support obligations and recognize such amounts in our consolidated statements of operations over the estimated period of post-contract support. The Audit Committee concurred with management s recommendation.

In November 2006 we announced that the Nominating and Corporate Governance Committee of our Board of Directors (Governance Committee), comprised of independent directors, was conducting a voluntary review, with the assistance of independent legal counsel and forensic accounting experts (the Option Grant Review Team), of our historic option granting practices, the timing of option grants and related accounting matters. The review considered all option grant awards made in the period from February 29, 2000, shortly before the initial public offering of our Common Stock, through August 2006 for compliance with the various stock-based compensation accounting standards applicable as well as the rules of our stock option plans. Upon completion of the review, management concluded the adjustments to correct errors in stock option accounting in our previously issued financial statements for the years ended December 31, 1998 and 2000 through 2005, and the quarterly periods of 2005, as well as in the quarterly periods ended March 31 and June 30, 2006 that are reflected in our consolidated financial statements included in Exhibit 99.1 in this Annual Report on Form 10-K should be made.

In determining the restatement adjustments in connection with the review of our historical option granting practices, management used all reasonably available relevant information to form conclusions it believes are reasonable as to the most likely option granting actions that occurred, the dates when such actions occurred, and the determination of grant dates for financial accounting purposes based on when the requirements of the accounting standards were met. The Option Grant Review Team and management considered various alternatives throughout the course of the review and restatement; management believes the adjustments to measurement dates used in our restatement of our financial statements are reasonable and appropriate in our circumstances.

Our restatement of previously issued financial statements to correct revenue recognition for certain sales in China and for the effects of past stock options granting practices has exposed us to greater risks associated with litigation and regulatory proceedings. We have voluntarily provided information about the conduct of our independent investigation and review, the findings of the reviews, and our conclusions to the staff of the Securities and Exchange Commission (SEC), and are cooperating, and will continue to cooperate fully with the SEC. In addition, as described in Part I, Item 3, Legal Proceedings, of this Form 10-K, several derivative complaints have been filed against certain of our current and former officers and directors pertaining to allegations relating to stock option grants. However, our judgments may be challenged in legal proceedings or regulatory reviews, and we could be subject to adverse findings that could require us to again restate our financial statements, to pay damages or penalties, or have other remedies imposed upon us that could harm our business, financial condition, results of operations and cash flows. We may also be exposed to legal proceedings in connection with the results of our investigation of certain sales in China. We cannot guarantee that new lawsuits related to the matters resulting in the restatements will not be filed, and we cannot predict the outcome of any current or potential future litigation or regulatory proceeding against the Company or our current and former directors or officers.

The matters relating to the Audit Committee s investigation of revenue recognition in China, the Governance Committee s review of our past stock option granting practice, and the restatement of our consolidated financial statements may otherwise adversely impact our business.

As a result of our delayed filing of our Quarterly Reports on Form 10-Q for the quarters ended September 30, 2006, March 31, 2007 and June 30, 2007, as well as this Form 10-K, we will be ineligible to register our securities on Form S-3 for sale by us or resale by others until we have been current in our SEC filings for 12 calendar months. We may use Form S-1 to raise capital, but doing so could increase transaction costs and the time required to complete such transactions.

Employees who were awarded options at a discount from fair market value and were totally or partially unvested as of December 31, 2004, may be subject to a penalty tax under Internal Revenue Code Section 409A (Section 409A) and corresponding states taxes upon exercise of these stock options. We are considering certain actions, which we believe would be in the best interests of our stockholders and employees that might substantially reduce or eliminate the federal and state penalty taxes. However, there is no guarantee that we will be successful in developing effective measures to address employees adverse tax consequences, and any such measures may cause us to incur additional cash or noncash compensation expense. Furthermore, such measures, or the failure of such measures, may require the Company to incur substantial expenses for legal, accounting, tax and other professional services and may divert management s attention from our business, which could in the future harm our business, financial condition, results of operations and cash flows.

Our future product sales are unpredictable and, as a result, our operating results are likely to fluctuate from quarter to quarter.

Our quarterly and annual operating results have fluctuated in the past and are likely to fluctuate in the future due to a variety of factors, some of which are outside of our control. Factors that may affect our future operating results include:

- the timing and size of the orders for our products;
- consumer acceptance of new products we may introduce to market;
- changes in the growth rate of customer purchases of communications services;
- the lengthy and unpredictable sales cycles associated with sales of our products;
- revenue recognition, which is based primarily on customer acceptance of delivered products, is unpredictable;
- cancellation, deferment or delay in implementation of large contracts;
- quality issues resulting from the design or manufacture of the products, or from the software used in the product;
- cash collection cycles in China and other emerging markets;
- reliance on product, software and component suppliers who may constitute a sole source of supply or may have going concern issues;
- the decline in business activity we typically experience during the Chinese Lunar New Year, which leads to decreased sales and collections during our first fiscal quarter;
- issues that might arise from the integration of acquired entities or the inability to achieve expected results from such acquisitions; and
- shifts in our product mix or market focus.

As a result of these and other factors, period-to-period comparisons of our operating results are not necessarily meaningful or indicative of future performance. In addition, the factors noted above may make it difficult for us to forecast and provide in a timely manner public guidance (including updates to prior guidance) related to our projected financial performance. Furthermore, it is possible that in some future quarters our operating results will fall below the expectations of securities analysts or investors. If this occurs, the trading price of our common stock could decline.

Competition in our markets may lead to reduced prices, revenues and market share.

We have experienced intense competition in the past years, and we believe that we will continue to face intense competition from both domestic and international companies in our target markets, many of which may operate under lower cost structures or may be given preferential treatment by applicable governmental regulators and policies and have much larger sales forces than we do. Additionally, other

companies not presently offering competing products may also enter our target markets. Many of our competitors have significantly greater financial, technical, product development, sales, marketing and other resources than we do. As a result, our competitors may be able to respond more quickly to new or emerging technologies and changes in service provider requirements. Our competitors may also be able to devote greater resources than we can to the development, promotion and sale of new products. These competitors may be able to offer significant financing arrangements to service providers, which may give them a competitive advantage in selling systems to service providers with limited financial resources. In many of the developing markets in which we operate or intend to operate, relationships with local governmental telecommunications agencies are important to establish and maintain. In many such markets, our competitors may have or be able to establish better relationships with local governmental telecommunications agencies than we have, which could result in their ability to influence governmental policy formation and interpretation to their advantage. Additionally, our competitors might have better relationships with their third party suppliers and obtain component parts at a reduced rate, allowing them to offer their end products at reduced prices. Moreover, the telecommunications and data transmission industries have experienced significant consolidation, and we expect this trend to continue. If we have fewer significant customers, we may be more reliant on such large customers and our bargaining position and profit margins may suffer. Increased competition is likely to result in price reductions, reduced gross profit as a percentage of net sales and loss of market share, any one of which could materially harm our business, cash flows and financial condition, including potential impairment in value of our tangible and intangible assets and goodwill if extended losses were incurred.

We have incurred net losses in the past and will need to renew our lines of credit in China, refinance our convertible subordinated notes, and transfer cash from our subsidiaries in China to have sufficient cash resources and liquidity. Our ability to accomplish these actions is not assured, and our ability to raise funds for other purposes is uncertain.

At December 31, 2006, we had cash and short-term investments of $671.2 million to meet our liquidity requirements of which $483.7 million was held by our subsidiaries in China. China imposes currency exchange controls on transfers of funds outside of China; such controls limit transfers of approximately $200 million of our net assets outside of China without first obtaining the consent of the Chinese government. While we believed the China subsidiaries could freely transfer at least $200 million as of December 31, 2006, the amount of cash available for transfer from the China subsidiaries is limited both by the liquidity needs of the subsidiaries in China and by the Chinese government requirements that the China subsidiaries retain adequate capital levels in China to protect creditors and to have funds available for mandated employee benefits. Additionally, available credit facilities in China at December 31, 2006 totaled $698.3 million, of which $357.5 million was available for working capital purposes and $340.8 million was available for use in support of letters of credit and corporate guarantees. These credit facilities expire principally in November and December 2007, and we had borrowed $102.5 million at December 31, 2006 under the working capital portion of the available credit lines, and such borrowings increased to $140.1 million at September 30, 2007. We also have outstanding long-term debt outside of China in the form of our convertible subordinated notes with a principal balance of $274.6 million that mature in March 2008 (the Notes).

During the nine months ended September 30, 2007 our China subsidiaries have made transfers of funds out of China to the Company totaling $150 million. Although we believe the Company now has sufficient amount of cash resources to finance the Company s anticipated working capital and capital expenditure requirements for the next 12 months, we do not have enough cash outside of China to also repay the convertible notes maturing in March 2008, and we expect our recent financial performance and financial position will cause the lenders to reduce the total available credit facilities when we negotiate renewals of the lines of credit in China in late 2007. Management s liquidity plans include a partial or complete refinancing of the convertible notes, renewal of the lines of credit in China, transfers of additional cash from its subsidiaries in China to the extent necessary, and, if needed, liquidation of certain investments and/or seeking new financing arrangements. In addition, it may be necessary for us to make significant changes to our business plan to maintain adequate liquidity for at least the next 12 months in the event of various matters, such as:

- changes in financial market conditions or our business condition that could limit our access to existing credit facilities or make planned re-financings more costly or even unfeasible;

- changes in China s currency exchange control regulations that could limit our ability to access cash in China to meet liquidity requirements outside of China; and

- inability to achieve planned operating results that could increase liquidity requirements beyond those considered in our financial plans.

We may desire to raise additional funds for purposes not presently included in our financial plans such as to develop new or enhanced products, respond to competitive pressures, take advantage of acquisition opportunities or raise capital for strategic purposes. There is no assurance that additional financing for these or other purposes would be available on acceptable terms or at all. If we raise additional funds through the issuance of equity securities, our stockholders will experience dilution of their ownership interest, and the newly issued securities may have rights superior to those of common stock. If we raise additional funds by issuing debt, our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control, we may be subject to limitations on our operations, and our leverage may increase. The degree to which we are leveraged could materially and adversely affect our ability to obtain financing for working capital, acquisitions or other purposes and could make us more vulnerable to industry downturns and competitive pressures.

Our ability to meet our obligations under the terms of our outstanding convertible notes and to continue operations may be compromised if we are unable to transfer funds from our China operations as needed.

During the nine months ended September 30, 2007 our China subsidiaries have made transfers of funds out of China to the Company totaling $150 million. Although we believe the Company now has sufficient amount of cash resources to finance the Company s anticipated working capital and capital expenditure requirements for the next 12 months, we do not have enough cash outside of China to also repay the convertible notes aggregating $275 million maturing on March 1, 2008. Because we are limited by the Chinese government s imposition of currency controls on transfer of funds outside of China, it may be time-consuming, difficult and /or expensive for us to transfer funds from China to repay the Notes. As a result, if an Event of Default on the Notes were to occur, we may not have sufficient cash resources to repay the Notes and to continue operations without seeking new financing arrangements. We cannot be certain that additional financing for these purposes would be available on acceptable terms or at all, and if such financing is not available, our business could be seriously harmed. See the risk factor entitled *We face a variety of risks related to our convertible subordinated notes* for a further description of our obligations under the Notes, our recent consent solicitation of the noteholders and our compliance with certain covenants under the Indenture.

Sales in China have historically accounted for a material portion of our total sales, and our business, financial condition and results of operations are to a significant degree subject to economic, political and social events, and the performance of our senior management team in China.

Approximately $785.5 million, or 32%, $870.6 million, or 30%, and $2,028.2 million, or 79%, of our net sales for fiscal years 2006, 2005 and 2004, respectively, occurred in China. While we have expanded into other markets, we have made substantial investments in China and, therefore, our business, financial condition and results of operations are to a significant degree subject to economic, political, legal and social developments and other events in China. In addition, we have had significant changes within our senior management team in China recently, and our current senior management team as a whole does not have the same degree of experience in China as our senior management team had in the past. (See the risk factor entitled *Our success is dependent on continuing to hire and retain qualified personnel, including for senior management positions, and if we are not successful in attracting and retaining these personnel and in managing key employee turnover, our business will suffer*). If our current senior management in China cannot maintain and /or establish key relationships with customers, governmental entities and others in China, our business in China may decline significantly. If our business in China declines, our financial condition and results of operations may be significantly harmed.

The average selling prices of our products may decrease, which may reduce our revenues and our gross profit. As a result, we must introduce new products and reduce our costs in order to maintain profitability.

The average selling prices for communications access and switching systems and handsets have historically declined as a result of a number of factors, including:

- increased competition;
- aggressive price reductions by competitors;
- rapid technological change; and
- constant change in customer buying behavior and market trends.

The average selling prices of our products may continue to decrease in the future in response to product introductions by us or our competitors or other factors, including price pressures from customers. Certain of our products, including wireless handsets, have historically had low gross profit margins, and any further deterioration of our profit margins on such products could result in losses with respect to such products. Therefore, we must continue to develop, source and introduce new products and enhancements to existing products that incorporate features that can be sold at higher average selling prices. Failure to do so or the failure of consumers or our direct customers to accept such new products could cause our revenues and gross profit to decline.

Our cost reduction efforts initiated in 2005 and our subsequent efforts in the second half of 2007 and early 2008 may not allow us to keep pace with competitive pricing pressures or lead to improved gross profit, as a percentage of net sales. In order to be competitive, we must continually reduce the cost of manufacturing our products through design and engineering changes. We may not be successful in these efforts or in delivering our products to market in a timely manner. In addition, any redesign may not result in sufficient cost reductions to allow us to reduce the prices of our products to remain competitive or to improve or maintain our gross profit, as a percentage of net sales, which would cause our financial results to suffer.

Our market is subject to rapid technological change, and to compete effectively, we must continually introduce new products and product enhancements that achieve market acceptance.

The market for communications equipment is characterized by rapid technological developments, frequent new product introductions, changes in consumer preferences and evolving industry and regulatory standards. Our success will depend in large part on our ability to enhance our technologies and develop and introduce new products and product enhancements that anticipate changing service provider requirements, technological developments and evolving consumer preferences. We may need to make substantial capital expenditures and incur significant research and development costs to develop and introduce new products and enhancements. If we fail to develop and introduce new products or enhancements to existing products that effectively respond to technological change on a timely basis, our business, financial condition and results of operations could be materially adversely affected. Certain of our products, including wireless handsets, have a short product life. Moreover, from time to time, our competitors or we may announce new products or product enhancements, technologies or services that have the potential to replace or shorten the life cycles of our products and that may cause customers to defer purchasing our existing products, resulting in charges for inventory obsolescence reserves. Future technological advances in the communications industry may diminish or inhibit market acceptance of our existing or future products or render our products obsolete. Even if we are able to develop and introduce new products, they may not gain market acceptance. Market acceptance of our products will depend on various factors, including:

- our ability to obtain necessary approvals from regulatory organizations within the countries in which we operate and for any new technologies that we introduce;
- the length of time it takes service providers to evaluate our products, causing the timing of purchases to be unpredictable;
- the compatibility of our products with legacy technologies and standards existing in previously deployed network equipment;
- our ability to attract customers who may have pre-existing relationships with our competitors;
- product pricing relative to performance;
- the level of customer service available to support new products; and
- the timing of new product introductions meeting demand patterns.

If our products fail to obtain market acceptance in a timely manner, our business and results of operations could suffer.

We depend on some sole source and key suppliers for handsets, base stations, components and materials used in our products. If we cannot secure adequate supplies of high quality products at competitive prices or in a timely manner from these suppliers or sources, or if the suppliers successfully market their products directly to our customers, our competitive position, reputation and business could be harmed.

We have contracts with a limited group of suppliers to purchase some components and materials used in our products. If any supplier is unwilling or unable to provide us with high-quality components and materials in the quantities required and at the costs specified by us, we may not be able to find alternative sources on favorable terms, in a timely manner, or at all. Further, a supplier could market its products directly to our customers. The possibility of a supplier marketing its own products would create direct competition and may affect our ability to obtain adequate supplies. Our inability to obtain or to develop alternative sources if and as required could result in delays or reductions in manufacturing or product shipments. From time to time, there could be shortages of certain products or components. Moreover, our suppliers may supply us with inferior quality products. If an inferior product supplied by a third party is embedded in our end product and causes a problem, it might be difficult to identify the source of the problem as being due to the component parts. If any of these events occur, our competitive position, reputation and business could suffer.

Our ability to source a sufficient quantity of high-quality, cost-effective components used in our products may also be limited by import restrictions and duties in the foreign countries in which we manufacture our products. We require a significant number of imported components to manufacture our products, and imported electronic components and other imported goods used in the operation of our business may be limited by a variety of permit requirements, approval procedures, patent infringement claims, import duties and licensing requirements. As an example, a recent court case between a third party and one of our suppliers involved a patent dispute potentially restricting the importation of handsets into the U.S. While this case has been resolved in the supplier s favor at the trial court level, our supply of products could be affected by similar cases in the future. Moreover, import duties on such components increase the cost of our products and may make them less competitive.

Product defects or performance quality issues could cause us to lose customers and revenue or to incur unexpected expenses.

Many of our products are highly complex and may have quality deficiencies resulting from the design or manufacture of such product, or from the software or components used in the product. For example, during 2005 we recorded warranty charges of $70.6 million, including special warranty charges of $11.7 million for certain asynchronous digital subscriber line (ADSL) products, $4.0 million for NetRing equipment and $14.9 million for GEPON equipment sold to SBBC, an affiliate of SOFTBANK CORP and SOFTBANK America Inc., during 2003 and 2004. Often these issues are identified prior to the shipment of the products and may cause delays in market acceptance of our products, delays in shipping products to customers, or the cancellation of orders. In other cases, we may identify the quality issues after the shipment of products. In such cases, we may incur unexpected expenses and diversion of resources to replace defective products or correct problems. Such pre-shipment and post-shipment quality issues could result in delays in the recognition of revenue, loss of revenue or future orders, and damage to our reputation and customer relationships. In addition, we may be required to pay damages for failed performance under certain customer contracts, and may receive claims from customers related to the performance of our products. Such pre-shipment and post-shipment quality issues could result in delays in the recognition of revenue, loss of revenue or future orders, and damage to our reputation and customer relationships. In addition, we may be required to pay damages for failed performance under certain customer contracts and may receive claims from customers related to the performance of our products.

Our global diversification strategy and growth has strained our resources, adversely affected our reported gross margins, and if we are unable to manage this growth, our future operating results will be further negatively affected.

Over the last four years we have experienced a rapid expansion of our international operations and anticipate that we must continue to transform our operations to address market demands and potential market opportunities globally.

Competition in international markets for new service provider customers and for new infrastructure deployments is particularly intense and increasingly focused on price. To meet competitive offerings we may accept contracts with low profitability or even enter into contracts with anticipated losses if we believe it is necessary to establish a relationship with a customer or a presence in a market that we consider important to our international expansion strategy. We believe these decisions will facilitate the development of our international business, but we can provide no assurance that they will. Accepting a contract with an anticipated loss requires us to a recognize a provision for the entire loss in the period in which it becomes evident rather than in later periods in which contract performance occurs. Accepting contracts with low gross margins adversely affects our reported results when the revenues from such contracts are recognized; in some cases revenue recognition must be deferred until all revenue recognition criteria have been met, and this would result in recognizing the adverse effects of low gross margin contracts in periods subsequent to when contract performance occurred.

Our transformation to a global focus will place a significant strain on our management, operational, financial and other resources. To manage this transformation effectively, we will need to take various actions, including:

- enhancing management information systems, including forecasting procedures;
- further developing our operating, administrative, financial and accounting systems and controls;
- managing our working capital and sources of financing;
- maintaining close coordination among our engineering, accounting, finance, marketing, sales and operations organizations;
- retaining, training and managing our employee base;
- enhancing human resource operations and improving employee hiring and training programs;
- reorganizing our business structure to more effectively allocate and utilize our internal resources;
- improving and sustaining our supply chain capability; and
- managing both our direct and indirect sales channels in a cost-efficient and competitive manner.

If we fail to implement or improve systems or controls or to manage any future growth and transformation effectively, our business could suffer.

Any failure by us to execute planned cost reductions successfully could result in total costs and expenses that are greater than expected.

From time to time we have undertaken restructuring plans to bring operational expenses to appropriate levels for each of our businesses, while simultaneously implementing extensive new company-wide expense-control programs. For example, in 2005, we announced workforce restructurings. These programs resulted in the termination of approximately 1,595 employees worldwide through December 31, 2005. We anticipate making further workforce reductions and taking additional rebalancing actions in the future. In October 2007, our Board of Directors approved a restructuring plan which includes a worldwide reduction in force of approximately 11% of the Company s headcount, or approximately 700 employees. We expect cost savings from planned restructuring activities to be used to offset market forces or to be reinvested in our businesses to strengthen our competitiveness, but we cannot be certain that we will be successful in these efforts. Significant risks associated with these actions and other workforce management issues that may impair our ability to achieve anticipated cost reductions or may otherwise harm our business include delays in implementation of anticipated workforce reductions in highly regulated locations outside of the United States, particularly in Europe and Asia, redundancies among restructuring programs, decreases in employee morale and the failure to meet operational targets due to the loss of employees, particularly sales employees.

Our success is dependent on continuing to hire and retain qualified personnel, including for senior management positions, and if we are not successful in attracting and retaining these personnel and in managing key employee turnover, our business will suffer.

The success of our business depends in significant part upon the continued contributions of key technical and senior management personnel, many of whom would be difficult to replace. In particular, our success depends in large part on the knowledge, expertise and services of Hong Liang Lu, our Chief Executive Officer, Peter Blackmore, our President and Chief Operating Officer, Francis P. Barton, Executive Vice President and Chief Financial Officer and Philip Christopher, President and Chief Executive Officer of our Personal Communications Division. The loss of any key employee, the failure of any key employee to perform satisfactorily in his or her current position or our failure to attract and retain other key technical and senior management employees could have a significant negative impact on our operations. We have had significant changes within our senior management team recently, and our current senior management team as a whole does not have the same degree of experience in China as our senior management had in the past. If our current senior management cannot maintain and/or establish key relationships with customers, governmental entities and others in China, our business in China may decline significantly and our financial condition and results of operations may be significantly harmed.

Notwithstanding our workforce restructurings, to effectively manage our operations, we will need to recruit, train, assimilate, motivate and retain qualified employees both locally and internationally. Competition for qualified employees is intense, and the process of recruiting personnel in all fields, including technology, research and development, sales and marketing, administration and management with the combination of skills and attributes required to execute our business strategy can be difficult, time-consuming and expensive. As we grow globally, we must implement hiring and training processes that are capable of quickly deploying qualified local residents to knowledgeably support our products and services. Alternatively, if there is an insufficient number of qualified local residents available, we might incur substantial costs importing expatriates to service new global markets. For example, we have historically experienced difficulty finding qualified accounting personnel knowledgeable in both U.S. and Chinese accounting standards who are Chinese residents. If we fail to attract, hire, assimilate or retain qualified personnel, our business would be harmed. Competitors and others have in the past, and may in the future, attempt to recruit our employees. In addition, companies in the telecommunications industry whose employees accept positions with competitors frequently claim that the competitors have engaged in unfair hiring practices. We may be the subject of these types of claims in the future as we seek to hire qualified personnel. Some of these claims may result in material litigation and disruption to our operations. We could incur substantial costs in defending ourselves against these claims, regardless of their merit.

Any acquisitions and divestitures that we undertake could be difficult to integrate, disrupt our business, dilute our stockholders and harm our operating results.

We have acquired and divested certain businesses, products and technologies. Anticipated benefits of these acquisitions and divestitures may not be realized. We have in the past and will continue to evaluate acquisition prospects that would complement our existing product offerings, augment our market coverage, enhance our technological capabilities, or that may otherwise offer growth opportunities. Acquisitions may result in dilutive issuances of equity securities, use of our cash resources, the incurrence of debt and the amortization of expenses related to intangible assets. In addition, acquisitions involve numerous risks, including difficulties in the assimilation of operations, technologies, products and personnel of the acquired company, diversion of management s attention from other business concerns, risks of entering markets in which we have no direct or limited prior experience, the potential loss of key employees of the acquired company, unanticipated costs and, in the case of the acquisition of financially troubled businesses, challenges as to the validity of such acquisitions from third party creditors of such businesses. For example, in the fourth quarter 2004, we encountered difficulties in integrating Hyundai Syscomm, Inc. (HSI) legacy operations into our operations and determined to abandon a substantial amount of HSI s legacy operations. As a result, in the fourth quarter 2004, we wrote off the entire goodwill and intangibles associated with HSI.

We may be unable to adequately protect the loss or misappropriation of our intellectual property, which could substantially harm our business.

We rely on a combination of patents, copyrights, trademarks, trade secret laws and contractual obligations to protect our technology. We have applied for patents in the United States and internationally. Additional patents may not be issued from our pending patent applications, and our issued patents may not be upheld. In addition, we have, from time to time, chosen to abandon previously filed patent and trademark applications. Moreover, we may face difficulties in registering our existing trademarks in new jurisdictions in which we operate, and we may be forced to abandon or change product or service trademarks because of the unavailability of our existing trademarks or because of oppositions filed or legal challenges to our trademark filings. We cannot guarantee that the intellectual property protection measures that we have taken will be sufficient to prevent misappropriation of our technology or trademarks or that our competitors will not independently develop technologies that are substantially equivalent or superior to ours. In addition, the legal systems of many foreign countries do not protect or honor intellectual property rights to the same extent as the legal system of the United States. For example, in China, the legal system in general, and the intellectual property regime in particular, are still in the development stage. It may be very difficult, time-consuming and costly for us to attempt to enforce our intellectual property rights in these jurisdictions.

We may be subject to claims that we infringe the intellectual property rights of others, which could substantially harm our business.

The industry in which we compete is moving towards aggressive assertion, licensing, and litigation of patents and other intellectual property rights. From time to time, we have become aware of the possibility or have been notified that we may be infringing certain patents or other intellectual property rights of others. Regardless of their merit, responding to such claims could be time consuming, divert management s attention and resources and cause us to incur significant expenses. In addition, although some of our supplier contracts provide for indemnification from the supplier with respect to losses or expenses incurred in connection with any infringement claim, certain contracts with our key suppliers do not provide for such protection. Moreover, certain of our sales contracts provide that we must indemnify our customers against claims by third parties for intellectual property rights infringement related to our products. There are no limitations on the maximum potential future payments under these guarantees. Therefore, we may incur substantial costs related to any infringement claim, which may substantially harm our results of operations and financial condition.

We have been and may in the future become subject to litigation to defend against claimed infringements of the rights of others or to determine the scope and validity of the proprietary rights of others. Future litigation may also be necessary to enforce and protect our patents, trade secrets and other intellectual property rights. Any intellectual property litigation or threatened intellectual property litigation could be costly, and adverse determinations or settlements could result in the loss of our proprietary rights, subject us to significant liabilities, require us to seek licenses from or pay royalties to third parties which may not be available on commercially reasonable terms, if at all, and/or prevent us from manufacturing or selling our products, which could cause disruptions to our operations.

In the event that there is a successful claim of infringement against us and we fail to develop non-infringing technology or license the proprietary rights on commercially reasonable terms and conditions, our business, results of operations and financial condition could be materially and adversely impacted.

Our multinational operations subject us to various economic, political, regulatory and legal risks.

We market and sell our products globally, with a significant portion of our sales made in China. The expansion of our existing multinational operations and entry into new markets will require significant management attention and financial resources. Multinational operations are subject to a variety of risks, such as:

- the burden of complying with a variety of foreign laws and regulations;
- the burden of complying with United States laws and regulations for foreign operations, including the Foreign Corrupt Practices Act;
- difficulty complying with continually evolving and changing global product and communications standards and regulations for both our end products and their component technology;
- market acceptance of our new products, including longer product acceptance periods in new markets into which we enter;
- reliance on local original equipment manufacturers (OEMs), third party distributors and agents to effectively market and sell our products;
- unusual contract terms required by customers in developing markets;
- changes in local governmental control or influence over our customers;
- changes to import and export regulations, including quotas, tariffs, licensing restrictions and other trade barriers;
- the burden of compliance with complex and varying taxation requirements of multiple jurisdictions;
- evolving and unpredictable nature of the economic, regulatory, competitive and political environments;
- reduced protection for intellectual property rights in some countries;
- unproven business operation models developed or operated in specific countries or regions;
- longer accounts receivable collection periods; and
- difficulties and costs of staffing, monitoring and managing multinational operations, including but not limited to internal controls and compliance.

We do business in markets that are not fully developed, which subjects us to various economic, political, regulatory and legal risks unique to developing economies.

Less developed markets present additional risks, such as the following:

- customers that may be unable to pay for our products in a timely manner or at all;
- new and unproven markets for our products and the telecommunications services that our products enable;
- lack of a large, highly trained workforce;
- difficulty in controlling local operations from our headquarters;

- variable ethical standards and an increased potential for fraud;
- unstable political and economic environments; and
- lack of a secure environment for our personnel, facilities and equipment.

In particular, these factors create the potential for physical loss of inventory and misappropriation of operating assets. We have in the past experienced cases of vandalism and armed theft of our equipment that had been or was being installed in the field. If disruptions for any of these reasons become too severe in any particular market, it may become necessary for us to terminate contracts and withdraw from that market and suffer the associated costs and lost revenue.

Our wireless handset products are subject to a wide range of environmental, health and safety laws, and may expose us to potential health and environmental liability claims.

Our handset products are subject to a wide range of environmental, health and safety laws, including laws relating to the use, disposal and clean up of, and human exposure to hazardous substances. In the United States, these laws often require parties to fund remedial action regardless of fault. Factors such as the discovery of additional contaminants, the extent of remediation and compliance expenses, and the imposition of additional clean up obligations could cause us to incur substantial costs relating to remediation activities. Compliance with existing or future environmental, health and safety laws could also cause us to incur substantial costs relating to such compliance, including the expense of modifying product designs and manufacturing processes. In addition, restrictions on the use of certain materials in our facilities or products in the future could have a negative impact on our operations.

Additionally, there have been claims made alleging a link between the use of wireless handsets and the development or aggravation of certain cancers, including brain cancer. The scientific community is divided on whether there is a risk from wireless handset use, and if so, the magnitude of the risk. Even if there is no link established between wireless handset use and cancer, the negative publicity and possible litigation could have a material adverse effect on our business. In the past, several plaintiffs groups have brought class actions against wireless handset manufacturers and distributors, alleging that wireless handsets have caused cancer. To date, we have not been named in any of these actions and none of these actions has been successful. In the future we could incur substantial costs in defending ourselves against similar claims, regardless of their merit. Also, claims may be successful in the future and may have a material adverse effect on our business.

Furthermore, there have been claims made alleging a link between the use of Bluetooth enabled mobile phone handsets and noise-induced hearing loss. To date, we have not been named in any of these actions. In the future we could incur substantial costs in defending ourselves against similar claims, regardless of their merit. Also, claims may be successful in the future and may have a material adverse effect on our business.

We are subject to a wide range of environmental, health and safety laws and efforts to comply with such laws may be costly and may adversely impact our financial performance.

Our operations and the products we manufacture and/or sell are subject to a wide range of global environmental, health and safety laws. Compliance with existing or future environmental, health and safety laws could subject us to future costs, liabilities, impact our production capabilities, constrict our ability to sell, expand or acquire facilities and generally impact our financial performance. Some of these laws relate to the use, disposal, clean up of, and exposure to hazardous substances. In the United States, laws often require parties to fund remedial studies or action regardless of fault. Over the last several years, the European Union (the EU) countries have enacted environmental laws regulating electronic products. For example, beginning July 1, 2006, our products have been subject to laws that mandate the recycling of waste in electronic products sold in the EU and that limit or prohibit the use of certain substances in electronic products. Other countries outside of Europe are expected to adopt similar laws. We may incur additional expenses to comply with these laws.

Currency rate fluctuations and exchange controls may adversely affect our cash flow and operating results.

Because a significant percentage of our sales are made in foreign countries and denominated in local currency, we are exposed to market risk for changes in foreign exchange rates on our foreign currency denominated accounts and notes receivable balances. Historically, the majority of our sales have been made in China and denominated in Renminbi. Prior to July 2005, the impact of currency fluctuations of Renminbi were insignificant as it was fixed to the U.S. dollar. However, in July 2005, China uncoupled the Renminbi from the U.S. dollar and let it float in a narrow band against a basket of foreign currencies. The move revalued the Renminbi by 2.1% against the U.S. dollar; however, it is uncertain what further adjustments may be made in the future. The Renminbi-U.S. dollar exchange rate could float, and the Renminbi could appreciate relative to the U.S. dollar. For example, the Renminbi-U.S. dollar exchange rate was 8.28 to the U.S. dollar prior to the float of the Renminbi in July 2005 and 7.80 Renminbi to the U.S. dollar at December 31, 2006. Any significant revaluation of the Renminbi may materially and adversely affect our cash flows, revenues, operating results and financial position.

Outside of China, our primary foreign currency exposures have related to non-dollar denominated sales and purchases in Japan, Europe and Canada. Additionally, we have exposures to emerging market currencies, which can have extreme currency volatility. We have experienced material adverse impacts on our results of operations from fluctuations in currency exchange rates and may continue to do so in the future.

We may, from time to time, enter into foreign exchange forward contracts to minimize the short-term impact of foreign currency fluctuations on certain foreign currency receivables and payables. Our attempts to hedge against these risks may not be successful, resulting in an adverse impact on our results of operations. Moreover, some of the foreign countries in which we do business might impose currency restrictions that may limit the ability of our subsidiaries and joint ventures in such countries to obtain and remit foreign currency necessary for the purchase of imported components and may limit our ability to obtain and remit foreign currency in exchange for foreign earnings. For example, China employs currency controls restricting Renminbi conversion, limiting our ability to engage in currency hedging activities in China. Various foreign exchange controls may also make it difficult for us to repatriate earnings, which could have a material adverse effect on our ability to conduct business globally.

Business interruptions could adversely affect our business.

Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, external interference with our information technology systems, incidents of terrorism and other events beyond our control. For example, our Hangzhou manufacturing facility s ability to produce sufficient products is dependent upon a continuous power supply. However, the Hangzhou facility has in the past been subject to power shortages, which has affected our ability to produce and ship sufficient products. Also, our operations in Alameda, California are located in an area prone to earthquakes. We do not have a detailed disaster recovery plan, and the occurrence of any events like these that disrupt our business could harm our business and operating results.

We may suffer losses with respect to equipment held at customer sites, which could harm our business.

We face the risk of loss relating to our equipment held at customer sites. In some cases, our equipment held at customer sites is under contract, pending final acceptance by the customer. We generally do not hold title or risk of loss on such equipment, as title and risk of loss are typically transferred to the customer upon delivery of our equipment. However, we do not recognize revenue and accounts receivable with respect to the sale of such equipment until we obtain acceptance from the customer. If we do not obtain final acceptance, we may not be able to collect the contract price and recover this equipment or its associated costs. In other cases, particularly in China, where governmental approval is required to finalize certain contracts, inventory not under contract may be held at customer sites. We hold title and risk of loss on this inventory until the contracts are finalized and, as such, are subject to any losses incurred resulting from any damage to or loss of this inventory.

If our contract negotiations fail or if the government of China otherwise delays approving contracts, we may not recover or receive payment for this inventory. Moreover, our insurance may not cover all losses incurred if our inventory at customer sites not under contract is damaged prior to contract finalization. If we incur a loss relating to inventory for any of the above reasons, our financial condition, cash flows, and operating results could be harmed.

Restrictions on the use of handsets while driving could affect our future growth.

Several foreign governments and U.S. state and local governments have adopted or are considering adopting legislation that would restrict or prohibit the use of wireless handsets while driving. Widespread legislation that restricts or prohibits the use of wireless handsets while driving could negatively affect our future growth.

We have been named as a defendant in securities litigation and other lawsuits, as well as lawsuits in the ordinary course of business.

Currently, we are a defendant in securities litigation class action lawsuits, as well as other lawsuits. Additionally, from time to time we are plaintiffs or defendants in other lawsuits including lawsuits in the ordinary course of our business. The pursuit or defense of these lawsuits may divert our management s attention, and we may incur significant expenses in pursuing or defending these lawsuits. In addition, we may be required to pay judgments or settlements that could have a material adverse effect on our results of operations, financial condition and liquidity.

We face risks related to pending governmental inquiries.

In September 2005, we received notice of a formal inquiry by the staff of the Securities & Exchange Commission (SEC) into certain aspects of our financial disclosures during prior reporting periods and certain other issues. In addition, in December 2005, the U.S. Embassy in Mongolia informed us that it had forwarded to the Department of Justice (DOJ) allegations that an agent of our Mongolia joint venture had offered payments to a Mongolian government official in possible violation of the Foreign Corrupt Practices Act (the FCPA). We, through our Audit Committee, authorized an independent investigation into possible violations of the FCPA, and we have been in contact with the DOJ and SEC regarding the investigation. The investigation has identified possible FCPA violations in Mongolia, Southeast Asia, India and China, as well as possible violations of U.S. immigration laws. The DOJ has requested that the Company voluntarily produce documents related to the investigation and the SEC has subpoenaed the Company for documents. The Company has executed tolling agreements extending the statute of limitations for the FCPA issues under investigation by the SEC and the DOJ and the immigration issues under investigation by the DOJ. At this time, we cannot predict when any inquiry will be completed or what the outcome of any inquiry will be. These inquiries could harm relationships with existing customers and our ability to obtain new customers and partners. If the SEC or the DOJ makes a determination that we have violated federal laws, we may face sanctions including, but not limited to, fines, disgorgement and an injunction. Additionally, such a determination by the SEC or the DOJ could adversely affect our business, results of operations, financial position and cash flow, and ultimately our stock price.

We have also been in communication with the SEC regarding our voluntary review of our historical option grant awards grant practices and our review of certain historical sales contracts in China. Although we have now completed both of those voluntary reviews, it is possible that the SEC may question the findings of our reviews or initiate its own review into related matters.

It is possible that the findings and outcome of any of these inquiries may affect other lawsuits that are pending. These inquiries could divert management attention and resources, which could harm our business.

Failure to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 could have a material adverse effect on our business and stock price.

Section 404 of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act) requires that we establish and maintain an adequate internal control structure and procedures for financial reporting and include a report of management on our internal control over financial reporting. Our annual report on Form 10-K must contain an assessment by management of the effectiveness of our internal control over financial reporting and must include disclosure of any material weaknesses in internal control over financial reporting that we have identified. In addition, our independent registered public accounting firm must attest to and report on management s assessment of the effectiveness of our internal control over financial reporting.

We have identified material weaknesses in our internal control over financial reporting. See Item 9A Controls and Procedures Management s Report on Internal Control Over Financial Reporting. As of the date of this annual report on Form 10-K, we are still in the process of implementing remedial measures related to the material weaknesses identified in 2004 through 2006. If our efforts to remediate the weaknesses we identified are not successful, our business and operating results could be harmed and the reliability of our financial statements could be impaired, which could adversely affect our stock price. The requirements of Section 404 of the Sarbanes-Oxley Act are ongoing and also apply to future years. We expect that our internal control over financial reporting will continue to evolve as we continue in our efforts to transform our business. Although we are committed to continue to improve our internal control processes and we will continue to diligently and vigorously review our internal control over financial reporting in order to ensure compliance with the Section 404 requirements, any control system, regardless of how well designed, operated and evaluated, can provide only reasonable, not absolute, assurance that its objectives will be met. In addition, successful remediation of the noted control deficiencies is dependent on the Company s ability to hire and retain qualified personnel. Therefore, we cannot be certain that in the future additional material weaknesses or significant deficiencies will not exist or otherwise be discovered.

RISKS RELATED TO CONDUCTING BUSINESS IN CHINA

China s governmental and regulatory reforms may impact our ability to do business in China.

Since 1978, the Chinese government has been in a state of evolution and reform. The reforms have resulted in and are expected to continue to result in significant economic and social development in China. Many of the reforms are unprecedented or experimental and may be subject to change or readjustment due to a variety of political, economic and social factors. Multiple government bodies are involved in regulating and administering affairs in the telecommunications and information technology industries, among which the Ministry of Information Industry (MII), the National Development and Reform Commission (NDRC), the State-owned Assets Supervision and Administration Commission (SASAC) and the State Administration of Radio, Film and Television (SARFT) play the leading roles. These government agencies have broad discretion and authority over all aspects of the telecommunications and information technology industry in China, including but not limited to, setting the telecommunications tariff structure, granting carrier licenses and frequencies, approving equipment and products, granting product licenses, approving of the form and content of transmitted data, specifying technological standards as well as appointing carrier executives, all of which may impact our ability to do business in China.

Any of the following changes in China s political and economic conditions and governmental policies could have a substantial impact on our business:

- the promulgation of new laws and regulations and the interpretation of those laws and regulations;
- inconsistent enforcement and application of the telecommunications industry s rules and regulations by the Chinese government between foreign and domestic companies;
- the restructuring of telecommunications carriers in China, including policy making governing 3G network infrastructure and licensing;
- restrictions on IPTV license grants, which could limit the potential market for our products;
- the introduction of measures to control inflation or stimulate growth;
- the introduction of new guidelines for tariffs and service rates, which affect our ability to competitively price our products and services;
- changes in the rate or method of taxation;
- the imposition of laws, rules or regulations affecting the direct or indirect nationalization of assets controlled by non-governmental persons or entities;
- the imposition of additional restrictions on currency conversion and remittances abroad; or
- any actions that limit our ability to develop, manufacture, import or sell our products in China, or to finance and operate our business in China.

In addition to modifying the existing telecommunications regulatory framework, the Chinese government is currently preparing a draft of a standard, national telecommunications law (Telecommunications Law) to provide a uniform regulatory framework for the telecommunications industry. Currently a draft of the law has been finished and delivered to the National People s Congress for discussion. We do not yet know the final nature or scope of the regulations that would be created if the Telecommunications Law is passed. Accordingly, we cannot predict whether it will have a positive or negative effect on us or on some or all aspects of our business.

Under China s current regulatory structure, the communications products that we offer in China must meet government and industry standards. In addition, a network access license for the equipment must be obtained. Without a license, telecommunications equipment is not allowed to be connected to public telecommunications networks or sold in China. Moreover, we must ensure that the quality of the telecommunications equipment for which we have obtained a network access license is stable and reliable, and will not negatively affect the quality or performance of other installed licensed products.

China s changing economic environment may impact our ability to do business in China.

Since 1978, the Chinese government has been reforming the economic system in China to increase the emphasis placed on decentralization and the utilization of market forces in the development of China s economy. These reforms have resulted in significant economic growth. However, any economic reform policies or measures in China may from time to time be modified or revised by the Chinese government. While we may be able to benefit from the effects of some of these policies, these policies and other measures taken by the Chinese government to regulate the economy could also have a significant negative impact on economic conditions in China, which would result in a negative impact on our business.

China s entry into the World Trade Organization and relaxation of trade restrictions have led to increased foreign investment in China s telecommunications industry and may lead to increased competition in our markets which may have an adverse impact on our business.

China s economic environment has been changing as a result of China s entry, in December of 2001, into the World Trade Organization (WTO). Foreign investment in the telecommunications sector is regulated by the Provisions on Administration of Foreign Invested Telecommunications Enterprises promulgated by the State Council in December 2001 and effective as of January 1, 2002. The provisions brought foreign equity limits into conformity with China s WTO commitments, allowing foreign investors to own equity generally up to 49% for basic telecom services enterprises and up to 50% for value-added telecom services enterprises. Furthermore, China is gradually introducing a market oriented pricing mechanism for telecommunication services. On July 13, 2005, China s Ministry of Information Industry (MII) and National Development and Reform Commission (NDRC) approved the launch of plan-based pricing for fixed-line telephone service by China s two fixed-line operators, China Telecom and China Netcom. In August 2005, MII and NDRC endorsed a Circular on the Changes in Administration of Telecom Service Pricing, which became effective on October 1, 2005 and further relaxed the pricing administration on certain telecom services. As China gradually relaxes such legal provisions, international telecommunication service vendors may seize this opportunity to adjust their China strategy, increasing their investment in China and converting some of their joint-ventures into fully-owned enterprises.

As the existing international vendors increase their investment in China, and more vendors enter the China market, the competition in the telecommunication equipment market may increase, and as a result, our business may suffer. If China s entry into the WTO results in increased competition or has a negative impact on China s economy, our business could suffer. In addition, although China is increasingly according foreign companies and foreign investment enterprises established in China the same rights and privileges as Chinese domestic companies as a result of its admission into the WTO, special laws, administrative rules and regulations governing foreign companies and foreign investment enterprises in China may still place foreign companies at a disadvantage in relation to Chinese domestic companies and may adversely affect our competitive position.

Uncertainties with respect to the Chinese legal system may adversely affect us.

We conduct our business in China primarily through our wholly owned subsidiaries incorporated in China. Our subsidiaries are generally subject to laws and regulations applicable to foreign investment in China. Accordingly, our business might be affected by China s developing legal system. Since 1978, many new laws and regulations covering general economic matters have been promulgated in China, and government policies and internal rules promulgated by governmental agencies may not be published in time, or at all. As a result, we may operate our business in violation of new rules and policies without having any knowledge of their existence. In addition, there are uncertainties regarding the interpretation and enforcement of laws, rules and policies in China. Governmental authorities have broad discretion in the interpretation and enforcement of the laws, regulations and rules. The Chinese legal system is based on written statutes, and prior court decisions have limited precedential value. Because many laws and regulations are relatively new and the Chinese legal system is still evolving, the interpretations of many laws, regulations and rules are not always uniform. Moreover, the relative inexperience of China s judiciary in many cases creates additional uncertainty as to the outcome of any litigation, and the interpretation of statutes and regulations may be subject to government policies reflecting domestic political changes. Finally, enforcement of existing laws or contracts based on existing law may be uncertain and sporadic, and it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction. Any litigation in China may be protracted and result in substantial costs and diversion of resources and management s attention.

If tax benefits available to our subsidiaries located in China are reduced or repealed, our business could suffer.

On March 16, 2007, China s top legislature, the National People s Congress, passed the China Corporate Income Tax Law (CIT Law). CIT Law will be effective on January 1, 2008. Under the CIT Law, China s dual tax system for domestic enterprises and foreign investment enterprises (FIEs) would be effectively replaced by a unified system. The new law establishes a tax rate of 25% for most enterprises and a reduced tax rate of 15% for certain qualified high technology enterprises.

Prior to this change in tax law, certain subsidiaries and joint ventures located in China enjoyed tax benefits in China which are generally available to FIEs. The tax holidays/incentives for FIEs were applicable or potentially applicable to UTStarcom ChongQing Telecom Co. Ltd. (CUTS), UTStarcom Telecom Co., Ltd. (HUTS), Hangzhou UTStarcom Telecom Co., Ltd. (HSTC) and UTStarcom China Co., Ltd. (UTSC), our active subsidiaries in China, because these entities may qualify as accredited technologically advanced enterprises.

CIT Law targets certain industries for the reduced 15% tax rate for certain qualified high technology enterprises. For FIEs established before the promulgation of the new law who currently enjoy lower tax rates, any increase in their tax rates would be gradually phased in over five years. Significant regulations regarding the interpretation and implementation of the new tax law are still pending. There is potential risk that our subsidiaries may not qualify for the reduced 15% tax rate. Therefore, the new law may have an adverse impact on our future tax expense in China.

Moreover, the Chinese central government may review and audit tax benefits granted by local or provincial authorities and could determine to disallow such benefits. Certain of our subsidiaries and joint ventures located in China enjoy tax benefits in China that are generally available to foreign investment enterprises. If these tax benefits are reduced, disallowed or repealed due to changes in tax laws or determination by the Chinese government, our business could suffer.

Our ability to continue successful deployment of PAS system and sales of PAS handsets are limited by certain factors, including the following:

Maturing PAS market and increased competition in handsets and tariffs.

The market for PAS exceeded 96 million users as of the end of fiscal year 2006 and is available in most of the provinces throughout China. We believe the PAS market has matured. For example, during fiscal year 2005, net sales of the PAS/iPAS system and the wireless infrastructure market declined significantly as compared to fiscal year 2004. This decline continued through fiscal year 2006, and the first quarter of 2007. If additional handset competitors enter the market, or if competitors decide to further reduce pricing, our sales of PAS handsets may be adversely impacted.

Furthermore, competition from mobile operators, such as China Mobile and China Unicom, has increased in cities where PAS is deployed. Mobile operators offering special promotional pricing or incentives to customers, such as free incoming calls or free mobile-to-mobile calls, have harmed the ability of our customers, China Telecom and China Netcom, to compete effectively. The continued use of such incentive programs by mobile operators may adversely impact China Telecom and China Netcom s ability to increase PAS subscriptions. Due to our relationships with China Telecom and China Netcom, reduced subscription growth at these carriers may have a material adverse effect on our pricing and harm our business or results of operations.

Our PAS system and handsets sales may experience a sharp decline if China Telecom or China Netcom obtain licenses allowing them to deliver mobile services.

China s media sources have widely reported that the MII may grant 3G mobile licenses to China Telecom or China Netcom, or to both in 2007. If China Telecom or China Netcom obtains 3G mobile licenses, they may re-allocate capital expenditures to construct 3G networks, and as a consequence, may significantly reduce capital expenditures relating to PAS networks that utilize our existing products. In addition, it is possible that current PAS frequency bands utilized by PAS networks may be reallocated for use by 3G networks, resulting in the restriction of or shutting down of PAS networks. If this were to occur, we could lose current and potential future customers of our products, and our financial condition and results of operations could be significantly harmed.

We only have trial licenses for the PAS system and handsets in China.

We only have trial licenses for our PAS systems and handsets. We have applied for, but have not yet received, a final official network access license for our PAS systems and handsets. Based upon communication with the MII, we understand that our PAS systems and handsets are considered to still be in the trial period and sales of our PAS systems and handsets may continue to be made by us during this trial period, but that licenses will ultimately be required. If we fail to obtain the required licenses, we could be prohibited from making further sales of the unlicensed products, including our PAS systems and handsets, in China, which would substantially harm our business, financial condition and results of operations. The regulations implementing these requirements are not very detailed, have not been applied by a court and may be interpreted and enforced by regulatory authorities in a number of different ways. Our external legal counsel in China has advised us that China s governmental authorities may interpret or apply the regulations with respect to which licenses are required and the ability to sell a product while a product is in the trial period in a manner that is inconsistent with the information received by our legal counsel in China, and either of these conditions could have a material adverse effect on our business, financial condition and results of operations.

Increasing centralization of purchasing decision-making by carriers may lead to customer concentration and affect the results of our business.

Most Chinese carriers have three levels of operations: the central headquarters level, the provincial level and the local city/county level. Both central and provincial levels are independent legal persons and have their own corporate mandate. The purchasing decision-making process may take various forms for different projects and may also differ significantly from carrier to carrier. In the case of PAS systems, we negotiate and enter into all China Netcom contracts with the provincial operators. However, the central headquarters of China Telecom has chosen to exert its influence in the purchasing decision-making process by negotiating contractual terms, such as purchase price, payment terms, and acceptance clauses at the central level. The provincial operator then further negotiates the contract based on the guidelines provided by the headquarters. We enter into final contracts with the provincial operator. However, if this trend of centralized decision-making expands to unified purchasing, resulting in the negotiation and execution of contracts at the central headquarter level, there may be a concentration of customers which could have a significant impact on our business. If China Netcom follows China Telecom and exerts the headquarters influence in price negotiation, it may give downward pressure to the margin of our PAS system products to China Netcom.

Television over the internet is a new business in China and laws regulating the business have not been fully developed and may be unpredictable. Unfavorable regulation of the industry may adversely affect our IPTV operations in China and negatively impact our business.

Broadcasting television over the internet has only recently begun in China. The State Administration of Radio, Film and Television (SARFT), the central government s regulatory body, issued a measure in July 2004 to regulate the broadcasting of audio-visual programs through the information network, which includes our Internet Protocol television (IPTV) business. SARFT categorized the information network into the mobile telecommunication network, fixed communications network, microwave communication network, cable television network, satellite or other metropolitan area network, wide area network, local area network and other information networks categories. The receiving terminal equipment includes computers, television sets, mobile phones and other electronic products. While regulating the IPTV business, SARFT is encouraging development in China of the digital television business, a business that may be competitive with IPTV in the target market. The digital television and IPTV target complementary markets and it is not clear the extent of support SARFT will provide for IPTV in setting regulations. For example, the Guangzhou Administration of Radio, Film, and Television, the municipal regulatory body in the city of Guangzhou, issued a notice to stop all IPTV business in Guangzhou on December 25, 2005. The Zhejiang Administration of Radio, Film, and Television, the local regulatory body in the province of Zhejiang, issued a similar notice on January 10, 2006. In both instances, SARFT had not formally endorsed the launch of commercial IPTV services in those localities. Because the IPTV industry relates to both television and telecom sectors, it may be subject to regulation by different governmental authorities, including the Ministry of Information Industry (MII). At the end of 2005, an official of MII declared that MII and SARFT would jointly administer the IPTV industry in the coming years. However, due to a lack of uniform regulation on the development of the IPTV industry, we cannot predict that our IPTV business will operate smoothly in China. Our business may suffer if the law or policy in China does not encourage the IPTV industry.

We currently do not have a license to engage in the IPTV operator service business in China and development of our IPTV business depends upon the cooperation of IPTV license holder(s) and network operators. If we are unable to work cooperatively with license holder(s) and network operators, our business may suffer.

Under the measures issued by SARFT in July 2004, entities intending to engage in the IPTV operator service business should obtain a license from SARFT and foreign investment enterprises are prohibited from engaging in the IPTV operator service business. In practice, SARFT only grants such licenses to state-owned companies. Since we are the technical service and equipment provider in this field, our business development will depend on the cooperation of license holders and network operators. Our business may suffer if we fail to cooperate with license holders or network operators, or if the license holder(s) we re cooperating with lose their licenses.

RISKS RELATED TO OUR STOCK PERFORMANCE AND CONVERTIBLE DEBT SECURITIES

Our stock price is highly volatile.

The trading price of our common stock has fluctuated significantly since our initial public offering in March of 2000. Our stock price could be subject to wide fluctuations in the future in response to many events or factors, including those discussed in the preceding risk factors relating to our operations, as well as:

- actual or anticipated fluctuations in operating results, actual or anticipated gross profit as a percentage of net sales, levels of inventory, our actual or anticipated rate of growth and our actual or anticipated earnings per share;

- changes in expectations as to future financial performance or changes in financial estimates or buy/sell recommendations of securities analysts;

- changes in governmental regulations or policies in China;

- our, or a competitor s, announcement of new products, services or technological innovations;

- the operating and stock price performance of other comparable companies; and

- news and commentary emanating from the media, securities analysts or government bodies in China relating to us and to the industry in general.

General market conditions and domestic or international macroeconomic factors unrelated to our performance may also affect our stock price. For these reasons, investors should not rely on recent trends to predict future stock prices or financial results. In addition, following periods of volatility in a company s securities, securities class action litigation against a company is sometimes instituted. We have experienced substantial costs and the diversion of management s time and resources on this type of litigation and may do so in the future.

In addition, public announcements by China Telecom, China Netcom, China Mobile, and China Unicom each of which exert significant influence over many of our major customers in China, may contribute to volatility in the price of our stock. The price of our stock may react to such announcements.

SOFTBANK CORP. with its related entities, including SOFTBANK America Inc., has significant influence over our management and affairs, which it could exercise against the best interests of our stockholders.

SOFTBANK CORP. and its related entities, including SOFTBANK America Inc. (collectively, SOFTBANK), beneficially owned approximately 12% of our outstanding stock as of December 31, 2006. As a result, SOFTBANK has the ability to influence all matters submitted to our stockholders for approval, as well as our management and affairs. Matters that could require stockholder approval include:

- election and removal of directors;
- our merger or consolidation with or into another entity; and
- sale of all or substantially all of our assets.

This concentration of ownership may delay or prevent a change of control or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of us, which could decrease the market price of our common stock.

Delaware law and our charter documents contain provisions that could discourage or prevent a potential takeover, even if the transaction would benefit our stockholders.

Other companies may seek to acquire or merge with us. Our acquisition or merger could result in benefits to our stockholders, including an increase in the value of our common stock. Some provisions of our Certificate of Incorporation and Bylaws, as well as provisions of Delaware law, may discourage, delay or prevent a merger or acquisition that a stockholder may consider favorable. These provisions include:

- authorizing the board of directors to issue additional preferred stock;
- prohibiting cumulative voting in the election of directors;
- limiting the persons who may call special meetings of stockholders;
- prohibiting stockholder action by written consent;
- creating a classified board of directors pursuant to which our directors are elected for staggered three year terms; and
- establishing advance notice requirements for nominations for election to the board of directors and for proposing matters that can be acted on by stockholders at stockholder meetings.

We face a variety of risks related to our convertible subordinated notes.

We face a variety of risks with respect to our convertible subordinated notes due in 2008 (Notes), including the following:

- we have significantly increased our leverage as a result of the sale of the Notes which could have an adverse impact on our ability to obtain additional financing for working capital;

- we may be limited in our ability to purchase the Notes in the event of a change in control, either for cash or stock, which could result in our defaulting on the Notes at the time of the change in control, and purchases for stock would be subject to market risk; and

- hedging transactions related to the Notes and our common stock and other transactions, as well as changes in interest rates and our creditworthiness, may affect the value of our common stock.

In addition, we are subject to various covenants pursuant to the terms of the indenture governing the Notes (the Indenture). Should we fail to comply with certain covenants in the Indenture, including covenants requiring us to file certain reports required to be filed pursuant to the Exchange Act (the SEC Reports) with the Securities and Exchange Commission (the SEC) and to provide the trustee for the notes (the Trustee) with copies of such reports and certain certificates regarding our compliance with our obligations under the Indenture, the Trustee or the holders of 25% of the aggregate principal amount of the Notes outstanding (the 25% Holders) could accelerate the maturity of the Notes and the Notes could become immediately due and payable. In the past, there have been delays in filing such reports: For example, as of November 9, 2006 and continuing through the date hereof there has been a delay in the filing of our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (the 2006 Q3 Form 10-Q), our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 (the 2006 Form 10-K), our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 (the 2007 Q1 Form 10-Q), and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 (the 2007 Q2 Form 10-Q, and together with the 2006 Q3 Form 10-Q, the 2006 Form 10-K, and the 2007 Q1 Form 10-Q, the Delayed Reports). We received a notice from the Trustee on May 31, 2007, asserting that our failure to file the 2006 Q3 Form 10-Q, the 2006 Form 10-K and the 2007 Q-1 Form 10-Q had resulted in a default under the Indenture, and that if we failed to file such reports within 60 days, an event of default would arise under the Indenture.

In July 2007, we sought and obtained the requisite consents from holders of the Notes to certain amendments to the Indenture, which provide that (i) any failure by us to file SEC Reports with the SEC and provide copies of such reports and certain certificates to the Trustee prior to 5:30 p.m. New York City time on October 15, 2007 (the Expiration Date) will not cause a default under the Indenture, (ii) any such failure continuing after the Expiration Date would cause a default under the Indenture, which would be deemed to have occurred as of the Expiration Date, and (iii) we will pay additional interest on the Notes of (a) 6.75% annually from January 9, 2007 to and including July 25, 2007, and (b) 10.0% annually from and including July 26, 2007 to the date the Notes are paid, prepaid, converted, redeemed or otherwise cease to be outstanding (in each case, in addition to interest of ⅞% annually, as provided by the Indenture, without regard to any amendments). Thus, if we fail to file the SEC Reports and deliver copies of such reports and certain certificates to the Trustee on or prior to October 15, 2007, the Trustee or the 25% Holders may give notice to us asserting that such failure caused a default under the Indenture, which, if not cured within 60 days after the date the notice is effective, would cause an event of default under the Indenture. If an event of default were to occur, the Trustee or the 25% Holders would have the right to accelerate the maturity of the Notes and declare all unpaid principal and accrued interest on the Notes then outstanding to be immediately due and payable, as described above. No assurance can be given that we would be able to obtain the requisite consents of the Holders to a further amendment to the Indenture, providing for a waiver of compliance with covenants in the Indenture relating to the filing of SEC Reports, on acceptable terms or at all. If an event of default under the Indenture were to occur, and the maturity of the Notes were accelerated, and all unpaid principal and accrued interest is declared immediately due and payable, our business would be seriously harmed. If we have not filed the SEC Reports, our ability to raise additional capital may be limited, and specifically, we would not be able to refinance indebtedness under the Notes from the proceeds of an issuance of new convertible notes. In addition, if we are able to raise capital to refinance indebtedness under the Notes by issuing new convertible notes, the terms of such notes may be significantly less favorable than the terms of the Notes, and may cause greater dilution to holders of our common stock.

Our failure to timely file periodic reports with the Securities and Exchange Commission could result in the delisting of our common stock from the NASDAQ Stock Market.

As a result of our failure to timely file our Quarterly Report on Form 10-Q for the period ended September 30, 2006 (Q3 2006 Form 10-Q), this Annual Report on Form 10-K for the year ended December 31, 2006, our Quarterly Report on Form 10-Q for the period ended March 31, 2007 (Q1 2007 Form 10-Q) and our Quarterly Report on Form 10-Q for the period ended June 30, 2007 (Q2 2007 Form 10-Q), we have not been in full compliance with NASDAQ Marketplace Rule 4310(c)(14), which requires us to make, on a timely basis, all filings with the Securities and Exchange Commission required by the Securities Exchange Act of 1934. Although we have now filed our Q3 2006 10-Q and this Form 10-K, we have not yet filed our Q1 2007 Form 10-Q and Q2 2007 Form 10-Q and thus continue not to be in full compliance with this rule. We are required to comply with NASDAQ Marketplace Rule 4310(c)(14) as a condition for our common stock to continue to be listed on the NASDAQ Stock Market.

In connection with our failure to timely file our periodic reports, we received four NASDAQ Staff Determination letters, dated November 15, 2006, March 7, 2007, May 16, 2007 and August 13, 2007, respectively, stating that, as a result of each of these non-timely filings, we were not in compliance with the requirements of Marketplace Rule 4310(c)(14) and, therefore, that our stock was subject to delisting from the NASDAQ Stock Market. We appealed the November 15, 2006 determination to the Nasdaq Listing Qualifications Panels (the Panel) and were granted a conditional extension to our request for continued listing until April 16, 2007. On April 17, 2007 the Panel extended the deadline for filing our Q3 2006 Form 10-Q to May 14, 2007. The Panel also extended the deadline for filing our 2006 Form 10-K until July 16, 2007. On May 2, 2007, we asked the NASDAQ Listing and Hearing Review Council (Listing Council) to review the April 17, 2007 decision of the Panel. On May 14, 2007, the Listing Council called the Panel s decision for review and requested that we provide an update on our efforts to file our delinquent filings. We have continued and continue to comply with that request. In addition, the Listing Council stayed the Panel s decision that required us to file our Q3 2006 Form 10-Q by May 14, 2007, and to file our 2006 Form 10-K by July 16, 2007. On August 23, 2007, the Listing Council granted the Company an extension until October 22, 2007 to file our delinquent periodic reports and restatements.

If we are unable to maintain compliance with the conditions for continued listing required by NASDAQ, then our shares of common stock may be subject to delisting from the NASDAQ Stock Market. If our shares of common stock are delisted from the NASDAQ Stock Market, they may not be eligible to trade on any national securities exchange or the over-the counter market. If our common stock is no longer traded through a market system, the liquidity of our common stock may be greatly reduced, which could negatively affect its price. In addition, we may be unable to obtain future equity financing, or use our common stock as consideration for mergers or other business combinations. A delisting from the NASDAQ Stock Market may also have other negative implications, including the potential loss of confidence by suppliers, customers and employees, the loss of institutional investor interest, and fewer business development opportunities.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

Our headquarters are located on a leased site in Alameda, California. Additionally, we operate facilities in the United States, China and globally consisting of office, research and development, warehousing and manufacturing sites primarily used jointly by our reporting segments.

The headquarters for our China operations is located in Hangzhou. In 2001, we purchased the rights to use 49 acres of land located in Zhejiang Science and Technology Industry Garden of Hangzhou Hi-tech Industry Development Zone and have built a 2.7 million square foot facility on this site. The facility was occupied in October 2004 and is used for manufacturing operations, research and development and administrative offices. At the end of 2006, approximately two-thirds of the facility was being utilized.

We lease approximately 1.5 million square feet of property, of which 0.8 million square feet are properties in China and 0.5 million square feet are properties in North America. We maintain 43 sales and customer support offices in 25 countries covering the United States, Canada, Latin America, the Caribbean, Europe, the Middle East, India, and the Asia-Pacific region. We lease sales offices in 24 locations in China.

We believe our facilities are suitable and adequate to meet our current needs.

ITEM 3 LEGAL PROCEEDINGS

Securities Class Action Litigation

Beginning in October 2004, several shareholder class actions alleging federal securities violations were filed against us and various officers and directors of our company. The actions have been consolidated in United States District Court for the Northern District of California under the caption *In re UTStarcom, Inc. Securities Litigation*, Master File No. C-04-4908-JW(PVT). The lead plaintiffs in the case filed a First Amended Consolidated Complaint on July 26, 2005. The First Amended Complaint alleged violations of the Securities Exchange Act of 1934, and was brought on behalf of a putative class of shareholders who purchased our stock after April 16, 2003 and before September 20, 2004. On April 13, 2006, the lead plaintiffs filed a Second Amended Complaint adding new allegations and extending the end of the class period to October 6, 2005. In addition to the company defendants, the plaintiffs are also suing Softbank. Plaintiffs complaint seeks recovery of damages in an unspecified amount.

On June 2, 2006, we and the individual defendants filed a motion to dismiss the Second Amended Complaint. On March 21, 2007, the Court granted defendants motion and dismissed plaintiffs Second Amended Complaint. The Court granted plaintiffs leave to file a Third Amended Complaint, which plaintiffs filed on May 25, 2007. On July 13, 2007, we and the individual defendants filed a motion to dismiss and a motion to strike the Third Amended Complaint.

On September 4, 2007, a second shareholder class action complaint captioned *Peter Rudolph v. UTStarcom, et al.*, Case No. C-07-4578 SI, was filed in the United States District Court for the Northern District of California against us and some of our current and former directors and officers. The complaint alleges violations of the Securities Exchange Act of 1934 through undisclosed improper accounting practices concerning our historical equity award grants. Plaintiff seeks unspecified damages on behalf of a purported class of purchasers of our common stock between July 24, 2002 and September 4, 2007.

Due to the preliminary status of these lawsuits and uncertainties related to litigation, we are unable to evaluate the likelihood of either a favorable or unfavorable outcome. Accordingly, we are unable at this time to estimate the effects of these complaints on our financial position, results of operations, or cash flows.

Governmental Investigations

In September 2005, we received notice of a formal inquiry by the staff of the Securities & Exchange Commission (SEC) into certain aspects of our financial disclosures during prior reporting periods and certain other issues. In addition, in December 2005, the U.S. Embassy in Mongolia informed us that it had forwarded to the Department of Justice (DOJ) allegations that an agent of our Mongolia joint venture had offered payments to a Mongolian government official in possible violation of the Foreign Corrupt Practices Act (the FCPA). We, through our Audit Committee, authorized an independent investigation into possible violations of the FCPA, and we have been in contact with the DOJ and SEC regarding the investigation. The investigation has identified possible FCPA violations in Mongolia, Southeast Asia, India, and China, as well as possible violations of U.S. immigration laws. The DOJ has requested that we voluntarily produce documents related to the investigation and the SEC has subpoenaed us for documents. We have executed tolling agreements extending the statute of limitations for the FCPA issues under investigation by the SEC and DOJ and the immigration issues under investigation by the DOJ. At this time, we cannot predict when any inquiry will be completed or what the outcome of any inquiry will be.

Shareholder Litigation

On November 17, 2006, a shareholder derivative complaint captioned *Ernesto Espinoza v. Ying Wu et al.*, Case No. RG06298775, was filed against certain of our current and former officers and directors in the Superior Court of the County of Alameda, California. The complaint alleges that the individual defendants, among other things, breached their duties, were unjustly enriched, and violated the California Corporations Code in connection with the timing of stock option grants. The complaint names us as a nominal defendant and seeks unspecified monetary damages against the individual defendants and various forms of injunctive relief. On February 2, 2007, we and the individual defendants filed demurrers against the complaint. On April 11, 2007, the Court sustained the individual defendants demurrer, overruled our demurrer, ordered the plaintiff to file an amended complaint, and ordered us to answer the original complaint. The plaintiff filed an amended complaint and we have filed an answer to the amended complaint. On August 21, 2007, the individual defendants filed demurrers against the amended complaint. The Court sustained the individual defendants demurrers and ordered the plaintiff to file a second amended complaint.

Due to the preliminary status of this complaint and uncertainties related to litigation, we are unable to evaluate the likelihood of either a favorable or unfavorable outcome. Accordingly, we are unable at this time to estimate the effects of this complaint on our financial position, results of operations, or cash flows.

IPO Allocation

On October 31, 2001, a complaint was filed in United States District Court for the Southern District of New York against us, some of our directors and officers and various underwriters for our initial public offering. Substantially similar actions were filed concerning the initial public offerings for more than 300 different issuers, and the cases were coordinated as *In re Initial Public Offering Securities Litigation*, 21 MC 92 for pretrial purposes. In April 2002, a consolidated amended complaint was filed in the matter against us, captioned *In re UTStarcom, Initial Public Offering Securities Litigation*, Civil Action No. 01-CV-9604. Plaintiffs allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 through undisclosed improper underwriting practices concerning the allocation of IPO shares in exchange for excessive brokerage commissions, agreements to purchase shares at higher prices in the aftermarket and misleading analyst reports. Plaintiffs seek unspecified damages on behalf of a purported class of purchasers of our common stock between March 2, 2000 and December 6, 2000. Our directors and officers have been dismissed without prejudice pursuant to a stipulation. On February 19, 2003, the Court granted in part and denied in part a motion to dismiss brought by defendants including us. The order dismissed all claims against us except for a claim brought under Section 11 of the Securities Act of 1933,

which alleges that the registration statement filed in accordance with the IPO was misleading. In June 2004, a stipulation of settlement and release of claims against the issuer defendants, including us, was submitted to the court for approval. The terms of the settlement, if approved, would have dismissed and released all claims against the participating defendants (including us). In August 2005, the Court preliminarily approved the settlement. In December 2006, the Court of Appeals for the Second Circuit reversed the Court s October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceedings. Our case is not one of the test cases. Because class certification was a condition of the settlement, it was unlikely that the settlement would receive final Court approval. On June 25, 2007, the Court entered an order terminating the proposed settlement based on a stipulation among the parties to the settlement. Plaintiffs have filed amended master allegations and amended complaints in the six test cases. It is unclear whether there will be any revised or future settlement. If the litigation proceeds, we believe that we have meritorious defenses and intend to defend the action vigorously. The total amount of the loss associated with the above litigation is not determinable at this time. Therefore, we are unable to currently estimate the loss, if any, associated with the litigation.

Passave Litigation

In November 2005, we filed suit in the Superior Court of California, County of Santa Clara, against Passave, Inc. (Passave) for breaches of contract and warranties in connection with a semiconductor device sold by Passave, Ltd. (Passave s wholly-–owned subsidiary) to us. Our Complaint alleges that the Passave device, known as the PAS5001M3 chip, has exhibited certain operational malfunctions within some of our Fiber-to-the-Home product line, and has thereby caused damage to us. The parties entered into a settlement agreement, dated August 7, 2007, and have since dismissed all claims with prejudice.

UTStarcom, Inc. v. Starent Patent Infringement Litigations

We brought suit against Starent Networks Corporation (Starent) for patent infringement in the U.S. District Court for the Northern District of California. The Complaint was filed on March 22, 2004, and later amended. In this action, we asserted that Starent infringed our patent U. S. Reg. No. 6,628,671 through the manufacture, use, offer, for sale, and sale of Starent s ST-16 Intelligent Mobile Gateway. We sought damages and injunctive relief. Starent filed its answer to the Amended Complaint and counterclaims, denying our allegations and seeking a declaration that the patent-in-suit is not infringed, is invalid, and is unenforceable. A motion for a preliminary injunction against the making, using or selling of infringing products and methods was brought, but the Court denied it on June 17, 2005. After a claims construction hearing and order, on September 20, 2005, Starent filed a motion for summary judgment of non-infringement and we filed a motion for summary judgment that Starent is estopped from asserting invalidity and unenforceability. On December 6, 2005, the Court granted Starent s motion for summary judgment. On February 2, 2006, the Court entered judgment in favor of Starent and dismissed the case. On March 2, 2006 we filed an appeal to the Federal Circuit. On April 6, 2007, after reviewing the parties briefs and hearing oral argument on April 2, 2007, the Federal Circuit, without a written opinion, affirmed the District Court s judgment and dismissal of the case. Although the Federal Circuit ruled against the Company, this decision will not have a material adverse effect on the business, financial condition, or results of its operations.

On February 16, 2005, we filed a second suit against Starent for patent infringement in the U.S. District Court for the Northern District of California. In the Complaint, we assert that Starent infringes UTStarcom patent U.S. Reg. No. 6,829,473 (the 473 patent) through Starent s development and testing of a software upgrade for its customer s installed ST-16 Intelligent Mobile Gateways. We seek declaratory and injunctive relief. Starent subsequently filed its answer and counterclaims, denying our allegations and seeking a declaration that the patent-in-suit is not infringed, is invalid, and is unenforceable. On June 16, 2005, we filed a motion to strike Starent s affirmative defense and dismiss Starent s counterclaim alleging inequitable conduct. On July 19, 2005, the parties stipulated that Starent would file an amended answer and counterclaim by July 27, 2005 and that we would withdraw our motion to strike. On August 10, 2005, we responded to Starent s amended counterclaim filed on July 27, 2005. In early December 2006, we filed a reissue application for the 473 patent with the United States Patent and Trademark Office. Starent has also filed for reexamination of the 473 patent. The reexamination and reissue are currently copending. The litigation is still in a preliminary stage and its outcome cannot be predicted, although we believe the litigation has merit. Nonetheless, we believe that any adverse judgment on Starent s counterclaims will not have a material adverse effect on our business, financial condition, or results of operations.

On May 8, 2007, we filed a third suit against Starent and sixteen individual defendants (who were all former employees of 3Com s CommWorks division which we acquired certain assets of in May of 2003) in the Northern District of Illinois. The causes of action include claims for patent infringement, misappropriation of trade secrets, intentional interference with business relations and prospective economic advantage and declarations of ownership of certain patent rights. In its Complaint, we assert that Starent infringes UTStarcom patents U. S. Reg. Nos. 7,173,905; 6,978,128; 6,963,582; 6,975,900; and 6,684,256 through the manufacture, use, offer, for sale, and sale of Starent s ST16 Intelligent Mobile Gateway and ST40 multimedia code platform, that the individual Defendants and Starent have misappropriated valuable Company trade secrets by improperly taking and using our confidential and proprietary information for the benefit of Starent, that the individual defendants and Starent have interfered with our business relations and prospective economic advantage by using the misappropriated information to obtain and enhance sales of Starent s products, and that several of Starent s patent applications and one issued patent are based on information obtained by the former employees while at the Company (CommWorks) and on that basis belong to UTStarcom. We seek compensatory damages, punitive damages and injunctive relief. After the court denied the defendants motion to dismiss the misappropriation of trade secrets claims, on August 30, 2007, Starent answered our complaint, denying our allegations and asserting a number of affirmative defenses and counterclaims, including non-infringement of the subject patents and alleged tortious interference with prospective economic advantage. We have filed a motion to dismiss most of the counterclaims and the court has ordered appointment of a special master to handle discovery, which is just beginning. We believe that any adverse judgment on Starent s counterclaims will not have a material adverse effect on our business, financial condition or results of operations.

Telemetrix, Inc. Arbitration

On October 19, 2006, Telemetrix, Inc. (Telemetrix) filed a formal Request for Arbitration against us to the World Intellectual Property Organization (WIPO) in Geneva, Switzerland. The Request for Arbitration sought unspecified damages arising from a contract between Telemetrix and Telos Technology, Inc., dated October 22, 2003. We assumed Telos rights and obligations under this contract pursuant to our purchase of Telos assets on May 19, 2004. Telemetrix alleged nine causes of action, including breach of contract, fraud, negligent misrepresentation, interference with contractual relations, and interference with prospective economic advantage. In December 2006, we filed a formal response to the Request for Arbitration, denying all material factual allegations asserted by Telemetrix. An arbitrator was selected by the parties, and, on August 2, 2007, the arbitrator granted a pleading motion in favor of us due to Telemetrix s failure to allege sufficient facts in support of a majority of its causes of action. On August 17, 2007, Telemetrix filed an Amended Statement of Claim, alleging six causes of action, including breach of contract, fraud, interference with contractual relations and interference with prospective economic advantage. The previous hearing date of December 11-13 has been vacated. No hearing date has been rescheduled. Discovery has begun.

Telos Technology, Inc. Litigation

On November 22, 2005, plaintiffs Telos Technology, Inc., Telos Technology (Canada), Inc., Telos Technology (Bermuda) Ltd., and Telos Engineering Limited (collectively, the Telos Plaintiffs) filed a Complaint against the Company in the Superior Court of California, County of Santa Clara. The Complaint alleges five causes of action, including breach of contract, breach of the implied covenant of good faith and fair dealing, fraudulent inducement, intentional misrepresentation and negligent misrepresentation, all of which arise from the Asset Purchase Agreement between the parties dated April 21, 2004. The Telos Plaintiffs assert that the Company breached the express and implied terms of the Asset Purchase Agreement and made representations to the Telos Plaintiffs during negotiations that it never intended to fulfill. The Telos Plaintiffs sought at least $19 million in damages, unspecified punitive damages and attorneys fees. The parties executed a settlement agreement in the amount of $4.5 million on August 20, 2007 and the case was dismissed on September 26, 2007 with prejudice.

Other Litigation

We are a party to other litigation matters and claims that are normal in the course of operations, and while the results of such litigation matters and claims cannot be predicted with certainty, we believe that the final outcome of such matters will not have a material adverse impact on our financial position or results of operations.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

PART II

ITEM 5 MARKET FOR UTSTARCOM, INC. S COMMON EQUITY, RELATED STOCKHOLDER MATTERS, AND ISSUER PURCHASES OF EQUITY SECURITIES

	High	Low
Fiscal 2005		
First Quarter	$ 22.20	$ 10.95
Second Quarter	11.11	6.84
Third Quarter	9.09	7.27
Fourth Quarter	8.91	5.26
Fiscal 2006		
First Quarter	$ 8.06	$ 5.86
Second Quarter	7.79	5.92
Third Quarter	9.06	6.61
Fourth Quarter	10.78	8.60

Our common stock has been traded on The NASDAQ Stock Market, LLC (NASDAQ) under the symbol UTSI since our initial public offering on March 2, 2000. The preceding table sets forth the high and low closing sales prices per share of our common stock as reported on NASDAQ for the periods indicated. As of September 30, 2007, we had approximately 180 stockholders of record.

To date, we have not paid any cash dividends on our common stock. We currently anticipate that we will retain any available funds to finance the growth and operation of our business and we do not anticipate paying any cash dividends in the foreseeable future. Certain present or future agreements may limit or prevent the payment of dividends on our common stock. For example, our convertible debt requires that we have to provide notice of our intent to pay certain dividends. Additionally, our cash held in foreign countries may be subject to certain control limitations or repatriation requirements, limiting our ability to use this cash to pay dividends.

COMPANY S STOCK PERFORMANCE

Set forth below is a line graph comparing the annual percentage change in the cumulative return to the stockholders of our common stock with the cumulative return of the NASDAQ composite (U.S. and foreign) index and the S&P Wireless Telecommunication Services index for the period commencing on December 31, 2001 and ending on December 31, 2006. The information contained in the performance graph shall not be deemed to be soliciting material or to be filed with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.

The graph assumes that $100 was invested on December 31, 2001 in our common stock and in each index (based on the sales closing price of $28.50 per share on December 31, 2001), and that all dividends were reinvested. No cash dividends have been declared or paid on our common stock. Stockholder returns over the indicated period should not be considered indicative of future stockholder returns. We operate on a 52-week fiscal year that ended on Sunday, December 31, 2006. Under the assumptions stated above, over the period from December 31, 2001 to December 31, 2006 the total return on an investment in our common stock would have been 69.3% as compared to 27.52% for the NASDAQ composite (U.S. and foreign) index and 11.80% for the S&P Wireless Telecommunication Services index shown below.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among UTStarcom, Inc., The NASDAQ Composite Index
And The S & P Wireless Telecommunication Services Index

	Period Ending					
Index	**12/01**	**12/02**	**12/03**	**12/04**	**12/05**	**12/06**
UTSTARCOM, INC.	$ 100.00	$ 69.58	$ 130.07	$ 77.72	$ 28.28	$ 30.70
NASDAQ STOCK MARKET (U.S. & FOREIGN)	$ 100.00	$ 68.85	$ 101.86	$ 112.16	$ 115.32	$ 127.52
S & P WIRELESS TELECOMMUNICATION SERVICES	$ 100.00	$ 40.30	$ 71.62	$ 112.68	$ 114.81	$ 111.80

The following table summarizes our stock repurchase activity for the three months ended December 31, 2006:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total number of shares (or Units) Purchased (1)	Average price paid per share (or Unit)	Total number of shares (or Units) purchased as part of publicly annouced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs ($ million)
10/1-31/2006		$		$
11/1-30/2006		$		$
12/1-31/2006	4,468	$ 8.84		$

(1) During the fourth quarter of 2006, the Company acquired 4,468 shares of common stock that employees presented to the Company to satisfy withholding taxes in connection with the vesting of restricted stock awards.

EQUITY COMPENSATION PLAN INFORMATION

The following table sets forth information, as of December 31, 2006, with respect to compensation plans under which the Company s equity securities are authorized to be issued:

Plan category (1)	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)		Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)	
Equity compensation plans approved by security holders	18,712,967	(2)	14.36	13,152,829	(3)
Equity compensation plans not approved by security holders	909,310	(4)	28.55		(5)
Total	19,622,277		15.02	13,152,829	

(1) See Note 15 to our Consolidated Financial Statements for a description of our equity compensation plans.

(2) Includes shares of common stock to be issued upon exercise of options granted under our 2006 Stock Plan, our 1997 Stock Plan and our 2001 Director Option Plan.

(3) Includes 1,914,934 shares of common stock available for issuance under our 2000 Employee Stock Purchase Plan and 11,237,895 shares of common stock available for issuance under our 2006 Plan.

(4) Includes shares of common stock to be issued upon exercise of options granted under our 2003 Non-Statutory Stock Option Plan. Upon implementation of the 2006 Stock Plan the remaining securities available for future issuance under the 2003 Non-Statutory Stock Option Plan were rolled into the 2006 Stock Plan. Does not include 6,051 shares and 5,522 shares of common stock subject to outstanding options with a weighted-average exercise price of $2.54 that were assumed in our acquisitions of Advanced Communication Devices Corporation, and RollingStreams Systems, Ltd., respectively.

(5) Does not include 212 shares and 743 shares remaining available for future issuance under equity compensation plans related to our acquisitions of Advanced Communication Devices Corporation, and RollingStreams Systems Ltd., respectively.

ITEM 6 SELECTED FINANCIAL DATA

The selected financial data for the years ending December 31, 2006, 2005 and 2004, and as of December 31, 2006 and 2005 is derived from our audited consolidated financial statements, which are included elsewhere in this Annual Report on Form 10-K. As discussed in the Explanatory Note at the beginning of this Report and in Note 2, Restatement of Financial Statements of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report, the selected consolidated financial data as of and for the years ended December 31, 2005, 2004, 2003 and 2002 have been restated to correct our past accounting for stock options and revenue recognition for certain sales contracts in China.

	Years ended December 31,				
	2006	**2005(4)**	**2004(4)**	**2003**	**2002**
		As restated	**As restated**	**As restated**	**As restated**
	(in thousands, except per share amounts)				
Consolidated Statement of Operations Data:					
Net sales(1)	$ 2,458,861	$ 2,871,110	$ 2,579,415	$ 1,920,161	$ 917,074
Gross profit	385,744	435,836	569,532	607,927	322,548
Operating (loss) income(2)	(138,160)	(456,714)	16,885	230,966	114,928
(Loss) income from continuing operations(3)	(117,345)	(532,645)	50,849	192,385	81,605
(Loss) earnings per share:					
Basic	$ (0.97)	$ (4.55)	$ 0.45	$ 1.86	$ 0.74
Diluted	$ (0.97)	$ (4.55)	$ 0.40	$ 1.56	$ 0.71

	Years ended December 31,				
	2006	**2005(4)**	**2004(5)**	**2003**	**2002**
		As restated	**As restated**	**As restated**	**As restated**
	(in thousands)				
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$ 661,623	$ 645,571	$ 562,532	$ 377,747	$ 231,944
Working capital	793,544	834,126	1,083,097	859,963	545,784
Total assets	2,373,950	2,551,331	3,517,605	2,345,995	1,372,206
Total short-term debt	102,758	198,826	351,183	1	
Total long-term debt	275,161	274,900	402,500	402,500	
Total stockholders equity	774,360	826,649	1,302,891	854,166	738,755

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Set forth below is a schedule which presents the detailed effects of the restatement of 2003 and 2002 which is not included in the Consolidated Financial Statements although the description of the errors giving rise to the restatement and the amount of the adjustments by year are included in Note 2 to those financial statements. This data should be read in conjunction with Note 2 of the Notes to the Consolidated Financial Statements in Item 8, Financial Statements and Supplementary Data and Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations in this Report.

	Years ended December 31, 2003 As previously reported	**Adjustments**	**As restated**	**2002 As previously reported**	**Adjustments**	**As restated**
	(in thousands, except per share amounts)					
Consolidated Statement of Operations Data:						
Net sales	$ 1,941,221	$ (21,060)	$ 1,920,161	$ 981,806	$ (64,732)	$ 917,074
Gross profit	615,942	(8,015)	607,927	345,472	(22,924)	322,548
Operating income	252,351	(21,385)	230,966	145,962	(31,034)	114,928
Income from continuing operations	209,856	(17,471)	192,385	107,862	(26,257)	81,605
Earnings per share:						
Basic	$ 2.02	$ (0.16)	$ 1.86	$ 0.98	$ (0.24)	$ 0.74
Diluted	$ 1.70	$ (0.14)	$ 1.56	$ 0.94	$ (0.23)	$ 0.71
Consolidated Balance Sheet Data:						
Cash and cash equivalents	$ 377,747	$	$ 377,747	$ 231,944	$	$ 231,944
Working capital	874,449	(14,486)	859,963	568,215	(22,431)	545,784
Total assets	2,262,610	83,385	2,345,995	1,305,552	66,654	1,372,206
Total short-term debt	1		1			
Total long-term debt	402,500		402,500			
Total stockholders equity	887,655	(33,489)	854,166	766,395	(27,640)	738,755

(1) On November 1, 2004, we completed our acquisition of selected assets of Audiovox Communications Corporation. Revenue for the years ended December 31, 2006, 2005 and 2004 from this acquisition was $1,339.0 million, $1,369.3 million and $277.4 million, respectively.

(2) The operating loss for the year ended December 31, 2006 includes a $12.3 million gain on sale of assets. The operating (loss) income for the years ended December 31, 2005 and 2004 included $218.1 million and $12.7 million, respectively, of charges associated with the impairment of various long-lived assets including goodwill, intangible assets and certain property plant and equipment. The operating loss for the year ended December 31, 2005 also contained $35.3 million of restructuring charges, including $29.7 million in operating expenses and $5.6 million in cost of goods sold. Operating (loss) income for the years ended December 31, 2005 and 2004 included charges of $0.7 million and $1.4 million, respectively, for in-process research and development associated with various acquisitions. See Notes 5, 10 and 21 of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report.

(3) Loss from continuing operations for the year ended December 31, 2006 includes a $13.5 million charge associated with the other-than-temporary impairment of a long-term investment. Loss from continuing operations for the year ended December 31, 2005 included a gain of $47.2 million from the sale of a long term investment to Softbank Corp., a related party. Income from continuing operations for the year ended December 31, 2005 also included a $31.4 million gain on extinguishment of subordinated notes and income tax expense of $136.5 million, which included a valuation allowance of $237.3 million on our net deferred tax assets.

(4) See Note 2, Restatement of Financial Statements , of Notes to Consolidated Financial Statements in Item 8 of this Annual Report for the effect of the restatement adjustments on income (loss) from continuing operations for the years ended December 31, 2005 and 2004 and on the consolidated balance sheet at December 31, 2005. The restatement adjustments decreased net income $45.3 million and $19.0 million for the years ended December 31, 2005 and 2004, respectively.

(5) At December 31, 2004 working capital decreased by $20.1 million, total assets increased by $169.2 million, long-term deferred revenue increased by $196.4 million and total stockholders equity decreased by $53.2 million as a result of the restatement adjustments.

ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the federal securities laws. These statements are based on information that is currently available to management. We intend such forward-looking statements to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, and we are including this statement for purposes of complying with those provisions. The forward-looking statements include, without limitation, those concerning the following: our expectations regarding our compliance with SEC reporting requirements and NASDAQ listing requirements; our expectations as to the nature of possible market trends; our expectations regarding continued growth in our business and operations; our expectations regarding fluctuations in gross profit; our plans regarding payment of cash dividends; our expectations regarding recognition of certain compensation costs; our plans regarding legal proceedings; our expectations regarding the effect of legal proceedings and government inquiries; our expectations regarding the functionality, performance and features of our products; our expectations regarding Softbank s continued service of certain modems and modem rental agreements; our plans and expectations regarding relationships with vendors and suppliers; our plan to fulfill the purchase commitment under various orders from our suppliers; our expectations regarding the exchange rate risks with respect to accountable receivables and payables in Renminbi, Japanese Yen and Euros; our plans regarding the use of financial instruments to hedge against certain foreign currency exchange rate risks; our plans regarding the use of derivative financial instruments for speculative trading purposes; our plans regarding the discounting of certain bank notes and commercial notes; our expectations regarding our ability to raise funds, including the impact of the late filing of our reports with the Securities and Exchange Commission on our ability to raise funds; our expectations regarding the availability of funding under the account receivable financing program with Citibank, N.A. and our plan to continue service the accounts receivable; our expectations regarding our investment in Global Asia Partners L.P.; our expectations regarding our right to intellectual property embedded in our products; our expectations regarding our ability to protect our intellectual property; our expectations regarding the effect of market risks on our operating results; our plans to implement measures to remediate material weaknesses; our expectations regarding the effectiveness of remediation measures; our plans to continue to review internal controls; our expectations regarding competition and the competitive advantages of our competitors; our expectations regarding consolidation of the telecommunications industry; our expectations regarding the development and introduction of new and more advanced products; our expectations regarding deployment of our products; our plans and expectations regarding our workforce restructurings; our expectations regarding the adoption of environmental, health and safety laws by countries world-wide; our expectations regarding the effect of the Sarbanes-Oxley Act on our corporate governance and disclosure practices; our expectations regarding the expenses associated with compliance with the Sarbanes-Oxley Act; our expectations regarding the impact of the restatement of our consolidated financial statements; our expectations regarding the maturation of the PAS market and corresponding decrease in PAS subscriber growth; our expectations regarding the long-term demand for our PAS products; our expectations regarding our ability to offset the decline in PAS sales through pursuing other products; our expectations regarding PAS system spending; our plan to improve PCD gross margins by supplying CDMA handsets we design and manufacture; our plan to pursue opportunities for our wireless infrastructure products in multiple markets; our expectations regarding our investment in and development of the IPTV market; our expectations regarding product margins; our expectations regarding the impact of our initiatives on our revenue plan; our expectations regarding our annual effective tax rate; our expectations regarding the likelihood to realize the tax benefits in the U.S. and other countries; our expectations regarding the effect of the China Corporate Income Tax Law on our future tax expenses; our expectations regarding valuation allowance on our net deferred tax assets and its impact; our expectations regarding the reporting of net losses throughout 2007; our expectations regarding our level of capital expenditures in China; our plans to maintain adequate liquidity levels through at least the next 12 months; our expectations regarding the availability and sufficiency of credit lines from lenders; our plans to issue new debt instruments, sell investments and assets; our expectations regarding refinancing of the convertible notes and access to cash in our China subsidiaries to meet our liquidity requirements outside of China; our expectations regarding interest rates; our expectations regarding sufficiency of cash resources; our expectations regarding our ability to receive licenses for our products; our expectation that our business, financial condition and results of operations will continue to be significantly influenced by the political, economic, legal and social environment in China and other international markets, including Japan, India and Europe; our expectations regarding the nature of political, economic and legal reform in China; our expectations regarding the continued importance of the Chinese market for our technologies and development and the importance of sales in China to our operating results; our expectations regarding future sales generated from China as a percentage of total sales; our expectations regarding the impact of our receiving the license to sell GSM and CDMA handsets in China on our ability to meet future market demands; our expectations regarding subscriber growth in China; our expectations regarding global expansion of sales outside of China; our plan to extend our supplier base by introducing more models of our own design and expanding relationships with more manufacturers; our plans to pursue opportunities to divest additional non-core assets; our expectation that research and development expenses will be stable; our expectations regarding future amortization expenses; our expectations regarding the impact of product defects or performance quality issues; our expectations regarding the impact of international expansion on our management, operational, financial and other resources; our expectations regarding the impact of legislation that restricts or prohibits the use of wireless handsets while driving on our future sales; our expectations regarding days sales outstanding; our plans regarding improvement of our internal supply chain and inventory management processes; our expectations regarding our product cost reduction efforts; our expectations regarding the reliability of stock-based compensation valuation models and the impact of SFAS 123(R); and our expectations regarding our ability to implement and enhance our administrative infrastructure. Additional forward-looking statements may be identified by the words anticipate, expect, believe, intend, will, may, and similar expressions, as they relate to us or our management, or by the words designed, intended and similar expressions, as they relate to our products and services. Investors are cautioned that these forward-looking statements are inherently uncertain. These statements are subject to risks and uncertainties that may cause actual results and events to differ materially. For a detailed discussion of these risks and uncertainties, see Item 1A, Risk Factors section of this Form 10-K. We do not guarantee future results and undertake no obligation to update the forward-looking statements to reflect events or circumstances occurring after the date of this Form 10-K.

RESTATEMENT OF CONSOLIDATED FINANCIAL STATEMENTS

Our consolidated financial statements and financial information in this Annual Report on Form 10-K for accounting periods prior to the third quarter of 2006 have been restated.

Summary

In July 2007, the Company announced the Audit Committee was conducting an independent investigation of historical sales with certain customers in China and stated that it could not rule out the possibility that the outcome of the investigation could impact revenue recognized for certain of such contracts as recorded in previously issued financial statements. In September 2007, the Company announced the investigative phase of the Audit Committee s investigation had been completed. After consultation with and upon the recommendation of management, the Audit Committee determined revenue in the Company s Western Region of China was recognized earlier than it should have been and that the financial statements for the affected periods should be restated. The Company also announced that its previously issued financial statements for each of the fiscal years ended December 31 in the period 2000 through 2005, the financial statements for the interim periods contained in the Quarterly Reports on

Form 10-Q filed with respect to each of these years, and the quarterly reports on Form 10-Q filed with respect to each of the quarterly periods ended March 31 and June 30, 2006 should not be relied upon. In this Annual Report we have corrected for the effects of net sales and related costs of net sales that were recorded earlier than they should have been. The net effect at December 31, 2005 was to reduce and defer previously recognized revenue and gross profit of $278.6 million and $97.7 million, respectively.

We also conducted a voluntary review of historical stock option practices under the direction of the Nominating and Corporate Governance Committee of our Board of Directors (Governance Committee). This review considered all option grant awards made in the period from February 29, 2000, shortly before the initial public offering of our Common Stock, through August 2006 for compliance with the various stock-based compensation accounting standards applicable during this period as well as the rules of our stock option plans. We found that in a number of instances we did not use the proper date as the measurement date in determining whether stock options had been issued with exercise prices below the fair value of our common stock. Therefore, we have restated our previously issued financial statements for the years ended December 31, 1998 through 2005 to account for an additional $25.5 million of stock compensation expense that should have been recognized over the period together with an equal increase in additional paid-in capital to recognize the intrinsic value assigned to these issuances of equity securities. Related adjustments of payroll and income taxes resulted in an additional $0.5 million of expense being recognized for the 1998 through 2005 period and total stockholders equity being reduced by a total of $2.1 million at December 31, 2005. During the first six months of 2006 an additional $1.2 million of stock compensation expense was recognized, which reduces our previously reported operating results for this period.

In restating our previously issued financial statements for the investigations described above, we also corrected other previously reported amounts. We corrected our reporting for $80.3 million of net sales to certain third party resellers and $41.2 million of associated cost of net sales in 2005 to classify these amounts as related party net sales and related party cost of net sales classifications, respectively, because in 2006 we determined that sales to these entities were, in substance, sales to one of our significant shareholders, SOFTBANK CORP. The accounts receivable from these sales was similarly reclassified into accounts receivable from related parties in our 2005 balance sheets. We also corrected our reporting of $6.3 million of time deposits at March 31 and June 30, 2006 because they did not mature within three months. Formerly the time deposits had been reported in error as cash equivalents, but now these amounts are included in short-term investments in these balance sheets and in the statements of cash flows for the March and June 2006 reporting periods. The corrections for all 2006 and 2005 interim periods have been recorded in the condensed consolidated financial statements included in Exhibit 99.1 of this Annual Report.

None of these restatements has any effect on any of our December 31 cash balances; however, cash equivalents were reduced in the March and June 2006 periods due to the reclassifications described above.

Additional information about these restatements and their effects on our financial statements is presented below as well as in the Notes to Consolidated Financial Statements.

China Sales Investigation

The Audit Committee of the Company s Board of Directors (Audit Committee) engaged independent counsel to conduct an investigation of sales in China following a determination by the Internal Audit group that allegations of improper activities in a sales office in the Western Region were credible. The allegations were made by a Company employee using the Company s whistle blower program. The independent counsel engaged forensic accountants, and this group is collectively referred to as the Investigating Team in the rest of this discussion.

In conducting its procedures, the Investigating Team found instances where the customer contracts that evidenced the arrangement contained obligations for the Company to deliver software upgrades when and if made available for the equipment sold for no additional consideration and for an unspecified period that could extend over the term of the contract. This additional contract obligation is an element of post contract support. In these cases, the Investigating Team found that the contract documentation for the same transaction submitted by the sales office to the Company s China headquarters for accounting purposes and utilized by the Company in determining the amount of revenue recognized did not include evidence of such post contract support obligations.

Accounting standards governing revenue recognition for system sales require all revenue to be deferred while there are undelivered elements under the arrangement unless the seller has established vendor specific objective evidence (VSOE) of fair value for such contract elements. Because these arrangements included such undelivered elements, revenue should be deferred based on the VSOE of the fair value of the underlying elements. VSOE of fair value represents the price charged when the same element is sold separately. Since the Company does not sell this element separately, it has not established VSOE for such undelivered elements, and as such the revenue from such contracts is required to be deferred and recognized over the period the Company is obligated to provide the post contract support.

The China sales investigation covered each of the seven years in the period ended December 31, 2006 and included: investigating approximately 1,200 contracts in all of our five regions in China; reviews of the electronic files of 45 employees; and formal interviews of 96 employees in China. Additionally, the China sales investigation included reviewing contract files, performing various financial analyses including comparison of payments received per our accounting records to the contract terms, and computer forensic procedures where destruction of electronic documents was suspected. In the aggregate, the Investigating Team expended approximately 25,000 hours in conducting this investigation, which commenced in February 2007 and was completed in September 2007 when the independent counsel and forensic accountants presented their final report to the Audit Committee. In July 2007, we announced the Audit Committee was conducting an independent investigation of historical sales with certain customers in China and we stated that we could not rule out the possibility that the outcome of the investigation could impact revenue recognized for certain of such contracts as recorded in our previously issued financial statements.

Upon completion of the investigative phase of the independent investigation by the Audit Committee, our management:

- conducted follow-up procedures to attempt to locate any additional relevant information to ensure the Company considered all available information and documents;

- evaluated the accounting for identified system sales using the contract template and documentation found in the sales contract files from the Western Region offices. This included calculating the financial statement effects of correcting the accounting for all system sales where the contract template found at our sales offices contained post contract support obligations to recognize revenue and cost of net sales over estimated period of post contract support;

- concluded that as a result of the existence of this undelivered post contract support obligation our previously issued financial statements should be restated to defer system sales contract revenue and the related cost of net sales over the estimated period of post contract support when a contract contained unspecified software upgrade rights.

The Audit Committee concurred with management s decisions.

The effect of correcting improperly recognized revenue and cost of net sales is to (reduce) increase previously reported net sales, gross profit and net income by the following amounts (in thousands of dollars):

Year ended December 31,	Net sales	Gross profit	Net income
2000	$ (12,408)	$ (5,294)	$ (4,781)
2001	(17,154)	(6,330)	(5,779)
2002	(64,732)	(22,924)	(19,697)
2003	(21,060)	(8,014)	(6,382)
Totals through December 31, 2003	(115,354)	(42,562)	(36,639)
2004	(104,965)	(27,241)	(18,594)
2005	(58,232)	(27,863)	(42,433)
2000 - 2005 Total	(278,551)	(97,666)	(97,666)
2006 quarter ended			
March 31	5,410	1,360	1,360
June 30	2,380	(371)	(371)
Total China Sales Restatement	$ (270,761)	$ (96,677)	$ (96,677)

The cumulative effect of all of the China sales restatement adjustments to our consolidated balance sheet as of December 31, 2003 resulted in a decrease in retained earnings of $36.6 million, an increase in deferred revenue of $115.4 million to account for previously recognized sales, an increase in deferred costs of $75.7 million to account for previously recognized cost of net sales, and an increase in deferred tax assets of $3.0 million. In our consolidated balance sheet at December 31, 2006, deferred revenue is $275.7 million, of which $35.6 million is classified as current and $240.1 million as non-current, and the deferred costs balance is $176.6 million. These amounts will be recognized in our consolidated statements of operations over the estimated remaining period of post contract support.

Upon completing its investigation, the Audit Committee concluded that the conditions and practices relating to systems contracts prevalent in the Western Region resulted primarily from the failure to prevent or detect instances of override related to controls in China over customer agreements, lack of proper management oversight, unclear record retention policies and procedures relating to systems contracts, and inadequate employee training. The Investigating Team and the Audit Committee also concluded that with respect to four regions other than the Western Region there was no evidence of fraud or misconduct or reason to suspect such occurred. The Investigating Team and the Audit Committee also concluded that there was no credible evidence of knowledge by senior management in China or the United States of the conditions and practices related to the Western Region of China that were discovered in the investigation. The Audit Committee concluded that local management in several of the sales offices in the Western Region of China did not submit appropriate information to the Company s senior management in China and the United States. Therefore, in prior years, neither the Company s management nor the Company s independent registered accounting firm were able to properly evaluate the effect of that information on revenue recognition. The Audit Committee also concluded that certain members of management in China bear varying degrees of responsibility for inadequate oversight of activities. As a result, certain employees in China have either been terminated or placed on suspension for failure to provide adequate oversight of activities.

We have restructured the management of the Western Region sales organization and are working to identify and implement changes to our policies and procedures and enhance employee training to improve internal control consciousness and lessen the possibility of accounting errors occurring in the future.

Stock Option Accounting

In November 2006, we announced we had commenced a voluntary review of historical stock option practices under the leadership of the Governance Committee following a preliminary review by management which identified potential deficiencies and discrepancies in the documentation of stock option grants. The review considered all option grant awards made in the period from February 29, 2000, shortly before the initial public offering of our Common Stock, through August 2006 (Review Period) for compliance with the various stock-based compensation accounting standards applicable during the Review Period as well as the rules of our stock option plans. The Governance Committee engaged independent outside legal counsel to assist in the review who, in turn, engaged forensic accountants. (Separate law firms and separate forensic accounting firms were engaged by the Audit Committee and the Governance Committee for the China sales investigation and the stock option accounting review.) In the rest of this discussion, this group collectively is referred to as the Stock Option Review Team and their actions and activities are referred to as the Stock Option Review. The Stock Option Review Team members spent over 11,000 hours in this review, and the Governance Committee met with the Stock Option Review Team on more than a dozen occasions to receive, discuss, and consider the Stock Option Review Team s information and findings.

At the time the review commenced, the Governance Committee consisted of three members of the Board of Directors, all of whom are independent directors. The Committee decided to delegate supervision of the review to Mr. Jeff Clarke, its Chairman, who joined our Board in 2005 and had not served on the Compensation Committee of the Board of Directors (Compensation Committee) during the period under review. The Governance Committee also consisted of two other independent directors, Mr. Larry D. Horner and Mr. Thomas Toy, who also serve on the Board s Compensation Committee. Mr. Allen Lenzmeier was appointed to the Governance Committee on April 27, 2007.

Review procedures included:

- interviews of individuals involved with granting, advising, administering, or accounting for stock options, including current and former: management, members of the Board of Directors, employees, and non-employee professionals;

- review of relevant stock administration, human resource, legal, and finance department files and records;

- review of stock option grant information in select employee personnel files;

- review by at least 30 attorneys and 15 forensic accountants of approximately 250,000 potentially relevant e-mails and documents in electronic format selected through electronic discovery techniques from over 1.8 million electronic documents processed;

- review of the electronic database of the Company s stock option activity maintained by a third party along with communications to and from this service provider;

- reconciliation of grant activity from approval documents executed by the Compensation Committee with the electronic database;

- reconciliation of stock option grant, exercise, and cancellation information from SEC filings with select employee personnel files and the electronic database;

- statistical and judgmental pattern analysis;

- follow-up on matters raising questions about the option granting process and its history, conduct of those involved with granting, advising, administering, or accounting for stock options, or the accounting treatment for stock options; and

- follow-up on items or issues requested or identified by management or the Company s independent registered public accounting firm.

The Stock Option Review Team, management, and the Governance Committee decided to group stock option grants into six award categories based on differences in what constituted substantive approval for each category under our stock option granting practices as well as giving consideration to the risk of intentional misstatement of the grant date. Guidance in a September 19, 2006 letter publicly issued by the SEC s Chief Accountant focuses on the concept that a measurement date under Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* (APB 25), the accounting standard governing our stock option accounting through 2005, does not occur until the number of shares an individual employee is entitled to receive and the exercise price is determined with finality (i.e., no longer subject to change). This is the date on which substantive approval occurred, and depending on a company s facts and circumstances the guidance from the SEC discussed above recognizes a company may determine that the measurement date for some stock option grants may occur before all required granting actions have occurred such as final approval by the Compensation Committee. This alternative is available only when a review of all facts and circumstances supports a conclusion that substantive approval occurs earlier than when all required granting actions have occurred and there is no evidence of fraudulent or manipulative conduct in the company s option granting practices.

In determining the measurement date to be used, the Stock Option Review Team, management, and the Governance Committee agreed to use the following definitions as constituting the proper measurement date, and generally these dates were used in testing the stated grant dates or establishing corrected measurement dates:

Discretionary Director and Officer Grants	The date of a Compensation Committee meeting where the grant was approved or the date the final Compensation Committee signer approved the grant when approval occurred through unanimous written consent documents (UWC).
Automatic Director Grants	The date specified in the relevant stock option plan.
Broadbase	The date the grantee list, including the allocation of shares to individual grantees, was complete. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
Acquisition	The first Compensation Committee meeting following the acquisition, provided grantees had received employment offer letters stating the number of stock options to be granted before such date, because this was the date at which the option exercise price was established. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
New Hire	The first scheduled Compensation Committee meeting following the first day of employment, because this was the date at which the option exercise price was established. The number of options was based on either grant amounts specified in an employment offer letter or, in some cases, on a matrix that assigned grant amounts based on position and level within the Company. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
Other Merit	The date the grantee list, including the allocation of shares to grantees, was substantially complete. Compensation Committee approval was considered perfunctory due to delegation of authority to management.

For 12 tested grant dates where a corrected measurement date was required, the Stock Option Review Team and management were unable to locate sufficient evidence to establish a corrected measurement date using our established criteria for the applicable option grant type. In these situations alternative available evidence was used to establish the corrected measurement date.

During the period covered by the Stock Option Review, we granted stock options on approximately 34 million shares of our Common Stock at 197 grant dates. The review specifically examined the appropriateness of the stated grant date for approximately 90% of the stock options granted, including all stock option grants made to directors and officers, all broadbase grants and all option grants made in connection with business acquisitions.

The findings of this review are summarized as follows:

				Measurement date changed	
Grant Type	**Number of grants**	**Grants tested**	**No change required**	**additional compensation expense required**	**no additional compensation expense required** (1)
Discretionary Director & Officer	16	16	8	4	4
Automatic Director	5	5	5		
Broadbase	8	8		6	2
Acquisition	10	10	10		
New Hire	166	48	48		
Other Merit	96	41	4	21	16
Total	301 (2)	128	75	31	22

(1) Under APB 25 there is no expense adjustment arising from using the corrected measurement date for these grants because the amount the employee would have to pay to exercise these stock option grants exceeded the quoted market price of our Common Stock at the corrected measurement date, and therefore, these stock option grants contained no intrinsic value at the corrected measurement date.

(2) The number of grants exceeds the number of grant dates because on certain grant dates more than one category of stock option grants were approved.

In late January 2007 the Governance Committee reported its interim findings concerning the use of incorrect measurement dates in our stock option accounting under APB 25 to our Board of Directors. On February 1, 2007, the Audit Committee of the Board of Directors then concluded, in consultation with and upon the recommendation of management, that we should correct for errors in previously reported stock-based compensation expense through restatement of our previously issued financial statements and that our previously issued financial statements for all periods should no longer be relied upon. We communicated this decision in a February 1, 2007 public announcement.

A non-cash compensation charge, to be recognized as an expense over a grantee s service period, arises under APB 25 if a stock option has intrinsic value at its measurement date. This intrinsic value is measured by the excess, if any, of the fair value at the date of grant of the underlying common stock over the stock option s exercise price. Our practice has been to grant stock options with exercise prices equal to the closing price of our Common Stock at each grant date, to use the grant date as the measurement date for stock-based compensation purposes, and as such previously we had determined the granted stock options had no intrinsic value at their grant dates and no compensation expense was recognized. However, APB 25 states the measurement date does not occur until all essential actions necessary to grant the option are completed, including the final determination of both the number of shares to be granted to each employee or director and the exercise price, and the option grant is approved by those with requisite authority. This is reinforced by the September 19, 2006 letter issued by the SEC s Chief Accountant which focuses on the need for the number of shares and exercise price of an award to an individual to be finalized to have a measurement date. This letter clarifies the SEC staff s view that if it is possible that those terms could change, a measurement date has not occurred, even if the award s terms are not actually changed.

Based on the available evidence, the review found that the number of shares an individual employee was entitled to receive and/or the exercise price was not determined with finality at the stated grant date on 53 tested grant dates, and we should have used a later date as the measurement date. The principal reasons for the stated grant date not qualifying as the measurement date under APB 25 include:

- certain listings of grantees, below officer level, were incomplete and added to or modified by stock option administration personnel after the grant was approved by the Compensation Committee;

- for certain grants where Compensation Committee approval was not considered perfunctory, the date a UWC document was sent to Compensation Committee members for approval was used as the stated grant date for some discretionary officer and director grants rather than the date the UWC was signed by all Compensation Committee members and therefore became effective;

- the Stock Option Review Team was unable to locate contemporaneous documentation of some director and officer, broadbase, new hire, and other merit grants.

During the review the Company also discovered a stock option grant to a former officer that was modified in 1998 in connection with his termination of employment. This change was never included in the Company s stock option grant records and the additional compensation expense resulting from the change in the option s terms (approximately $1.2 million) was not recorded previously. This discovery is consistent with the Stock Option Review Team s finding that in certain instances there was a lack of formal documentation in the stock option granting process and/or expected documentation is missing from the stock option administration files. In addition, the Stock Option Review Team found that, in many instances, there was a lack of self-authenticating evidence to corroborate that cash exercises were contemporaneous. As a result, the findings on the issue of backdating of cash exercises were inconclusive.

We are restating our consolidated financial statements to recognize additional non-cash stock-based compensation expense arising from using corrected measurement dates for certain stock option grants made during the years 2000 through 2005 and to reflect the modification of the 1998 grant described above. Consistent with our historical accounting policy this additional stock-based compensation expense is being recognized on an accelerated basis by treating each vesting tranche as a separate stock option grant (graded vesting).

Our accounting for stock-based compensation changed to a fair value based method in 2006 when, as required by accounting standards, we ceased accounting for stock-based compensation under the intrinsic value method pursuant to APB 25 and began accounting for stock-based compensation under Statement of Financial Accounting Standards 123(R) *Share-Based Payments* (SFAS 123(R)). Under this method all stock option grants have a fair value determined using an option pricing model, and such fair value is used to recognize non-cash stock-based compensation expense. We are restating our unaudited condensed consolidated financial statements for the first and second fiscal quarters of 2006, included in Exhibit 99.1, to recognize changes in non-cash stock-based compensation expense that arose from a re-determination of the fair value of stock options granted in 2005 and prior where the Governance Committee s review resulted in a corrected measurement date. By January 1, 2006, of the 17.9 million options granted in 2000 - 2005 where corrections were made to the measurement dates in the Stock Option Review, 4.4 million options with corrected measurement dates granted in 2000 and 2001 had fully vested. Therefore, the fair values of the outstanding and unvested portion of the remaining 13.5 million stock options granted in 2002 - 2005 with incorrect measurement dates were recalculated. We are also recording additional non-cash stock-based compensation expense in the first two quarters of 2006 arising from correcting the measurement date for stock option grants to three individuals in this period. We recognize stock compensation expense on a straight-line basis under SFAS 123(R).

Those stock option grants with corrected measurement dates have also been restated using the fair value based measurement principles of Statement of Financial Accounting Standards 123 *Accounting for Stock-Based Compensation* (SFAS 123) to present, in Note 2, Restatement of Financial Statements of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report, the pro forma effect on stock-based compensation expense, net income (loss), and earnings (loss) per share amounts in 2004 and 2005 of using the fair value based method to determine stock-based compensation expense rather than using APB 25 s intrinsic value method. Such disclosure is required in financial statements for periods prior to the adoption of SFAS 123(R).

In addition to restating the consolidated financial statements in response to the Governance Committee s findings, we are recording additional non-cash adjustments to account for the modification in 1998 of a stock option grant to a former officer in connection with his termination of employment and to record in the first two quarters of 2006 corrections relating to accounting for performance related stock options and restricted stock grants, all of which were previously identified and considered immaterial.

Correcting the measurement date for previously granted stock options in some cases results in additional taxable income to employees on which additional payroll taxes are due from the employees as well as us. We have provided for all additional payroll taxes plus related penalties and interest arising from the restatement of stock-based compensation, including amounts otherwise payable by stock option recipients, and our restated financial statements include an accrual in all affected years of approximately $1.5 million for all estimated payroll tax related expenses.

The corrections for the stock option restatement are to increase (reduce) previously reported non-cash compensation expense, payroll taxes, income taxes and net income by the following amounts (in thousands of dollars):

Year ended December 31,	**Non-cash stock compensation**	**Payroll taxes**	**Income taxes**	**Net income**
1998	$ 1,244	$	$ (448)	$ (796)
1999				
2000	556		(104)	(452)
2001	4,870		(942)	(3,928)
2002	8,110		(1,550)	(6,560)
2003	12,470	900	(2,281)	(11,089)
Totals through December 31, 2003	27,250	900	(5,325)	(22,825)
2004	(410)	541	250	(381)
2005	(1,290)	60	4,083	(2,853)
2000 - 2005 Total	25,550	1,501	(992)	(26,059)
2006 quarter ended				
March 31	662	9		(671)
June 30	504	6		(510)
	$ 26,716	$ 1,516	$ (992)	$ (27,240)

The Governance Committee s review found 17.9 million stock options of the 28.8 million options granted on our Common Stock during 2000 through 2005 had incorrect measurement dates. Using the corrected measurement dates, 7.6 million stock options had exercise prices that exceeded the closing price of our Common Stock and therefore had no intrinsic value to be accounted for under APB 25, and 10.3 million stock options had intrinsic value because their exercise prices were below the closing price of our Common Stock. These 10.3 million stock options resulted in an increase in additional non-cash stock-based compensation expense of $24.3 million, and an additional $1.5 million of payroll tax related expenses during 2000 - 2005 partially offset by $0.5 million of income tax benefit as shown in the above table. Of the 10.3 million stock options resulting in additional non-cash stock-based compensation expense, 2.0 million options were granted to officers and directors and resulted in $6.1 million of additional non-cash stock-based compensation expense.

Upon completing its review, the Governance Committee concluded it found no evidence of intent to manipulate the Company s operating results or financial statements. A key finding of the Governance Committee was that there were deficiencies with the process by which stock options were granted during the period from our initial public offering in 2000 through at least 2005, which resulted in accounting errors. The Governance Committee concluded that certain members of management bear varying degrees of responsibility for the deficiencies in the process by which options were granted. The Governance Committee s review also concluded that none of the current or former employees or directors of the Company engaged in intentional wrongdoing.

In determining the above restatement amounts, management used all reasonably available relevant information to form conclusions it believes are reasonable as to the most likely option granting actions that occurred, the dates when such actions occurred, and the determination of grant dates for financial accounting purposes based on when the requirements of the accounting standards were met. In light of significant judgment used in establishing revised measurement dates, alternative approaches to those used by the Stock Option Review Team and management could have resulted in different compensation charges than those recorded in the restatement. The Stock Option Review Team and management considered various alternatives throughout the course of the review and restatement, and management believes the approaches used were the most appropriate in the circumstances, and the choices of measurement dates used in our review of stock option grant accounting and restatement of our financial statements were reasonable and appropriate in our circumstances.

Summary of Restatement Amounts

The following table presents the decrease in net earnings from the restatement for each restated year:

Year ended December 31,	Net income (loss), as previously reported	Restatement adjustments China Sales (Decrease) Increase (in thousands)	Stock Options	Total	Net income (loss), as restated
1998		$	$ (796)	$ (796)	
1999					
2000		(4,781)	(452)	(5,233)	
2001		(5,779)	(3,928)	(9,707)	
2002	$ 107,862	(19,697)	(6,560)	(26,257)	$ 81,605
2003	$ 209,856	(6,382)	(11,089)	(17,471)	$ 192,385
Totals through December 31, 2003		(36,639)	(22,825)	(59,464)	
2004	$ 69,824	(18,594)	(381)	(18,975)	$ 50,849
2005	$ (487,359)	(42,433)	(2,853)	(45,286)	$ (532,645)
2000 - 2005 Total		(97,666)	(26,059)	(123,725)	

2006 quarter ended			
2006 Q1	1,360	(671)	689
2006 Q2	(371)	(510)	(881)
	$ (96,677)	$ (27,240)	$ (123,917)

The effect these corrections on diluted earnings (loss) per share for 2002 to 2005 are as follows:

Year ended December 31,	Diluted earnings (loss) per share, as previously reported	Restatement amounts China sales	Stock options	Total restatement	Diluted earnings (loss) per share, as restated
2002	0.94	(0.17)	(0.06)	(0.23)	0.71
2003	1.70	(0.05)	(0.09)	(0.14)	1.56
2004	0.54	(0.14)	(0.00)	(0.14)	0.40
2005	(4.16)	(0.36)	(0.03)	(0.39)	(4.55)

The cumulative effect on stockholders equity at December 31, 2003 from the above corrections is as follows (in thousands):

Increase (decrease) in additional paid-in capital and deferred stock compensation:	
Values assigned to stock options	$ 27,250
Reduction of previously recorded income tax benefits from stock options	(1,278)
Net increase in additional paid-in capital and deferred stock compensation	25,972
(Increase) decrease in retained earnings:	
Revenue and related cost of sales deferral for China system sales	(36,639)
Additional non-cash compensation expense from stock options	(27,250)
Payroll taxes for values assigned to stock options	(900)
Income tax benefit from additional compensation and payroll tax expense	5,325
Net increase in retained earnings	(59,464)
Net decrease in stockholders equity at December 31, 2003	$ (33,492)

In restating our previously issued financial statements we also corrected other previously reported amounts. We corrected our reporting for $80.3 million of net sales to certain third party resellers and $41.2 million of associated cost of net sales in 2005 to classify these amounts as related party net sales and related party cost of net sales classifications, respectively, because in 2006 we determined that sales to these entities were, in substance, sales to one of our significant shareholders, SOFTBANK CORP. The accounts receivable from these sales was similarly reclassified into accounts receivable from related parties in our 2005 balance sheets. We also corrected our reporting of $6.3 million of time deposits at March 31 and June 30, 2006 because they did not mature within three months. Formerly the time deposits had been reported in error as cash equivalents, but now these amounts are included in short-term investments in these balance sheets and in the statements of cash flows for the March and June 2006 reporting periods.

ALL AMOUNTS IN THE FOLLOWING SECTIONS OF THIS MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, EXCEPT THOSE IDENTIFIED AS PREVIOUSLY REPORTED IN TABLES WITHIN THE QUARTERLY DATA (UNAUDITED), AS RESTATED CAPTION, REFLECT THE EFFECTS OF THE RESTATEMENT OF OUR FINANCIAL STATEMENTS TO CORRECT OUR REVENUE RECOGNITION FOR CERTAIN SALES CONTRACTS IN CHINA AND OUR HISTORICAL STOCK OPTION ACCOUNTING, AS WELL AS CERTAIN 2005 SALES, COST OF SALES AND ACCOUNTS RECEIVABLES AMOUNTS DISCOVERED TO BE RELATED PARTY TRANSACTIONS AND THE CORRECTION OF THE CLASSIFICATION OF A TIME DEPOSIT FROM CASH TO SHORT-TERM INVESTMENTS IN THE FIRST TWO QUARTERS OF 2006.

Late SEC Filings and NASDAQ Delisting Proceedings

As a result of the Nominating and Corporate Governance s Committee s review of our historical stock option accounting and the resulting restatements, we did not timely file our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006 (Q3 2006 Form 10-Q), our Annual Report on Form 10-K for the fiscal year ended December 31, 2006 (2006 Form 10-K), and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007 (Q1 2007 Form 10-Q) with the Securities and Exchange Commission. In addition, as a result of the Audit Committee s review of certain historical sales contracts in China, we did not timely file our Quarterly Report on Form 10-Q for the quarter ended June 30, 2007 (Q2 2007 Form 10-Q) with the Securities and Exchange Commission.

In connection with our failure to timely file our periodic reports, we received four NASDAQ Staff Determination letters, dated November 15, 2006, March 7, 2007, May 16, 2007 and August 13, 2007, respectively, stating that, as a result of each of these non-timely filings, we were not in compliance with the requirements of Marketplace Rule 4310(c)(14) and, therefore, our stock was subject to delisting from the NASDAQ Stock Market. We appealed the November 15, 2006 determination to the NASDAQ Listing Qualifications Panel (the Panel) and were granted a conditional extension to our request for continued listing until April 16, 2007. On April 17, 2007, the Panel extended the deadline for filing our Q3 2006 Form 10-Q to May 14, 2007. The Panel also extended the deadline for filing our 2006 Form 10-K until July 16, 2007.

On May 2, 2007, we asked the NASDAQ Listing and Hearing Review Council (Listing Council) to review the April 17, 2007 decision of the Panel. On May 14, 2007, the Listing Council called the Panel s decision for review and requested that we provide an update on our efforts to file our delinquent filings. We have continued and continue to comply with that request. In addition, the Listing Council stayed the Panel s decision that required us to file our Q3 2006 Form 10-Q by May 14, 2007, and to file our 2006 Form 10-K by July 16, 2007. On August 23, 2007, the Listing Council granted the Company an extension until October 22, 2007 to file our delinquent periodic reports and restatements. As of the date of the filing of this Form 10-K (which is filed concurrently with our Q3 2006 Form 10-Q), we will have two periodic reports still outstanding, our Q1 2007 Form 10-Q and our Q2 2007 Form 10-Q. We expect to be able to complete the filing of our outstanding reports as soon as practicable.

OVERVIEW

We design, manufacture and sell telecommunications equipment and handset products and provide services associated with their operation. Our telecommunication equipment products are deployed and installed globally primarily by wireless and wireline telecommunications service providers. We provide an extensive range of products for transportation of voice, data and video traffic for these service providers. We differentiate ourselves with products designed to reduce network complexity, integrate high performance capabilities and allow a simple transition to next generation networks.

Personal Communications Division

The Personal Communications Division (PCD) is our distribution channel into the Code Division Multiple Access (CDMA) handset market. PCD was established with the acquisition of the assets of the wireless handset division of Audiovox Corporation (ACC) in November 2004 (see Note 5, Acquisitions and Sale of Assets , of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report). We acquired ACC s sales, service and support infrastructure, its CDMA handset brand, access to supply-chain channels, product marketing expertise and key relationships with CDMA operators in North and South America. We believe this distribution channel strengthens our position in the handset market by providing additional sales volume of UTStarcom designed products to benefit economies of scale in manufacturing, sourcing and development.

In 2005, PCD became our largest segment on the basis of net sales, generating 48% of our total sales. This was primarily due to the fact that in 2005 a full year of PCD operations were reflected in our results as compared to 2004 where approximately two months of PCD revenues were included. At the same time, sales in our Network Solutions segment declined significantly. In 2006, PCD continued to be our largest segment on the basis of net sales, generating $1,339.5 million, or 55%, of our total sales. The gross margins on PCD distribution and marketing services are much lower than the margins traditionally realized in our other operating segments. We plan to improve PCD gross margins by supplying CDMA handsets we design and manufacture. We introduced three CDMA handset models in 2006, and plan to introduce six additional models in 2007.

Historically, PCD has relied upon a limited number of third party vendors to supply its handset products. During 2006 and 2005, three vendors accounted for approximately 88% and 97% of purchases, respectively. In September 2006, we entered into a strategic alliance agreement with one of these vendors whereby we were appointed exclusive distributor in certain territories. Additionally, during 2006 we extended our supplier base by introducing more models of our own design and expanding our relationships with other manufacturers.

Wireless Infrastructure and Handsets

Our Personal Access Service (PAS) infrastructure and handset products are primarily sold in China. Historically, China has been our largest market and we believe that it will continue to be an important market for our current and future technologies. The percentage of our sales generated in China has declined to 32% and 30% of total sales in 2006 and 2005, respectively compared with 79% in 2004. This decline is due to maturation of the PAS market coupled with proportionally increased sales outside of China through organic growth and acquisitions.

In 2006 and 2005, our sales of Wireless Infrastructure products declined by $8.6 million, or 2%, and $832.8 million, or 66%, respectively, compared with the previous year. The decline in our sales of Wireless Infrastructure products is primarily due to our customers in China reducing their capital spending in anticipation of next generation technology networks while shifting their PAS investments from geographical extension to expanding the capacity and improving the quality of the existing networks.

In 2006 and 2005, our sales for Handset products declined by $77.7 million, or 16%, and $275.6 million, or 37%, respectively, compared with the previous year, primarily due to declines in both the total market size and average selling price. The decline in handset market size is a result of lower subscriber growth in 2006, which was driven by lower marketing efforts by service providers. Despite competitive pressures, the margin rate on handsets improved by 18 percentage points from 2005 to 2006 as the China handset business focused on higher end products and cost reductions rather than increase in volume. We will continue to focus on product cost reductions through the increased sale of handset models with lower cost chipsets as well as higher end products including dual mode handsets.

Despite the market conditions experienced in 2006, we expect long-term demand for our PAS products will continue as we believe PAS will remain an important technology and market in China for the foreseeable future. According to China s Ministry of Information Industry, the mobile phone teledensity rate was 35% at the end of 2006, which is still far behind most developed countries in the world. This means almost 65% of China s 1.3 billion population still did not have mobile phone service. As China s economic growth and urbanization continues in the coming years, we believe this represents a huge market demand for cost-effective communication services, the addressable market of PAS. At the end of fiscal year 2006, the number of PAS subscribers exceeded 96 million users, an increase of 10% over the prior year. Positioned as an extension of fixed-line service and an affordable city-wide mobile phone service, PAS has a significant cost advantage over the 2nd and 3rd generation mobile phone technologies, in terms of the existing infrastructure of the network and lower service tariffs.

Restructuring Programs

Over the past few years, we have undertaken a significant globalization program and we intend to continue to build our global sales outside of China. We intend to continue to enhance our manufacturing capabilities and improve our internal supply chain and inventory management processes to ensure timely deliveries of quality products. We also intend to continue to implement and enhance our administrative infrastructure to assist our globalization.

As part of this program, we reviewed our corporate wide operations with the aim of narrowing our strategic focus with regard to market concentration, product portfolio selection, and resources allocation. In the second quarter of fiscal 2005, we announced and initiated a restructuring plan to rationalize our cost structure in response to the decline in demand for certain products and to align investments with key growth opportunities. The primary goal of these improvements is to optimize our cost structure and enable us to deliver consistent and sustainable profitability for our stockholders.

During 2005, we incurred approximately $35.3 million in restructuring expenses consisting of $15.2 million in severance payments to approximately 1,595 employees terminated in workforce reduction programs, $14.5 million in asset impairments to write-off equipment and licenses associated with discontinued products, and a $5.6 million inventory write-off for discontinued products. Restructuring expense related to severance and asset impairments are reported in operating expense, while the inventory write-off is reported in cost of sales in the consolidated statements of operations (see Note 21, Restructuring Costs, to Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report).

During 2006, no additional restructuring expenses were incurred and approximately $1.1 million of accrued expenses were settled. The remaining $0.1 million of accrued expenses as of December 31, 2006 relate to a facility lease and will be settled in 2007.

On October 2, 2007, our Board of Directors approved a restructuring plan (the Plan) to reduce operating costs, which includes a worldwide reduction in force of approximately 11% of the Company s headcount, or approximately 700 employees. The workforce reduction will be based primarily in the United States and China and, to a lesser degree, other international locations. Management expects the Plan to be completed in the fourth quarter of fiscal year 2007. We expect to incur a restructuring charge in connection with the Plan of approximately $10 million, comprised largely of cash payments associated with one-time severance benefits, with the majority of the charge to be taken in the fourth quarter of 2007. In addition, the Company expects to realize annual cost savings in salary and compensation related expenses of approximately $21 million on an annualized basis.

We will continue our efforts to evaluate certain operations and will actively pursue opportunities to divest additional non-core assets and may incur additional costs associated with future actions to further align our business operations and streamline our business processes.

Debt Extinguishment and Supplemental Indenture Agreements

During 2005, we entered into agreements to exchange 4,988,100 shares of our common stock with a fair value of approximately $37.6 million and approximately $57.1 million in cash for $127.9 million aggregate principal amount of our outstanding convertible subordinated notes due 2008 (Notes) with five of our Note holders. These exchanges are considered early extinguishments of debt in which the aggregate fair value of the common stock and cash is less than the carrying value of the Notes. Accordingly, we recorded gains of $31.4 million on the exchanges during 2005.

Effective January 9, 2007, we entered into a Supplemental Indenture Agreement with the holders of our Notes, providing that any failure by us to comply with certain provisions of the original agreement will not result in a default or an event of default. In accordance with this supplemental indenture agreement, the Notes will accrue an additional 6.75% per annum (as compared to the 7⁄8% annual interest provided for under the original indenture related to the Notes) in special interest beginning January 9, 2007 to the maturity date of the Notes, unless the Notes are earlier repurchased or converted. On July 26, 2007, we entered into a Second Supplemental Indenture after receiving consent from holders of more than 50% of the outstanding aggregate principal amount of the convertible subordinated notes in connection with our consent solicitation announced July 19, 2007. Under the Second Supplemental Indenture, the convertible subordinated notes will accrue an aggregate of an additional 10% per annum (as compared to the 7⁄8% annual interest provided for under the original indenture related to the Notes) in special interest from and including July 26, 2007 to the March 1, 2008 maturity date of the notes unless the notes are earlier repurchased or converted. The special interest rate represents an increase of 3.25% per annum over the previous special interest rate of 6.75% per annum in the First Supplemental Indenture. As a result of the Second Supplemental Indenture, the convertible subordinated notes now bear a stated interest rate of 10.875% (see Note 11, Debt , to Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report).

Asset Impairment and Valuation Allowance on Deferred Tax Assets

Management held a series of planning meetings in September 2005 to assess the current business forecast for all of our reporting units. This assessment analyzed various factors including a reduction in the rate of growth of PAS subscribers, a delay of the expected granting of 3G licenses in China and Japan, challenges with product quality primarily in our Broadband reporting unit, a narrowing of our strategic focus related to our product offering and greater than expected revenue and margin decline due to continued pricing pressures for several of our key markets. We determined that certain circumstances have changed sufficiently to indicate that the fair value of certain of our reporting units may be below their book values. As a result, we conducted an evaluation of our long-lived assets including goodwill, intangible assets, and certain property plant and equipment for impairment and recorded impairment charges.

Based upon this analysis as discussed further in Results of Operations below, during 2005 we recorded impairment charges totaling $218.1 million consisting of $192.9 million of goodwill, $1.7 million of intangible assets, and $23.5 million of property, plant and equipment (see Note 8 and Note 10 of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report).

Management also evaluated the expected realization of deferred tax assets during 2005 and recorded a non-cash charge of $237.3 million to provide a full valuation allowance on the net deferred tax assets at December 31, 2005 in the United States and China.

No additional asset impairment charges were recorded in fiscal 2006.

Softbank China

In December, 2005, we sold our 10% ownership interest in Softbank China Holdings PTE LTD (Softbank China) to SOFTBANK CORP., a related party and owner of the remaining 90% of Softbank China for $56.9 million. As a result, we recorded in other income a gain of $47.2 million after management fees, transaction expenses and net of the investment s carrying value.

RESULTS OF OPERATIONS

We reorganized our business based principally upon product families and realigned our business into four operating units: (i) Network Solutions , (ii) PCD, (iii) Handsets and (iv) Services. The Network Solutions operating unit provides its products and services through two reporting segments; Broadband Infrastructure and Wireless Infrastructure. We aligned our reporting by business segment with this reorganization because, in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, this is the basis on which our management evaluated and managed our business during the period through December 31, 2006.

Broadband infrastructure is primarily comprised of the iAN-8000, IP-Based Digital Subscriber Line Access Multiplexer, GEPON, NetRing™, RollingStream™, and other wireline products. Wireless infrastructure is primarily comprised of the PAS and CDMA products. Handsets is primarily comprised of PAS handsets. PCD is primarily comprised of CDMA handsets and digital devices. We also provide installation and certain maintenance services. For each of the periods presented, total services sales accounted for less than 10% of net sales.

NET SALES

	Years Ended December 31,					
	2006	% of net sales	2005 (As restated)	% of net sales	2004 (As restated)	% of net sales
	(in thousands)					
Net Sales by Segment						
Broadband Infrastructure	$ 219,557	9 %	$ 507,978	18 %	$ 232,442	9 %
Wireless Infrastructure	427,400	17 %	436,016	15 %	1,268,850	49 %
Network Solutions	646,957	26 %	943,994	33 %	1,501,292	58 %
PCD	1,339,496	55 %	1,369,324	48 %	277,410	11 %
Handsets	395,812	16 %	473,472	16 %	749,073	29 %
Services	76,596	3 %	84,320	3 %	51,640	2 %
	$ 2,458,861	100 %	$ 2,871,110	100 %	$ 2,579,415	100 %
Net Sales by Region						
United States	$ 1,351,839	55 %	$ 1,332,213	46 %	$ 341,517	13 %
China	785,525	32 %	870,612	30 %	2,028,194	79 %
Japan	136,877	6 %	479,114	17 %	156,416	6 %
Other	184,620	7 %	189,171	7 %	53,288	2 %
	$ 2,458,861	100 %	$ 2,871,110	100 %	$ 2,579,415	100 %

Fiscal 2006 vs. 2005

Net sales decreased by 14% to $2.5 billion in 2006 compared with 2005. While revenues were lower in all operating segments, the 57% decrease in net sales of the Broadband Infrastructure segment contributed over half of the total net sales decrease. Broadband Infrastructure revenues in 2005 were driven by sales of iAN-8000 equipment to Japan Telecom, an affiliate of SOFTBANK CORP. and a related party. In 2006, Broadband Infrastructure sales to Softbank and affiliates decreased by $333.0 million as Softbank completed its initial investment in fixed line businesses and changed its focus to wireless business following its acquisition of Vodafone Japan. The decrease in Wireless Infrastructure revenues and Handsets revenues reflect the lower demand in the China market for our PAS systems and handsets as PAS subscriber growth declined to 10% in 2006 compared with 31% in 2005 and 70% in 2004. PCD net sales remained relatively consistent with a decrease in the average selling price offset by a 6% increase in the number of units sold. During 2006, Verizon Wireless and T-Mobile, respectively, accounted for approximately 14% and 11% of our total net sales.

The demand for our PAS products has weakened as telecommunication service providers have reduced expenditures for deploying PAS systems and promoting PAS handsets in anticipation of the introduction of new technology for next generation telecommunication equipment. However, we expect long-term demand for our PAS products will continue as we believe PAS will remain an important technology and market in China for the foreseeable future. Due to a mix of higher growth in our other segments and geographies with declining revenues in our PAS dominated Wireless Infrastructure and Handsets segments, the revenues from customers in China now represent only 32% of total Company revenues. No individual province sales accounted for over 10% of total Company revenues in 2006 or 2005. During 2005, the Company recorded restatement adjustments to defer $49.6 million of revenue as all conditions necessary for revenue recognition had not been achieved. Net sales during the year ended

December 31, 2006 include approximately $44.7 million of the revenue deferred as part of the 2005 restatement adjustments. For additional discussion of our business segments, see Segment Reporting.

In 2007, we expect that revenues from PAS products and infrastructure will continue to decline with increased competition but will be partially offset by revenues from higher end PAS products including dual mode PAS handsets, dual mode CDMA and Softswitch products in multiple markets, though we do not anticipate that these sales will fully offset the decline in PAS sales. We currently offer and have initial market acceptance of our RollingStream™ IPTV products in China, Japan and other geographic regions. We believe that the IPTV market presents a meaningful growth opportunity in these regions as well as other regions we have targeted to expand our IPTV offerings, including India.

Fiscal 2005 vs. 2004

Revenues increased by 11% to $2.9 billion in 2005 driven by higher PCD revenues in the United States and Broadband Infrastructure revenues in Japan, offset by declining Wireless Infrastructure and Handsets revenue in China.

PCD was established from the selected assets and liabilities acquired from Audiovox in November 2004. In 2005, PCD revenues for the 12 month period increased by $1.1 billion compared to revenues for the two month post acquisition period in 2004. Due to PCD, our revenues in the United States almost quadrupled and represent 46% of total Company revenues in 2005. Additionally, Verizon Wireless accounted for 12% of total Company revenues in 2005.

Broadband Infrastructure revenues more than doubled in 2005 driven by sales of iAN-8000 equipment to Japan Telecom, an affiliate of SOFTBANK CORP. and a related party. SOFTBANK CORP. and affiliates accounted for 89% of Broadband Infrastructure revenues and 17% of total Company revenues in 2005.

We experienced a 66% decline in Wireless Infrastructure revenues and a 37% decline in Handsets revenues due to lower demand in the China market for our PAS systems and handsets as PAS subscriber growth declined from over 70% in 2004 to 31% in 2005. In 2004, the Guangdong and Jiangsu provinces accounted for 13% and 10% of our net sales, respectively.

GROSS PROFIT

	Years Ended December 31,					
	2006	**Gross profit %**	**2005 (As restated)**	**Gross profit %**	**2004 (As restated)**	**Gross profit %**
	(in thousands)					
Gross profit by Segment						
Broadband Infrastructure	$ (3,019)	(1)%	$ 157,890	31 %	$ 45,585	20 %
Wireless Infrastructure	206,193	48 %	121,077	28 %	364,028	29 %
Network Solutions	203,174	31 %	278,967	30 %	409,613	27 %
PCD	39,932	3 %	52,812	4 %	11,866	4 %
Handsets	118,459	30 %	58,166	12 %	131,708	18 %
Services	24,179	32 %	45,891	54 %	16,345	32 %
	$ 385,744	16 %	$ 435,836	15 %	$ 569,532	22 %

Cost of sales consists primarily of material and labor costs associated with manufacturing, assembly and testing of products, costs associated with installation and customer training, warranty costs, fees to agents, inventory and contract loss provisions and overhead. Cost of sales also includes import taxes and tariffs on components and assemblies. Some components and materials used in our products are purchased from a single supplier or a limited group of suppliers and, in some cases, are subject to our obtaining Chinese import permits and approvals. We also rely on third party manufacturers to manufacture and assemble most of our CDMA handsets.

Our gross profit has been affected by average selling prices, material costs, product mix, the impact of warranty charges and contract loss provisions, as well as inventory reserves and release of deferred revenues and related cost pertaining to prior years. In addition, the acquisition of PCD in November 2004 has resulted in a higher percentage of revenue associated with product offerings at lower margins. Our gross profit, as a percentage of net sales, varies among our product families. We expect that our overall gross profit, as a percentage of net sales, will fluctuate in the future as a result of shifts in product mix, stage of product life cycle, anticipated decreases in average selling prices and our ability to reduce cost of sales.

Fiscal 2006 vs. 2005

Gross profit declined in absolute dollars but remained relatively constant as a percentage of net sales at 16% in 2006 compared to 15% in 2005. Our Wireless and Handsets segments contributed to the increase in gross profit in absolute dollars, primarily as a result of a shift in product mix and a reduction in production costs. The absolute decrease in gross profit dollars was primarily the result of the decline in gross profit from the Broadband segment resulting from a 57% decline in segment sales and a reduced profit as a percentage of segment sales due to additional inventory reserves and a $32.1 million provision for anticipated losses on an infrastructure deployment contract entered into in the fourth quarter of 2006. In addition, the increased percentage of our revenue derived from the lower margin PCD segment resulted in a decrease in our total gross profit as a percentage of net sales. For additional discussion of our business segments, see Segment Reporting.

Fiscal 2005 vs. 2004

Gross profit declined both in absolute dollars and as a percentage of net sales in 2005, compared to 2004. The absolute decrease in gross profit dollars was primarily the result of a 67% decline in Wireless operating segment gross profit reflective of the maturing PAS market in China, offset by higher absolute gross profit dollars for Broadband and PCD. We primarily attribute the decrease in gross profit, as a percentage of sales, to the impact of PCD margins and lower Handsets margins due to declines in PAS handset average selling prices, offset by higher Broadband Infrastructure gross margins achieved on our iAN8000 products relating to sales to Japan Telecom in the first quarter. PCD contributed $52.8 million in gross margin in 2005 and contributed only $11.9 million in 2004 because we did not acquire PCD until November 2004. The gross profit in 2005 was negatively affected by a $5.6 million inventory write-off associated with discontinued products.

OPERATING EXPENSES (INCOME)

The following table summarizes our operating expenses:

	Years Ended December 31,					
	2006	**% of net sales**	**2005 (As restated)**	**% of net sales**	**2004 (As restated)**	**% of net sales**
	(in thousands)					
Selling, general and administrative	$ 334,455	14 %	$ 371,461	13 %	$ 303,911	12 %
Research and development	182,869	7 %	246,813	8 %	219,079	8 %
Amortization of intangible assets	18,871	1 %	25,853	1 %	15,551	1 %
Gain on sale of semiconductor design assets	(12,291)	-1 %		0 %		0 %
Impairment of long-lived assets		0 %	218,094	8 %	12,706	0 %
Restructuring costs		0 %	29,669	1 %		0 %
In-process research and development		0 %	660	0 %	1,400	0 %
	$ 523,904	21 %	$ 892,550	31 %	$ 552,647	21 %

Selling, general and administrative expenses (SG&A) include compensation and benefits, professional fees, sales commissions, provision for doubtful accounts receivable and travel and entertainment costs. Research and development expenses consist primarily of compensation and benefits of employees engaged in research, design and development activities, costs of parts for prototypes, equipment depreciation and third party development expenses. A portion of our costs are fixed and are difficult to quickly reduce in periods of lower sales. However, during the second quarter of 2005, we announced and initiated a restructuring plan which resulted in the reduction of certain SG&A and research and development costs. We believe that continued investment in research and development is critical to our long-term success. Although the total absolute expenditures in research and development in 2006 was lower than in 2005, we streamlined R&D activities and focused on high value strategic projects for our businesses.

SELLING, GENERAL AND ADMINISTRATIVE

Fiscal 2006 vs. 2005

Selling, general and administrative expenses decreased $37.0 million, or 10%, in fiscal 2006 as compared to fiscal 2005. This decrease is primarily due to a $27.8 million decrease in our provision for doubtful accounts in 2006 compared to 2005 resulting from strong cash collection of fully reserved receivables in China. Days sales outstanding was 60 days at December 31, 2006 as compared to 66 days outstanding at December 31, 2005 due to strong cash collections in the fourth quarter of 2006 and the high percentage of fourth quarter revenue derived from our PCD segment, which generally has experienced a shorter collection period on related receivables. In 2007, we expect the days sales outstanding to increase in line with historical trends. In addition, sales and marketing personnel costs decreased approximately $16.7 million as a result of cost saving resulting from reduced sales and marketing headcount, offset partially by increased stock-based compensation charges. The reduction in sales and marketing headcount was primarily due to the shift during 2006 of approximately 477 employees previously providing sales and support services towards generating revenue from support arrangements. Other cost savings in sales and marketing, primarily related to the 2005 restructuring and cost containment measures, included a $12.0 million decrease in depreciation, facility and equipment costs, a $10.1 million decrease in travel expenses and a $4.0 million decrease in professional services. These cost savings in sales and marketing expenses were partially offset by an increase in general and administrative costs. Primary factors in the increased general and administrative costs include: (i) an increase of $21.3 million in general and administrative personnel costs due to increased stock-based compensation charges and additional finance and information technology resources hired to improve processes and controls and (ii) $7.9 million of value added tax expense resulting from an audit of 2003 through 2005 tax years by China tax authorities and (iii) a $4.7 million write-off of net assets in connection with the termination of a joint venture. In 2006, selling, general and administrative costs included approximately $10 million of stock-based compensation as a result of adoption of SFAS 123(R).

Fiscal 2005 vs. 2004

Selling, general and administrative expenses increased $67.5 million or 22% in fiscal 2005 as compared to fiscal 2004. The increase in SG&A was primarily due to i) increased headcount and overhead of $19.9 million which includes our PCD operations that did not exist until November 2004, ii) increased professional services fees of $18.5 million in 2005 from 2004 associated with supply chain management, system integration, Sarbanes-Oxley Act compliance projects and audit fees, iii) increased litigation and legal costs of $13.3 million, and iv) an increase in facilities expense of $12.4 million for the Hangzhou, China office placed in service in October 2004.

RESEARCH AND DEVELOPMENT

Fiscal 2006 vs. 2005

Research and development (R&D) expenses decreased $63.9 million, or 26%, in fiscal 2006 compared with 2005. The decrease was primarily due to i) a decrease of $30.6 million in depreciation, facility and equipment costs as a result of the restructuring and write-down of R&D equipment in 2005, ii) a decrease in personnel expenses of approximately $16.4 million attributed to a decrease in headcount due to the restructuring activities and the transfer of engineers as part of the sale of our semiconductor design operations to Marvell Technology and the transfer of our non-PAS wireless research and development in China to Cellon, and iii) a decrease in professional costs of $9.3 million associated with the decrease in outsourced projects. R&D expenses were approximately 7% and 8% of net sales in 2006 and 2005, respectively. We expect R&D expenses to be stable as we continue to streamline R&D activities and invest in product lines that improve our long-term profitability and growth.

Fiscal 2005 vs. 2004

R&D expenses in fiscal 2005 were approximately 8% of net sales in 2005, as compared to 8% of net sales in 2004. In absolute amounts, R&D expenses increased $27.7 million or 13% compared to the prior year. The absolute increase was primarily due to i) an increase in personnel expenses by approximately $19.8 million attributed to a 15% increase in average head count from 2,757 to 3,170 employees due to the retention of personnel from various acquisitions as well as the hiring of personnel to support product enhancements and development primarily in the Broadband and Handsets segments, and ii) an increase in professional costs of $3.2 million associated with outsourced projects driven by product development projects primarily in the Handsets segment.

IN-PROCESS RESEARCH AND DEVELOPMENT

Fiscal 2005 vs. 2004

The $0.7 million and $1.4 million charges to in-process research and development in 2005 and 2004, respectively, were related to our acquisitions of Pedestal Networks and TELOS. All charges to IPR&D were based, in part, upon independent valuations. In assessing IPR&D projects, we considered key product characteristics including each product s development stage at the acquisition date, each product s life cycle and each product s future prospects. We also considered the rate at which technology changes in the relevant industry, the industry s competitive environment and the economic market outlook.

AMORTIZATION OF INTANGIBLE ASSETS

Fiscal 2006 vs. 2005

Amortization of intangible assets expenses decreased $7.0 million in 2006 as compared to 2005. The decrease in the amortization of intangible assets was due to several intangible assets being fully amortized during the preceding twelve months. Amortization expenses for the next five years, beginning with the year ending December 31, 2007, are expected to amount to $16.0 million, $12.7 million, $6.9 million, $5.1 million and $5.1 million, respectively.

Fiscal 2005 vs. 2004

Amortization of intangible assets expenses increased $10.3 million in 2005 as compared to 2004. The increase in the amortization of intangible assets in 2005 was due to the intangibles recorded as a result of the acquisitions of TELOS in May 2004, ACC in November 2004 and Giga in January 2005, which are in the results of the 2005 fiscal year but were only amortized for a portion of the prior year in the case of ACC and TELOS.

GAIN ON SALEOF SEMICONDUCTOR DESIGN ASSETS

Fiscal 2006

In February 2006, we sold substantially all of the assets and selected liabilities of our semiconductor design operations, including the assets related to the prior acquisition of Advanced Communications Devices Corporation to Marvell Technology Group Ltd. We recognized a $12.3 million gain on sale of these assets in the third quarter of 2006 upon achieving the defined milestones.

RESTRUCTURING COSTS

Fiscal 2006

The restructuring plan initiated in 2005 was completed by December 31, 2005 and no major restructuring effort was undertaken in 2006. During 2006 we settled approximately $1.1 million of accrued expenses, and the remaining $0.1 million of accrued expenses will be settled in 2007.

Fiscal 2005

In the second quarter of fiscal 2005, we announced and initiated a restructuring plan to rationalize our cost structure in response to the decline in demand for certain of our products. In 2005, we incurred approximately $29.7 million in operating expenses in relation to the restructuring plan actions, primarily consisting of $15.2 million related to severance payments and $14.5 million in asset impairments primarily related to the impairment of equipment and licenses associated with discontinued products. Included in the restructuring costs of $29.7 million are non-cash charges of $13.4 million in asset impairments. We made cash payments of $16.6 million for severance and other benefits in 2005. As part of the restructuring plan, we recorded a $5.6 million inventory write-off associated with discontinued products in 2005. Restructuring expense related to the inventory write-off is included in cost of sales in the consolidated statements of operations. As of the end of 2005 approximately 1,595 employees had been terminated or placed in workforce reduction programs.

ASSET IMPAIRMENT

Fiscal 2005

In the third quarter of 2005, we determined that certain circumstances had changed sufficiently to indicate that the fair value of certain of our reporting units may be below their book values. As a result, we conducted an evaluation of our long-lived assets including goodwill, intangible assets, and certain property plant and equipment for impairment and recorded impairment charges.

Intangible assets classified as goodwill and those with indefinite lives are not amortized. Intangible assets with determinable lives are amortized over their estimated useful lives. We perform an annual impairment test of our goodwill as of November 1st of each year. We also test for impairment between annual tests if a triggering event occurs that may have the effect of reducing the fair value of a reporting unit below their respective carrying values. When conducting the goodwill impairment analysis, we calculate impairment charges based on the two-step test prescribed in SFAS 142, Goodwill and Other Intangible Assets (SFAS 142) and using the estimated fair value of the respective reporting units. We use the present value of future cash flows from the respective reporting units to determine the estimated fair value of the reporting unit and the implied fair value of goodwill. We also test long-lived assets in all of our asset groups for potential impairment in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long- lived Assets. Our long-lived assets are tested for recoverability based on undiscounted cash flows, and if impaired, written down to fair value based on either discounted cash flows or appraised values.

Management held a series of planning meetings in September 2005 to assess the current business forecast for all reporting units. This assessment analyzed various factors including a reduction in the rate of growth of PAS subscribers in the third quarter, a delay of the expected granting of 3G licenses in China and Japan, challenges with product quality primarily in our Broadband reporting unit, a narrowing of our strategic focus related to our product offering and greater than expected revenue and margin decline due to continued pricing pressures for several of our key markets. Management concluded these factors combined represented a triggering event.

Due to the existence of the triggering event in September 2005, we determined that there were significant adverse changes in the business outlook which could indicate the carrying value of certain of our long lived assets groups may not be recoverable and could indicate the fair value of our reporting units may be below their fair value. As a result, we performed interim impairment tests on goodwill and certain other long lived tangible and intangible assets.

Goodwill:

We performed an impairment analysis pursuant to SFAS 142 as of September 30, 2005 for all of our reporting units. We compared the fair value of the reporting units to their carrying value. We determined the fair value of each reporting unit using both present value and comparable company techniques based, in part, upon an independent valuation. The fair values of the reporting units were reconciled to our overall market capitalization at September 30, 2005.

Based on the impairment assessment noted above, a goodwill impairment charge of $192.9 million was estimated and recorded during the three months ended September 30, 2005 to write off the full value of goodwill for the Wireless, Broadband, Handsets and PCD business units. The second step of the goodwill impairment test for Broadband and Handsets segments was completed in the third quarter and for the Wireless and PCD units was performed in the fourth quarter of 2005, which reaffirmed the estimate from the third quarter that the goodwill was fully impaired. As such, there was no adjustment from the amount previously recorded.

Long-lived Assets:

We also tested our long-lived assets in all of our asset groups for potential impairment during the third quarter of 2005 in accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-lived Assets. Based on this analysis, we determined that the undiscounted expected future cash flows for the broadband and handset asset groups were less than the carrying value of the net assets.

We determined the relative estimated fair value of tangible assets through a comparison of similar assets, and wherever practical, based on quoted market prices taking into consideration the asset type, age, condition, and physical location of the asset. As a result of this analysis, we recorded an impairment charge of $14.1 million for long-lived tangible assets related to the Broadband asset group and $9.4 million for long-lived tangible assets related to the Handset asset group.

In addition, we determined that the fair value of technology-related intangible assets within the Handset asset group as calculated using the discounted future cash flows was less than the carrying value of the net assets and as such, we recorded a net asset write-off of $1.7 million.

The following table summarizes the impairment charges incurred during 2005:

	Goodwill Impairment (in thousands)	Intangible Impairment	PP&E Impairment	Total
Handsets	$ 89,337	$ 1,678	$ 9,417	$ 100,432
Wireless	55,670			55,670
PCD	24,712			24,712
Broadband	23,210		14,070	37,280
Total	$ 192,929	$ 1,678	$ 23,487	$ 218,094

Fiscal 2004

During the second quarter of 2004, we consummated the acquisition of Hyundai Syscomm, Inc. (HSI) in order to gain a foothold in the CDMA infrastructure market. We encountered difficulties integrating the HSI operations into our CDMA operations after the acquisition. In the fourth quarter of 2004, we decided to wind-down the legacy operations and transfer employees to support handset engineering in Korea. The decision to substantially abandon the operations occurred within nine months of the acquisition and before the HSI operations were integrated. Therefore, we have written off all of the remaining values of the intangible assets associated with this acquisition, totaling $12.7 million during the year ended December 31, 2004.

OTHER INCOME (EXPENSE)

INTEREST INCOME

Fiscal 2006 vs. 2005

Interest income was $14.8 million in 2006 compared to $7.1 million in 2005. Higher average cash balances in 2006 was the primary reason for the increase. In addition, an increase in the average interest rate, due in part to the geographic location of the cash balances, also had a favorable impact on interest income.

Fiscal 2005 vs. 2004

Interest income was $7.1 million in 2005 compared to $6.2 million in 2004. An increase in average cash and short-term investment balances in 2005 as compared to 2004, coupled with an increase in the average interest rate resulted in an increase in interest income.

INTEREST EXPENSE

Fiscal 2006 vs. 2005

Interest expense was $11.7 million in 2006 compared to $16.8 million in 2005. The decrease in interest expense was primarily attributable to the decrease in short-term borrowings in China in the form of bank loans and the extinguishment of long-term debt during 2005. The average quarterly borrowings outstanding were $400.6 million and $570.7 million during 2006 and 2005, respectively, and the average interest rate thereon was 2.9% during both 2006 and 2005. We expect interest expense will increase significantly in 2007 as a result of the First Supplemental Indenture agreement entered into in January 2007 which increased the interest rate on the subordinated notes to 7.625% beginning January 9, 2007, and the Second Supplemental Indenture agreement entered into in July 2007 which increased the interest rate on the subordinated notes to 10.875% beginning July 26, 2007.

Fiscal 2005 vs. 2004

Interest expense was $16.8 million in 2005 compared to $6.9 million in 2004. The increase in interest expense was attributable to an increase in the average short-term borrowings in China in the form of bank loans, which had relatively higher interest rates. The average quarterly borrowings outstanding were $570.7 million and $534.5 million during 2005 and 2004, respectively, and the average interest rates thereon were 2.9% and 1.3% during 2005 and 2004, respectively.

GAIN ON EXTINGUISHMENT OF DEBT

Fiscal 2005

Gain on extinguishment of debt, net of write-off of unamortized issuance expenses, was $31.4 million in 2005. In the year ended December 31, 2005, 4,988,100 shares of our common stock with a fair value of approximately $37.6 million and approximately $57.1 million in cash were exchanged for $127.9 million aggregate principal amount of our outstanding convertible subordinated notes due 2008.

OTHER INCOME (EXPENSES)

Fiscal 2006 vs. 2005

Other income was $1.1 million in 2006 compared to $43.7 million in 2005. Other income in 2006 consisted primarily of foreign exchange gains of $7.6 million, a gain on the sale of an asset of $2.5 million, dividend income of $2.1 million and miscellaneous other income of $2.1 million, offset by a $13.5 million impairment charge on a long-term investment.

Fiscal 2005 vs. 2004

Other income was $43.7 million in 2005 compared to $15.4 million in 2004. Other income in 2005 primarily consisted of a gain on sale of Softbank China of $47.2 million and a $6.0 million consumption tax refund in Japan, partially offset by a foreign exchange loss of $10.0 million. In December 2005, we sold our 10% ownership in Softbank China Holdings PTE LTD (Softbank China) to SOFTBANK CORP., a related party and owner of the remaining 90% of Softbank China for $56.9 million. Accordingly, we recorded in other income a gain of $47.2 million after management fees, transaction expenses and net of the investment carrying value. The foreign exchange losses primarily consisted of losses attributed to the appreciation of the US dollar on Japanese Yen denominated cash and accounts receivable, offset by gains for the Company s China subsidiaries attributed to the appreciation of the Chinese Renminbi on US dollar denominated short-term debt and payables. Yen-denominated sales were significantly higher during 2005 as compared to 2004.

INCOME TAX EXPENSE (BENEFIT)

Fiscal 2006 vs. 2005

Income tax benefit was $15.0 million in 2006 compared to tax expense of $136.5 million in 2005.

The Company is subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. The Company establishes reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes and interest will be due. These reserves are established when, despite the Company s belief that its tax return positions are fully supportable, the Company believes that certain positions are likely to be challenged and may not be sustained on review by tax authorities. The Company adjusts these reserves in light of changing facts and circumstances, such as the closing of a tax audit. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest. In 2006, we recorded a $29.0 million income tax benefit related to the settlement of a tax audit in China for the 2003 through 2005 tax years for UTStarcom Telecom Co., Ltd. (HUTS) and Hangzhou UTStarcom Telecom Co., Ltd (HSTC), two of our subsidiaries in China and the acceptance of our tax holiday for HSTC.

Without the $29.0 million tax benefit, the Company would have a negative 10% effective tax rate. There are two primary reasons for the negative 10% effective tax rate. First, the Company has not provided any tax benefit on the current years losses incurred and tax credits generated in the United States and other countries, because the Company believes it is more likely than not that the tax benefit associated with these losses will not be realized. Second, the Company continues to accrue tax expense in jurisdictions where the Company has been historically profitable.

In 2005, as discussed below, we incurred a $237.3 million non-cash charge to provide a full valuation allowance on our net deferred tax assets at December 31, 2005 in the United States and China. Also, we recorded a $11.9 million increase in tax expense in 2005 due to the revaluation of deferred tax assets in China because of statutory rate changes for certain of the Company s subsidiaries in China.

Fiscal 2005 vs. 2004

In establishing our deferred income tax assets and liabilities, we make judgments and interpretations based on the enacted tax laws and published tax guidance applicable to our operations as well as the amount and jurisdiction of future taxable income. We record deferred tax assets and liabilities and evaluate the need for valuation allowances to reduce the deferred tax assets to realizable amounts. During 2005, we did not believe it was more likely than not that we would generate a sufficient level and proper mix of taxable income within the appropriate period to utilize all the deferred tax assets. As a result of the review undertaken, we concluded that it was appropriate to establish a full valuation allowance for the net deferred tax assets in China and the United States wherein the cumulative losses weigh heavily in the overall assessment. Accordingly, we recorded a $237.3 million non-cash charge in the United States and China.

Income tax expense was $136.5 million in 2005 compared to a benefit of $20.3 million in 2004. The increase in income tax expense was primarily attributable to a $237.3 million non-cash charge to provide a full valuation allowance on our net deferred tax assets at December 31, 2005 in the United States and China. Also, we recorded a $11.9 million increase in tax expense due to the revaluation of deferred tax assets in China because of statutory rate changes for certain of the Company s subsidiaries in China. In addition, we did not provide any tax benefit on the 2005 losses incurred and tax credits generated in the United States and China. These are the three primary reasons for the negative 34% effective income tax rate for 2005, despite the pretax loss for the year.

EQUITY IN LOSS OF AFFILIATED COMPANIES

Fiscal 2006 vs. 2005

Equity in loss of affiliated companies was $0 in 2006 compared to $5.5 million in 2005 as our joint venture investment with Matsushita Communication Industrial Co., Ltd. (Matsushita) was liquidated in 2005.

Fiscal 2005 vs. 2004

Equity in loss of affiliated companies was $5.5 million in 2005 compared to $1.3 million in 2004. During 2005 we incurred a loss from our joint venture investment with Matsushita of $4.8 million and a gain of $0.7 million from our investment in Restructuring Fund No. 1. The loss in 2004 was attributable to our joint venture investment with Matsushita. In December 2005, the venture partners agreed to liquidate this venture.

SEGMENT REPORTING

We historically managed our business as a single reportable segment. Effective with the fourth quarter of 2004, it was determined that our chief operating decision makers, in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, were evaluating performance, making operating decisions and allocating resources based on two operating segments, (i) China and (ii) all other regions referred to as International (International).

On November 1, 2004, we acquired selected assets of the wireless handset division of Audiovox Corporation. The acquired business has been integrated into our operation as a separate and distinct operating division referred to as the Personal Communications Division, (PCD). As a result, as of December 31, 2004, we were organized, principally based on geographical market locations, in three operating segments, China, International and PCD. Each segment consisted of one reporting unit.

Effective in the first quarter of 2005, the Company elected to reorganize its business based principally upon product family and realigned its business into five operating units, (i) Broadband Infrastructure, (ii) Wireless Infrastructure, (iii) Handsets, (iv) Personal Communications Division (PCD), and (v) Services. The Company announced that effective July 1, 2006, a newly created operating unit; Network Solutions would begin offering products and services through the combination of the Broadband Infrastructure and the Wireless Infrastructure reporting segments. Each reporting segment and operating unit is responsible for managing its own performance.

Each operating unit represents its own reporting segment and each operating unit is responsible for its own production and sales management. We currently evaluate the operating performance of and allocate resources to the reporting segments based on segment gross profit. Cost of sales and direct expenses in relation to production are assigned to the reporting segments. The accounting policies used in measuring segment assets and operating performance are the same as those used at the consolidated level.

Network Solutions

Broadband Infrastructure

	Years Ended December 31, 2006	2005 (As restated)	2004 (As restated)
	(in thousands)		
Net sales	$ 219,557	$ 507,978	$ 232,442
Gross profit	$ (3,019)	$ 157,890	$ 45,585
Gross profit as a percentage of net sales	(1)%	31 %	20 %

Fiscal 2006 vs. 2005

Our largest Broadband Infrastructure customer is Softbank and affiliates, including Japan Telecom, representing approximately 54% and 89% of total Broadband Infrastructure sales in 2006 and 2005, respectively. Due to the customer concentration in this segment, revenues fluctuate based upon the magnitude and timing of revenue recognition on certain contracts. During 2006 sales to Softbank declined by $333.0 million as Softbank completed its initial investment in fixed line businesses and changed its focus to wireless business following its acquisition of Vodafone Japan.

The decline in gross profit as a percentage of net sales from 31% in 2005 to negative 1% in 2006 was due primarily to decreased revenues of our high margin iAN8000 products which included $271.9 million relating to the Japan Telecom agreements in the first quarter 2005. Gross profit in 2006 and 2005 also was negatively impacted by additional warranty reserves for ADSL, GEPON and NetRing products sold to Softbank in 2003 and 2004. These special warranty charges approximated $5.6 million and $30.6 million in 2006 and 2005, respectively. Further contributing to the gross profit decline in 2006 was a $32.1 million provision for anticipated losses on an infrastructure deployment contract entered into in the fourth quarter of 2006. We accepted this contract because we felt it would allow us to develop a relationship with a customer we consider important to the international expansion of our broadband infrastructure business. Both our experience of incurring higher warranty costs in our Broadband Infrastructure segment as we have introduced new products and the requirement to adjust contract losses provisions as additional information becomes available may potentially have negative impacts on our future gross margins.

We believe that the IPTV market presents a meaningful growth opportunity. We currently offer and have initial market acceptance of our RollingStream IPTV products in China, Japan and other geographic regions. In addition to the investments we have made to develop and market our Broadband products, in 2005 we loaned $12.4 million to a China based company to support the development of a technical service information and networking technology venture in China. The loan is partially secured by an indirect ownership interest in the venture. This venture s continuing viability will also be heavily dependent on our future provisioning of equipment. As such, we determined that we are the primary beneficiary of the venture and consolidated the venture s results of operations into our results for the years ended December 31, 2006 and 2005. We expect that we will continue to invest in the development of this important market in the future.

Fiscal 2005 vs. 2004

In 2005, Broadband Infrastructure net sales more than doubled primarily due to two large transactions with Softbank; $271.9 million of revenue recognized in the first quarter on certain agreements entered into with Japan Telecom primarily for the iAN8000 product; and $57.7 million of revenue recognized in the fourth quarter on our Rolling Stream internet protocol television (IPTV) product launched with Yahoo! BB. During the fourth quarter of 2004, approximately $79.1 million of revenue was recognized on sales of primarily GEPON and NetRing products to Softbank.

The gross profit improvement, both in absolute dollars and as a percentage of net sales, was largely due to (i) the margins on our iAN8000 products relating to the Japan Telecom agreements in the first quarter 2005; (ii) low margins in the fourth quarter of 2004 on GEPON and NetRing products; and (iii) offset by higher warranty costs in 2005 for ADSL, GEPON and NetRing products. We have experienced higher warranty costs in our Broadband Infrastructure segment as we have introduced new products.

Wireless Infrastructure

	Years Ended December 31,		
	2006	**2005 (As restated)**	**2004 (As restated)**
	(in thousands)		
Net sales	$ 427,400	$ 436,016	$ 1,268,850
Gross profit	$ 206,193	$ 121,077	$ 364,028
Gross profit as a percentage of net sales	48 %	28 %	29 %

Fiscal 2006 vs. 2005

Net sales declined 2% in 2006 compared with 2005, primarily due to decreased sales of PAS systems in China. In 2006, approximately 79% of our Wireless Infrastructure sales were attributed to PAS systems in China compared with 85% in 2005. The decrease in PAS system sales was primarily the result of our customers in China transitioning from new system installations to system expansions as PAS systems reach product maturity.

Gross profit as a percentage of net sales increased by 20 percentage points in 2006 compared to 2005, due to a number of factors, including: (i) the margins on PAS infrastructure improved due to a shift in product mix towards higher margin cell sites as well as a reduction in product discounts given; (ii) an improvement in inventory management and product quality resulting in a decrease in excess inventory write-downs and scrap; and (iii) sales of voice and data networks software totaling $16.1 million which typically have gross margins of approximately 90%.

We expect future PAS infrastructure spending to decline further in 2007 compared with 2006 levels as China prepares for 3G launch. However, we expect the revenue decline will be moderate, as most of 2007 revenue is expected to come from existing backlog based on current projection of receiving final acceptance. We plan to aggressively pursue opportunities for our Packet PAS products (for broadband wireless data market based on PAS technology), high end PAS products including dual mode, CDMA products and Softswitch products in multiple markets; though we do not anticipate that these sales will fully offset the decline in PAS sales in 2007.

Fiscal 2005 vs. 2004

In 2005, approximately 85% of our Wireless Infrastructure sales were attributed to PAS systems in China. Net sales declined 66% as demand decreased due to (i) product maturation resulting in transition from new system installations to system expansions and (ii) our customers reduced fiscal capital spending in anticipation of next generation technology.

Gross margin as a percentage of net sales declined by one percentage point primarily due to the impact of our China customers shifting their investments on PAS from geographical extension to expanding the capacity and improving the quality of the existing network. Compared with building networks in new areas, the cost of expanding capacity is much lower. Additionally, there was less competition and pricing pressure in PAS network expansion contracts. Included in cost of goods sold in 2005 is an inventory write-off of $5.6 million, which had a negligible effect on the gross profit as a percentage of sales.

PCD

	Years Ended December 31, 2006	2005 (As restated)	2004 (As restated)
	(in thousands)		
Net sales	$ 1,339,496	$ 1,369,324	$ 277,410
Gross profit	$ 39,932	$ 52,812	$ 11,866
Gross profit as a percentage of net sales	3 %	4 %	4 %

Fiscal 2006 vs. 2005

Net sales for the PCD operating segment were $1,339.5 million in 2006, a decrease of 2% compared to net sales of $1,369.3 million in 2005. The relatively consistent net sales was the result of a decrease in the overall average selling price, offset by a 6% increase in the number of units sold. In 2006, a greater percentage of revenue was derived from internally manufactured handsets and we expect this trend to continue in the future.

The gross profit as a percentage of net sales recognized on handset sales through PCD declined by one percentage point in 2006 compared with 2005. Gross profit was negatively impacted by inventory write-downs to market of certain slow moving models. Partially offsetting these inventory charges were higher margins on UTStarcom branded devices sold during 2006. The gross profit as a percentage of net sales is typically lower than that realized on PAS systems based handsets sold in the China market. As the percentage of UTStarcom designed and manufactured products increases, we expect the PCD margin to increase in the future.

Fiscal 2005 vs. 2004

Revenue for the PCD operating segment was $1,369.3 million in 2005 compared to $277.4 million in 2004. Revenues for PCD were significantly greater in 2005 than 2004 since the acquisition of the wireless handset division of Audiovox Corporation and the creation of PCD did not occur until November 2004. Revenues for 2005 are consistent with 2004 pro forma revenues (see Note 5, Acquisitions and Sale of Assets , of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report). The gross profit as a percentage of net sales recognized on handset sales through PCD was consistent at 4% for 2005 and 2004.

Handsets

	Years Ended December 31,		
	2006	**2005 (As restated)**	**2004 (As restated)**
	(in thousands)		
Net sales	$ 395,812	$ 473,472	$ 749,073
Gross profit	$ 118,459	$ 58,166	$ 131,708
Gross profit as a percentage of net sales	30 %	12 %	18 %

Fiscal 2006 vs. 2005

Net sales declined 16% primarily due to a volume decrease for our PAS handsets in China as the units sold declined to 7.8 million in 2006 compared to 10.2 million in 2005. The 25% volume decline was primarily attributed to lower demand for our PAS handsets resulting from slower subscriber growth. In 2006, PAS subscriber growth was 10% compared to 31% in 2005 and 70% in 2004 as service providers reduced marketing efforts for PAS handsets in anticipation of next generation technology. The average selling price per unit (ASP) improved 10% due to a shift in product mix to sales of higher-end models, as well as the introduction of new PAS/GSM dual mode product line in 2006. This shift in product mix more than offset declining prices of other models due to competitive pricing pressures in the PAS market, which we have experienced in the China telecommunications market since the latter part of 2003. We expect cumulative PAS subscriber growth to continue at lower growth rates in future periods.

Gross profit as a percentage of sales for our handsets segment increased by 18 percentage points in 2006, as compared to 2005. A portion of the improvement in the gross profit percentage relates to shifting most of our products to the use of chip-sets with greater functionality in PAS handsets that reduce the overall component costs of each unit. Additionally, we have had a shift in product mix towards higher margin products such as our PAS/GSM dual mode and ultra-thin high-end PAS handsets. Additional factors leading to the improvement in gross profit are a reduction in scrap, variances and warranty costs.

In 2007 and beyond, we continue to expect lower cumulative growth rates of PAS subscribers. At the same time, we anticipate the market demand for PAS/GSM dual mode to increase. We will continue to develop unique high-end models which have higher gross margin and average selling price. We will continue to focus on product cost reductions efforts through supply chain improvements and R&D improvement.

Fiscal 2005 vs. 2004

Net sales declined 37% primarily due to decreases in both volume and price for our PAS handsets in China as the units sold declined to 10.2 million compared to 14.0 million in 2004. The 27% volume decline was primarily attributed to (i) lower demand for our PAS handsets resulting from slower subscriber growth. In 2005, PAS subscriber growth slowed to 31% from over 70% in 2004 as service providers reduced marketing efforts for PAS handsets in anticipation of next generation technology networks and (ii) our inability to supply product to our customers during the fourth quarter due to component shortages. As a result of shortages of key components (such as printed circuit boards, flash memory and radio frequency components) in the fourth quarter, we were unable to fill our customers orders for Chinese New Year sales promotions.

The average selling price per unit declined 18% due to a combination of competitive pricing pressures during the first half of the year, and a shift in product mix to sales of lower-end models. We have also experienced continuing pricing pressure in the China telecommunications market since the later part of 2003, which has driven average unit selling prices lower.

Our gross profit as a percentage of sales decreased by 6 percentage points, primarily due to a decline in the PAS handset average unit price, offset by lower material costs as we renegotiated prices with vendors, and a shift in product mix to lower-end, higher margin models.

Services

	Years Ended December 31,		
	2006	**2005**	**2004**
		(As restated)	**(As restated)**
	(in thousands)		
Net sales	$ 76,596	$ 84,320	$ 51,640
Gross profit	$ 24,179	$ 45,891	$ 16,345
Gross profit as a percentage of net sales	32 %	54 %	32 %

Fiscal 2006 vs. 2005

Our Services segment s net sales decreased by $7.7 million, or 9%, for 2006 compared to 2005. The decrease in net sales is primarily due to delays associated with receiving final acceptance from existing projects that were completed. During 2006, we focused on the revenue opportunities with respect to support in China. Approximately 477 employees previously providing sales and support services were shifted towards generating revenue from support arrangements, resulting in additional cost of goods sold for 2006 of $15.0 million, and a corresponding decrease to operating expenses. Additionally, revenues of $9.7 million from Wireless Infrastructure and $0.7 million from Broadband segment sales in China were allocated to the Services segment during 2006. The allocation was made on certain completed contracts for which the service element was not separately priced. Our gross profit as a percentage of sales decreased by 22 percentage points, primarily due to a one time service charge for marketing services to Softbank during 2005 that was not repeated in 2006.

In order to succeed in today s multi-services convergence environment, operators need to differentiate their subscriber offerings, make their operations more efficient and cost effective, enhance productivity, grow their businesses, and increase revenues. Our new solutions methodology is designed to let operators concentrate on their business model and their end-customers while we provide complete end to end support for implementing and managing their multi-vendor networks. These are primarily non-core business processes and activities that many service providers feel can be outsourced to their infrastructure vendor partners such as UTStarcom.

Our new Value Added Service portfolio aims to extend its solution-oriented approach from supplying platforms to all aspects of planning for, deploying, and managing both platforms and services. We are targeting new geographies and customers with an end-to-end solution approach. We expect this initiative to significantly improve our revenue plan during 2007.

Fiscal 2005 vs. 2004

The increase in Services segment revenue was due to the continuing development of our service product offerings and the $12.6 million of revenue and gross profit associated with promotional services for Japan Telecom recognized in the first quarter of 2005.

The increase in absolute gross profit and gross profit as a percentage of sales was due to an increase in overall net sales for this segment performed by a relatively consistent headcount as well as an increase in China services that have lower associated costs. The $12.6 million of revenue and gross profit associated with promotional services for Japan Telecom recognized in the first quarter of 2005 contributed significantly to the total gross profit for the year ended December 31, 2005.

TRANSACTIONS WITH RELATED PARTIES AND OTHER INFORMATION

Softbank

We recognized revenue of $130.8 million, $475.3 million and $143.7 million during the years ended December 31, 2006, 2005 and 2004, respectively, with respect to sales of telecommunications equipment to affiliates of SOFTBANK CORP. (Softbank), a significant stockholder of our company. Softbank offers asynchronous digital subscriber line (ADSL) coverage throughout Japan, which is marketed under the name YAHOO! BB. In 2006, we determined that certain sales to third party resellers were, in substance, sales to Softbank and therefore, we have included these amounts in related party sales. Prior year amounts have been reclassified to conform to the current period presentation. We support Softbank s fiber-to-the-home service through sales of our carrier class Gigabit Ethernet Passive Optical Network (GEPON) product as well as our multi-service optical transport product (NetRing). In addition, we support Softbank s new internet protocol television (IPTV), through sales of our RollingStream product. Included in revenue for the year ended December 31, 2006 is a fee of $31.2 million charged for the cancellation of orders for broadband products and $10.0 million charged for the cancellation of orders for wireless infrastructure products.

Included in accounts receivable at December 31, 2006 and December 31, 2005 were $29.9 million and $83.4 million, respectively, related to these transactions. During 2006 and 2005, sales to Softbank include a three year service period and a penalty clause if product failure rates exceed a certain level over a seven year period. There was $11.5 million and $19.6 million included in long term deferred revenue with respect to these agreements at December 31, 2006 and 2005, respectively. Additionally, there was $11.6 million and $8.0 million included in current deferred revenue at December 31, 2006 and 2005, respectively. As of December 31, 2005, $5.4 million was included in customer advances related to other Softbank agreements.

During August 2004, we entered into several agreements with Japan Telecom Co., Ltd (JT), a wholly owned subsidiary of Softbank. These agreements relate to the sale of *i*AN-8000 equipment with specified value and delivery dates, as well as an oral agreement which subsequently converted into specific service contracts to manage a sales promotional program for JT. We determined that the service activities revenue should be recorded net of expected promotional spending.

Because we had not provided these activities in the past and could not estimate the fair value of these services, we determined under the guidance of SAB 104 that all revenue related to these agreements could not be recognized until all goods and services were delivered. We delivered and received final acceptance for all equipment contemplated under these agreements in the quarter ended March 31, 2005.

The promotional services discussed above involved contracting with third party promotional vendors, who in turn, facilitated the marketing and subscriber recruitment for the JT fiber-to-the-home program. During the fourth quarter of 2004, we determined that we would end our involvement with the JT promotional program after completion of the contract discussed above. Accordingly, late in the fourth quarter of 2004 and during the first quarter of 2005, we either cancelled or assigned to another party all third party contracts with promotional vendors related to the JT contract. Such termination or assignment of all third party promotional agreements, as well as effective satisfaction of our obligations with JT under such agreements, satisfied the revenue recognition criteria for these agreements and as such, the net value of the promotional services and the value of equipment delivered, which totaled $204.8 million, was reported in the quarter ended March 31, 2005.

We also entered into an agreement with JT during the third quarter of 2004 to supply chassis equipment. The equipment shipped under this agreement is considered linked to the *i*AN-8000 sale noted above and as such, was also deferred until the completion of the above-mentioned promotional activities. The revenue recognition criteria related to the sale of the *i*AN- 8000 equipment was satisfied in the first quarter of 2005 and as such, the revenue related to the chassis sale of $66.5 million was reported in the quarter ended March 31, 2005. During the years ended December 31, 2006 and 2005, sales to Softbank included $6.7 million and $280.1 million, respectively, with regards to sales of telecommunications equipment and service sold to JT, and none for 2004.

We invested in Restructuring Fund No.1, a venture capital investment limited partnership established by Softbank. The partnership was dissolved in July 2006 with a total cash distribution of $3.0 million to us during 2006. We have recorded a gain on investment of $1.4 million and $0.7 million, respectively, for the year ended December 31, 2006 and 2005. We recorded an immaterial equity loss for the year ended December 31, 2004.

On July 17, 2003, we entered into a Mezzanine Loan Agreement with BB Modem Rental PLC (BB Modem), an affiliate of SOFTBANK CORP. Under the terms of the agreement, we loaned BB Modem $10.1 million at an effective interest rate of 12.01% per annum, for the purpose of investing in a portfolio of ADSL modems and associated modem rental agreements, from Softbank. Softbank will continue to service such modems and modem rental agreements. Our loan was subordinated to certain senior lenders of BB Modem, and repayments were payable to us over a 42-month period through January 31, 2007, with a substantial portion of the principal amount of the loan repaid during the last 16 months of this period During the year ended 2006, 2005 and 2004, we recorded $0.6 million, $1.3 million and 1.3 million, respectively in interest income in respect to this loan. The loan receivable at December 31, 2006 was approximately $1.0 million, included in other current assets. At December 31, 2005, the loan balance was approximately $9.0 million and was included in other long-term assets. The note receivable was paid in full in January 2007.

As of December 31, 2006, Softbank beneficially owned approximately 12% of our outstanding stock.

Acoustek Int l Corp.

In 2005 and 2006, we received consulting services from Acoustek Int l Corp. (Acoustek), which employed Minnie Huang, spouse of William Huang, our former Senior Vice President and Chief Technology Officer. Mr. Haung s employment with the Company terminated on December 31, 2006. We paid $0.1 million in each of the years of 2006 and 2005 for consulting services provided by Acoustek.

Audiovox

One of our officers also serves as a director for Audiovox Corporation (Audiovox). During the year ended 2006 and 2005, we paid approximately $1.4 million and $0.7 million, respectively, for IT services from Audiovox.

Cellon

In September 2001, we invested $2.0 million in Cellon International Holdings Corporation (Cellon) and made additional investments of $3.0 million each in April and December 2002. Cellon designs wireless terminals and related technology for handset manufacturers and private distributors. In November 2005, we entered into an agreement with Cellon under which we received consideration in the form of preferred stock and warrants of Cellon valued at $5.5 million in exchange for the transfer of fixed assets with a net book value of $3.0 million, a facilities lease and a workforce in place consisting of 156 employees. This transaction was completed on May 31, 2006 and a gain on sale of assets of $2.5 million was recorded in other income. As of December 31, 2006, with the additional shares obtained in this transaction, we had an 11% ownership interest in Cellon. In the fourth quarter of 2006, our review of this investment included, but was not limited to, a review of Cellon s cash position, recent financing activities, financing needs, earnings/revenue outlook, operational performance, management/ownership changes, and competition. Based on the deterioration of Cellon s financial condition, we determined that the carrying value of the investment was at an amount above the fair value of the investment, and the decline was other-than temporary. During the fourth quarter of 2006, we recorded a $13.5 million other-than-temporary impairment charge for this investment in other income, net.

In November 2005, we entered into a Development Service Agreement with Cellon in which $5.0 million was prepaid in exchange for future product development. Approximately $2.0 million of the prepaid amount was used in year ended December 31, 2006 as payments for design services. We may also use the prepayment in satisfaction of royalties Cellon may earn from sales by us of products Cellon designs under the Development Services Agreement. This agreement also obligates Cellon to pay us a royalty if certain technology shared by us to Cellon is used in products developed and sold to customers other than us through November 2007. During 2006, no royalty was earned by us related to product developed and sold to customers other than us. During the fourth quarter of 2006, we recorded an operating expense of $3.0 million to write-off this prepayment in connection with our assessment of the financial condition of Cellon as discussed above. On June 18, 2007, a meeting of Cellon s shareholders was held where a resolution was passed to place Cellon in voluntary liquidation.

Fiberxon

We had an outstanding purchase commitment with Fiberxon, in which we have a 7% ownership interest, to purchase component parts for optical networking products. In addition, we provided a letter of credit for $5.0 million to purchase raw materials for the manufacture of these component parts. This commitment expired during 2005. There was no such commitment arrangement for 2006. Purchases from Fiberxon totaled $2.6 million, $9.7 million and $15.1 million during the years ended December 31, 2006, 2005 and 2004, respectively and we had $0.4 million and $0.3 million in accounts payable to Fiberxon at December 31, 2006 and 2005, respectively.

GCT Semiconductor

We have an outstanding purchase commitment with GCT Semiconductor, Inc. (GCT), in which we have a 2% ownership interest, to purchase component parts. Purchases from GCT totaled $6.3 million and $1.9 million for the years ended December 31, 2006 and 2005, respectively. We had $1.1 million in accounts payable to GCT at each December 31, 2006 and 2005.

Global Asia Partners L.P.

Global Asia Partners L.P. is a venture capital fund formed to make private equity investments in private or pre-IPO technology and telecommunications companies in Asia. The general partner of this fund was also a sales agent of ours until the third quarter of 2006. Between June 2002 and April 2005, we invested a total of $2.6 million in the fund. As of December 31, 2006 we owned 49% of the fund s outstanding partnership units. We had a commitment to invest up to a maximum of $5.0 million, but as the result of a reorganization of capital contributions by the partners, reached in April 2005, our capital contribution of $0.6 million in April 2005 was the final capital contribution to be made. In addition, the agreement allows the partnership to re-invest up to $2.5 million that otherwise would have been available to us as future distributions.

Matsushita Joint Venture

In July 2002, we entered into a joint venture agreement with Matsushita Communication Industrial Co., Ltd. to jointly design and develop, manufacture and sell telecommunication products. We had a 49% ownership interest in the joint venture company. We performed engineering services for the joint venture for approximately $2.8 million which was recognized as revenue during 2005. As of December 31, 2005, we had a receivable of $0.1 million. In December 2005, the partners agreed to dissolve the joint venture and the dissolution was completed during 2006.

MDC Holding, Ltd.

We had an outstanding accounts receivable balance with MDC Holding, Inc. (MDC) related to a PAS system purchase of $1.3 million at December 31, 2006. There was no accounts receivable balance at December 31, 2005. Certain of our employees were shareholders of MDC as of December 31, 2006. MDC is in the business of providing value-added services, such as short message, voicemail or ring-tone services for PAS telecom networks.

ORG, Inc.

We have a 49% ownership in Global Asia Partners L.P. which in turn is a significant shareholder in ORG, Inc. We had sales of $1.6 million and $0.5 million to ORG, Inc. during 2006 and 2005, respectively. We had accounts receivable of $1.0 million and $0.2 million from ORG, Inc. as of December 31, 2006 and 2005, respectively. There was no deferred revenue at December 31, 2006 and there was $0.1 million in deferred revenue at December 31, 2005.

Starcom Products, Inc.

We obtain engineering consulting and employee placement services from Starcom Products, Inc. (Starcom), which is 31% owned by an individual related to one of our former officers who was also a member of our Board of Directors. We paid less than $0.1 million in 2006, $0.7 million in 2005 and $1.1 million in 2004 for engineering consulting and employee placement services provided by Starcom.

Xalted Networks

In May 2005 and August 2005, we invested $2.0 million and $1.0 million, respectively, in Xalted Networks (Xalted). In March 2006 we invested an additional $0.3 million in Xalted. Xalted is a development stage company providing telecommunication operator customers with a comprehensive set of network systems, software solutions and service offerings, in which we have an 11% ownership interest. We received purchase orders from Xalted Networks totaling approximately $1.3 million in 2005 for telecommunications equipment that is for product not typically sold by us to other customers. We charge a ten percent procurement fee to Xalted for obtaining and reselling these products. The equipment was delivered during 2005 but revenue has not been recognized as the revenue recognition process has not yet been completed.

Liquidity and Capital Resources

Operating Activities

2006

Net cash provided by operating activities for the year ended December 31, 2006 was $66.1 million. Cash from operating activities was positively affected by changes in accounts receivable, deferred costs and customer advances, partially offset by the net loss as well as changes in inventories, payables and other current liabilities.

The decrease in accounts receivable resulting from improved cash collections in 2006 compared to 2005 provided cash of $133.1 million. Days sales outstanding was 60 days at December 31, 2006 as compared to 66 days outstanding at December 31, 2005 due to strong cash collections in the fourth quarter of 2006 and the high percentage of fourth quarter revenue derived from our PCD segment, which generally has experienced a shorter collection period on related receivables. In 2007, we expect the days sales outstanding to increase in line with historical trends.

Customer advances increased by $38.4 million at December 31, 2006. Customer advances represent cash deposits we have received from our customers for orders that have not yet received final acceptance. Upon subsequent receipt of final acceptances and revenue recognition, customer advances are reduced and revenue and cost of sales is recorded.

The decrease in payables and other current liabilities primarily resulted from a decrease in accounts payable of $22.3 million, a decrease in income taxes payable of $28.9 million, and a decrease in other current liabilities of $27.6 million. The decrease in other current liabilities included decreases in payroll and other taxes payable, accrued contract costs, which relate to purchase of goods and services for which invoices have not been received, and warranty costs, offset by a $32.1 million increase in other current liabilities related to a loss contract reserve.

Non-cash charges for the year ended December 31, 2006 included $68.0 million of depreciation and amortization, $16.6 million of stock-based compensation expense, and a $13.5 million other-than-temporary charge related to impairment of a long-term investment. The net gain on sale of assets of $9.6 million, included the gain of $12.3 million related to the sale of the semiconductor design business division to Marvell Technology Group, Ltd.

2005

Net cash provided by operating activities for the year ended December 31, 2005 was $218.4 million. Operating cash was affected by changes in accounts receivable, inventories, income taxes payable and accounts payable.

The $268.2 million decrease in accounts receivable was primarily attributable to increased collections in the final quarter of 2005 as compared to the final quarter of 2004. Days sales outstanding was 66 days at December 31, 2005 as compared to 113 days at December 31, 2004. The shorter days sales outstanding was primarily a result of a shift in sales from China, which typically has a long collection cycle, to the United States, which typically has a shorter collection cycle. The decrease in inventory balance of $165.9 million, primarily a result of a shift in sales to the PCD segment which has faster inventory turnover, has also contributed to our increase in operating cash.

Customer advances decreased by $150.3 million during the year ended December 31, 2005. Upon subsequent receipt of final acceptances and revenue recognition, customer advances are reduced and revenue and cost of sales is recorded. Income taxes payable decreased by $110.2 million due to the losses incurred during 2005. In addition, accounts payable decreased by $87.8 million due to lower inventory and lower forecast sales. All of these factors contributed to a decrease in operating cash.

The reduction of customer advances in 2005 was primarily due to the completion of the revenue earning process for most of the agreements with Japan Telecom, Inc. (JT), an affiliate of Softbank Corp., as well as the decline in sales and the corresponding cash advances for products sold in China. All cash received from JT in advance of revenue recognition and in advance of spending for promotional activities was reflected as customer advances in prior periods. Revenue for certain of these agreements has been recognized during the year ended December 31, 2005. For additional information, see Note 20, Related Party Transactions , of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report.

2004

Net cash used in operating activities for the year ended December 31, 2004 was $95.0 million. Operating cash was affected by changes in accounts receivable, inventory and customer advances offset by changes in accounts payable and deferred costs.

The $453.9 million increase in accounts receivable was attributable to increased sales, and longer collection periods experienced during 2004. The increase in accounts receivable was, in part, due to the addition of the PCD business of Audiovox Communications Corporation. Approximately 14.4% of the accounts receivable balance outstanding at December 31, 2004 was attributable to PCD. Inventory increased by $175.9 million in 2004 and includes $156.0 million of inventory attributable to the PCD acquisition. Customer advances decreased by $116.9 million for the year ended December 31, 2004. Upon receipt of final acceptances, customer advance is reduced and revenue and cost of sales is recorded. The reduction of customer advances and deferred costs for inventory at customer sites in 2004 is largely a result of our customers in China transitioning from new system installations to system expansions, which generally requires a shorter period between customer advance and acceptance. Our working capital of $1.1 billion increased in proportion to the growth of our business in addition to the $175.0 million increase associated with our acquisition of ACC.

Offsetting the activity that decreased operating cash for the period were net income and non-cash charges including a $12.7 million provision for long-lived asset impairment, $76.2 million in depreciation and amortization, a $21.3 million provision for doubtful accounts, and a $18.3 million deferred cost provision. Accounts payable increased by $97.7 million, consistent with increased inventory purchasing. Inventories at customer sites under contracts awaiting final acceptance are classified as deferred costs, separate from what was historically considered inventory. The title and risk of loss of this inventory is transferred to the customer. Revenue and costs of sales are recorded when final acceptance is received from the customer. Deferred costs decreased by $207.4 million from December 31, 2003 to December 31, 2004. The decrease in deferred costs resulted from a greater number of customer acceptances, corresponding to the decrease in customer advances.

Investing Activities

2006

Net cash provided by investing activities in fiscal 2006 totaled $36.1 million. Cash inflows from investing activities included $36.0 million received from the sale of our semiconductor design operations to Marvell Technology Group, Ltd., $4.0 million of net proceeds from the sale of short-term investments and $20.9 million in changes to restricted cash. Cash used for additions to property, plant and equipment totaled $26.3 million.

2005

Net cash provided by investing activities in fiscal 2005 was $70.1 million. This was mainly due to net proceeds from the sale of investments of $181.7 million, including the $56.9 million received on the sale of the Softbank China Restructuring Fund No. 1 and $124.8 million of net sales of our other investment holdings, partially offset by $64.4 million of property, plant and equipment purchases and $24.3 million of for our acquisitions of Giga Telecom, Inc. and Pedestal Networks.

2004

Net cash used in investing activities was $468.0 million for the year ended December 31, 2004. The most significant components of our investing activities are business acquisitions, additions to property, plant and equipment and the net investment in short-term securities. Cash used for business acquisitions totaled $217.8 million during 2004, including approximately $178.3 million for selected assets of ACC, $30.0 million for substantially all assets and liabilities of TELOS, and $9.1 million for HSI. Cash used for the purchase of property, plant and equipment, including $57.1 million for the construction of our Hangzhou facility, totaled $135.6 million. Net cash used for the purchase of short-term investments was $82.8 million.

Financing Activities

2006

Net cash used in financing activities was $99.5 million, primarily consisting of a net repayment of short-term borrowings in excess of new borrowings.

2005

Net cash used in financing activities in fiscal 2005 was $202.8 million. This was primarily due to net repayments of $216.4 million on borrowings including $57.1 million cash payment in connection with early debt extinguishments.

2004

Net cash provided by financing activities was $742.7 million for the year ended December 31, 2004. This was primarily due to proceeds raised from the sale of 12.1 million shares of common stock at $39.25 per share to Banc of America Securities, LLC, in January 2004 for net proceeds of approximately $474.6 million. In addition, we incurred net borrowing of $350.0 million during the year from existing lines of credit in China to fund our operations needs in China. We also received $25.7 million for the issuance of common stock through stock option and warrant exercises. Offsetting cash provided by financing activities, during the first and second quarter of 2004, we used a portion of the capital raised to repurchase a total of 3.6 million shares of our common stock at an average price of $30.25 per share for a total cost of $107.6 million, including transaction fees.

Liquidity

We reported net losses in each quarter in the period beginning April 1, 2005 and continuing through December 31, 2006, which has resulted in an accumulated deficit of $494.2 million and total stockholders equity being reduced to $774.4 million at December 31, 2006. Additionally, at December 31, 2006, we had short-term debt in China under lines of credit to our China subsidiaries of $102.5 million maturing in 2007 and long-term debt outside of China in the form of 7⁄8% convertible subordinated notes with a principal balance of $274.6 million that matures in March 2008.

Our working capital was $793.5 million and $834.1 million at December 31, 2006 and 2005, respectively, and includes cash on hand of $661.6 million and $645.6 million and short term investments of $9.5 million in and $13.3 million, respectively in 2006 and 2005. Planned capital expenditures include an increase in the level of our capital expenditures in China in 2007 by approximately $40 million to support wire line telephone carriers in China who utilize our products and services to provide television service to their customers using the IPTV protocol.

Credit facilities in China at December 31, 2006 totaled $698.3 million, with $357.5 million of this amount available for working capital purposes, of which we had drawn $102.5 million in outstanding borrowings with interest rates up to 5.51%, and $340.8 million was available for use in support of letters of credit and corporate guarantees. These facilities expire primarily in November and December of 2007. We believe that based upon our recent financial performance and financial position our lenders may reduce the total available credit when it negotiates renewals of these lines. Furthermore, each borrowing under the credit facilities is subject to the bank s current favorable opinion of the credit worthiness of the Company s China subsidiaries, as well as the bank having funds available for lending and other Chinese banking regulations. However, we believe the amounts of credit our lenders may make available and the borrowings made under the renewed lines of credit will be sufficient to meet planned uses of these credit facilities.

As of September 30, 2007 our outstanding borrowings under the credit facilities in China total $140.1 million, with interest rates of up to 6.67%, and with varying maturity dates through September 2008. The Company s practice in China is to draw new loans under the credit facilities prior to either the maturity of our borrowings or expiration of our facilities to ensure we maintain adequate liquidity to re-pay the existing borrowings at maturity, or to effectively lengthen the credit facility period to the latest maturity date of the underlying borrowings.

Of our total cash and short-term investments at December 31, 2006 of $671.2 million, a total of $483.7 million is held in China. To meet liquidity needs outside of China, our subsidiaries in China have the ability to transfer cash to the Company in the United States under China s current exchange control regulations. The amount of cash available for transfer from the China subsidiaries is limited both by liquidity needs of the subsidiaries in China and by Chinese government requirements that the China subsidiaries retain adequate capital levels in China to protect creditors and to have funds available for mandated employee benefits. We believed the China subsidiaries could freely transfer at least $200 million as of December 31, 2006, and during the nine months ended September 30, 2007 our China subsidiaries have made such transfers of funds out of China to the Company totaling $150 million.

Although management believes we now have a sufficient amount of cash resources to finance our anticipated working capital and capital expenditure requirements for the next 12 months, we do not have enough cash outside of China to repay the convertible notes due on March 1, 2008. Management s liquidity plans include a partial or complete refinancing of the convertible notes, renewal of the lines of credit in China, transfers of more cash from its subsidiaries in China to the extent necessary, and, if needed, liquidation of certain investments and/or seeking new financing arrangements. Our ability to maintain sufficient liquidity is also dependent on achieving projected sales and operating margin forecasts.

The convertible notes were issued in March 2003 when we completed an offering of $402.5 million of ⅞% convertible subordinated notes due March 1, 2008 to qualified institutional buyers. The notes are convertible into our common stock at a conversion price of $23.79 per share and are subordinated to all of our present and future senior debt. Concurrent with the issuance of the convertible notes, we entered into a convertible bond hedge and a call option transaction with respect to our common stock. Both the bond hedge and call option transactions may be settled at our option either in cash or net shares and expire on March 1, 2008. During 2005, we completed exchanges of approximately 5.0 million shares of our common stock and approximately $57.1 million in cash for $127.9 million aggregate principal amount of outstanding notes. As a result of the early extinguishment, we also amended the convertible bond hedge and call option transactions to reflect the change in principal amount of the underlying notes.

If an event of default were to occur and be continuing, the Trustee or the holders of at least 25% in aggregate principal amount of the notes then outstanding could declare all unpaid principal and accrued interest on the Notes then outstanding to be immediately due and payable. Therefore as a result of our inability to timely file our Quarterly Report on Form 10-Q for the period ended September 30, 2006, because the independent review by the Governance Committee of the Company s historic stock option accounting was not completed, after receiving a purported notice of default from the trustee asserting that the delay in filing and a failure to comply with certain covenants had caused a default under the indenture, we solicited and received the requisite consents from the holders of the notes to a waiver of any defaults which may have occurred to and including January 9, 2007, caused by a delay in filing SEC Reports and entered into a First Supplemental Indenture with the trustee, dated January 9, 2007, which provided that any failure by us to comply with certain provisions of the original agreement will not result in a default or an event of default through May 31, 2007. After receiving a notice of default from the trustee asserting that our inability to timely file SEC Reports and comply with certain covenants as of May 31, 2007 had caused a default under the indenture, we solicited and received the requisite consents from the holders of the notes to a waiver of any defaults which may have occurred to and including July 26, 2007 and entered into a Second Supplemental Indenture with the trustee, after receiving consent from holders of more than 50% of the outstanding aggregate principal amount of the convertible subordinated notes in connection with our consent solicitation announced July 19, 2007. The Second Supplemental Indenture provides that (i) during the period from and including July 26, 2007 to and including October 15, 2007 (Covenant Reversion Date), any failure by us to comply with the covenants contained in the original indenture agreement related to the required filing of reports with the SEC, and the furnishing of copies of the SEC reports and certain compliance certificates to the Trustee, will not constitute a default, and that (ii) if, but for the Second Supplemental Indenture, a default would be deemed to have occurred as a result of a failure to comply with such covenants and such default remains uncured and is continuing as of the Covenant Reversion Date, such default will be deemed to have occurred on the Covenant Reversion Date.

Under the Second Supplemental Indenture, the convertible subordinated notes accrue an additional 6.75% per annum in special interest from and after January 9, 2007 to and including July 25, 2007, and an additional 10% per annum in special interest from and after July 26, 2007 to the date the notes are paid, prepaid, redeemed, converted or otherwise cease to be outstanding. The special interest rate accruing on the notes after July 26, 2007 represents an increase of 3.25% per annum over the previous special interest rate of 6.75% per annum provided by the First Supplemental Indenture. As a result of the Second Supplemental Indenture, the convertible subordinated notes now bear a stated interest rate of 10.875%. Accordingly, we will have $22.0 million of additional annual interest expense in 2007 while the convertible subordinated notes are outstanding. Payments of special interest will be made in addition to, and at the same time and in the same manner as, regularly scheduled payments of interest to holders entitled to such regularly scheduled payments of interest.

If additional sources of liquidity were needed, the Company would consider new debt or equity offerings or obtaining cash from asset sales, but there is no assurance that such transactions could be consummated on acceptable terms or at all. Failure to raise sufficient capital when needed could have a material adverse effect on the business, results of operations and financial position of the Company.

Our China sales are generally denominated in local currency, and we accept commercial notes receivable with maturity dates of between three and six months from our customers in China in the normal course of business. Notes receivable available for sale was $5.1 million and $2.1 million at December 31, 2006 and 2005, respectively. We may discount these notes with banking institutions in China. Any notes that have been sold are not included in our consolidated balance sheets as the criteria for sale treatment established by Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS 140) have been met.

Due to the limitations on converting Renminbi, we are limited in our ability to engage in foreign currency hedging activities in China. We cannot guarantee that fluctuations in foreign currency exchange rates in the future will not have a material adverse effect on revenues from international sales and, correspondingly, on our business, financial condition, results of operations and cash flows. We have contracts negotiated in Japanese Yen and we maintain bank accounts in Japanese Yen for purchasing portions of our inventories and supplies. The balance of these Japanese Yen accounts at December 31, 2006 was approximately $13.1 million.

On August 1, 2005, we entered into a 364-day $100.0 million committed receivables purchase facility with a financial institution. In March 2007, the agreement was amended and restated to reflect that the purchase of trade receivables shall be at the sole discretion of the financial institution. The agreement was also extended to the earlier of (i) March 28, 2008 or (ii) upon 90 days written notice by the financial institution. Pursuant to the terms of the receivable purchase facility, we may sell certain receivables arising from the sale of telecommunications equipment to this financial institution. No receivables had been sold pursuant to this arrangement.

We have not guaranteed any debt that is not included in the consolidated balance sheet.

Income taxes

Certain subsidiaries and joint ventures located in China enjoy tax benefits in China which are generally available to foreign investment enterprises, including full exemption from national enterprise income tax for two years starting from the first profit-making year and/or a 50% reduction in national income tax rate for the following three years. In addition, local enterprise income tax is often waived or reduced during this tax holiday/incentive period. Under current regulations in China, foreign investment enterprises that have been accredited as technologically advanced enterprises are entitled to additional tax incentives. These tax incentives vary in different locales and could include preferential national enterprise income tax treatment at 50% of the usual rates for different periods of time. The tax holidays/incentives discussed above are applicable or potentially applicable to UTStarcom ChongQing Telecom Co. Ltd. (CUTS), UTStarcom Telecom Co., Ltd. (HUTS), Hangzhou UTStarcom Telecom Co., Ltd. (HSTC) and UTStarcom China Co., Ltd. (UTSC), our active subsidiaries in China, because these entities may qualify as accredited technologically advanced enterprises.

During the second quarter of 2005, HUTS received approval for a Knowledge Intensive, Technology Intensive Certificate (the Certificate) which subjects the company to a reduced national tax rate of 15%. In the first quarter of 2005, the Company recorded a reduction in tax expense attributable to an increase in deferred tax assets arising from the assessment of a local income tax for HUTS and HSTC in China. The approval of the Certificate currently has no effect on the local taxation of HUTS.

Off balance sheet arrangements

On August 1, 2005 we entered into a 364-day committed receivables purchase facility with Citibank, N.A., which provides for the sale of up to $100.0 million of trade accounts receivable of our PCD segment. On March 30, 2007, the agreement was amended and restated to reflect that the purchase of trade receivables shall be at the sole discretion of Citibank, N.A. Sales of the accounts receivables to Citibank, N.A. under this program will result in a reduction of total accounts receivable in our consolidated balance sheet. The remaining accounts receivables not sold to Citibank, N.A. will be carried at their net realizable value, including an allowance for doubtful accounts. We did not sell any receivables pursuant to this facility during 2006 and 2005. We believe that available funding under our accounts receivable financing program provides us increased flexibility to manage working capital requirements, and that there are sufficient trade accounts receivable to support the U.S. financing programs. Under the program, we will continue to service the accounts receivable.

At December 31, 2006, we have no other off balance sheet arrangements

Contractual obligations and other commercial commitments

Our obligations under contractual obligations and commercial commitments are primarily with regard to leasing arrangements and standby letters of credit and are as follows:

	Total (in thousands)	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Contractual Obligations					
Bank loans	$ 102,510	$ 102,510	$	$	$
Convertible subordinated notes	$ 274,600	$	$ 274,600	$	$
Interest payable on debt	$ 35,216	$ 30,239	$ 4,977	$	$
Capital leases	$ 923	$ 286	$ 533	$ 104	$
Operating leases	$ 38,200	$ 15,340	$ 18,765	$ 3,230	$ 865
Other Commercial Commitments					
Letters of credit	$ 56,569	$ 40,100	$ 16,469	$	$
Purchase commitments	$ 154,364	$ 150,587	$ 3,777	$	$

Bank loans

At December 31, 2006, we had loans with various banks totaling $102.5 million with interest rates ranging from 5.02% to 5.51% per annum. These bank loans mature during 2007 and are included in short-term debt. There are no significant covenants associated with these loans.

Convertible subordinated notes

Our convertible subordinated notes, due March 1, 2008, are convertible into our common stock at a conversion price of $23.79 per share and are subordinated to all our present and future senior debt. The principal is due only at maturity of the notes.

Effective January 9, 2007, the Company and the holders of the remaining $274.6 million of convertible subordinated notes entered into a First Supplemental Indenture, providing that any failure by us to comply with certain provisions of the original agreement will not result in a default or an event of default through May 31, 2007. The convertible subordinated notes accrue an additional 6.75% per annum in special interest from and after January 9, 2007 to the March 1, 2008 maturity date of the notes, unless the notes are earlier repurchased or converted. On July 26, 2007, we entered into a Second Supplemental Indenture providing that the convertible subordinated notes will accrue an additional 10% per annum in special interest from and after July 26, 2007 to the March 31, 2008 maturity date of the notes unless the notes are earlier repurchased or converted. The special interest rate represents an increase of 3.25% per annum over the previous special interest rate of 6.75% per annum in the First Supplemental Indenture. As a result of the Second Supplemental Indenture, the convertible subordinated notes now bear a stated interest rate of 10.875%. Interest is payable semiannually on March 1 and September 1, and payments of the special interest are made in addition to and at the same time and in the same manner as regularly scheduled payments of interest to holders entitled to such regularly scheduled payments of interest. For more information regarding the notice of default on May 31, 2007 and the Company s Second Supplemental Indenture, see the Liquidity section of this Annual Report.

Leases

We lease certain facilities under non-cancelable operating leases that expire at various dates through 2013.

Letters of credit

We issue standby letters of credit primarily to support international sales activities outside of China. When we submit a bid for a sale, often the potential customer will require that we issue a bid bond or a standby letter of credit to demonstrate our commitment through the bid process. In addition, we may be required to issue standby letters of credit as guarantees for advance customer payments upon contract signing or for performance guarantees. The standby letters of credit usually expire without being drawn by the beneficiary thereof. Finally, we may issue commercial letters of credit in support of purchase commitments.

Purchase commitments

We are obligated to purchase raw materials and work-in-progress inventory under various orders from our suppliers, all of which are expected to be fulfilled, with no adverse consequences material to our operations or financial condition. Purchase commitments exclude agreements that are cancelable without penalty.

Accounts receivable transferred to notes receivable

We accept commercial notes receivable from our customers in China in the normal course of business. The notes are typically non-interest bearing, with maturity dates between three and six months. Notes receivable available for sale were $5.1 million and $2.1 million at December 31, 2006 and December 31, 2005, respectively. We may discount these notes with banking institutions in China. A sale of these notes is reflected as a reduction of notes receivable and the proceeds of the settlement of these notes are included in cash flows from operating activities in the consolidated statement of cash flows. During the year ended December 31, 2005 we sold notes receivable totaling $13.0 million. There were no notes receivable sold during the year ended December 31, 2006. Any notes that have been sold are not included in our consolidated balance sheets as the criteria for sale treatment established by Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, (SFAS 140) has been met. The costs of settling or transferring these notes receivable were $0.7 million for the year ended December 31, 2005, and were included in other income (expense), net in the consolidated statements of operations.

Investment commitments

As of December 31, 2006, we had invested a total of $2.6 million in Global Asia Partners L.P., a fund formed to make private equity investments in private or pre-IPO technology and telecommunications companies in Asia. We had a commitment to invest up to a maximum of $5.0 million, but as the result of a reorganization of capital contributions by the partners, reached in April 2005, our capital contribution of $0.6 million in April 2005 was the final capital contribution to be made. In addition, the agreement allows the partnership to re-invest up to $2.5 million that otherwise would have been available to us as future distributions.

Intellectual property

Certain sales contracts include provisions under which customers would be indemnified by us in the event of, among other things, a third-party claim against the customer for intellectual property rights infringement related to our products. There are no limitations on the maximum potential future payments under these guarantees. We have not accrued any amounts in relation to these provisions as no such claims have been made and we believe we have valid enforceable rights to the intellectual property embedded in our products.

QUARTERLY FINANCIAL DATA (UNAUDITED), AS RESTATED AND DISCUSSION AND ANALYSIS OF QUARTERLY RESULTS OF OPERATIONS

The following tables set forth some of the key quarterly unaudited financial information. See Note 2, Restatement of Financial Statements , of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report and Exhibit 99.1 for further details of the impact of the restatement on these quarterly results.

UTSTARCOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three months ended December 31, 2006	Three months ended September 30, 2006	Three months ended June 30, 2006 (As restated)	Three months ended March 31, 2006 (As restated)
Net sales				
Unrelated party	$ 685,718	$ 569,826	$ 513,898	$ 557,037
Related party	18,738	31,073	37,628	44,944
	704,456	600,899	551,526	601,981
Cost of net sales				
Unrelated party	609,386	503,618	414,113	461,585
Related party	16,867	22,480	28,463	16,605
Gross profit(1)	78,203	74,801	108,950	123,791
Operating expenses (income):				
Selling, general and administrative	87,547	80,076	83,109	83,724
Research and development	43,559	46,305	46,603	46,402
Amortization of intangible assets	4,304	4,821	4,821	4,925
Gain on sale of semiconductor design assets		(12,291)		
Total operating expenses	135,410	118,911	134,533	135,051
Operating loss	(57,207)	(44,110)	(25,583)	(11,260)
Interest income	4,136	3,214	3,947	3,532
Interest expense	(2,402)	(2,620)	(3,166)	(3,500)
Other (expense) income, net	(11,198)	1,835	6,887	3,568
Loss before income taxes, minority interest and equity in loss of affiliated companies(2)	(66,671)	(41,681)	(17,915)	(7,660)
Income tax (expense) benefit	23,991	(1,459)	(4,669)	(2,839)
Minority interest in losses of consolidated subsidiaries	651	92	259	556
Net loss	$ (42,029)	$ (43,048)	$ (22,325)	$ (9,943)
Loss per share:				
Basic	$ (0.35)	$ (0.36)	$ (0.19)	$ (0.08)
Diluted	$ (0.35)	$ (0.36)	$ (0.19)	$ (0.08)

(1) Gross profit in the fourth quarter of 2006 was unfavorably impacted by a $32.1 million loss contract provision.

(2) Loss from continuing operations for the fourth quarter of 2006 included a $13.5 million other than temporary impairment charge for a long-term investment.

UTSTARCOM, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three months ended December 31, 2005 (As restated)	Three months ended September 30, 2005 (As restated)	Three months ended June 30, 2005 (As restated)	Three months ended March 31, 2005 (As restated)
Net sales				
Unrelated party	$ 600,403	$ 584,072	$ 649,390	$ 561,432
Related party	80,689	13,363	51,123	330,637
	681,092	597,435	700,513	892,069
Cost of net sales				
Unrelated party	541,346	548,686	573,134	523,972
Related party	77,091	10,862	24,525	135,657
Gross profit	62,655	37,887	102,854	232,440
Operating expenses:				
Selling, general and administrative	74,073	86,414	103,087	107,886
Research and development	54,515	60,817	65,650	65,831
Amortization of intangible assets	5,462	6,643	6,776	6,972
Impairment of long-lived assets		218,094		
Restructuring	11,164	3,378	15,127	
In-process research and development			660	
Total operating expenses	145,214	375,346	191,300	180,689
Operating (loss) income	(82,559)	(337,459)	(88,446)	51,751
Interest income	2,617	1,673	1,452	1,349
Interest expense	(3,900)	(3,876)	(4,711)	(4,278)
Gain on extinguishment of subordinated notes		20,297	11,095	
Other income (expense), net	45,388	7,352	(2,228)	(6,847)
(Loss) income before income taxes, minority interest and equity in loss of affiliated companies	(38,454)	(312,013)	(82,838)	41,975
Income tax (expense) benefit	(2,501)	(125,222)	(3,290)	(5,530)
Minority interest in losses of consolidated subsidiaries	598	3	313	(222)
Equity in loss of affiliated companies	(3,645)	(786)	(574)	(459)
Net (loss) income	$ (44,002)	$ (438,018)	$ (86,389)	$ 35,764
(Loss) earnings per share:				
Basic	$ (0.37)	$ (3.70)	$ (0.75)	$ 0.31
Diluted	$ (0.37)	$ (3.70)	$ (0.75)	$ 0.27

NET SALES

	Three months ended March 31, 2006 As previously reported (in thousands)	As restated	% of net sales	Three months ended June 30, 2006 As previously reported (in thousands)	As restated	% of net sales	Three months ended September 30, 2006 (in thousands)	% of net sales
Sales by Segment								
Broadband Infrastructure	$ 57,156	$ 57,251	10 %	$ 44,674	$ 44,769	8 %	$ 50,754	8 %
Wireless Infrastructure	100,433	105,733	18 %	113,680	115,965	21 %	110,299	18 %
Network Solutions	157,589	162,984	28 %	158,354	160,734	29 %	161,053	26 %
PCD	322,995	322,995	54 %	266,247	266,247	49 %	328,701	55 %
Handsets	99,019	99,034	16 %	107,069	107,069	19 %	93,163	16 %
Service	16,968	16,968	2 %	17,476	17,476	3 %	17,982	3 %
	$ 596,571	$ 601,981	100 %	$ 549,146	$ 551,526	100 %	$ 600,899	100 %

	Three months ended March 31, 2005 As previously reported (in thousands)	As restated	% of net sales	Three months ended June 30, 2005 As previously reported (in thousands)	As restated	% of net sales	Three months ended September 30, 2005 As previously reported (in thousands)	As restated	% of net sales
Sales by Segment									
Broadband Infrastructure	$ 326,307	$ 326,396	37 %	$ 56,644	$ 56,734	8 %	$ 30,927	$ 31,018	5 %
Wireless Infrastructure	109,437	99,533	11 %	152,925	133,589	19 %	113,188	77,586	13 %
Network Solutions	435,744	425,929	48 %	209,569	190,323	27 %	144,115	108,604	18 %
PCD	315,552	315,552	35 %	342,263	342,263	49 %	363,637	363,637	61 %
Handsets	128,083	128,083	14 %	143,879	143,879	21 %	105,394	106,294	18 %
Service	22,505	22,505	3 %	24,048	24,048	3 %	18,900	18,900	3 %
	$ 901,884	$ 892,069	100 %	$ 719,759	$ 700,513	100 %	$ 632,046	$ 597,435	100 %

	Six months ended June 30, 2006 As previously reported (in thousands)	As restated	% of net sales	Six months ended June 30, 2005 As previously reported (in thousands)	As restated	% of net sales
Sales by Segment						
Broadband Infrastructure	$ 101,830	$ 102,020	9 %	$ 382,951	$ 383,130	24 %
Wireless Infrastructure	214,113	221,698	19 %	262,362	233,122	15 %
Network Solutions	315,943	323,718	28 %	645,313	616,252	39 %
PCD	589,242	589,242	51 %	657,815	657,815	41 %
Handsets	206,088	206,103	18 %	271,962	271,962	17 %
Services	34,444	34,443	3 %	46,553	46,554	3 %
	$ 1,145,717	$ 1,153,506	100 %	$ 1,621,643	$ 1,592,583	100 %

	Nine months ended September 30, 2006 (in thousands)	% of net sales	Nine months ended September 30, 2005 As previously reported (in thousands)	As restated	% of net sales
Sales by Segment					
Broadband Infrastructure	$ 152,774	9 %	$ 413,878	$ 414,148	19 %
Wireless Infrastructure	331,997	19 %	375,550	310,708	14 %
Network Solutions	484,771	28 %	789,428	724,856	33 %
PCD	917,943	52 %	1,021,452	1,021,452	47 %
Handsets	299,266	17 %	377,356	378,256	17 %
Service	52,426	3 %	65,453	65,454	3 %
	$ 1,754,406	100 %	$ 2,253,689	$ 2,190,018	100 %

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NET SALES

Three months ended March 31, 2006 and 2005

Net sales decreased by 33% to $602.0 million during the quarter ended March 31, 2006 compared to the same period in 2005. The decrease is primarily due to a decrease in sales in the Broadband segment by 82% from March 31, 2005 to March 31, 2006. The greater Broadband segment sales during the three months ended March 31, 2005 included sales of $271.9 million to Japan Telecom, an affiliate of Softbank, primarily for the iAN8000 product. Due to the customer concentration in the Broadband segment, revenues fluctuate based upon the magnitude and timing of revenue recognition on certain contracts. Additionally, Handset sales declined by $29.0 million, or 23%. As we have been experiencing in recent quarters, the demand of our PAS/iPAS products including PAS/iPAS system based handsets in the China market continued to mature which resulted in lower demand and average selling price. Net sales increased in our PCD and Wireless segments and declined in the Services segment in the three months ended March 31, 2006, compared to the corresponding quarter in fiscal 2005.

Three and six months ended June 30, 2006 and 2005

Net sales decreased by 21% to $551.5 million during the quarter ended June 30, 2006 compared to the same period in 2005. The decline in sales occurred across each operating segment equally, as each segment reported sales were between 13% and 27% lower during the three months June 30, 2006 than the same period in the prior year. Broadband segment sales are concentrated with one customer, Softbank in Japan, and as such fluctuate based upon the magnitude and timing of revenue recognition on certain contracts. The decline in Broadband segment revenue is the result of a decline in sales to Softbank during the three months ended June 30, 2006 as compared to the same period in the prior year. As we have been experiencing in the recent quarters, our PAS/iPAS wireless infrastructure products as well as our PAS/iPAS based handsets in the China market continued to mature which resulted in lower unit demand. In our PCD operating segment, our unit sales during the three months ended June 30, 2006 have remained substantially unchanged from the comparable period in the prior year, but our average price per unit has declined from the prior year.

Net sales were $1,153.5 million in the six months ended June 30, 2006, a decrease of 28% from $1,592.6 million in the corresponding period of 2005. The overall decrease in net sales was largely due to a decrease in sales in the Broadband segment of 73%, from June 30, 2005 to June 30, 2006. Broadband segment sales during the six months ended June 30, 2005 included one large transaction with Softbank totaling $271.9 million of revenue on certain agreements entered into with Japan Telecom primarily for iAN8000 product. As we have been experiencing in the recent quarters, our PAS/iPAS wireless infrastructure products and our PAS/iPAS based handsets in the China market continued to mature, which resulted in lower unit demand. This led to a decrease in our wireless infrastructure and handset segment sales of 5% and 24%, respectively, from June 30, 2005 to June 30, 2006. In our PCD operating segment, our unit sales during the six months ended June 30, 2006 did not change significantly from the comparable period in the prior year, but our average price per unit has declined leading to a 10% decline in segment revenue.

Three and nine months ended September 30, 2006 and 2005

Net sales increased by 1% to $600.9 million during the quarter ended September 30, 2006 compared to the same period in 2005. While net sales increased 48% in the Network Solutions segment, sales declined in all other operating segments. The reported sales of the remaining segments were between 5% and 12% lower during the three months ended September 30, 2006 than the same period in the prior year. Broadband segment sales are concentrated with one customer, Softbank in Japan, and as such fluctuate based upon the magnitude and timing of revenue recognition on certain contracts. As we have been experiencing in the recent quarters, our PAS/iPAS wireless infrastructure products as well as our PAS/iPAS based handsets in the China market continued to mature which resulted in lower unit demand. In our PCD operating segment, net sales decreased 10% during the three months ended September 30, 2006 from the comparable period in the prior year, due to a decline in the number of handsets sold, partially offset by an increase in our average price per unit.

Net sales were $1,754.4 million in the nine months ended September 30, 2006, a decrease of 20% from $2,190.0 million in the corresponding period of 2005. The overall decrease in net sales was largely due to a decrease in sales in the Broadband segment of 63%, from September 30, 2005 to September 30, 2006. Broadband segment sales during the nine months ended September 30, 2005 included one large transaction with Softbank totaling $271.9 million of revenue on certain agreements entered into with Japan Telecom primarily for iAN8000 product. As we have been experiencing in the recent quarters, our PAS/iPAS wireless infrastructure products and our PAS/iPAS based handsets in the China market continued to mature, which resulted in lower unit demand. This led to a decrease in our handset segment sales of 21% from September 30, 2005 to September 30, 2006. In our PCD operating segment, our unit sales and average price per unit declined during the nine months ended September 30, 2006 from the comparable period in the prior year, leading to a 10% decline in segment revenue.

Net sales revenue by geography shifted in comparison to the corresponding period of 2005. Revenue derived from China remained relatively constant, accounting for approximately 34% of our net sales revenue in the nine months ended September 30, 2006, in comparison to approximately 30% in the corresponding period last year. Revenue derived from the United States accounted for approximately 52% of our net sales revenue in the nine months ended September 30, 2006, in comparison to approximately 45% in the corresponding period last year. Due to the completion of a large contract during 2005, revenue from Japan accounted for approximately 7% of our net sales revenue in the nine months ended September 30, 2006, in comparison to approximately 18% for the comparable period in the prior year.

GROSS PROFIT

	Three months ended March 31, 2006			**Three months ended June 30, 2006**			**Three months ended September 30, 2006**	
	As previously reported (in thousands)	**As restated**	**% of net sales**	**As previously reported (in thousands)**	**As restated**	**% of net sales**	**(in thousands)**	**% of net sales**
Gross profit by Segment								
Broadband Infrastructure	$ 22,957	$ 23,086	40 %	$ 4,852	$ 4,889	11 %	$ (837)	(2)%
Wireless Infrastructure	49,517	50,761	48 %	54,240	53,857	46 %	54,217	49 %
Network Solutions	72,474	73,847	45 %	59,092	58,746	37 %	53,380	33 %
PCD	14,434	14,389	4 %	12,322	12,321	5 %	(7,057)	(2)%
Handsets	31,599	31,613	32 %	32,894	32,896	31 %	24,012	26 %
Services	3,947	3,942	23 %	4,978	4,987	29 %	4,466	25 %
	$ 122,454	$ 123,791	21 %	$ 109,286	$ 108,950	20 %	$ 74,801	12 %

	Three months ended March 31, 2005			**Three months ended June 30, 2005**			**Three months ended September 30, 2005**		
	As previously reported (in thousands)	**As restated**	**% of net sales**	**As previously reported (in thousands)**	**As restated**	**% of net sales**	**As previously reported (in thousands)**	**As restated**	**% of net sales**
Gross profit by Segment									
Broadband Infrastructure	$ 164,057	$ 164,076	50 %	$ 16,739	$ 16,757	30 %	$ (13,971)	$ (13,875)	(45)%
Wireless Infrastructure	29,670	24,667	25 %	45,964	36,662	27 %	32,381	16,332	21 %
Network Solutions	193,727	188,743	44 %	62,703	53,419	28 %	18,410	2,457	2 %
PCD	13,692	13,692	4 %	15,990	15,990	5 %	13,199	13,199	4 %
Handsets	14,539	14,539	11 %	20,800	20,800	14 %	12,746	13,633	13 %
Services	15,466	15,466	69 %	12,645	12,645	53 %	8,599	8,598	45 %
	$ 237,424	$ 232,440	26 %	$ 112,138	$ 102,854	15 %	$ 52,954	$ 37,887	6 %

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	Six months ended June 30, 2006 As previously reported (in thousands)	As restated	% of net sales	Six months ended June 30, 2005 As previously reported (in thousands)	As restated	% of net sales
Gross profit by Segment						
Broadband Infrastructure	$ 27,809	$ 27,975	27 %	$ 180,796	$ 180,833	47 %
Wireless Infrastructure	103,757	104,618	47 %	75,634	61,329	26 %
Network Solutions	131,566	132,593	41 %	256,430	242,162	39 %
PCD	26,756	26,710	5 %	29,682	29,682	5 %
Handsets	64,493	64,509	31 %	35,339	35,339	13 %
Services	8,925	8,929	26 %	28,111	28,111	60 %
	$ 231,740	$ 232,741	20 %	$ 349,562	$ 335,294	21 %

	Nine months ended September 30, 2006 (in thousands)	% of net sales	Nine months ended September 30, 2005 As previously reported (in thousands)	As restated	% of net sales
Gross profit by Segment					
Broadband Infrastructure	$ 27,138	18 %	$ 166,825	$ 166,958	40 %
Wireless Infrastructure	158,835	48 %	108,015	77,661	25 %
Network Solutions	185,973	38 %	274,840	244,619	34 %
PCD	19,653	2 %	42,881	42,881	4 %
Handsets	88,521	30 %	48,085	48,972	13 %
Services	13,395	26 %	36,710	36,709	56 %
	$ 307,542	18 %	$ 402,516	$ 373,181	17 %

Three months ended March 31, 2006 and 2005

Gross profit was $123.8 million, or 21% of net sales, in the three months ended March 31, 2006, compared to $232.4 million, or 26% of net sales, in the corresponding quarter of 2005. The overall gross profit decrease is due to a decline in sales and lower gross profit percentages in the Broadband segment. Broadband Infrastructure net sales during the three months ended March 31, 2005 included one large transaction with Softbank totaling $271.9 million of revenue on certain agreements entered into with Japan Telecom primarily for the iAN8000 product in 2005. Gross profit percentages improved in the Wireless and Handset segments, declined in the Broadband and Services segments, and remained the same in PCD. Gross profit as a percentage of sales in the Wireless Infrastructure segment increased by 23 percentage points in the three months ended March 31, 2006, as compared to the corresponding quarter in 2005 due to a number of factors, including: (i) The margins on PAS infrastructure improved due to a shift in product mix towards higher margin cell sites as well as a reduction in product discounts given; (ii) an improvement in inventory management resulting in a decrease in excess inventory write-downs; and (iii) sales of voice and data networks software totaling $8.6 million which has nearly 100% gross margins. Gross profit as a percentage of sales for our handsets segment increased by 21 percentage points in the three months ended March 31, 2006, as compared to the corresponding quarter in 2005. A portion of the improvement in the gross profit percentage relates to increased use of chip-sets with greater functionality in PAS handsets that reduce the overall component costs of each unit. Additional factors leading to the improvement in gross profit is a reduction in scrap, variances and warranty costs.

Three and six months ended June 30, 2006 and 2005

Gross profit was $109.0 million, or 20% of net sales, in the three months ended June 30, 2006, compared to $102.9 million, or 15% of net sales, in the corresponding quarter of 2005. The overall gross profit increased due to improved gross profit percentages in the Wireless Infrastructure and Handset segments, partially offset by a decline in sales and lower gross profit percentages in our Broadband Infrastructure and Services segments.

Gross profit was $232.7 million, or 20% of net sales, in the six months ended June 30, 2006, compared to $335.3 million, or 21% of net sales as restated, in the corresponding period of 2005. The decline in gross profit dollars primarily reflects an 85% decrease in the Broadband Infrastructure segment. As mentioned previously, revenue from the Broadband Infrastructure segment is concentrated with one customer in Japan and a significant contract was recognized as revenue during the first quarter of 2005. There was no similar-sized transaction in the Broadband Infrastructure segment during the six months ended June 30, 2006. Gross profit percentages improved in the Wireless and Handset segments, declined in the Broadband Infrastructure and Services segments and remained the same in PCD.

Three and nine months ended September 30, 2006 and 2005

Gross profit was $74.8 million, or 12% of net sales, in the three months ended September 30, 2006, compared to $37.9 million, or 6% of net sales in the corresponding quarter of 2005. The overall gross profit increased in real terms even though net sales declined, due to significant increase in gross profit percentages in our Broadband Infrastructure, Wireless, and Handsets segments.

Gross profit was $307.5 million, or 18% of net sales, in the nine months ended September 30, 2006, compared to $373.2 million, or 17% of net sales in the corresponding period of 2005. While the gross profit percentage remained relatively constant, Broadband Infrastructure gross profit dollars decreased $139.8 million due to a decline in sales of $261.4 million and a decrease in the gross profit percentage from 40% during the nine months ended September 30, 2005 to 18% in the corresponding period of 2006. As mentioned previously, revenue from the Broadband Infrastructure segment was concentrated with one customer in Japan and a significant contract was recognized as revenue during the first quarter of 2005. There was no similar-sized transaction in the Broadband Infrastructure segment during the nine months ended September 30, 2006. The decrease in gross profit resulting from the Broadband Infrastructure segment was partially offset by increased gross profit dollars resulting from improvement in gross profit percentages in the Wireless Infrastructure and Handset segments.

OPERATING EXPENSES

	Three months ended March 31, 2006		**Three months ended June 30, 2006**		**Three months ended September 30, 2006**
	As previously reported	**As restated**	**As previously reported**	**As restated**	
	(in thousands)				
Selling, general and administrative	$ 83,172	$ 83,724	$ 82,423	$ 83,109	$ 80,076
Research and development	46,309	46,402	46,743	46,603	46,305
Amortization of intangible assets	4,925	4,925	4,821	4,821	4,821
Gain on sale of semiconductor design assets					(12,291)
	$ 134,406	$ 135,051	$ 133,987	$ 134,533	$ 118,911

	Three months ended March 31, 2005		Three months ended June 30, 2005		Three months ended September 30, 2005	
	As previously reported	As restated	As previously reported	As restated	As previously reported	As restated
	(in thousands)					
Selling, general and administrative	$ 109,011	$ 107,886	$ 103,009	$ 103,087	$ 86,362	$ 86,414
Research and development	66,260	65,831	65,621	65,650	60,797	60,817
Amortization of intangible assets	6,972	6,972	6,776	6,776	6,643	6,643
Impairment of long-lived assets					218,094	218,094
Restructuring			15,127	15,127	3,378	3,378
In-process research and development			660	660		
	$ 182,243	$ 180,689	$ 191,193	$ 191,300	$ 375,274	$ 375,346

	Six months ended June 30, 2006		Six months ended June 30, 2005	
	As previously reported	As restated	As previously reported	As restated
	(in thousands)			
Selling, general and administrative	$ 165,593	$ 166,833	$ 212,020	$ 210,974
Research and development	93,052	93,005	131,881	131,481
Amortization of intangible assets	9,746	9,746	13,748	13,748
Restructuring			15,127	15,127
In-process research and development			660	660
	$ 268,391	$ 269,584	$ 373,436	$ 371,990

	Nine months ended September 30, 2006	Nine months ended September 30, 2005	
		As previously reported	As restated
	(in thousands)		
Selling, general and administrative	$ 246,908	$ 298,384	$ 297,390
Research and development	139,310	192,678	192,297
Amortization of intangible assets	14,567	20,391	20,391
Gain on sale of semiconductor design assets	(12,291)		
Impairment of long-lived assets		218,094	218,094
Restructuring		18,505	18,505
In-process research and development		660	660
	$ 388,494	$ 748,712	$ 747,337

SELLING, GENERAL AND ADMINISTRATIVE

Three months ended March 31, 2006 and 2005

Selling, general and administrative expenses decreased $24.2 million but increased to 14% of net sales during the three months ended March 31, 2006 compared to 12% of net sales for the same period in 2005. The decrease in SG&A expenses was primarily due to a $16.7 million decrease in our provision for doubtful accounts compared to the same period in 2005. Approximately $4.5 million in reduction was due to lower travel and entertainment costs, particularly in the China operations. In addition, there were reductions in expenses across all entities due to expense controls. Days sales outstanding was 74 days at March 31, 2006 as compared to 91 days at March 31, 2005. The shorter days sales outstanding and resultant decrease in provision for doubtful accounts is the result of improved cash collections in the first quarter of 2006 relative to the comparable period in 2005.

In the first quarter of 2006, we decided to terminate the Mongolian joint venture arrangement and wrote off the remaining net assets of approximately $4.7 million.

Three and six months ended June 30, 2006 and 2005

Selling, general and administrative expenses decreased $20.0 million but remained relatively consistent as a percentage of net sales during the three months ended June 30, 2006 compared to the same period in 2005. The decrease in SG&A expenses was primarily due to a $13.7 million decrease in our provision for doubtful accounts compared to the same period in 2005. In addition, there were reductions in expenses across all entities due to expense controls. Days sales outstanding was 69 days at June 30, 2006 as compared to 109 days at June 30, 2005. The shorter days sales outstanding and resulting decrease in provision for doubtful accounts was the result of improved cash collections for the three months ended June 30, 2006 relative to the comparable period in 2005.

SG&A expenses were $166.8 million and $211.0 million in the six months ended June 30, 2006 and 2005, respectively. SG&A expenses as a percentage of net sales were 14% and 13% the six months ended June 30, 2006 and 2005, respectively. The decrease in SG&A expenses was primarily due to a $30.5 million decrease in our provision for doubtful accounts compared to the same period in 2005. In addition, there were reductions in expenses across all entities due to expense controls. Days sales outstanding was 72 days at June 30, 2006 as compared to 99 days at June 30, 2005. The shorter days sales outstanding and resulting decrease in provision for doubtful accounts was the result of improved cash collections in the three months ended June 30, 2006 relative to the comparable period in 2005.

Three and nine months ended September 30, 2006 and 2005

Selling, general and administrative expenses decreased $6.3 million during the three months ended September 30, 2006 compared to the same period in 2005. The decrease in SG&A expenses was primarily due to a $14.7 million decrease in our provision for doubtful accounts compared to the same period in 2005. Days sales outstanding was 64 days at September 30, 2006 as compared to 86 days at September 30, 2005. The shorter days sales outstanding and resulting decrease in provision for doubtful accounts was the result of improved cash collections in the three months ended September 30, 2006 relative to the comparable period in 2005. In addition, there were reductions in expenses due to expense controls. These cost savings were partially offset by a value added tax expense of $7.9 million resulting from an audit of our 2003 through 2005 tax years by China tax authorities.

SG&A expenses were $246.9 million and $297.4 million in the nine months ended September 30, 2006 and 2005, respectively. SG&A expenses as a percentage of net sales were 14% and 14% for the nine months ended September 30, 2006 and 2005, respectively. The decrease in SG&A expenses was primarily due to a $45.1 million decrease in our provision for doubtful accounts compared to the same period in 2005. Days sales outstanding was 69 days at September 30, 2006 as compared to 95 days at September 30, 2005. The shorter days sales outstanding and resulting decrease in provision for doubtful accounts was the result of improved cash collections in the nine months ended September 30, 2006 relative to the comparable period in 2005. In addition, there were reductions in expenses due to expense controls. These cost savings were partially offset by a value added tax expense of $7.9 million resulting from an audit of our 2003 through 2005 tax years by China tax authorities.

RESEARCH AND DEVELOPMENT

Three months ended March 31, 2006 and 2005

Research and development (R&D) expenses decreased by $19.4 million but increased by 1% as a percentage of net sales during the three months ended March 31, 2006 compared to the same period in 2005. The absolute decrease in R&D expenses can be attributed to a decrease in headcount of approximately 778 employees resulting from restructuring activities and the transfer of engineers as part of the sale of ACD. Personnel related expenses decreased by $4.7 million and facility and depreciation costs decreased by $5.6 million as a result of restructuring and write down of R&D equipment. Additionally, professional services decreased by $3.6 million due to a decreased use of consultants.

Three and six months ended June 30, 2006 and 2005

R&D expenses were $46.6 million, or 8% of net sales, in the three months ended June 30, 2006, compared to $65.7 million, or 9% of net sales, in the corresponding period of 2005. The decrease of $19.0 million in absolute dollars of R&D expenses can be primarily attributed to the decreased headcount of approximately 778 employees resulting from restructuring activities and the transfer of engineers as part of the sale of ACD. Personnel related expenses decreased by $5.5 million and facility and depreciation cost decreased by $6.2 million as a result of restructuring and write down of R&D equipment. Additionally, professional services costs decreased by $2.5 million due to a decreased use of consultants.

R&D expenses were $93.0 million and $131.5 million or 8% and 8% of net sales, in the six months ended June 30, 2006 and 2005, respectively. In absolute dollars, R&D expenses decreased by $38.5 million, primarily due to a decrease in facility and depreciation costs of $11.8 million as a result of restructuring and write-down of R&D equipment. Also, there was a decrease in personnel expenses, including payroll, payroll taxes and benefits totaling $10.2 million resulting from the decreased headcount as described above. In addition, the decrease in R&D expenses also can be attributed to decreased a professional costs of $6.0 million associated with decreased use of consultants.

Three and nine months ended September 30, 2006 and 2005

Research and development expenses were $46.3 million, or 8% of net sales, in the three months ended September 30, 2006, compared to $60.8 million, or 10% of net sales in the corresponding period of 2005. The decrease of $14.5 million in absolute dollars of R&D expenses can be primarily attributed to the decreased headcount of approximately 778 employees resulting from restructuring activities and the transfer of engineers as part of the sale of ACD. Personnel related expenses decreased by $3.9 million and equipment, facility and depreciation cost decreased by $8.5 million as a result of restructuring and write down of R&D equipment.

R&D expenses were $139.3 million and $192.3 million, or 8% and 9% of net sales, in the nine months ended September 30, 2006 and 2005, respectively. In absolute dollars, R&D expenses decreased by $53.0 million, primarily due to a decrease in equipment, facility and depreciation costs of $25.4 million as a result of restructuring and write-down of R&D equipment. Also, there was a decrease in personnel expenses, including payroll, payroll taxes and benefits totaling $14.1 million resulting from the decreased headcount as described above. In addition, the decrease in R&D expenses can be attributed in part to a $7.1 million cost savings resulting from a decreased use of consultants.

ASSET IMPAIRMENT

Three and nine months ended September 30, 2005

Due to the existence of impairment indicators in September 2005, it was determined that there were significant adverse changes in the business outlook which could indicate the carrying value of certain of our long-lived asset groups may not be recoverable and could indicate the fair value of our reporting units may be below their carrying value. We performed interim impairment tests on goodwill and certain other long lived assets. As a result of the impairment test, we recorded an impairment charge of long-lived assets of $218.1 million for the quarter ended September 30, 2005. This impairment charge consisted of $192.9 million of goodwill, $1.7 million of intangible assets and $23.5 million of property, plant and equipment.

RESTRUCTURING COSTS

Three and six months ended June 30, 2006 and 2005

In the second quarter of the fiscal year 2005, we announced and initiated a restructuring plan to rationalize our cost structure in response to the decline in demand for certain of our products. In addition, the restructuring plan was designed to allow us to reduce break-even revenues for each product line, align investments with key growth opportunities and facilitate the process of globalization.

During the three and six months ended June 30, 2005, we incurred approximately $15.1 million in operating expenses relating to the restructuring plan actions, primarily consisting of $7.6 million in severance payments, $7.5 million in asset impairments primarily related to the impairment of equipment and licenses associated with discontinued products. Included in the restructuring costs of $15.1 million are non-cash charges of $6.9 million in asset impairments. We made cash payments of $6.3 million for severance and other benefits, and $2.7 million of accrued expenses. As part of the restructuring plan, during the three and six months ended June 30, 2005 we recorded $5.6 million in inventory write-off which was associated with discontinued products. Restructuring expense related to the inventory write-off was included in cost of sales in the consolidated statements of operations.

Three and nine months ended September 30, 2005

During the three months ended September 30, 2005, the Company incurred approximately $3.4 million in expenses in relation to the restructuring plan actions, consisting of $2.1 million related to severance payments and $1.2 million in asset impairments primarily related to the write-off of equipment and licenses associated with discontinued products.

During the nine months ended September 30, 2005, the Company incurred approximately $18.5 million in operating expenses in relation to the restructuring plan actions, primarily consisting of $9.8 million related to severance payments and $8.7 million in asset impairments primarily related to the impairment of equipment and licenses associated with discontinued products. Included in the restructuring costs of $18.5 million are non-cash charges of $7.6 million in asset impairments. We made cash payments of $10.5 million for severance and other benefits, and $1.1 million of accrued expenses. As part of the restructuring plan, during the nine months ended September 30, 2005 we recorded $5.6 million in inventory write-off which is associated with discontinued products. Restructuring expense related to the inventory write-off was included in cost of sales in the consolidated statements of operations. As of the end of the third quarter of 2005 approximately 965 employees had been terminated or placed in workforce reduction programs.

GAIN ON EXTINGUISHMENT OF DEBT

Three and six months ended June 30, 2006 and 2005

Gain on extinguishment of debt, net of write-off of unamortized issuance expenses, was $11.1 million for the three and six months ended June 30, 2005. In June 2005, 1,482,000 shares of our common stock with a fair value of approximately $10.6 million and approximately $15.8 million in cash were exchanged for $38.0 million aggregate principal amount of our outstanding convertible subordinated notes due 2008. There was no extinguishment of debt during the six months ended June 30, 2006.

Three and nine months ended September 30, 2006 and 2005

Gain on extinguishment of debt, net of write-off of unamortized issuance expenses, was $20.3 million and $31.4 million for the three and nine months ended September 30, 2005, respectively. In June 2005, 1,482,000 shares of our common stock with a fair value of approximately $10.6 million and approximately $15.8 million in cash were exchanged for $38.0 million aggregate principal amount of our outstanding convertible subordinated notes due 2008. In the third quarter of 2005, we completed four additional exchanges wherein we exchanged a total of 3,506,100 shares of our common stock with a fair value of approximately $27.0 million and approximately $41.4 million in cash for $89.9 million aggregate principal amount of our notes. There was no extinguishment of debt during the nine months ended September 30, 2006.

OTHER INCOME (EXPENSE)

Three months ended March 31, 2006 and 2005

Net other income (expense) was income of $3.6 million and expense of $6.8 million for the three months ended March 31, 2006 and 2005, respectively. Net other income for the three months ended March 31, 2006 was primarily due to a $2.8 million gain on foreign currency revaluation and a $0.5 million financial subsidy from the local Chinese government. Net other expense for the three months ended March 31, 2005 was primarily due to a $7.8 million loss on foreign currency revaluation, offset by consumption tax refunds in Japan of $1.2 million and a $0.5 million financial subsidy from the local Chinese government.

Three and six months ended June 30, 2006 and 2005

Net other income was $6.9 million and net other expense was $2.2 million for the three months ended June 30, 2006 and 2005, respectively. Net other income for the three months ended June 30, 2006 primarily consisted of $2.9 million of currency exchange and $2.5 million for a gain on sales of assets. For the three months ended June 30, 2005, net other expense consisted of foreign exchange losses of $6.8 million, partially offset by a $4.8 million Japan consumption tax refund

Net other income was $10.5 million and net other expense was $9.1 million for the six months ended June 30, 2006 and 2005, respectively. Net other income for the six months ended June 30, 2006 primarily consisted of gains from foreign exchange of $5.7 million and a gain on the sale of an asset of $2.5 million. Net other expense for the six months ended June 30, 2005 primarily consisted of a foreign exchange loss of $14.6 million, partially offset by a $6.0 million consumption tax refund in Japan Yen-denominated sales and accounts receivable were significantly higher during the six months ended June 30, 2005 as compared to the same period in 2004. As such, we incurred a $14.6 million unrealized loss in foreign exchange due to the weakened Japanese Yen against the US dollar for the six months ended June 30, 2005.

Three and nine months ended September 30, 2006 and 2005

Net other income was $1.8 million and $7.4 million for the three months ended September 30, 2006 and 2005, respectively. Net other income for the three months ended September 30, 2006 primarily consisted of dividend income of $1.0 million. Net other income for the three months ended September 30, 2005 primarily consisted of foreign exchange gains of $7.3 million. The foreign exchange gains were primarily the result of gains for the company s China subsidiaries attributed to the appreciation of the Chinese Renminbi on US dollar denominated short-term debt and payables, offset by a loss attributed to the appreciation of the US dollar on Japanese Yen denominated cash and accounts receivable.

Net other income was $12.3 million for the nine months ended September 30, 2006 and net other expense was $1.7 million for the nine months ended September 30, 2005. Net other income for the nine months ended September 30, 2006 primarily consisted of gains from foreign exchange of $6.1 million, a $2.5 million gain on the sale of assets to Cellon and dividend income of $1.7 million. Net other income for the nine months ended September 30, 2005 primarily consisted of a $6.0 million consumption tax refund in Japan offset by a foreign exchange loss of $7.3 million.

INCOME TAX EXPENSE

Three months ended March 31, 2006 and 2005

Income tax expense was $2.8 million and $5.5 million for the three months ended March 31, 2006 and 2005, respectively. The Company s 2006 annual effective tax rate is estimated to be negative 14%. There are two primary reasons for the negative 14% effective tax rate. First, we have not provided any tax benefit on the forecasted current year losses incurred and tax credits generated in the United States and other countries, because management believes that it is more likely than not that the tax benefit associated with these losses will not be realized. Second, we continue to accrue tax expense in jurisdictions where we have been historically profitable. Estimates of the annual effective tax rate at the end of the interim periods are based on evaluations of possible future events and transactions and may be subject to subsequent refinement or revision.

Three and six months ended June 30, 2006 and 2005

Income tax expense was $4.7 million and $3.3 million for the three months ended June 30, 2006 and 2005, respectively. Our 2006 annual effective tax rate is estimated to be negative 17%. There are two primary reasons for the negative 17% effective tax rate. First, we have not provided any tax benefit on the forecasted current year losses incurred and tax credits generated in the United States and other countries, because management believes that it is more likely than not that the tax benefit associated with these losses will not be realized. Second, we continue to accrue tax expense in jurisdictions where we have been historically profitable. Estimates of the annual effective tax rate at the end of the interim periods are based on evaluations of possible future events and transactions and may be subject to subsequent refinement or revision.

Income tax expense was $7.5 million and $8.8 million for the six months ended June 30, 2006 and 2005, respectively. In the six months ended June 30, 2005, tax expense consisted of $9.0 million primarily relating to the valuation of our deferred tax assets in China.

Three and nine months ended September 30, 2006 and 2005

Income tax expense was $1.5 million and $125.2 million for the three months ended September 30, 2006 and 2005, respectively. There are two primary reasons why the Company has tax expense while the Company has pretax losses. First, we have not provided any tax benefit on the forecasted current year losses incurred and tax credits generated in the United States and other countries, because management believes that it is more likely than not that the tax benefit associated with these losses will not be realized. Second, we continue to accrue tax expense in jurisdictions where we have been historically profitable. Estimates of the annual effective tax rate at the end of the interim periods are based on evaluations of possible future events and transactions and may be subject to subsequent refinement or revision. As of September 30, 2005, we did not believe it was more likely than not that we would generate a sufficient level and proper mix of taxable income within the appropriate period to utilize all the deferred tax assets. As a result of the review undertaken at September 30, 2005, we have concluded that it was appropriate to establish a full valuation allowance for the net deferred tax assets which the cumulative losses weigh heavily in the overall assessment. Accordingly, we recorded a $116.6 million non-cash charge at September 30, 2005 in the United States and China.

Income tax expense was $9.0 million and $134.0 million for the nine months ended September 30, 2006 and 2005, respectively. In the nine months ended September 30, 2005 we recorded a $116.6 million non-cash charge to provide a full valuation allowance on our remaining net deferred tax assets at September 30, 2005 in the United States and China.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our financial condition and results of operations are based on certain critical accounting policies and estimates, which include judgments, estimates, and assumptions on the part of management. Estimates are based on historical experience, knowledge of economic and market factors and various other assumptions that management believes to be reasonable under the circumstances. Actual results may differ from those estimates. The following summary of critical accounting policies and estimates highlights those areas of significant judgment in the application of our accounting policies that affect our financial condition and results of operations.

Revenue Recognition

Revenues from sales of telecommunications equipment and handsets are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. If the payment due from the customer is not fixed or determinable due to extended payment terms, revenue is recognized as payments become due and payable by the customer, assuming all other criteria for revenue recognition are met. Any payments received prior to revenue recognition are recorded as customer advances. Normal payment terms differ for various reasons amongst different customer regions, depending upon common business practices for customers within a region. Billing to customers for shipping and handling are recorded as revenues and the associated costs are recorded as costs of revenues. Any expected losses on contracts are recognized when identified on an individual basis in accordance with the prevailing accounting guidance for the respective contract.

Sales may be generated from complex contractual arrangements that require significant revenue recognition judgments, particularly in the area of contracts with multiple deliverable elements (multiple element arrangements). Where multiple elements exist in an arrangement, the contract price is allocated to the different elements based upon and in proportion to verifiable objective evidence of the fair value of the various elements, as governed under Emerging Issues Task Force Issue (EITF) No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, and SEC Staff Accounting Bulletin No. 104, Revenue Recognition. Multiple element arrangements primarily involve the sale of equipment, installation, training and post-contract support. Revenue is recognized as each element is earned, namely upon installation and acceptance of equipment or delivery of handsets, provided that the fair value of the undelivered element(s) has been determined, the delivered element(s) has stand-alone value, there is no right of return on delivered element(s), and we are in control of the undelivered element(s). For arrangements that include service elements, including promotional support and installation, for which verifiable objective evidence of the fair value does not exist, revenue is deferred until such services are deemed complete, or until the time we can establish verifiable objective evidence of the fair value.

Final acceptance is required for revenue recognition when installation services are not considered perfunctory. Final acceptance indicates that the customer has fully accepted delivery of equipment and we are entitled to full payment. We do not recognize revenue before final acceptance is granted by the customer if acceptance is considered substantive to the transaction.

Where multiple elements exist in an arrangement that includes software, and the software is considered more than incidental to the equipment or services in the arrangement, software and software related elements are recognized under the provisions of Statement of Position 97-2, Software Revenue Recognition, as amended, and EITF No. 03-05, Applicability of SOP 97-2 to Non-software Deliverables

Containing More Than Incidental Software. We allocate revenues to each element of software arrangements based on vendor specific objective evidence (VSOE) of fair value. VSOE of fair value of each element is based on the price charged when the same element is sold separately. We use the residual method to recognize revenue when an arrangement includes one or more elements to be delivered at a future date and VSOE of the fair value of all the undelivered elements exists. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the contract price is recognized as revenue when all other revenue recognition criteria are met. If VSOE of fair value of one or more undelivered elements does not exist, all revenue for delivered and undelivered elements is deferred until delivery of all elements occurs or when VSOE of fair value of the undelivered elements can be established. In some cases we have agreed to give software upgrade rights on a when and if made available basis for equipment sold for no additional consideration and for an unspecified period which could extend over the term of the contract. This additional contract obligation is an element of post contract support. We have not established VSOE for such contract element. Accordingly, the revenues from such contracts are recognized ratably over the period during which the post contract support is expected to be provided. The expected period of support is generally the term of the contract. In some cases where there is no stated contractual term, revenue is recognized ratably over the estimated period of support. We review assumptions regarding the estimated post contract support periods on a regular basis. If we determine that it is necessary to revise our estimates of the support periods, the amount of revenue recognized over the life of the contract would not be affected. However, to the extent the new assumptions regarding the post contract support periods were different than original assumptions, the contract revenues would be recognized over the remaining expected period of support.

Contract accounting is utilized for contracts that include a requirement for significant software modification or customization; when utilized we generally account for such contracts using the completed contract method of accounting, whereby no revenue is recognized prior to the completion of the project, because for contracts involving unique requirements we are unable to make reasonably dependable estimates of its progress towards meeting contractual requirements. In the event estimated total project costs exceed estimated total project revenues, the entire estimated loss is charged to operations in the period in which the loss becomes probable and can be reasonably estimated. The complexity of the estimation process and judgments about internal and external factors including labor utilization, changes to specifications and testing requirements, time required for performance and resulting incurrence of contract penalties, and the performance of subcontractors affect the estimation process. During the year ended December 31, 2006, we recorded a $32.1 million loss on a fixed price contract.

We recognize revenue for system integration, installation and training upon completion of performance and if all other revenue recognition criteria are met. Other service revenue, principally related to maintenance and support contracts, is recognized ratably over the maintenance term. Revenues from services were less than 10% of revenues for all periods presented.

We also sell products through resellers. Revenue is generally recognized when the standard price protection period, which ranges from 30 to 90 days, has lapsed. If collectibility cannot be reasonably assured in a reseller arrangement, revenue is recognized upon sell through to the end customer and receipt of cash. There may be additional obligations in reseller arrangements such as inventory rotation, or stock exchange rights on the product. As such, revenue is recognized in accordance with Statement of Financial Accounting Standards (SFAS) No. 48, Revenue Recognition When Right of Return Exists. In most cases, we have developed reasonable estimates for stock exchanges based on historical experience with similar types of sales of similar products.

We have sales agreements with certain wireless customers that provide for a rebate of the selling price to such customers if the particular product is subsequently sold at a lower price to such customers or to a different customer. The rebate period extends for a relatively short period of time. Historically, the amounts of such rebates paid to customers have not been material. We estimate the amount of the rebate based upon the terms of each individual arrangement, historical experience and future expectations of price reductions and then records its estimate of the rebate amount at the time of the sale. We also enter into sales incentive programs, such as co-marketing arrangements, with certain wireless and handset customers. We record the incurred incentive as a reduction of revenue when the sales revenue is recognized.

The assessment of collectibility is also a factor in determining whether revenue should be recognized. We assess collectibility based on a number of factors, including payment history and the credit worthiness of the customer. We do not request collateral from our customers. In international sales, we may require letters of credit from our customers that can be drawn on demand if the customer defaults on its payment. If we determine that collection of a payment is not reasonably assured, we defer revenue recognition until collection becomes reasonably assured, which is generally upon receipt of cash.

Occasionally, we enter into revenue sharing arrangements. Under these arrangements, we collect payment only after our customer, the telecommunications service provider, collects service revenues. When we enter a revenue sharing arrangement, we do not recognize revenue until collection is reasonably assured.

Because of the nature of doing business in China and other emerging markets, our billings and/or customer payments may not correlate with the contractual payment terms and we generally do not enforce contractual payment terms prior to final acceptance. Accordingly, accounts receivable are not recorded until we recognize the related customer revenue. Advances from customers are recognized when we have collected cash from the customer, prior to recognizing revenue. Deferred revenue is recorded if there are undelivered elements after final acceptance has been obtained.

Stock-Based Compensation

Prior to January 1, 2006, we accounted for share-based payment awards under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and provided the required pro forma disclosures under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation. In accordance with APB 25, non-cash compensation expense was recognized for any options for which the exercise price was below the market price on the actual grant date, based on the difference between the exercise price and the market price. The expense was recognized ratably over the associated service period, which was generally the option vesting term.

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)), using the modified prospective transition method. Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in our Consolidated Statement of Operations for the year ended December 31, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. We have elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods for establishing the beginning balance of the additional paid-in-capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R).

Determining the appropriate fair value model and calculating the fair value of share-based payment awards require the input of subjective assumptions, including the expected term of the share-based payment awards and stock volatility. We estimate an expected term of options granted based upon our historical exercise and cancellation data for vested options. We use historical volatility as management believes it is more representative of future stock price trends than implied volatility due to the relatively small number of actively traded options on our common stock available to determine implied volatility. The assumptions used in calculating the fair value of share-based payment awards represent management s best estimates, but these estimates involve inherent uncertainties and compensation expense could be materially different in the future. Because changes in the subjective assumptions can materially affect the estimated value, in management s opinion, the existing valuation models may not provide an accurate measure of the fair value of our employee stock options. In addition, we are required to estimate the expected forfeiture rate and recognize expense only for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period. See Note 15, Common Stock and Stock Incentive Plans , of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report for a further discussion on stock-based compensation.

Product Warranty

We provide a warranty on our equipment and handset sales for a period generally ranging from one to three years from the time of final acceptance. Very rarely, we have entered into arrangements to provide limited warranty services for periods longer than three years. The longest such warranty period is ten years. We provide for the expected cost of product warranties at the time that revenue is recognized based on an assessment of past warranty experience and when specific circumstances dictate.

Variable Interest Entities

The Financial Accounting Standards Board, (FASB) issued FASB Interpretation No. 46(R), (FIN 46(R)). FIN 46(R) requires that if an entity is the primary beneficiary of a variable interest entity, (VIE), the assets, liabilities, and results of operations of the VIE should be included in the consolidated financial statements of the entity. We adopted FIN 46(R) in the quarter ended December 31, 2003, and consolidated one related party deemed a VIE and for whom we were the primary beneficiary during 2003 and 2004. During the fourth quarter of 2005, we sold our equity interest, terminated all material commercial arrangements, settled bank debt and determined that we are no longer the primary beneficiary. As a result, the assets and liabilities of the entity were not consolidated as of December 31, 2005. In 2005, we invested in two additional entities, each of which was considered a VIE and included the assets, liabilities and results of operations of these entities in the consolidated financial statements for 2005. In 2006, we disassociated from one of these VIEs and, as such, triggered a reconsideration event under FIN 46(R) resulting in a determination that we were no longer the primary beneficiary. For additional information regarding variable interest entities, see Note 22, Variable Interest Entities , of Notes to Consolidated Financial Statements in Item 8 of this Annual Report.

Receivables

Although we evaluate customer credit worthiness prior to a sale, we provide an allowance for doubtful accounts for the estimated loss on trade and notes receivable when collection may no longer be reasonably assured. We assess collectibility of receivables based a number of factors including analysis of creditworthiness, our ability to collect payment and on the length of time an individual receivable balance is outstanding. We believe that the accounting estimate related to the allowance for doubtful accounts is a critical accounting estimate because of the length of the collection cycle for our China based receivables and the material effect of this estimate on our results of operations.

Inventories

Inventories consist of product held at our manufacturing facility and warehouses, as well as finished goods at customer sites for which the customer has taken possession, but based on specific contractual terms, title has not yet passed to the customer. We may ship inventory to existing customers that require additional equipment to expand their existing networks prior to the signing of an expansion contract. Our inventories are stated at the lower of cost or market value, net of write-downs for excess, slow moving and obsolete inventory. Inventory is written down for estimated obsolescence or unmarketable inventory equal to the difference between inventory cost and the estimated market value. Write-downs are based on our assumptions about future market conditions and customer demand, including projected changes in average selling prices resulting from competitive pricing pressures. We continually monitor inventory valuation for potential losses and obsolete inventory at our manufacturing facilities as well as at customer sites.

Deferred costs

Deferred costs consist of product shipped to the customer for which the rights and obligations of ownership have passed to the customer, but revenue has not yet been recognized. Deferred costs also include the costs associated with third party integrators and freight. All deferred costs are stated at cost. We periodically assess the recoverability of deferred costs and provide reserves against deferred cost balances when recovery of deferred costs is not probable. Recoverability is evaluated based on various factors including the length of time product has been held at the customer site, the viability of payment, including assessment of product demand if a revenue sharing arrangement exists and/or the evaluation if a related transaction will result in a gross margin loss. In a loss situation for a transaction, the deferred cost balance is adjusted for an impairment equal to the value of the excess of cost over the amount of revenue that will be eventually recognized for the transaction. Revenue and cost of sales are recorded when final acceptance is received from the customer. With greater concentration of product at customer sites under contract with specific or individual customer, the financial conditions of any specific or individual customer may result in increased concentration risk exposure for our inventory.

For any post contract support services where the revenue is deferred, the entire related deferred direct costs are classified as a noncurrent asset, consistent with the definition of a current asset per Accounting Research Bulletin No. 43, Working Capital: Current Assets and Current Liabilities.

Research and Development and Capitalized Software Development Costs

Our research and development costs are charged to expense as incurred. We capitalize software development costs, incurred in the development of software that will ultimately be sold, between the time technological feasibility has been attained and the related product is ready for general release. Management judgment is required in assessing technological feasibility, expected future revenues, estimated product lives and changes in product technologies, and the ultimate recoverability of our capitalized software development costs.

Income Taxes

We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. We establish reserves for tax-related uncertainties based on estimates of whether, and the extent to which, additional taxes and interest will be due. These reserves are established when, despite our belief that our tax return positions are fully supportable, we believe that certain positions are likely to be challenged and may not be sustained on review by tax authorities. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest.

We recognize deferred income taxes as the difference between the tax bases of assets and liabilities and their financial statement amounts based on enacted tax rates. Management judgment is required in the assessment of the recoverability of our deferred tax assets based on our assessment of projected taxable income. Numerous factors could affect our results of operations in the future. If there was a significant decline in our future operating results, our assessment of the recoverability of our deferred tax assets would need to be revised, and any such adjustment to our deferred tax assets would be charged to income in that period. If necessary, we record a valuation allowance to reduce deferred tax assets to an amount management believes is more likely than not to be realized.

In 2006, due to recent developments in our business, we have made a determination that earnings from certain subsidiaries were not permanently reinvested outside the United States. We provide U.S. taxes on foreign undistributed earnings that are not considered to be permanently reinvested outside the United States. Under APB 23 Accounting for Income Taxes Special Areas, deferred income taxes must be provided on the unremitted earnings of foreign subsidiaries unless such earnings could be deemed to be permanently reinvested outside the United States. Prior to 2006, we had not provided for U.S. tax on any foreign unremitted earnings because we did not intend to repatriate such earnings. See Note 14.

Goodwill and Intangible Assets

We have recorded goodwill and intangible assets in connection with our business acquisitions. Management judgment is required in the assessment of the related useful lives, assumptions regarding our ability to successfully develop and ultimately commercialize acquired technology, and assumptions regarding the fair value and the recoverability of these assets. We perform our annual goodwill impairment review in the fourth quarter of each year or when changes in circumstances indicate a potential impairment exists. In the third quarter of 2005, we determined that such circumstances existed and performed an impairment review at the reporting unit level that resulted in an asset impairment charge. When assessing potential impairment to goodwill, we compare our book value to our fair market value. Fair market value is determined based on the present value of estimated future cash flows.

Long-Term Investments

We have invested directly in a number of private technology-based companies in the early stages of development and in publicly listed technology and real estate companies traded on securities exchanges. While quoted market prices are readily available to determine the fair value of our investments in these publicly traded companies, management judgment is required to determine when losses are other-than-temporary. Furthermore, management judgment is required in evaluating the carrying value of our private company investments for possible impairment. For our private technology company investments, we assess impairment based on an evaluation of the achievement of business objectives and milestones, the financial condition and prospects of these companies and other relevant factors. We continually monitor these investments for impairment, and charge to income any impairment amounts in the period such a determination is made. During 2006, we recorded a $13.5 million other-than-temporary impairment charge related to one of our investments.

RECENT ACCOUNTING PRONOUNCEMENTS

See Note 3, Summary of Significant Accounting Policies , of Notes to Consolidated Financial Statements contained in Item 8 of this Annual Report for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to the impact of interest rate changes, changes in foreign currency exchange rates and changes in the stock market.

Interest Rate Risk:

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The fair value of our investment portfolio would not be significantly affected by either a 10% increase or decrease in interest rates due mainly to the short term nature of most of our investment portfolio. However, our interest income can be sensitive to changes in the general level of U.S and China interest rates since the majority of our funds are invested in instruments with maturities of less than one year. Our policy is to limit the risk of principal loss and to ensure the safety of invested funds by generally attempting to limit market risk. Funds in excess of current operating requirements are mostly invested in government-backed notes, commercial paper, floating rate corporate bonds and fixed income corporate bonds. In accordance with our investment policy, all short-term investments are invested in investment grade rated securities with minimum A or better ratings. Currently, most of our short-term investments have AA or better ratings.

The table below represents carrying amounts and related weighted-average interest rates of our investment portfolio at December 31, 2006 and 2005:

	December 31, 2006		**2005**	
	(in thousands)			
Cash and cash equivalents	661,623		645,571	
Average interest rate	2.12	%	1.76	%
Restricted cash-short term	16,666		53,680	
Average interest rate	4.81	%	3.80	%
Short-term investments	9,546		13,266	
Average interest rate	1.91	%	1.44	%
Restricted cash long-term	16,469		331	
Average interest rate	4.95	%	3.83	%
Total investment securities	704,304		712,848	
Average interest rate	2.25	%	1.91	%

Equity Investment Risk:

Our investment portfolio includes equity investments in publicly traded companies, the values of which are subject to market price volatility. Economic events could adversely affect the public equities market and general economic conditions may continue to worsen. Should the fair value of our publicly traded equity investments decline below their cost basis in a manner deemed to be other-than-temporary, our earnings may be adversely affected. We have also invested in several privately held companies as well as investment funds which invest primarily in privately held companies, many of which can still be considered in the start-up or development stages. These investments are inherently risky, as the market for the technologies or products they have under development are typically in the early stages and may never materialize.

Debt Investment Risk:

At December 31, 2006 our debt investment portfolio consisted of a $1.0 million note receivable from BB Modem, an affiliate of SOFTBANK CORP., pursuant to a Mezzanine Loan Agreement we entered into with BB Modem on July 17, 2003. The note receivable was paid in full in January 2007.

Foreign Exchange Rate Risk:

We are exposed to foreign exchange rate risk because most of our sales in China are denominated in Renminbi and portions of our accounts receivable and payable are denominated in Japanese Yen. Due to the limitations on converting Renminbi, we are limited in our ability to engage in currency hedging activities in China. Fluctuations in currency exchange rates in the future could have a material adverse effect on our results of operations. The balance of cash and short-term investments held in China was $483.7 million at December 31, 2006. In July 2005, China uncoupled the Renminbi from the U.S. dollar and let it float in a narrow band against a basket of foreign currencies. The move revalued the Renminbi by 2.1% against the U.S. dollar. Additionally, during 2005 we made significant sales in both Japanese Yen and in Euros. We maintain Japanese yen bank accounts for purchasing portions of our inventories and supplies.

Our revenues, earnings and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. We may hedge currency exposures associated with certain assets and liabilities denominated in nonfunctional currencies and certain anticipated nonfunctional currency transactions using forward foreign currency exchange rate contracts. We have not hedged any such transactions, and due to the limitations on converting Renminbi, we are limited in our ability to engage in currency hedging activities in China. As a global concern, we face exposure to adverse movements in foreign currency exchange rates.

We have performed a sensitivity analysis as of December 31, 2006, using a modeling technique that measures the change in the fair values arising from a hypothetical 10% positive or adverse movement in the levels of foreign currency exchange rates relative to the functional currency with all other variables held constant. The analysis covers all of our underlying exposures for foreign currency denominated financial instruments. The foreign currency exchange rates used were based on market rates in effect at December 31, 2006. The sensitivity analysis indicated that a hypothetical 10% movement in foreign currency exchange rates would result in a gain or loss in the fair values of our foreign currency denominated financial instruments of $4.4 million at December 31, 2006.

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Consolidated Financial Statements and Financial Statement Schedules

All other schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of UTStarcom, Inc.:

We have completed integrated audits of UTStarcom, Inc. s consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

Consolidated financial statements and financial statement schedules

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of UTStarcom, Inc. and its subsidiaries as of December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedules are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and financial statement schedules based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As further described in Note 1 to the consolidated financial statements, the Company has $275 million principal amount of convertible notes maturing in March 2008 and certain credit facilities that will expire in November and December 2007. Management s plans in regard to these matters are also described in Note 1.

As discussed in Note 2 to the consolidated financial statements, the Company has restated its 2005 and 2004 consolidated financial statements.

As discussed in Note 3 to the consolidated financial statements, effective January 1, 2006, the Company changed its method of accounting for stock-based compensation.

Internal control over financial reporting

Also, we have audited management s assessment, included in Management s Annual Report on Internal Control Over Financial Reporting appearing under Item 9A, that UTStarcom, Inc. did not maintain effective internal control over financial reporting as of December 31, 2006, because the Company did not maintain an effective control environment, because (a) the Company did not maintain effective financial reporting processes, including sufficient formalized and consistent finance and accounting policies and procedures; nor did the Company prevent or detect instances of non-compliance with certain such policies and procedures that do exist, and (b) the Company failed to prevent or detect non compliance with established policies and procedures intended to ensure compliance with laws and regulations. The ineffective control environment also contributed to: (a) the Company s failure to prevent or detect instances of override related to controls in China over customer agreements, (b) the Company did not maintain effective controls at its U.S. headquarters over its accounting for inventory, including finished goods at customer sites, inventory reserves and deferred cost accounts and associated cost of sales,

(c) the Company did not maintain effective controls at its U.S. headquarters over its inventory reserves for losses on customer contracts and associated cost of sales, (d) the Company did not maintain effective controls at its U.S. headquarters over its accounting for warranty reserves and associated cost of sales, (e) the Company did not maintain effective controls over its accounting for and disclosure of stock-based compensation expense, and (f) the Company did not maintain effective controls at its U.S. headquarters over its process to ensure the complete, accurate and timely preparation and review of its consolidated financial statements in accordance with generally accepted accounting principles (GAAP), based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management s assessment and on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management s assessment as of December 31, 2006:

1. *The Company did not maintain an effective control environment.* Specifically, the following additional material weaknesses were identified within the control environment:

a) *The Company did not maintain effective financial reporting processes, including sufficient formalized and consistent finance and accounting policies and procedures; nor did the Company prevent or detect instances of non-compliance with certain such policies and procedures that do exist.* Specifically, the Company lacked formalized and current accounting and reporting policies and procedures across certain of its operating locations and various business cycles. These control deficiencies resulted in adjustments, including audit adjustments, to the consolidated financial statements for each of the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006 and for the year ended December 31, 2006 to correct certain accounts, as further described below.

b) *The Company failed to prevent or detect non compliance with established policies and procedures intended to ensure compliance with laws and regulations.* Specifically, this control deficiency may have permitted violations of certain Securities and Exchange Commission (SEC) regulations related to previous financial disclosures and the Foreign Corrupt Practices Act (FCPA), related to alleged potential payments made to government officials.

2. The material weakness in the Company s control environment contributed to the existence of the following control deficiencies, each of which is considered to be a material weakness:

a) *The Company failed to prevent or detect instances of override related to controls in China over customer agreements.* Specifically, this control deficiency permitted the override of established controls in China s western sales region, by allowing for the existence of undisclosed agreements with customers, which obligated the Company to provide products or perform certain services without the receipt of additional consideration. The existence of these agreements was not communicated to either the Company s financial reporting function or its independent registered public accounting firm. This control deficiency resulted in adjustments to restate revenue and deferred revenue accounts, cost of sales and deferred cost accounts, related income tax accounts, retained earnings, and related financial disclosures in the Company s consolidated financial statements for the years ended December 31, 2004 and 2005, each of the quarters in the year ended December 31, 2005, and for the first two quarters of the year ended December 31, 2006.

b) *The Company did not maintain effective controls at its U.S. headquarters over its accounting for inventory, including finished goods at customer sites, inventory reserves and deferred cost accounts and associated cost of sales.* Specifically, the Company s controls were not adequate to properly track and confirm inventory movements in the appropriate period, to ensure the proper classification of inventory and deferred costs (and associated accounts such as purchase price variance), and to ensure the completeness and accuracy of the recording of the cost of sales when revenue was recognized. These processes were not always performed correctly or timely, there was inadequate management review, and calculation and/or posting errors occurred. This control deficiency resulted in adjustments, including audit adjustments, to the consolidated financial statements for each of the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006 and for the year ended December 31, 2006 to correct cost of sales and the related inventory, finished goods at customer sites, inventory reserves and deferred costs accounts.

c) *The Company did not maintain effective controls at its U.S. headquarters over its inventory reserves for losses on customer contracts and associated cost of sales.* Specifically, the Company s controls were not designed, nor did they operate effectively, to adequately identify, document and analyze its inventory reserves for losses on customer contracts to ensure that all related costs were recorded in the appropriate period and that existing reserves were adequate. These processes were not always performed correctly or timely, there was inadequate management review, and calculation and/or posting errors occurred. This control deficiency resulted in adjustments, including audit adjustments, to the consolidated financial statements for each of the quarters ended June 30, 2006 and September 30, 2006 to correct inventory reserves for losses on customer contracts and the associated cost of sales.

d) *The Company did not maintain effective controls at its U.S. headquarters over its accounting for warranty reserves and associated cost of sales.* Specifically, the Company s controls failed to adequately identify, document and analyze required supporting information to ensure the completeness, accuracy, valuation and adequacy of its warranty reserves and to ensure all related costs were recorded in the appropriate period. These processes were not always performed correctly or timely, there was inadequate management review, and calculation and/or posting errors occurred. This control deficiency resulted in adjustments, including audit adjustments, to the consolidated financial statements for each of the quarters ended June 30, 2006 and September 30, 2006 and for the year ended December 31, 2006 to correct warranty reserves, which are included in other current liabilities, and the associated cost of sales.

e) *The Company did not maintain effective controls over its accounting for and disclosure of stock-based compensation expense.* Specifically, the Company did not maintain effective controls, including monitoring, to ensure the completeness, existence, valuation and presentation of stock-based compensation transactions related to the granting, pricing and accounting for certain of its stock-based compensation awards and the related financial reporting for these awards in accordance with GAAP. This control deficiency resulted in the misstatement of the stock-based compensation expense, additional paid-in capital accounts, related income tax accounts, retained earnings and related financial disclosures, and resulted in the restatement of the consolidated financial statements for the years ended December 31, 2004 and 2005, each of the quarters in the year ended December 31, 2005, and the first two quarters of the year ended December 31, 2006.

f) *The Company did not maintain effective controls at its U.S. headquarters over its process to ensure the complete, accurate and timely preparation and review of its consolidated financial statements in accordance with GAAP.* Specifically, the Company did not have effective controls over the process for identifying, accumulating and reviewing all required supporting information to ensure the completeness, accuracy and timely preparation and review of its consolidated financial statements and disclosures, including the statement of cash flows and segment reporting. This control deficiency resulted in adjustments, including audit adjustments, to the consolidated financial statements in each of the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006 and for the year ended December 31, 2006, and additional disclosures to these 2006 consolidated annual financial statements to correct the aforementioned accounts and disclosures.

Each of the material weaknesses described above could result in a misstatement of the Company s consolidated financial statements that would result in a material misstatement to the quarterly or annual consolidated financial statements that would not be prevented or detected. These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2006 consolidated financial statements, and our opinion regarding the effectiveness of the Company s internal control over financial reporting does not affect our opinion on those consolidated financial statements.

In our opinion, management s assessment that UTStarcom, Inc. did not maintain effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in *Internal Control Integrated Framework* issued by the COSO. Also, in our opinion, because of the effects of the material weaknesses described above on the achievement of the objectives of the control criteria, UTStarcom, Inc. has not maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control Integrated Framework* issued by the COSO.

PricewaterhouseCoopers LLP
San Jose, CA
October 10, 2007

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UTSTARCOM, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31, 2006	December 31, 2005 (As restated)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 661,623	$ 645,571
Short-term investments	9,546	13,266
Accounts receivable, net of allowances for doubtful accounts of $53,894 and $67,789	373,762	439,597
Accounts receivable, related parties, net of allowances for doubtful accounts of $19 and $5	32,318	83,367
Notes receivable	5,060	2,065
Inventories	440,445	425,955
Deferred costs	195,393	239,876
Prepaids and other current assets	101,795	99,062
Short-term restricted cash and investments	16,666	53,680
Total current assets	1,836,608	2,002,439
Property, plant and equipment, net	213,155	233,403
Long-term investments	47,809	26,023
Goodwill	3,063	3,063
Intangible assets, net	56,443	75,313
Long-term deferred costs	176,649	185,279
Other long-term assets	40,223	25,811
Total assets	$ 2,373,950	$ 2,551,331
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 304,869	$ 320,677
Short-term debt	102,758	198,826
Income taxes payable	2,483	34,229
Customer advances	265,812	221,301
Deferred revenue	95,742	101,912
Other current liabilities	271,400	291,368
Total current liabilities	1,043,064	1,168,313
Long-term deferred revenue	261,014	273,131
Long-term debt	275,161	274,900
Other long-term liabilities	13,858	
Total liabilities	1,593,097	1,716,344
Commitments and contingencies (Note 17)		
Minority interest in consolidated subsidiaries	6,493	8,338
Stockholders equity:		
Common stock: $0.00125 par value; 750,000,000 authorized shares; 121,299,113 issued and 121,294,645 outstanding at December 31, 2006; 121,018,036 issued and outstanding at December 31, 2005	152	152
Additional paid-in capital	1,205,592	1,192,201
Deferred stock-based compensation		(3,591)
Accumulated deficit	(494,244)	(376,899)
Accumulated other comprehensive income	62,899	14,786
Treasury stock: 4,468 shares held in treasury at December 31, 2006	(39)	
Total stockholders equity	774,360	826,649
Total liabilities, minority interest and stockholders equity	$ 2,373,950	$ 2,551,331

See accompanying notes to the consolidated financial statements.

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UTSTARCOM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Year ended December 31, 2006	2005 (As restated)	2004 (As restated)
Net sales			
Unrelated party	$ 2,326,478	$ 2,395,298	$ 2,434,742
Related party	132,383	475,812	144,673
	2,458,861	2,871,110	2,579,415
Cost of net sales			
Unrelated party	1,988,702	2,187,139	1,918,474
Related party	84,415	248,135	91,409
Gross profit	385,744	435,836	569,532
Operating expenses (income):			
Selling, general and administrative	334,455	371,461	303,911
Research and development	182,869	246,813	219,079
Amortization of intangible assets	18,871	25,853	15,551
Gain on sale of semiconductor design assets	(12,291)		
Impairment of long-lived assets		218,094	12,706
Restructuring		29,669	
In-process research and development		660	1,400
Total net operating expenses	523,904	892,550	552,647
Operating (loss) income	(138,160)	(456,714)	16,885
Interest income	14,829	7,091	6,172
Interest expense	(11,688)	(16,764)	(6,916)
Gain on extinguishment of subordinated notes		31,392	
Other income, net	1,092	43,665	15,431
(Loss) income before income taxes, minority interest and equity in loss of affiliated companies	(133,927)	(391,330)	31,572
Income tax benefit (expense)	15,024	(136,544)	20,292
Minority interest in losses of consolidated subsidiaries	1,558	692	285
Equity in loss of affiliated companies		(5,463)	(1,300)
Net (loss) income	$ (117,345)	$ (532,645)	$ 50,849
(Loss) earnings per share Basic	$ (0.97)	$ (4.55)	$ 0.45
(Loss) earnings per share Diluted	$ (0.97)	$ (4.55)	$ 0.40
Weighted average shares used in per-share calculation:			
Basic	120,657	117,034	114,135
Diluted	120,657	117,034	134,820

See accompanying notes to the consolidated financial statements.

UTSTARCOM, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(In thousands, except share data)

	Common Stock Shares	Amount	Additional Paid-in-Capital	Deferred Stock-based Compensation	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Treasury Stock Shares	Amount	Total Stockholders Equity	Comprehensive Income
Balance at December 31, 2003, as previously reported	**104,272,477**	**$ 131**	**$ 654,483**	**$ (7,761)**	**$ 237,382**	**$ 3,420**		**$**	**$ 887,655**	
Cumulative effect of adjustments to date	282,878		31,641	(5,669)	(59,464)				**(33,492)**	
Balance at December 31, 2003, as restated	**104,555,355**	**$ 131**	**$ 686,124**	**$ (13,430)**	**$ 177,918**	**$ 3,420**		**$**	**$ 854,163**	
Common stock issued upon exercise of options	1,191,877	2	18,525						**18,527**	
Common stock issued upon ESPP purchases	445,844		7,130						**7,130**	
Common stock issued upon secondary offering, net of expenses	12,100,000	15	474,539						**474,554**	
Common stock issued upon exercise of warrants	32,000		80						**80**	
Repurchase Plan, including fees	(3,555,566)	(4)	(34,544)		(73,021)				**(107,569)**	
Stock-based compensation, as restated			(5,204)	5,313					**109**	
Cancellation of deferred compensation charges due to employee terminations			(1,140)	1,140						
Tax benefits for non-qualified stock option exercises, as restated			3,657						**3,657**	
Net income, as restated					50,849				**50,849**	**50,849**
Other comprehensive income:										
Unrealized holding loss (net of tax of $516)						(1,351)			**(1,351)**	**(1,351)**
Translation adjustment						2,744			**2,744**	**2,744**
Total comprehensive income										**52,242**
Balance at December 31, 2004, as restated	**114,769,510**	**144**	**1,149,167**	**(6,977)**	**155,746**	**4,813**			**1,302,893**	
Common stock issued upon exercise of options	198,450	1	1,190						**1,191**	
Common stock issued upon ESPP purchases	911,976	1	5,760						**5,761**	
Comon stock issued upon debt extinguishment	4,988,100	6	37,562						**37,568**	
Common stock issued upon settlement of stock hedge			1,446						**1,446**	
Stock-based compensation, as restated			(2,067)	2,930					**863**	
Cancellation of deferred compensation charges due to employee terminations			(456)	456						
Restricted stock compensation	150,000		106						**106**	
Tax detriment for non-qualified stock option exercises			(507)						**(507)**	
Net loss, as restated					(532,645)				**(532,645)**	**(532,645)**
Other comprehensive income:										
Unrealized holding loss (net of tax of $11)						(30)			**(30)**	**(30)**
Translation adjustment						10,003			**10,003**	**10,003**
Total comprehensive loss										**(522,672)**
Balance at December 31, 2005, as restated	**121,018,036**	**152**	**1,192,201**	**(3,591)**	**(376,899)**	**14,786**			**826,649**	
Common stock issued upon exercise of options	106,193		390						**390**	

Elimination of deferred stock-based compensation upon adoption of SFAS No. 123(R)			(3,591)	3,591						
Stock-based compensation			16,647						**16,647**	
Reversal of stock-based compensation due to forfeitures upon disposal of business unit			(2,393)						**(2,393)**	
Restricted stock granted and amortization	174,884		2,338						**2,338**	
Purchase of treasury shares							(4,468)	(39)	**(39)**	
Net loss					(117,345)				**(117,345)**	**(117,345)**
Other comprehensive income:										
Unrealized holding gain (net of tax of $0)						32,662			**32,662**	**32,662**
Translation adjustment						15,451			**15,451**	**15,451**
Total comprehensive loss										**(69,232)**
Balance at December 31, 2006	**121,299,113**	**152**	**1,205,592**		**(494,244)**	**62,899**	**(4,468)**	**(39)**	**774,360**	

See accompanying notes to the consolidated financial statements.

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UTSTARCOM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year ended December 31 2006	2005 (As restated)	2004 (As restated)
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net (loss) income	$ (117,345)	$ (532,645)	$ 50,849
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:			
Depreciation and amortization	68,039	98,550	76,203
Gain on sale of semiconductor design assets	(12,291)		
Net loss on sale of assets	2,715	2,559	2,201
Impairment of long-lived assets		218,094	12,706
Impairment of long-term investments	13,500		
Stock-based compensation expense	16,592	863	109
Non-cash settlement of restructuring charges		17,250	
In-process research and development		660	1,400
Gain on sale of investment		(46,576)	(1,912)
Provision (recovery) for doubtful accounts	(9,347)	18,210	21,284
Provision for deferred costs	2,730	12,868	18,277
Gain on extinguishment of subordinated notes		(31,392)	
Deferred income taxes	(1,223)	190,658	(127,472)
Other	(36)	15,897	4,909
Changes in operating assets and liabilities:			
Accounts receivable	133,052	268,167	(453,862)
Inventories	(5,571)	165,923	(175,881)
Deferred costs	52,478	(49,376)	207,404
Other assets	(7,490)	95,802	(16,273)
Accounts payable	(22,296)	(87,811)	97,689
Income taxes payable	(28,946)	(110,209)	133,509
Customer advances	38,423	(150,313)	(116,917)
Deferred revenue	(29,328)	80,676	126,841
Other current liabilities	(27,577)	40,528	43,931
Net cash provided by (used in) operating activities	66,079	218,383	(95,005)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, plant and equipment	(26,274)	(64,396)	(135,575)
Proceeds from sale of semiconductor design assets	35,965		
Proceeds from disposition of investment interest	775		
Investment in affiliates	(302)	(3,550)	(19,292)
Purchase of businesses, net of cash acquired		(24,326)	(217,751)
Purchase of intangible assets	(658)	(750)	(4,158)
Change in restricted cash and long-term investments	20,882	(18,418)	(8,943)
Purchase of short-term investments	(42,400)	(165,284)	(319,253)
Proceeds from sale of short-term investments	46,428	346,966	236,497
Other	1,649	(105)	428
Net cash provided by (used in) investing activities	36,065	70,137	(468,047)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Issuance of stock, net of expenses	390	6,952	25,737
Proceeds from borrowings	100,629	436,678	390,000
Payments on borrowings	(200,742)	(653,123)	(40,000)
Repurchase of stock	(39)		(107,569)
Proceeds from equity offering			474,554
Other	253	6,689	
Net cash provided by (used in) financing activities	(99,509)	(202,804)	742,722
Effect of exchange rate changes on cash and cash equivalents	13,417	(2,677)	5,115
Net increase in cash and cash equivalents	16,052	83,039	184,785
Cash and cash equivalents at beginning of year	645,571	562,532	377,747
Cash and cash equivalents at end of year	$ 661,623	$ 645,571	$ 562,532
Supplemental disclosure of cash flow information:			
Cash paid:			
Interest	$ 9,773	$ 14,197	$ 5,074
Income taxes	$ 13,574	$ 11,265	$ 11,177
Non-cash operating activities			
Accounts receivable transferred to notes receivable	$ 22,921	$ 55,065	$ 118,021
Property, plant and equipment exchanged for long-term investment	$ 5,500	$	$
Non-cash financing activities			

Common stock issued in conjunction with debt extinguishment	$	$ 37,568	$

See accompanying notes to the consolidated financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 DESCRIPTION OF BUSINESS AND LIQUIDITY

UTStarcom Inc. (Company), a Delaware corporation incorporated in 1991 with headquarters in Alameda, California, designs, manufactures and sells telecommunications infrastructure and customer premises equipment and wireless telephone handsets to telecommunications service providers or operators throughout the world. It also provides telecommunications infrastructure installation, operations, and maintenance services. The Company enables its customers to rapidly deploy revenue-generating access services using their existing infrastructure, while providing a migration path to cost-efficient end-to-end IP networks

The Company reported net losses in each quarter in the period beginning April 1, 2005 and continuing through December 31, 2006, which has resulted in an accumulated deficit of $494.2 million and total stockholders equity being reduced to $774.4 million at December 31, 2006. Additionally, at December 31, 2006, the Company had short-term debt in China under its lines of credit of $102.5 million maturing in 2007 and long-term debt outside of China in the form of its 7⁄8% convertible subordinated notes with a principal balance of $274.6 million that matures in March 2008. Subsequent to December 31, 2006, the Company and the holders of the convertible subordinated notes entered into two agreements to prevent covenant defaults occurring from the Company s inability to timely file required periodic reports containing financial statements with the SEC; the first agreement increased the interest rate on the convertible subordinated notes from 7⁄8% to 7.625% effective as of January 9, 2007 and the second agreement increased the interest rate to 10.875% effective as of July 26, 2007. For additional information concerning the Company s Supplemental Indentures see Note 23.

The Company s cash and short-term investments aggregated $671.2 million (of which $483.7 million are held in China) at December 31, 2006.

Credit facilities in China at December 31, 2006 totaled $698.3 million, with $357.5 million of this amount available for working capital purposes, of which the Company had drawn $102.5 million in outstanding borrowings, and $340.8 million was available for use in support of letters of credit and corporate guarantees. These facilities expire primarily in November and December of 2007, and the Company believes that based upon its recent financial performance and financial position its lenders may reduce the total available credit when it negotiates renewals of these lines. Furthermore, each borrowing under the credit facilities is subject to the bank s current favorable opinion of the credit worthiness of the Company s China subsidiaries, as well as the bank having funds available for lending and other Chinese banking regulations. However, the Company believes the amounts of credit its lenders may make available and the borrowings made under the renewed lines of credit will be sufficient to meet planned uses of these credit facilities.

To meet liquidity needs outside of China, the Company s subsidiaries in China have the ability to transfer cash to the Company under China s current exchange control regulations. The amount of cash available for transfer from the Company s China subsidiaries is limited both by the Company s liquidity needs in China and by Chinese government requirements that the China subsidiaries retain adequate capital levels in China to protect creditors and to have funds available for mandated employee benefits. The Company believed the China subsidiaries could freely transfer at least $200 million to the Company as of December 31, 2006, and during the nine months ended September 30, 2007 its China subsidiaries have made such transfers totaling $150 million.

Although management believes the Company has a sufficient amount of cash resources to finance the Company s anticipated working capital and capital expenditure requirements for the next 12 months, the Company does not have enough cash outside of China to repay the convertible notes due on

March 1, 2008. Management s liquidity plans include a partial or complete refinancing of the convertible notes, renewal of the lines of credit in China, transfers of more cash from its subsidiaries in China to the extent necessary, and, if needed, liquidation of certain investments and/or seeking new financing arrangements. The Company s ability to maintain sufficient liquidity is also dependent on achieving projected sales and operating margin forecasts.

If additional sources of liquidity were needed, the Company would consider new debt or equity offerings or obtaining cash from asset sales, but there is no assurance that such transactions could be consummated on acceptable terms or at all. Failure to raise sufficient capital when needed could have a material adverse effect on the business, results of operations and financial position of the Company.

NOTE 2 RESTATEMENT OF FINANCIAL STATEMENTS

The consolidated balance sheet at December 31, 2005 and consolidated statements of operations, stockholders equity and cash flows for the years ended December 31, 2004 and 2005 included herein have been restated from the amounts previously reported. The reasons for the restatement are discussed below.

China Sales Investigation

The Audit Committee of the Company s Board of Directors (Audit Committee) engaged independent counsel to conduct an investigation of sales in China following a determination by the Internal Audit group that allegations of improper activities in a sales office in the Western Region were credible. The allegations were made by a Company employee using the Company s whistle blower program. The independent counsel engaged forensic accountants, and this group is collectively referred to as the Investigating Team in the rest of this discussion.

In conducting its procedures, the Investigating Team found instances where the customer contracts that evidenced the arrangement contained obligations for the Company to deliver software upgrades when and if made available for the equipment sold for no additional consideration and for an unspecified period that could extend over the term of the contract. This additional contract obligation is an element of post contract support. In these cases, the Investigating Team found that the contract documentation for the same transaction submitted by the sales office to the Company s China headquarters for accounting purposes and utilized by the Company in determining the amount of revenue recognized did not include evidence of such post contract support obligations.

Accounting standards governing revenue recognition for system sales require all revenue to be deferred while there are undelivered elements under the arrangement unless the seller has established vendor specific objective evidence (VSOE) of fair value for such contract elements. Because these arrangements included such undelivered elements, revenue should be deferred based on the VSOE of the fair value of the underlying elements. VSOE of fair value represents the price charged when the same element is sold separately. Since the Company does not sell this element separately, it has not established VSOE for such undelivered elements, and as such the revenue from such contracts is required to be deferred and recognized over the period the Company is obligated to provide the post contract support.

Upon completion of the investigative phase of the independent investigation by the Audit Committee, management:

- conducted follow-up procedures to attempt to locate any additional relevant information to ensure the Company considered all available information and documents;

- evaluated the accounting for identified system sales using the contract template and documentation found in the sales contract files from the Western Region offices. This included calculating the financial statement effects of correcting the accounting for all system sales where the contract

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template found at the sales offices contained post contract support obligations to recognize revenue and cost of net sales over estimated period of post contract support;

- concluded that as a result of this undelivered post contract support obligation the Company s previously issued financial statements should be restated to defer system sales contract revenue and the related cost of net sales over the estimated period of post contract support when a contract contained unspecified software upgrade rights.

The Audit Committee concurred with management s decisions.

The effect of correcting improperly recognized revenue and cost of net sales is to (reduce) increase previously reported net sales, gross profit and net income by the following amounts (in thousands of dollars):

Year ended December 31,	Net sales	Gross profit	Net income
2000	$ (12,408)	$ (5,294)	$ (4,781)
2001	(17,154)	(6,330)	(5,779)
2002	(64,732)	(22,924)	(19,697)
2003	(21,060)	(8,014)	(6,382)
Totals through December 31, 2003	(115,354)	(42,562)	(36,639)
2004	(104,965)	(27,241)	(18,594)
2005	(58,232)	(27,863)	(42,433)
2000 - 2005 Total	$ (278,551)	$ (97,666)	$ (97,666)

In the consolidated balance sheets at December 31, 2005 and 2006, the net reduction in previously recognized net sales is accounted for as deferred revenue, of which $32.9 million and $35.6 million, respectively, is classified as current, $252.1 million and $240.1 million, respectively, as non-current, and the related net reduction in cost of net sales of $185.3 million and $176.6 million, respectively, is accounted for as deferred costs. These amounts will be recognized in the Company s consolidated statements of operations over the estimated remaining period of post contract support.

Audit Committee Findings

Upon completing its investigation, the Audit Committee concluded that the conditions and practices relating to systems contracts prevalent in the Western Region resulted primarily from the failure to prevent or detect instances of override related to controls in China over customer agreements, lack of proper management oversight, unclear record retention policies and procedures relating to systems contracts, and inadequate employee training. The Investigating Team and the Audit Committee also concluded that with respect to four regions other than the Western Region there was no evidence of fraud or misconduct or reason to suspect such occurred. The Investigating Team and the Audit Committee also concluded that there was no credible evidence of knowledge by senior management in China or the United States of the conditions and practices related to the Western Region of China that were discovered in the investigation. The Audit Committee concluded that local management in several of the sales offices in the Western Region of China did not submit appropriate information to the Company s senior management in China and the United States. Therefore, in prior years, neither the Company s management nor the Company s independent registered accounting firm were able to properly evaluate the effect of that information on revenue recognition. The Audit Committee also concluded that certain members of management in China bear varying degrees of responsibility for inadequate oversight of activities. As a result, certain employees in China have either been terminated or placed on suspension for failure to provide adequate oversight of activities.

Governance Committee Review of Historical Stock Option Accounting

In November 2006 the Company announced it had commenced a voluntary review of historical stock option practices under the leadership of the Nominating and Corporate Governance Committee of the Company s Board of Directors (Governance Committee) following a preliminary review by management which identified potential deficiencies and discrepancies in the documentation of stock option grants. The review considered all option grant awards made in the period from February 29, 2000, shortly before the initial public offering of the Company s Common Stock, through August 2006 (Review Period) for compliance with the various stock-based compensation accounting standards applicable during the Review Period, the rules of the Company s stock option plans, and the guidance on stock option accounting issued by the SEC in the September 19, 2006 letter which was to be considered applicable to periods prior as well as subsequent to its issuance. At the time the review commenced, the Governance Committee consisted of three members of the Board of Directors, all of whom are independent directors. Mr. Allen Lenzmeier was appointed to the Governance Committee on April 27, 2007. The Governance Committee engaged independent outside legal counsel to assist in the review who, in turn, engaged forensic accounting experts (collectively referred to herein as the Review Team).

The Review Team, management, and the Governance Committee decided to group stock option grants into six award categories based on differences in what constituted substantive approval for each category under the Company s stock option granting practices as well as giving consideration to the risk of intentional misstatement of the grant date. Guidance in the September 19, 2006 letter on determining the date when substantive approval of a stock option grant occurs recognizes that depending on a company s facts and circumstances a company may determine that the measurement date for some stock option grants may occur before all required granting actions have occurred such as final approval by the Compensation Committee. This alternative is available only when a review of all facts and circumstances supports a conclusion that substantive approval occurs earlier than when all required granting actions have occurred and there is no evidence of fraudulent or manipulative conduct in the company s option granting practices.

In determining the measurement date to be used, the Review Team, management, and the Governance Committee agreed to use the following definitions as constituting the proper measurement date, and generally these dates were used in testing the stated grant dates or establishing corrected measurement dates:

Discretionary Director and Officer Grants	The date of a Compensation Committee meeting where the grant was approved or the date the final Compensation Committee signer approved the grant when approval occurred through unanimous written consent documents (UWC).
Automatic Director Grants	The date specified in the relevant stock option plan.
Broadbase	The date the grantee list, including the allocation of shares to individual grantees, was complete. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
Acquisition	The first Compensation Committee meeting following the acquisition, provided grantees had received employment offer letters stating the number of stock options to be granted before such date because this was the date at which the option exercise price was established. Compensation Committee approval was considered perfunctory due to delegation of authority to management.

New Hire	The first scheduled Compensation Committee meeting following the first day of employment because this was the date at which the option exercise price was established. The number of options was based on either grant amounts specified in an employment offer letter or, in some cases, on a matrix that assigned grant amounts based on position and level within the Company. Compensation Committee approval was considered perfunctory due to delegation of authority to management.
Other Merit	The date the grantee list, including the allocation of shares to grantees, was substantially complete. Compensation Committee approval was considered perfunctory due to delegation of authority to management.

During the Review Period, the Company granted stock options on approximately 34 million shares of the Company s common stock at 197 grant dates. The review specifically examined the appropriateness of the stated grant date for approximately 90% of the stock options granted, including all stock option grants made to directors and officers, all broadbase options and all option grants made in connection with business acquisitions. The review included an extensive examination of the Company s historical stock option practices including information from stock option administration, human resource, legal, and accounting department files and records as well as from e-mail communications, an electronic database of the Company s stock option activity maintained by a third party, and information stored in Company hard drives and back-up tapes. The Review Team also conducted interviews of individuals involved with the granting, advising, administering, or accounting for stock options, including current and former: management, members of the Board of Directors, employees, and non-employee professionals.

The findings of this review are summarized as follows:

				Measurement date changed	
Grant Type	**Number of grants**	**Grants tested**	**No change required**	**additional compensation expense required**	**no additional compensation expense required(1)**
Discretionary Director & Officer	16	16	8	4	4
Automatic Director	5	5	5		
Broadbase	8	8		6	2
Acquisition	10	10	10		
New Hire	166	48	48		
Other Merit	96	41	4	21	16
Total	301 (2)	128	75	31	22

(1) Under APB 25 there is no expense adjustment arising from using the corrected measurement date for these grants because the amount the employee would have to pay to exercise these stock option grants exceeded the quoted market price of the Company s Common Stock at the corrected measurement date, and therefore, these stock option grants contained no intrinsic value at the corrected measurement date.

(2) The number of grants exceeds the number of grant dates because on certain grant dates more than one category of stock option grants were approved.

A non-cash compensation charge, to be recognized as an expense over a grantee s service period, arises under Accounting Principles Board Opinion No. 25 *Accounting for Stock Issued to Employees* (APB 25), the accounting standard governing the Company s stock option accounting through 2005, if a stock option has intrinsic value at its measurement date. This intrinsic value is measured by the excess, if any, of the fair value at the date of grant of the underlying common stock over the stock option s exercise price. The Company s practice has been to grant stock options with exercise prices equal to the closing price of the underlying Company common stock at each grant date, to use the grant date as the measurement date for stock-based compensation purposes, and as such previously the Company had determined the granted stock options had no intrinsic value at their grant dates and no compensation expense was recognized. However, APB 25 states the measurement date does not occur until all essential actions necessary to grant the option are completed, including the final determination of both the number of shares to be granted to each employee or director and the exercise price, and the option grant is approved by those with requisite authority. A September 19, 2006 letter publicly issued by the SEC s Chief Accountant focused companies registered with the SEC on the need for the number of shares and exercise price of an award to an individual to be finalized to have a measurement date. This letter clarifies the SEC staff s view that if it is possible that those terms could change, a measurement date has not occurred, even if the award s terms are not actually changed.

Based on available evidence, the review found that the number of shares an individual employee was entitled to receive and/or the exercise price for stock option grants was not determined with finality at the stated grant date at 53 tested grant dates, and the Company should have used a later date as the measurement date. The principal reasons for the stated grant date not qualifying as the measurement date under APB 25 include:

- certain listings of grantees, below officer level, were incomplete and added to or modified by stock option administration personnel after the grant was approved by the Compensation Committee;

- for certain grants where Compensation Committee approval was not considered perfunctory, the date a UWC document was sent to Compensation Committee members for approval was used as the stated grant date for some discretionary officer and director grants rather than the date the UWC was signed by all Compensation Committee members and therefore became effective;

- the Stock Option Review Team was unable to locate contemporaneous documentation of some director and officer, broadbase, new hire, and other merit grants.

A total of 17.9 million stock options were granted at the 53 tested grant dates during 2000 through 2005 where the Governance Committee s review found the Company used incorrect measurement dates. Using the corrected measurement dates, 10.3 million stock options had intrinsic value because their exercise prices were below the closing price of the Company s Common Stock at the corrected measurement date, and 7.6 million stock options had exercise prices that exceeded the closing price of the Company s Common Stock and therefore had no intrinsic value to be accounted for under APB 25. These 10.3 million stock options resulted in an increase in non-cash stock-based compensation expense of $24.3 million during 2000 to 2005. Of the 10.3 million stock options resulting in additional non-cash stock-based compensations expense, 2.0 million options were granted to officers and directors and resulted in $6.1 million of additional non-cash stock-based compensation expense.

In some cases, in correcting the measurement date for previously granted stock options additional taxable income to employees arises on which additional payroll taxes are due from the employee as well as the Company. The Company has assumed responsibility for all additional payroll taxes plus related penalties and interest arising from the restatement of stock-based compensation, including amounts otherwise payable by stock option recipients, and the Company s restated financial statements include a $1.5 million accrual for this estimated expense.

Because the holders of stock options where corrections were made to the measurement dates were not aware that improper measurement dates were used, the Company has taken certain actions and is contemplating taking additional actions to deal with the adverse personal income tax consequences that may be incurred by the holders of stock options with corrected measurement dates. Adverse personal income tax consequences arise from the exercise of stock options vesting after December 31, 2004 where the corrected measurement dates cause them to have an exercise price below the fair market value of Company s common stock at the measurement date (409A Affected Options). Such an exercise would subject the option holder to a penalty tax under IRC Section 409A (and, as applicable, similar penalty taxes under California and other state tax laws). The Company has evaluated its stock option exercises through December 31, 2006 and determined there were no exercises of 409A Affected Options; accordingly, no penalty tax has been incurred by employees exercising stock options through that date.

The Company is considering how to deal with exercises of 409A Affected Options that occur in 2007 and beyond. One alternative would be to offer to amend all 409A Affected Options to change the exercise price to the fair market price of the Company s common stock on the corrected measurement date. These amended options would not be subject to taxation under IRC Section 409A. Under IRS regulations, option amendments had to be completed by December 31, 2006 for anyone who was an executive officer or member of the Board of Directors when he or she received 409A Affected Options. Therefore, prior to December 31, 2006 eight of the Company s current and former executive officers and directors executed an irrevocable Protective Amendment Election Form whereby any of their stock options will be automatically amended to restate the exercise price to the fair market value of the Company s common stock at the corrected measurement date if in the future such stock options would otherwise be determined to be 409A Affected Options. A similar offer to amend all 409A Affected Options held by non-officer employees is currently under consideration, but no decision has been reached and such an offer cannot be made until the Company is current with its SEC reporting obligations.

During the review the Company also discovered a stock option grant to a former officer that was modified in 1998 in connection with his termination of employment that should have resulted in additional compensation expense. This change was never included in the Company s stock option grant records and the additional compensation expense resulting from the change in the option s terms (approximately $1.2 million) was not recorded previously. This discovery is consistent with the Review Team s finding that in certain instances there was a lack of formal documentation in the stock option granting process and/or expected documentation is missing from the stock option administration files. In addition, the Review Team found that, in many instances, there was a lack of self-authenticating evidence to corroborate that cash exercises were contemporaneous. As a result, the findings on the issue of backdating of cash exercises were inconclusive.

The Company s accounting for stock-based compensation changed to a fair value method in 2006 when, as required by accounting standards, it ceased accounting for stock-based compensation under the intrinsic value method pursuant to APB 25 and began accounting for stock-based compensation pursuant to Statement of Financial Accounting Standards 123(R) Share-Based Payments (SFAS 123(R)). Under this method all stock option grants have a fair value determined using an option pricing model, and such fair value is used to recognize non-cash stock-based compensation expense. The Company recognizes stock compensation expense on a straight-line basis under SFAS 123(R).

The table below shows the effects of correcting the consolidated financial statements for the Governance Committee s findings and the modification in 1998 of a stock option grant to a former officer in connection with his termination of employment. Consistent with its historical accounting policy, this additional stock-based compensation expense is being recognized on an accelerated basis by treating each vesting tranche as a separate stock option grant (graded vesting). Additionally, the table gives effect to corrections of the accounting for performance related stock options and restricted stock grants in the first two quarters of 2006, all of which were previously identified and considered immaterial. The effects of correcting the errors in the Company s previous stock option accounting are to increase (reduce) previously reported non-cash compensation expense, payroll taxes, income taxes and net income by the following amounts (in thousands of dollars):

Year ended December 31,	**Non-cash stock compensation**	**Payroll taxes**	**Income taxes**	**Net income**
1998	$ 1,244	$	$ (448)	$ (796)
1999				
2000	556		(104)	(452)
2001	4,870		(942)	(3,928)
2002	8,110		(1,550)	(6,560)
2003	12,470	900	(2,281)	(11,089)
Totals through December 31, 2003	27,250	900	(5,325)	(22,825)
2004	(410)	541	250	(381)
2005	(1,290)	60	4,083	(2,853)
2000 - 2005 Total	25,550	1,501	(992)	(26,059)

The following table shows the Company s stock-based compensation expense as previously reported and the impact of the restatement (excluding payroll taxes) on stock-based compensation for periods prior to fiscal 2006, net of income tax:

Year ended December 31,	**Stock-Based Compensation Expense (Net of Tax) As Reported (in thousands)**	**Adjustments**	**As Restated**
1998 (net of income tax benefit/(expense) of $118, $448 and $566, respectively)	$ 294	$ 796	$ 1,090
1999 (net of income tax benefit/(expense) of $1,596, $0 and $1,596, respectively)	3,957		3,957
2000 (net of income tax benefit/(expense) of $3,323, $104 and $3,427, respectively)	8,238	452	8,690
2001 (net of income tax benefit/(expense) of $1,495, $942 and $2,437, respectively)	3,706	3,928	7,634
2002 (net of income tax benefit/(expense) of $891, $1,550 and $2,441, respectively)	2,209	6,560	8,769
2003 (net of income tax benefit/(expense) of $1,212, $2,281 and $3,493, respectively)	3,071	10,189	13,260
2004 (net of income tax benefit/(expense) of $149, ($250) and ($101), respectively)	370	(160)	210
2005 (net of income tax benefit/(expense) of $105, ($4,083) and ($3,978), respectively)	2,154	2,793	4,947

Governance Committee Findings

Upon completing its review, the Governance Committee concluded it found no evidence of intent to manipulate the Company s operating results or financial statements. A key finding of the Governance Committee was that there were deficiencies with the process by which stock options were granted during the period from the Company s initial public offering in 2000 through at least 2005, which resulted in accounting errors. The Governance Committee concluded that certain members of management bear varying degrees of responsibility for the deficiencies in the process by which options were granted. The Governance Committee s review also concluded that none of the current or former employees or directors of the Company engaged in intentional wrongdoing.

Restatement and Impact on Financial Statements

The following table presents the decrease in net income, by year, as a result of restating for the results of the China sales investigation and the historical stock option accounting review:

Year ended December 31,	**Net income (loss), as previously reported**	**Restatement adjustments China Sales (Decrease) Increase (in thousands)**	**Stock Options**	**Total**	**Net income (loss), as restated**
1998		$	$ (796)	$ (796)	
1999					
2000		(4,781)	(452)	(5,233)	
2001		(5,779)	(3,928)	(9,707)	
2002		(19,697)	(6,560)	(26,257)	
2003		(6,382)	(11,089)	(17,471)	
Totals through December 31, 2003		(36,639)	(22,825)	(59,464)	
2004	$ 69,824	(18,594)	(381)	(18,975)	50,849
2005	$ (487,359)	(42,433)	(2,853)	(45,286)	$ (532,645)
2000 - 2005 Total		(97,666)	(26,059)	(123,725)	

The cumulative effect of the restatements at December 31, 2003 was an increase to additional paid-in capital and deferred stock-based compensation of $26.0 million from $646.7 million to $672.7 million, and a decrease in retained earnings of $59.5 million from $237.4 million to $177.9 million, and a decrease in total stockholders equity of $33.5 million from $887.7 million to $854.2 million.

Other Changes

In restating the previously issued financial statements for the investigations discussed above, the Company also corrected other previously reported amounts. It corrected the reporting of $80.3 million of net sales to certain third party resellers and $41.2 million of associated cost of net sales in 2005 to classify these amounts as related party net sales and related party cost of net sales classifications, respectively, because in 2006 the Company determined that sales to these entities were, in substance, sales to a significant shareholder, SOFTBANK CORP. The classification of the accounts receivable from these sales was similarly changed to include them in accounts receivable from related parties in the December 31, 2005 consolidated balance sheet.

Restated Financial Information

The following tables reflect the impact of the China sales investigation, changes in non-cash charges for stock-based compensation expense, related additional payroll taxes, and income tax effects as well as the restatement to correct the classification of related party transactions discussed above on:

- the consolidated statements of operations for the years ended December 31, 2005 and 2004
- the consolidated balance sheet as of December 31, 2005
- the consolidated statements of cash flows for the years ended December 31, 2005 and 2004

Stock option grants with corrected measurement dates also are being restated in the following tables using the fair value based measurement principles of SFAS 123 *Accounting for Stock-Based Compensation* (SFAS 123) to present the pro forma effect on stock-based compensation expense, net income (loss), and earnings (loss) per share amounts in 2004 and 2005 of using SFAS 123 s fair value based method to determine stock-based compensation expense rather than using APB 25 s intrinsic value method. Such disclosure is required for periods prior to the adoption of SFAS No. 123(R).

The tables also present the impact of changes in previously reported gross profit by segment information for the years ended December 31, 2005 and 2004 resulting from the restatements of sales recognition in China and in non-cash charges for stock-based compensation expense and related additional payroll taxes in those periods.

UTSTARCOM, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)

	Year ended December 31, 2005 As previously reported	Adjustments	As restated	2004 As previously reported	Adjustments	As restated
Net sales						
Unrelated party	$ 2,533,792	$ (138,494)	$ 2,395,298	$ 2,539,706	$ (104,964)	$ 2,434,742
Related party	395,551	80,261	475,812	144,673		144,673
	2,929,343	(58,233)	2,871,110	2,684,379	(104,964)	2,579,415
Cost of net sales						
Unrelated party	2,258,824	(71,685)	2,187,139	1,996,188	(77,714)	1,918,474
Related party	206,902	41,233	248,135	91,409		91,409
Gross profit	463,617	(27,781)	435,836	596,782	(27,250)	569,532
Operating expenses:						
Selling, general and administrative	372,291	(830)	371,461	303,822	89	303,911
Research and development	247,133	(320)	246,813	219,045	34	219,079
Amortization of intangible assets	25,853		25,853	15,551		15,551
Impairment on long-lived assets	218,094		218,094	12,706		12,706
Restructuring	29,669		29,669			
In-process research and development	660		660	1,400		1,400
Total operating expenses	893,700	(1,150)	892,550	552,524	123	552,647
Operating (loss) income	(430,083)	(26,631)	(456,714)	44,258	(27,373)	16,885
Interest income	7,091		7,091	6,172		6,172
Interest expense	(16,764)		(16,764)	(6,916)		(6,916)
Gain on extinguishment of subordinated notes	31,392		31,392			
Other income, net	43,665		43,665	15,431		15,431
(Loss) income before income taxes, minority interest and equity in loss of affiliated companies	(364,699)	(26,631)	(391,330)	58,945	(27,373)	31,572
Income tax (expense) benefit	(117,889)	(18,655)	(136,544)	11,894	8,398	20,292
Minority interest in losses of consolidated subsidiaries	692		692	285		285
Equity in loss of affiliated companies	(5,463)		(5,463)	(1,300)		(1,300)
Net (loss) income	$ (487,359)	$ (45,286)	$ (532,645)	$ 69,824	$ (18,975)	$ 50,849
(Loss) earnings per share Basic	$ (4.16)	$ (0.39)	$ (4.55)	$ 0.61	$ (0.17)	$ 0.45
(Loss) earnings per share Diluted	$ (4.16)	$ (0.39)	$ (4.55)	$ 0.54	$ (0.14)	$ 0.40

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UTSTARCOM, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31, 2005 As previously reported	Adjustments	As restated
ASSETS			
Current assets:			
Cash and cash equivalents	$ 645,571	$	$ 645,571
Short-term investments	13,266		13,266
Accounts receivable, net of allowances for doubtful accounts of $67,789	453,671	(14,074)	439,597
Accounts receivable, related parties, net of allowances for doubtful accounts of $5	69,293	14,074	83,367
Notes receivable	2,065		2,065
Inventories	425,955		425,955
Deferred costs	239,876		239,876
Prepaids and other current assets	99,062		99,062
Short-term restricted cash and investments	53,680		53,680
Current deferred taxes			
Total current assets	2,002,439		2,002,439
Property, plant and equipment, net	233,403		233,403
Long-term investments	26,023		26,023
Goodwill	3,063		3,063
Intangible assets, net	75,313		75,313
Long-term deferred costs		185,279	185,279
Other long-term assets	25,811		25,811
Total assets	$ 2,366,052	$ 185,279	$ 2,551,331
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS EQUITY			
Current liabilities:			
Accounts payable	$ 320,677	$	$ 320,677
Short-term debt	198,826		198,826
Income taxes payable	33,608	621	34,229
Customer advances	221,301		221,301
Deferred revenue	69,030	32,882	101,912
Other current liabilities	289,867	1,501	291,368
Total current liabilities	1,133,309	35,004	1,168,313
Long-term deferred revenue	20,958	252,173	273,131
Long-term debt	274,900		274,900
Total liabilities	1,429,167	287,177	1,716,344
Minority interest in consolidated subsidiaries	8,338		8,338
Stockholders equity:			
Common stock: $0.00125 par value; authorized: 750,000,000 shares; issued and outstanding: 121,018,036 at December 31, 2005.	152		152
Additional paid-in capital	1,168,166	24,035	1,192,201
Deferred stock compensation	(3,493)	(98)	(3,591)
Accumulated deficit	(253,174)	(123,725)	(376,899)
Accumulated other comprehensive income	16,896	(2,110)	14,786
Total stockholders equity	928,547	(101,898)	826,649
Total liabilities, minority interest and stockholders equity	$ 2,366,052	$ 185,279	$ 2,551,331

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UTSTARCOM, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Year ended December 31, 2005			Year ended December 31, 2004		
	As previously reported		As restated	As previously reported	Adjustments	As restated
CASH FLOWS FROM OPERATING ACTIVITIES:						
Net (loss) income	$ (487,359)	$ (45,286)	$ (532,645)	$ 69,824	$ (18,975)	$ 50,849
Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities:						
Depreciation and amortization	98,550		98,550	76,203		76,203
Loss on sale of assets	2,559		2,559	2,201		2,201
Impairment of long-lived assets	218,094		218,094	12,706		12,706
Impairment of long-term investments						
Stock-based compensation expense	2,153	(1,290)	863	519	(410)	109
Non-cash settlement of restructuring charges	17,250		17,250			
In-process research and development	660		660	1,400		1,400
(Gain) loss on sale of investment	(46,576)		(46,576)	(1,912)		(1,912)
Provision for doubtful accounts	18,210		18,210	21,284		21,284
Provision for inventory reserve	12,868		12,868	18,277		18,277
Gain on extinguishment of subordinated notes	(31,392)		(31,392)			
Deferred income taxes	172,005	8,842	180,847	(119,074)	(2,448)	(121,522)
Other	15,897		15,897	4,909		4,909
Changes in operating assets and liabilities:						
Accounts receivable	268,167		268,167	(453,862)		(453,862)
Inventories	165,923		165,923	(175,881)		(175,881)
Deferred costs	(18,567)		(18,567)	285,127		285,127
Other assets	95,802	(20,994)	74,808	(16,273)	(83,672)	(99,945)
Accounts payable	(87,811)		(87,811)	97,689		97,689
Income taxes payable	(110,209)		(110,209)	133,509		133,509
Customer advances	(150,313)		(150,313)	(116,917)		(116,917)
Deferred revenue	22,008	58,668	80,676	21,877	104,964	126,841
Other current liabilities	40,464	60	40,524	43,389	541	43,930
Net cash provided by (used in) operating activities	218,383		218,383	(95,005)		(95,005)
CASH FLOWS FROM INVESTING ACTIVITIES:						
Additions to property, plant and equipment	(64,396)		(64,396)	(135,575)		(135,575)
Proceeds from sale of assets						
Investment in affiliates	(3,550)		(3,550)	(19,292)		(19,292)
Issuance of note receivable to related party						
Purchase of businesses, net of cash acquired	(24,326)		(24,326)	(217,751)		(217,751)
Purchase of intangible assets	(750)		(750)	(4,158)		(4,158)
Change in restricted cash and long-term investments	(18,418)		(18,418)	(8,943)		(8,943)
Purchase of short-term investments	(165,284)		(165,284)	(319,253)		(319,253)
Proceeds from sale of short-term investments	346,966		346,966	236,497		236,497
Other	(105)		(105)	428		428
Net cash provided by (used in) investing activities	70,137		70,137	(468,047)		(468,047)
CASH FLOWS FROM FINANCING ACTIVITIES:						
Issuance of stock, net of expenses	6,952		6,952	25,737		25,737
Purchase of convertible bond hedge and call option						

Proceeds from borrowings	436,678		436,678	390,000		390,000
Payments on borrowings	(653,123)		(653,123)	(40,000)		(40,000)
Repurchase of stock				(107,569)		(107,569)
Proceeds from equity offering				474,554		474,554
Other	6,689		6,689			
Net cash provided by (used in) financing activities	(202,804)		(202,804)	742,722		742,722
Effect of exchange rate changes on cash and cash equivalents	(2,677)		(2,677)	5,115		5,115
Net increase in cash and cash equivalents	83,039		83,039	184,785		184,785
Cash and cash equivalents at beginning of period	562,532		562,532	377,747		377,747
Cash and cash equivalents at end of period	$ 645,571	$	$ 645,571	$ 562,532	$	$ 562,532
Supplemental disclosure of cash flow information:						
Cash paid:						
Interest	$ 14,197		$ 14,197	$ 5,074		$ 5,074
Income taxes	$ 11,265		$ 11,265	$ 11,177		$ 11,177
Non-cash operating activities						
Accounts receivable transferred to notes receivable	$ 55,065		$ 55,065	$ 118,021		$ 118,021
Property, plant and equipment exchanged for long-term investment	$		$	$		$
Non-cash financing activities						
Common stock issued in conjunction with debt extinguishment	$ 37,568		$ 37,568	$		$

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GROSS PROFIT BY SEGMENT, RESTATED

	Year ended December 31, 2005 As previously reported		Adjustments (in thousands)	As restated	
Gross profit by Segment					
Broadband Infrastructure	$ 157,781	31 %	$ 109	$ 157,890	31 %
Wireless Infrastructure	149,842	30 %	(28,765)	121,077	28 %
Network Solutions	307,623	31 %	(28,656)	278,967	30 %
PCD	52,812	4 %		52,812	4 %
Handsets	57,291	12 %	875	58,166	12 %
Services	45,891	54 %		45,891	54 %
	$ 463,617	16 %	$ (27,781)	$ 435,836	15 %

	Year ended December 31, 2004 As previously reported		Adjustments (in thousands)	As restated	
Gross profit by Segment					
Broadband Infrastructure	$ 45,594	20 %	$ (9)	$ 45,585	20 %
Wireless Infrastructure	391,253	28 %	(27,225)	$ 364,028	29 %
Network Solutions	436,847	27 %	(27,234)	409,613	27 %
PCD	11,886	4 %	(20)	11,866	4 %
Handsets	131,704	18 %	4	131,708	18 %
Services	16,345	32 %		16,345	32 %
	$ 596,782	22 %	$ (27,250)	$ 569,532	22 %

PRO FORMA SFAS 123

	Year ended December 31, 2005 As previously reported (in thousands, except per share data)	As restated	Year ended December 31, 2004 As previously reported (in thousands, except per share data)	As restated
Basic				
Net (loss) income:				
As reported	$ (487,359)	$ (532,645)	$ 69,824	$ 50,849
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	2,154	4,947	370	210
Deduct: Total compensation expense determined under fair value based method for all awards, net of related tax effects	(30,588)	(23,142)	(68,083)	(82,553)
Pro forma net income (loss)	$ (515,793)	$ (550,840)	$ 2,111	$ (31,494)
Basic (loss) earnings per share:				
As reported	$ (4.16)	$ (4.55)	$ 0.61	$ 0.45
Pro forma	$ (4.41)	$ (4.71)	$ 0.02	$ (0.28)
Diluted				
Net (loss) income:				
As reported	$ (487,359)	$ (532,645)	$ 69,824	$ 50,849
Effect of dilutive securities 7/8% convertible subordinated notes				
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	2,154	4,947	370	210
Deduct: Total compensation expense determined under fair value based method for all awards, net of related tax effects	(30,588)	(23,142)	(68,083)	(82,553)
Pro forma diluted net (loss) income	$ (515,793)	$ (550,840)	$ 2,111	$ (31,494)
Diluted (loss) earnings per share:				
As reported	$ (4.16)	$ (4.55)	$ 0.54	$ 0.40
Pro forma	$ (4.41)	$ (4.71)	$ 0.02	$ (0.28)

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation:

The accompanying consolidated financial statements include the accounts of the Company and its wholly and majority (over 50 percent) owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in the preparation of these consolidated financial statements. Minority interest in consolidated subsidiaries and equity in affiliated companies are shown separately in the consolidated financial statements. The Company also consolidates variable interest entities as defined by Financial Accounting Standards Board Interpretation No. 46, Consolidation of Variable Interest Entities. See Note 22.

Use of Estimates:

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used for revenue recognition, allowance for doubtful accounts and sales returns, tax valuation allowances, reserves for inventory, deferred costs, accrued product warranty costs, provisions for contract losses, goodwill and other long-lived asset impairments, stock-based compensation expense, loss contingencies and restructuring expenses among others. Actual results could differ from those estimates.

Cash and Cash Equivalents:

Cash and cash equivalents consist of highly liquid instruments with maturities of three months or less at the date of purchase.

Of the total cash and short-term investment balance at December 31, 2006, $483.7 million was held in China where currency exchange controls exist. As a result, the Company s ability to make payments in other jurisdictions could be limited by its ability to transfer money from China to other jurisdictions. Chinese law requires that the Company s subsidiaries domiciled in China to obtain government consent prior to making certain payments to the Company. As a result, approximately $200 million of the Company s consolidated net assets cannot be transferred to the Company from its subsidiaries in China without first obtaining the consent of the Chinese government.

Short-term Investments:

Short-term investments consist of investments with original or remaining maturities of more than three months but less than twelve months. In accordance with the Company s investment policy, all short-term investments are invested in investment grade rated securities with a minimum of A or better ratings. Currently, most of the Company s short-term investments have AA or better ratings. Marketable securities are classified as available-for-sale and are carried at fair value. Unrealized holding gains and losses on securities classified as available-for-sale are recorded as a separate component of stockholders equity. Unrealized losses on securities classified as available-for-sale that are determined to be other-than-temporary are reported in earnings. Realized gains and losses are reported in earnings. The fair value of investments is based on quoted market prices. At December 31, 2006 and 2005, short-term investments in available-for-sale securities consisted of:

	December 31, 2006		
	Amortized Cost	**Gross Unrealized Gains**	**Estimated Fair Value**
	(in thousands)		
Debt securities	$ 9,546	$	$ 9,546
Total current available for-sale securities	$ 9,546	$	$ 9,546

	December 31, 2005		
	Amortized Cost	**Gross Unrealized Gains**	**Estimated Fair Value**
	(in thousands)		
Debt securities	$ 13,266	$	$ 13,266
Total current available for-sale securities	$ 13,266	$	$ 13,266

Long-term Investments:

The Company has investments in various publicly and privately held companies and investments funds. Equity securities of publicly listed companies traded on securities exchanges are classified as available-for-sale and are carried at fair value. Unrealized holding gains and losses on securities classified as available-for-sale are recorded as a separate component of stockholders equity. Investments in less than majority-owned privately held affiliates over which we exercise significant influence are accounted for under the equity method. All other investments in affiliates are carried at cost. The Company monitors for other-than-temporary impairment and makes appropriate reductions in the carrying value if the Company determines that an impairment charge is required based on the financial, economic and operational condition and near-term prospects of these companies.

Revenue Recognition:

Revenues from sales of telecommunications equipment and handsets are recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. If the payment due from the customer is not fixed or determinable due to extended payment terms, revenue is recognized as payments become due and payable by the customer, assuming all other criteria for revenue recognition are met. Any payments received prior to revenue recognition are recorded as customer advances. Normal payment terms differ for various reasons amongst different customer regions, depending upon common business practices for customers within a region. Billing to customers for shipping and handling are recorded as revenues and the associated costs are recorded as costs of revenues. Any expected losses on contracts are recognized when identified on an individual basis in accordance with the prevailing accounting guidance for the respective contract.

Sales may be generated from complex contractual arrangements that require significant revenue recognition judgments, particularly in the area of contracts with multiple deliverable elements (multiple element arrangements). Where multiple elements exist in an arrangement, the contract price is allocated to the different elements based upon and in proportion to verifiable objective evidence of the fair value of the various elements, as governed under Emerging Issues Task Force Issue (EITF) No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables, and SEC Staff Accounting Bulletin No. 104, Revenue Recognition. Multiple element arrangements primarily involve the sale of equipment, installation, training and post-contract support. Revenue is recognized as each element is earned, namely upon installation and acceptance of equipment or delivery of handsets, provided that the fair value of the undelivered element(s) has been determined, the delivered element(s) has stand-alone value, there is no right of return on delivered element(s), and the Company is in control of the undelivered element(s). For arrangements that include service elements, including promotional support and installation, for which verifiable objective evidence of the fair value does not exist, revenue is deferred until such services are deemed complete, or until the time the Company can establish verifiable objective evidence of the fair value.

Final acceptance is required for revenue recognition when installation services are not considered perfunctory. Final acceptance indicates that the customer has fully accepted delivery of equipment and the Company is entitled to full payment. The Company does not recognize revenue before final acceptance is granted by the customer if acceptance is considered substantive to the transaction.

Where multiple elements exist in an arrangement that includes software, and the software is considered more than incidental to the equipment or services in the arrangement, software and software related elements are recognized under the provisions of Statement of Position 97-2, Software Revenue Recognition, as amended, and EITF No. 03-05, Applicability of SOP 97-2 to Non-software Deliverables Containing More Than Incidental Software. The Company allocates revenues to each element of software arrangements based on vendor specific objective evidence (VSOE) of fair value. VSOE of fair value of each element is based on the price charged when the same element is sold separately. The Company uses the residual method to recognize revenue when an arrangement includes one or more elements to be delivered at a future date and VSOE of the fair value of all the undelivered elements exists. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the contract price is recognized as revenue when all other revenue recognition criteria are met. If VSOE of fair value of one or more undelivered elements does not exist, all revenue for delivered and undelivered elements is deferred until delivery of all elements occurs or when VSOE of fair value of the undelivered elements can be established. In some cases the Company has agreed to give software upgrade rights on a when and if made available basis for equipment sold for no additional consideration and for an unspecified period which could extend over the term of the contract. This additional contract obligation is an element of post contract support. The Company has not established VSOE for such contract element. Accordingly, the revenues from such contracts are recognized ratably over the period during which the post contract support is expected to be provided. The expected period of support is generally the term of the contract. In some cases where there is no stated contractual term, revenue is recognized ratably over the estimated period of support. The Company reviews assumptions regarding the estimated post contract support periods on a regular basis. If the Company determines that it is necessary to revise the Company s estimates of the support periods, the amount of revenue recognized over the life of the contract would not be affected. However, to the extent the new assumptions regarding the post contract support periods were different than original assumptions, the contract revenues would be recognized over the remaining expected period of support.

Contract accounting is utilized for contracts that include a requirement for significant software modification or customization; when utilized the Company generally accounts for such contracts using the completed contract method of accounting, whereby no revenue is recognized prior to the completion of the project, because for contracts involving unique requirements the Company is unable to make reasonably dependable estimates of its progress towards meeting contractual requirements. In the event estimated total project costs exceed estimated total project revenues, the entire estimated loss is charged to operations in the period in which the loss becomes probable and can be reasonably estimated. The complexity of the estimation process and judgments about internal and external factors including labor utilization, changes to specifications and testing requirements, time required for performance and resulting incurrence of contract penalties, and the performance of subcontractors affect the estimation process. During the year ended December 31, 2006, the Company recorded a $32.1 million loss on a fixed price contract.

The Company recognizes revenue for system integration, installation and training upon completion of performance and if all other revenue recognition criteria are met. Other service revenue, principally related to maintenance and support contracts, is recognized ratably over the maintenance term. Revenues from services were less than 10% of revenues for all periods presented.

The Company also sells products through resellers. Revenue is generally recognized when the standard price protection period, which ranges from 30 to 90 days, has lapsed. If collectibility cannot be reasonably assured in a reseller arrangement, revenue is recognized upon sell through to the end customer and receipt of cash. There may be additional obligations in reseller arrangements such as inventory rotation, or stock exchange rights on the product. As such, revenue is recognized in accordance with Statement of Financial Accounting Standards (SFAS) No. 48, Revenue Recognition When Right of Return Exists. In most cases, the Company has developed reasonable estimates for stock exchanges based on historical experience with similar types of sales of similar products.

The Company has sales agreements with certain wireless customers that provide for a rebate of the selling price to such customers if the particular product is subsequently sold at a lower price to such customers or to a different customer. The rebate period extends for a relatively short period of time. Historically, the amounts of such rebates paid to customers have not been material. The Company estimates the amount of the rebate based upon the terms of each individual arrangement, historical experience and future expectations of price reductions and then records its estimate of the rebate amount at the time of the sale. The Company also enters into sales incentive programs, such as co-marketing arrangements, with certain wireless and handset customers. The Company records the incurred incentive as a reduction of revenue when the sales revenue is recognized.

The assessment of collectibility is also a factor in determining whether revenue should be recognized. The Company assesses collectibility based on a number of factors, including payment history and the credit worthiness of the customer. The Company does not request collateral from its customers. In international sales, the Company may require letters of credit from its customers that can be drawn on demand if the customer defaults on its payment. If the Company determines that collection of a payment is not reasonably assured, the Company defers revenue recognition until collection becomes reasonably assured, which is generally upon receipt of cash.

Occasionally, the Company enters into revenue sharing arrangements. Under these arrangements, the Company collects payment only after its customer, the telecommunications service provider, collects service revenues. When the Company enters a revenue sharing arrangement, the Company does not recognize revenue until collection is reasonably assured.

Because of the nature of doing business in China and other emerging markets, the Company s billings and/or customer payments may not correlate with the contractual payment terms and the Company generally does not enforce contractual payment terms prior to final acceptance. Accordingly, accounts receivable are not recorded until the Company recognizes the related customer revenue. Advances from customers are recognized when the Company has collected cash from the customer, prior to recognizing revenue. Deferred revenue is recorded if there are undelivered elements after final acceptance has been obtained. The Company had current deferred revenue of $95.7 million and $101.9 million, and long-term deferred revenue of $261.0 million and $273.1 million at December 31, 2006 and 2005, respectively.

Product Warranty:

The Company provides a warranty on its equipment and handset sales for a period generally ranging from one to three years from the time of final acceptance. Very rarely, the Company has entered into arrangements to provide limited warranty services for periods longer than three years. The longest such warranty period is ten years. The Company provides for the expected cost of product warranties at the time that revenue is recognized based on an assessment of past warranty experience and when circumstances dictate.

Accounts and Notes Receivable:

The Company accepts bank notes and commercial notes from its customers in China in the normal course of business and estimates the collectibility of its trade receivables and notes receivable. The notes are typically non-interest bearing, with maturity dates between three and six months. An allowance for doubtful accounts is maintained for the estimated losses on the trade receivables and notes receivable when collection may no longer be reasonably assured. The Company assesses collectibility of the receivable by determining whether the creditworthiness of the customer has deteriorated and could result in an inability to collect payment; if collectibility is doubtful, the Company records an allowance against the receivable. If a customer s financial condition were to deteriorate, causing their ability to make payments to suffer as a result, the allowances for receivables may need to be increased. With greater concentration of accounts receivable with certain customers, the financial conditions of any specific or individual customer may result in increased concentration risk exposure. Allowances for doubtful accounts were $53.9 million and $67.8 million at December 31, 2006 and 2005, respectively, for total receivables, including accounts receivable from related parties.

Inventories:

Inventories consist of product held at the Company s manufacturing facility and warehouses, as well as finished goods at customer sites for which the customer has taken possession, but based on specific contractual terms, title has not yet passed to the customer. The Company may ship inventory to existing customers that require additional equipment to expand their existing networks prior to the signing of an expansion contract. Inventories are stated at the lower of cost or market value, net of write-downs for excess, slow moving and obsolete inventory. With the exception of the handset inventory for our Personal Communications Division (PCD), which is based on weighted average cost, inventory cost is computed using standard cost, which approximates actual cost on a first-in, first-out basis. Inventory is written down for estimated obsolescence or unmarketable inventory equal to the difference between inventory cost and the estimated market value.

Deferred costs:

Deferred costs consist of product shipped to the customer for which the rights and obligations of ownership have passed to the customer but revenue has not yet been recognized. Deferred costs also include the costs associated with third party integrators and freight. All deferred costs are stated at cost. Management periodically assesses the recoverability of deferred costs and provides reserves against deferred cost balances when recovery of deferred costs is not probable. Recoverability is evaluated based on various factors including the length of time the product has been held at the customer site, the viability of payment, including assessment of product demand if a revenue sharing arrangement exists and/or the evaluation if a related transaction will result in a gross margin loss. In a loss situation for a transaction, the deferred cost balance is adjusted for an impairment equal to the value of the excess of cost over the amount of revenue that will be eventually recognized for the transaction. Revenue and cost of sales are recorded when final acceptance is received from the customer. With greater concentration of product at customer sites with specific or individual customer, the financial conditions of any specific or individual customer may result in increased concentration risk exposure for our inventory.

For any post contract support services where the revenue is deferred, the entire related deferred direct costs are classified as a noncurrent asset, consistent with the definition of a current asset per Accounting Research Bulletin No. 43, Working Capital: Current Assets and Current Liabilities.

Research and Development and Capitalized Software Development Costs:

Research and development costs are charged to expense as incurred. Research and development costs include payroll related costs, contractor fees, facility expenses, third party license fees and allocations of overhead costs.

Purchased software costs and costs incurred in the development of software that will ultimately be sold are capitalized during the time between when technological feasibility has been attained and the related product is ready for general release. During 2006, 2005 and 2004, the Company capitalized $1.0 million, $6.0 million and $5.3 million of software development costs, respectively. Amortization of capitalized development costs was $2.1 million, $3.9 million, and $3.0 million in 2006, 2005 and 2004, respectively. Unamortized capitalized software development costs at December 31, 2006 and 2005 were $3.4 million and $6.9 million, respectively. Direct costs of software developed for internal use are expensed during the preliminary project stage and capitalized during the application development stage.

Property, Plant and Equipment:

Property, plant and equipment are recorded at cost and are stated net of accumulated depreciation. Depreciation is provided for on a straight-line basis over the estimated useful lives of the related assets. Land use rights related to property leased by the Company in China are amortized over the life of the lease. Leasehold improvements are amortized on a straight-line basis over the shorter of the useful life of the improvements or the term of the lease. When assets are disposed of, the cost and related accumulated depreciation are removed from the accounts and the resulting gains or losses are included in results of operations. The Company generally depreciates its assets over the following periods:

	Years
Furniture, test or manufacturing equipment	5
Computers and software	2-3
Buildings	38
Automobiles	5
Land use rights	life of use rights
Leasehold improvements	Lesser of 5 or remaining lease life

The Company capitalizes interest incurred related to construction of property, plant or equipment until it is ready for use. During 2004 the Company recorded $1.4 million of capitalized interest applicable to the construction of its China headquarters in Hangzhou. The China headquarters facility was placed in service in October 2004. Capitalized interest is being amortized on a straight-line basis over the life of the building.

Goodwill and Intangible Assets:

The Company has recorded goodwill and intangible assets in connection with business acquisitions. Management judgment is required in the assessment of the related useful lives, assumptions regarding the ability to successfully develop and ultimately commercialize acquired technology, and assumptions regarding the fair value and the recoverability of these assets. An annual goodwill impairment review is performed in the fourth quarter of each year or when changes in circumstances indicate a potential impairment exists. When assessing potential impairment to goodwill, book value of a reporting unit is compared to its fair value. Fair value is determined based on the present value of estimated future cash flows. In the third quarter of 2005, the Company performed an impairment analysis as a result of changes in the business environment. As a result of this analysis, an impairment charge was recorded during the third quarter of 2005. See Note 10.

Impairment of Long-Lived Assets:

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If undiscounted expected future cash flows are less than the carrying value of the assets, an impairment loss will be recognized based on the excess of the carrying amount over the fair value of the assets. Long-lived assets that are to be disposed of by sale are measured at the lower of book value or fair value less cost to sell. See Note 8.

Advertising Costs:

The Company expenses all advertising costs as incurred. Payment to customers for marketing development costs are accounted for as a reduction of the revenue associated with customers as incurred. For the years ended December 31, 2006, 2005 and 2004, advertising costs totaled $8.1 million, $8.2 million, and $8.0 million, respectively.

Stock-Based Compensation:

Prior to January 1, 2006, the Company accounted for share-based payment awards under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25), and provided the required pro forma disclosures under Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation. In accordance with APB 25, non-cash compensation expense was recognized for any options for which the exercise price was below the market price on the actual grant date, based on the difference between the exercise price and the market price. The expense was recognized ratably over the associated service period, which was generally the option vesting term.

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)), using the modified prospective transition method. Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the consolidated statement of operations for the year ended December 31, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. The Company adopted the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods for establishing the beginning balance of the additional paid-in-capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R). The Company accounts for utilization of windfall tax benefits based on tax law ordering and considered only the direct effects of stock-based compensation for purposes of measuring the windfall at settlement of an award.

Comprehensive Income:

Comprehensive income includes all changes in equity (net assets) during a period from non-owner sources. Accumulated other comprehensive income or loss for 2006, 2005 and 2004 is shown in the consolidated statement of stockholders equity. As of December 31 of each of the years indicated below, the components of accumulated other comprehensive income reported in the consolidated balance sheets were as follows:

	2006	**2005 (As restated)**
	(in thousands)	
Unrealized gain (loss) on available-for-sale securities, net of tax	$ 32,621	$ (41)
Foreign currency translation	30,278	14,827
Accumulated other comprehensive income	$ 62,899	$ 14,786

Income Taxes:

The Company accounts for income taxes under the liability method, and deferred income taxes are recognized for the differences between the tax bases of assets and liabilities and their financial statement amounts based on enacted tax rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. The Company is required to adjust its deferred tax asset and liabilities in the period when tax rates or the provisions of the income tax laws change.

In 2006, due to recent developments in its business, the Company determined that earnings from certain subsidiaries were not permanently reinvested outside the United States. The Company provides U.S. taxes on foreign undistributed earnings that are not considered to be permanently reinvested outside the United States. Under APB 23 Accounting for Income Taxes Special Areas, deferred income taxes must be provided on the unremitted earnings of foreign subsidiaries unless such earnings could be deemed to be permanently reinvested outside the United States. Prior to 2006, the Company had not provided for U.S. tax on any foreign unremitted earnings because the Company did not intend to repatriate such earnings. See Note 14.

Segment Reporting:

The Company had four operating units : Network Solutions, Personal Communications Division (PCD), Handsets and Services. The Network Solutions operating unit provides its products and services through two reporting segments; Broadband Infrastructure (Broadband) and Wireless Infrastructure (Wireless).

Financial Instruments and Derivatives:

Financial instruments consist of cash and cash equivalents, short and long-term investments, notes receivable, accounts receivable and payable, convertible subordinated debt, purchased and written call options and accrued liabilities. The carrying amounts of cash and cash equivalents, short-term investments, accounts receivable and payable and accrued liabilities approximate their fair values because of the short-term nature of those instruments. The carrying amounts of the notes receivable approximates its fair value based on the discounted value of future cash flow expected to be received from this note.

The Company may use derivative financial instruments to manage its exposures to foreign currency exchange rate changes. The objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible. Derivative instruments are recognized as either assets or liabilities on the balance sheet. The Company measures those instruments at fair value and recognizes changes in the fair value of derivatives in earnings in the period of change unless the derivative qualifies as an effective hedge that offsets certain exposures. Such contracts are designated at inception to the related foreign currency exposures being hedged. The Company has not hedged any such transactions in 2006 and 2005. The net gains and losses resulting from hedging activities for the year ended December 31, 2004 were insignificant.

The following table summarizes the Company s carrying values and the fair values of its other financial instruments:

	December 31, 2006 Carrying value (in thousands)	Fair value	2005 Carrying value	Fair value
Included in Assets				
Long-term investments	$ 47,809	$ 56,048	$ 26,023	$ 42,887
Included in Liabilities				
Bank loans	$ (102,510)	$ (102,510)	$ (198,826)	$ (198,826)
Convertible debt	$ (274,600)	$ (257,094)	$ (274,600)	$ (229,291)
Included in Stockholders Equity				
Convertible bond hedge	$ 85,307	$ 647	$ 85,307	$ 5,335
Written call option	$ (55,430)	$ (88)	$ (55,430)	$ (2,133)

The Company determines the fair value of its convertible debt and related convertible bond hedge and written call option using estimates of fair values at the balance sheet date provided by a major securities firm. The fair value of long-term investments is determined based on quoted market prices or available information about investees. Because of the short-term nature of the Company s bank loans, the Company believes carrying value approximates fair value.

Foreign Currency Translation:

The Company s operations are conducted through international subsidiaries and the financial statements of those subsidiaries are translated from their respective, functional currencies into U.S. dollars. All foreign currency assets and liabilities are translated at the period-end exchange rate and all revenues and expenses are translated at the average exchange rate for the period. The effects of translating the financial statements of foreign subsidiaries into U.S. dollars are reported as a cumulative translation adjustment, a separate component of comprehensive income in stockholders equity. The foreign currency transaction loss reported in earnings was $9.9 million in 2005 and a gain of $7.6 million and $0.8 million, in 2006 and 2004, respectively, and are recorded in other income, net.

Earnings Per Share (EPS):

Basic EPS is computed by dividing net income (loss) available to common stockholders by the weighted average number of shares of the Company s common stock outstanding during the period, which excludes unvested restricted shares. Diluted EPS presents the amount of net income (loss) available to each share of common stock outstanding during the period plus each share of common stock that would have been outstanding assuming the Company had issued shares of common stock for all dilutive potential common shares outstanding during the period. The Company s potential common shares include employee stock options, unvested restricted shares, a written call option, warrants, convertible subordinated notes and vested acquisition-related stock options.

The following is a summary of the calculation of basic and diluted EPS:

	Year ended December 31,		
	2006	**2005 (As restated)**	**2004 (As restated)**
	(in thousands, except per share data)		
Numerator:			
Net (loss) income used in basic EPS computation	$ (117,345)	$ (532,645)	$ 50,849
Effect of Dilutive Securities 7⁄8% Convertible subordinated notes			2,785
Net (loss) income adjusted for dilutive securities	$ (117,345)	$ (532,645)	$ 53,634
Denominator:			
Weighted average shares outstanding used in basic EPS computation	120,657	117,034	114,135
Dilutive potential common shares			
Stock options			3,118
Written call option			262
Convertible subordinated notes			16,919
Warrants			9
Other			377
Shares used to compute diluted EPS	120,657	117,034	134,820
Basic (loss) earnings per share	$ (0.97)	$ (4.55)	$ 0.45
Diluted (loss) earnings per share	$ (0.97)	$ (4.55)	$ 0.40

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For the years ended December 31, 2006 and 2005, no potential common shares were dilutive because of the net loss in each of these years, and basic and dilutive EPS are the same. The following table summarizes the total potential shares of common stock that were excluded from the diluted per share calculation, because to include them would have been anti-dilutive for the period.

	Year ended December 31, 2006	2005 (As restated)
	(in thousands)	
Stock options	19,634	19,908
Conversion of convertible subordinated notes	11,543	15,123
Other	795	342
	31,972	35,373

Recent Accounting Pronouncements:

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48). The interpretation contains a two-step approach to recognizing and measuring uncertain tax positions accounted for in accordance with SFAS No. 109, Accounting for Income Taxes. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48 as of January 1, 2007, by recording a $1.4 million increase to the liability for uncertain tax positions offset by a reduction to the opening balance of retained earnings.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to current accounting pronouncements that require or permit fair value measurements. SFAS 157 becomes effective for the Company on January 1, 2008. Upon adoption, the provisions of SFAS 157 are to be applied prospectively with limited exceptions. The Company is currently evaluating the effects of SFAS 157 on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 requires analysis of misstatements using both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. SAB 108 is effective for annual financial statements for the first fiscal year ending after November 15, 2006. The Company adopted SAB 108 during the fourth quarter of 2006. The adoption of SAB 108 had no impact on the Company s consolidated financial statements.

In February 2007, The FASB issued Statement of Financial Accounting Standard No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). This statement permits, but does not require, companies to report at fair value the majority of recognized financial assets, financial liabilities and firm commitments. Under this standard, unrealized gains and losses on items for which the fair value option is elected are reported in earnings at each subsequent reporting date. SFAS 159 becomes effective for the Company on January 1, 2008. The Company is currently evaluating the effects of SFAS 159 on its consolidated financial statements.

NOTE 4 RESTRICTED CASH AND INVESTMENTS

At December 31, 2006, the Company had short-term restricted cash and investments of $16.7 million and long-term restricted cash of $16.5 million included in other long-term assets. At December 31, 2005, the Company had short-term restricted cash and investments of $53.7 million and long-term restricted cash of $0.3 million included in other long-term assets. These amounts primarily collateralize the Company s issuances of standby and commercial letters of credit.

NOTE 5 ACQUISITIONS AND SALE OF ASSETS

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Sale of Assets to Marvell Technology Group Ltd:

In February 2006, the Company sold substantially all of the assets and selected liabilities of its semiconductor design business division to Marvell Technology Group Ltd. (Marvell). The Company received $35.4 million in cash, net of $0.6 million of transaction costs, and an additional $4.3 million in cash was paid by Marvell to the Company in August 2007. Included in the cash received was $16.0 million earned by the Company as a result of achieving certain defined milestones. The Company received payment of this $16.0 million in October 2006. The assets sold include the assets related to the prior acquisition of Advanced Communications Devices Corporation in 2001, and other system-on-chip semiconductors. In connection with the sale of assets, the Company has entered into a supply agreement with Marvell. Pursuant to the supply agreement, the Company has agreed to purchase chipsets supplied by Marvell for a period of five years. These chipsets will be included in certain handset products designed and manufactured by the Company.

The Company recognized a gain on this sale of assets of $12.3 million during 2006. The gain was determined based upon total net proceeds less the net book value of assets sold of $2.9 million and the value of the supply agreement of $20.2 million. The value allocated to the supply agreement is included in other current and long-term liabilities and is being amortized in proportion to the quantities of chipsets purchased under the supply agreement over the next five years. As of December 31, 2006, approximately $1.7 million has been amortized against cost of sales.

2005

Pedestal

In May 2005, the Company completed its acquisition of substantially all of the assets and certain liabilities of Pedestal Networks, Inc. (Pedestal). Pedestal develops and designs a Universal Broadband Server (UBS), an environmentally hardened, line-powered remote IP-based Digital Subscriber Line Access Multiplexer (IP DSLAM). The acquisition was intended to assist in the Company s expansion into digital subscriber line (DSL) and IP-based television (IPTV) by providing the Company with a strong remote broadband solution that is fully US-certified and complements other existing DSL, IPTV and optical product families. The total consideration for this transaction was $3.0 million. Approximately $2.6 million in cash was paid at the closing date and an additional $0.4 million was paid in May 2006. The acquisition was accounted for under the purchase method of accounting.

The existing technology acquired included the entire Pedestal family of IP DSLAM and UBS. The Company has integrated the Pedestal product line with the Company s Triple-Play products and IPTV solutions. In addition to developed product technology, the Company acquired fixed assets, in-process research and development (IPR&D) and customer relationships.

At the acquisition, Pedestal had one project under development related to the gigabit ethernet product that qualified as IPR&D. The gigabit ethernet project is focused on supporting a majority of Pedestal s products and was completed as of December 31, 2006. In assessing Pedestal s IPR&D project, the Company considered key product characteristics including the product s development stage at the acquisition date, the product s life cycle and the product s future prospects. The Company also considered the rate at which technology changes in the broadband equipment industry, the industry s competitive environment and the economic outlook for both local and global markets. The amount of the purchase price allocated to IPR&D of $0.7 million was charged to the Company s results of operations as no alternative future uses existed at the acquisition date.

The results of operations of Pedestal have been integrated with the Broadband segment and included in the Company s consolidated statements of operations beginning on the acquisition date of May 13, 2005. The pro forma effects of this acquisition on the Company s financial statements are not significant.

Subsequent to the May 2005 acquisition of Pedestal, the Company completed the allocation of the purchase price based in part upon an independent valuation. The estimated useful lives of the customer relationships and developed technology intangible assets are two years and five years, respectively.

The following table summarizes the final allocation of the purchase price for Pedestal:

	(in thousands)
Fair value of tangible net assets	$ 1,177
Fair value of liabilities assumed	(297)
Fair value of identified intangible assets:	
Developed technology	1,319
In-process research and development	660
Customer relations	141
Total purchase price	$ 3,000

Giga

In October 2004, the Company entered into an asset purchase agreement with Giga Telecom, Inc. (Giga), a Korean corporation that develops and designs wireless handsets. The acquisition is intended to facilitate the Company s expansion into the CDMA handset market. The Company completed the acquisition in January 2005. At the closing, $13.0 million in cash was paid, and an additional $2.0 million was paid into an escrow account for six months which was released in July 2005. The total consideration for the acquisition, funded from cash on hand, was approximately $19.0 million, including $2.0 million in acquisition-related transaction costs, a $1.5 million payment made previously to be applied against the purchase price and an earn-out of $0.5 million paid subsequently upon completion of certain product design milestones.

The following table summarizes the allocation of the purchase price for Giga based, in part, upon an independent valuation:

	(in thousands)
Fair value of tangible net assets	$ 458
Fair value of identified intangible assets:	
Existing technology	1,200
Pre-existing royalty agreement	1,920
Excess of costs of acquiring Giga over fair value of identified net assets acquired (goodwill)	15,391
Total purchase price	$ 18,969

The excess of the purchase price over the fair value of the identified net assets of approximately $15.4 million was allocated to goodwill and assigned to the Handsets segment. The goodwill is tax deductible. The goodwill created in this acquisition results from the decreased time to market and design related synergies. This goodwill was written off in September 2005 as a result of the intangible and other long-lived asset impairment. For additional information regarding the intangible and other long-lived assets impairment, refer to Note 10, Goodwill and Intangible Assets.

In accordance with EITF No. 04-1, Accounting for Preexisting Relationships between the Parties to a Business Combination, a settlement gain of $0.4 million relating to the pre-existing royalty agreement was recognized and recorded under Research and Development expense in the consolidated statements of operations. The purchased existing technology and pre-existing royalty agreement has been fully amortized.

The results of operations of Giga have been integrated with the Handsets segment and included in the Company s Consolidated Statement of Operations subsequent to the acquisition. The pro forma effects of this acquisition on the Company s financial statements were not significant.

2004

Audiovox Communications Corporation

In November 2004, the Company completed its acquisition of select assets and liabilities of Audiovox Communications Corporation (ACC), including inventories, prepaids, payables, accrued expenses and the right to hire approximately 250 employees. The Company paid $170.8 million in cash during 2004, an additional $2.8 million in cash in 2005 and incurred professional fees of $4.6 million. The Company acquired ACC s sales, service and support infrastructure, its code division multiple access (CDMA) handset brand, access to supply-chain channels, product marketing expertise, and key relationships with CDMA operators in North and South America. The goodwill created in this acquisition resulted from decreased time-to-market and volume related synergies. This goodwill was written off in September 2005 as a result of the intangible and other long-lived asset impairment. (See Note 10.) The following table summarizes the allocation of the purchase price for ACC based in part upon an independent valuation:

	(in thousands)
Fair value of tangible net assets:	
Property, plant and equipment	$ 873
Inventory	116,254
Deferred income taxes	7,739
Other tangible assets	5,719
Fair value of identified intangible assets:	
Customer/dealer relationships	24,400
Supplier relationships	5,300
Non-compete agreement	10,800
Trade names	4,000
Backlog	3,200
Liabilities assumed	(74,159)
Excess of costs of acquiring ACC over fair value of identified net assets acquired (goodwill)	74,125
Total purchase price	$ 178,251

The Company acquired $47.7 million of intangible assets, principally consisting of carrier and dealer relationships and non-compete agreement. No amount was allocated to in-process research and development.

The intangible assets have estimated useful lives ranging from one to ten years as follows: customer relationships, ten years; dealer relationships, two years; supplier relationships, two years; non-compete agreement, four years; trade name, three years; and backlog, one year.

The results of operations of ACC have been included in the Company s consolidated results of operations beginning on the acquisition date of November 1, 2004.

The following unaudited pro forma results of operations reflect the combined results of the Company and ACC for the year ended December 31, 2004 as if the business combination occurred at the beginning of the period. These results do not purport to be indicative of what would have occurred had the acquisition been made as of that date or the results of operations which may occur in future periods.

	2004 (As restated) (in thousands, except per share data)
Pro forma adjusted net sales	$ 3,664,391
Pro forma adjusted net income	$ 56,988
Pro forma adjusted basic earnings per share	$ 0.50
Pro forma adjusted diluted earnings per share	$ 0.42

TELOS Technology, Inc.

In May 2004, the Company completed its acquisition of substantially all of the assets and certain liabilities of TELOS Technology, Inc. and its subsidiaries (TELOS). TELOS is a provider of mobile switching products and services for voice and data communication networks to developing rural, enterprise and emerging wireless markets. The total consideration for the acquisition, funded from cash on hand, was approximately $30.0 million. The Company paid $29.0 million in cash, in addition to $1.0 million of acquisition-related transaction costs.

The existing technology acquired included the entire TELOS product family of CDMA softswitch technology products, supporting servers and operations maintenance centers. The TELOS product line was integrated with the Company s suite of CDMA products, strengthening the Company s existing CDMA product portfolio. In addition to developed product technology, the Company acquired fixed assets, in- process research and development (IPR&D), an assembled workforce of approximately 60 employees, customer relationships and recorded goodwill. The goodwill created in this acquisition resulted from decreased time to market in CDMA technologies. This goodwill is tax deductible.

Subsequent to the May 2004 acquisition of TELOS, the Company completed the allocation of the purchase price based in part upon an independent valuation. The amount of the purchase price allocated to IPR&D of $1.4 million was charged to the Company s results of operations, as no alternative future uses existed at the acquisition date. The Company recorded goodwill of $6.4 million in connection with the acquisition. This goodwill was written off in September 2005 as a result of the intangible and other long-lived asset impairment. (See Note 10) The results of operations of TELOS were included in the Company s consolidated results of operations beginning on the acquisition date of May 19, 2004.

As of the acquisition date, TELOS had two projects under development that qualified for IPR&D. The objective of both projects was to enhance the functionality of products designed to comply with the CDMA2000 technology standard. In assessing TELOS IPR&D projects, the Company considered key product characteristics including the product s development stage at the acquisition date, the product s life cycle and the product s future prospects. The Company also considered the rate at which technology changes in the telecommunications equipment industry, the industry s competitive environment and the economic outlook for both local and global markets.

The projects under development were enhancements to existing products that did not affect the functionality of those existing products. As of December 31, 2005, both projects were completed.

The following table summarizes the allocation of the purchase price for TELOS based upon the independent valuation:

	(in thousands)
Fair value of tangible net assets:	
Property, plant and equipment	$ 2,010
Inventory	1,382
Other tangible assets	1,242
Fair value of identified intangible assets:	
Customer relationships	5,000
Existing technology	15,900
In-process research and technology	1,400
Liabilities assumed	(3,380)
Excess of costs of acquiring TELOS over fair value of identified net assets acquired (goodwill)	6,449
Total purchase price	$ 30,003

The estimated useful lives of the customer relationships and existing technology intangible assets are five years.

The following unaudited pro forma results of operations reflect the combined results of the Company and TELOS for the year ended December 31, 2004 as if the business combination occurred at the beginning of the period. These results do not purport to be indicative of what would have occurred had the acquisition been made as of that date or the results of operations which may occur in future periods.

	2004 (As restated) (in thousands, except per share data)
Pro forma adjusted net sales	$ 2,581,104
Pro forma adjusted net income	$ 49,407
Pro forma adjusted basic earnings per share	$ 0.43
Pro forma adjusted diluted earnings per share	$ 0.37

Hyundai Syscomm, Inc.

In April 2004, the Company completed its acquisition of the assets, substantially all of the intellectual property, certain employees and certain contracts related to Hyundai Syscomm, Inc. s (HSI) CDMA infrastructure business for markets outside of Korea. Subject to the attainment of certain milestones and the transfer of certain know-how, the total consideration for this transaction was approximately $12.3 million excluding transaction costs of $1.8 million. Approximately $7.3 million in cash was paid at the closing date and an additional $3.0 million in cash was paid one year from the closing date. The remaining purchase price was comprised of $2.0 million that was paid by the Company upon the completion of HSI training of the Company s manufacturing employees in China under the terms of a Training Services Agreement. Not included in the purchase price was $2.0 million payable upon the completion of certain revenue milestones, however, the revenue milestones were not met and no additional payments were due under the agreement.

In conjunction with this transaction, the Company loaned HSI $3.2 million at an effective interest rate of 12% per annum, which was used by HSI to satisfy outstanding debt obligations. The principal amount of the loan was due in April 2005. During the year ended December 31, 2005 the Company offset HSI s payment obligations against the outstanding $3.0 million of the purchase price and other liabilities.

Under the terms of the transaction with HSI, the Company acquired existing technologies and entered into non-compete and licensing agreements. The existing technologies acquired were a base transceiver station and base station controller product lines. As part of the asset purchase agreement, the Company and HSI entered into a training services agreement, whereby HSI employees were to provide technical training to the Company manufacturing staff in China for the nine month period subsequent to the acquisition. This technology and technological know-how enabled the Company to strengthen the Company s existing CDMA product portfolio and the development of future CDMA technology.

In addition to acquiring existing technology, the Company entered into non-compete and licensing agreements with HSI. The non-compete agreement prohibits HSI from competing against the Company in all countries except Korea for four years from the consummation date. The licensing agreement requires that HSI pay the Company 1% of revenue as royalty for the usage of the intellectual property that the Company acquired under the terms of the acquisition for fifteen years subsequent to the consummation date.

Subsequent to the April, 2004 acquisition of HSI, the Company completed the allocation of the purchase price based in part upon an independent valuation. The Company recorded goodwill of $7.0 million in connection with the acquisition. The results of operations of HSI have been included in the Company s consolidated results of operations beginning on the acquisition date of April 2004.

The following table summarizes the final allocation of the purchase price for HSI:

	(in thousands)
Fair value of tangible net assets:	
Property, plant and equipment	$ 1,440
Other tangible assets	437
Fair value of identified intangible assets:	
Existing technology	3,559
Non-compete agreement	761
IP License agreement	891
Excess of costs of acquiring HSI over fair value of identified net assets acquired (goodwill)	7,042
Total purchase price	$ 14,130

The intangible assets have estimated useful lives ranging from three to five years as follows: existing technology, five years; non-compete agreement, three years; and intellectual property license agreement, three years. The Company encountered difficulties integrating the HSI operations after the acquisition. In the fourth quarter 2004, a decision was made to substantially abandon the acquired operations. Thus, the entire goodwill and all intangibles were written off in 2004. The write-offs were recorded under Selling, general and administrative expense in the statement of operations for the year ended December 31, 2004.

The following unaudited pro forma results of operations reflect the combined results of the Company and HSI for the year ended December 31, 2004, as if the business combination occurred at the beginning of the period. These results do not purport to be indicative of what would have occurred had the acquisition been made as of that date or the results of operations which may occur in future periods.

	2004 (As restated) (in thousands, except per share data)
Pro forma adjusted net sales	$ 2,582,197
Pro forma adjusted net income	$ 49,660
Pro forma adjusted basic earnings per share	$ 0.44
Pro forma adjusted diluted earnings per share	$ 0.37

NOTE 6 INVENTORIES

As of December 31, 2006 and 2005, inventories consist of the following:

	December 31, 2006 (in thousands)	2005
Raw materials	$ 72,230	$ 70,608
Work-in-process	43,542	27,582
Finished goods	324,673	327,765
	$ 440,445	$ 425,955

NOTE 7 ACCOUNTS AND NOTES RECEIVABLE

The Company accepts bank notes and commercial notes receivable from its customers in China in the normal course of business. The notes are typically non-interest bearing, with maturity dates between three and six months. Bank notes are included in short-term investments. Commercial notes receivable available for sale were $5.1 million and $2.1 million at December 31, 2006 and 2005, respectively. The Company may discount these notes with banking institutions in China. A sale of these notes is reflected as a reduction of notes receivable and the proceeds of the settlement of these notes are included in cash flows from operating activities in the consolidated statement of cash flows. There were no notes receivable sold during the year ended December 31, 2006 and $73.1 million bank notes and $13.0 million in commercial notes receivable were sold during the year ended December 31, 2005. Any notes that are sold are not included in the Company s consolidated balance sheets as the criteria for sale treatment established by SFAS No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, has been met. The costs of selling these notes receivable were $0.7 million for the year ended December 31, 2005.

In August 2005, the Company entered into a Committed Receivables Purchase Agreement (Agreement) with a commercial bank, whereby the Company may sell up to $100.0 million of its eligible accounts receivable, as defined in the Agreement. The Agreement contains provisions customary in transactions of this nature including certain commitment fees. During 2006 and 2005, no receivables were sold pursuant to provisions of the Agreement. The Company recorded commitment fees of $0.5 million and $0.2 million during the years ended December 31, 2006 and 2005, respectively. In March 2007, the Agreement was amended and restated to reflect that the purchase of trade receivables shall be at the sole discretion of the commercial bank, with no associated commitment fees.

NOTE 8 PROPERTY, PLANT AND EQUIPMENT

As of December 31, 2006 and 2005, property, plant and equipment consists of the following:

	December 31 2006 (in thousands)	2005
Buildings & land-use rights	$ 160,500	$ 156,404
Leasehold improvements	18,188	16,460
Automobiles	5,849	5,742
Software	38,945	37,064
Equipment and furniture	200,746	188,542
Construction in progress	940	2,303
	$ 425,168	$ 406,515
Less: accumulated depreciation	(212,013)	(173,112)
	$ 213,155	$ 233,403

In accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets, (SFAS 144), the Company periodically evaluates the recoverability and estimated lives of its long-lived assets, including property and equipment, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or the useful life has changed. For tangible assets, the Company determines the relative estimated fair value through a comparison of similar assets, and wherever practical, based on quoted market prices taking into consideration the asset type, age, condition, and physical location of the asset. The Company s intangible assets that are subject to amortization are tested for recoverability based on undiscounted cash flows, and if impaired, written down to fair value based on either discounted cash flows or appraised values.

In 2005, the Company determined the relative estimated fair value of tangible assets through a comparison of similar assets, and wherever practical, based on quoted market prices taking into consideration the asset type, age condition and physical location of the asset. As a result of this analysis, the Company recorded an impairment charge of $14.1 million of long-lived tangible assets related to the Broadband asset group and $9.4 million for long-lived tangible assets related to the Handset asset group.

Depreciation expense was $45.1 million, $66.9 million, and $55.8 million for the years ended December 31, 2006, 2005 and 2004, respectively.

NOTE 9 LONG-TERM INVESTMENTS

The Company s investments are as follows:

	December 31 2006	2005
	(in thousands)	
Gemdale	$ 32,781	$ 1,321
Cellon International		8,000
Global Asia Partners L.P.	1,700	1,700
Fiberxon Inc.	3,000	3,000
ImmenStar	2,000	2,000
GCT SemiConductor	3,000	3,000
Xalted Networks	3,302	3,000
Infinera	1,902	1,902
Matsushita Joint Venture		465
Restructuring Fund No. 1		1,538
Others	124	97
Total	$ 47,809	$ 26,023

Gemdale

In 1996, the Company invested $1.3 million in Gemdale Co., Ltd. (Gemdale) in return for 11 million non-negotiable shares of Gemdale. Gemdale is a real estate company that invests and develops properties in China, primarily in Shanghai, Beijing, Shenzhen and Wuhan. During 2004, the Company received an additional 8.8 million non-negotiable shares in dividends. This investment was accounted for under the cost method through July 2006.

In August 2006, pursuant to a Split Share Structure Reform Agreement in China, the Company transferred 6.0 million non-negotiable Gemdale shares to the holders of negotiable Gemdale shares in exchange for converting the remaining 13.8 million non-negotiable shares into negotiable shares, and a receivable for additional shares valued at $1.2 million at December 31, 2006. The negotiable Gemdale shares are traded on the Shanghai Stock Exchange. The 13.8 million negotiable shares are subject to a transfer restriction through August 2007. As of December 31, 2006 the Company had a 2% ownership interest in Gemdale. The investment is classified as equity securities available-for-sale and recorded at fair value. An unrealized gain on the investment and related receivable totaling $32.6 million was recorded in other comprehensive income during the year ended December 31, 2006. In 2006, the Company recorded $0.7 million of dividends received in other income, net.

Cellon International

In September 2001, the Company invested $2.0 million in Cellon International Holdings Corporation (Cellon) and made additional investments of $3.0 million each in Cellon in April and December 2002. Cellon designs wireless terminals and related technology for handset manufacturers and private distributors. In November 2005, the Company and Cellon entered into an agreement under which the Company received consideration in the form of preferred stock and warrants of Cellon valued at $5.5 million in exchange for the transfer of fixed assets with a net book value of $3.0 million, a facilities lease and a workforce in place consisting of 156 employees. This transaction was completed on May 31, 2006 and a gain on sale of assets of $2.5 million was recorded in other income, net. As of December 31, 2006, with the additional shares obtained in the purchase transaction, the Company had an 11% ownership interest in Cellon. In the fourth quarter of 2006, the Company s review of this investment included, but was not limited to, a review of Cellon s cash position, recent financing activities, financing needs, earnings/revenue outlook, operational performance, management/ownership changes, and competition. Based on the deterioration of Cellon s financial condition, the Company determined that the carrying value of the investment was at an amount above the fair value of the investment, and the decline was other-than temporary. As of December 31, 2006, the Company recorded a $13.5 million other-than-temporary impairment charge for this investment in other income, net.

In November 2005, the Company entered into a Development Service Agreement with Cellon in which $5.0 million was prepaid in exchange for future product development. Approximately $2.0 million of the prepaid amount was used during 2006 as payments for design services. The Company may also use the $5.0 million prepayment in satisfaction of royalties Cellon may earn from sales by the Company of products Cellon designs under the Development Services Agreement. This agreement also obligates Cellon to pay the Company a royalty if certain technology shared by the Company to Cellon is used in products developed and sold to customers other than the Company through November 2007. During the fourth quarter of 2006, the Company recorded an operating expense of $3.0 million to write-off this prepayment in connection with the Company s assessment of the financial condition of Cellon as discussed above. For additional information regarding the Company s investment in Cellon see Note 23.

Global Asia Partners L.P.

Global Asia Partners L.P. is a venture capital fund formed to make private equity investments in private or pre-IPO technology and telecommunications companies in Asia. Between June 2002 and April 2005, the Company invested a total of $2.6 million in the fund. As of December 31, 2006, the Company had 49% of the fund s outstanding partnership units. Prior to April 2005, the Company had a commitment to invest up to a maximum of $5.0 million, but as the result of a reorganization of capital contributions by the partners, reached in April 2005, our capital contribution of $0.6 million in April 2005 was the final capital contribution to be made. In addition, the agreement allows the partnership to re-invest up to $2.5 million that otherwise would have been available to the Company as future distributions. The Company recorded no equity losses for the years ended December 31, 2006 and 2005, and an equity loss of $0.5 million for the year ended December 31, 2004. For additional information regarding the Company s investment in Global Asia Partners L.P. see Note 23.

Fiberxon Inc.

In September 2002, the Company invested $2.0 million in Fiberxon Inc. (Fiberxon), a company that develops and sells optical modules and related systems. In March 2004, the Company invested an additional $1.0 million in Fiberxon. This investment is accounted for under the cost method, and its carrying value is evaluated for possible impairment based on the achievement of business objectives and milestones, the financial condition and prospects of the company and other relevant factors. For additional information regarding the Company s investment in Fiberxon see Note 23.

ImmenStar

In September 2004, the Company invested $2.0 million in the Series A preferred stock of ImmenStar, Inc. (ImmenStar). ImmenStar is a development stage company that is designing a chip that can be used in the Company s products. This investment is accounted for under the cost method. In February 2007, ImmenStar was acquired by Cortina Systems, Inc. In exchange for the Company s investment in ImmenStar, the Company received 4 million shares of Series D Preferred Stock of Cortina Systems, Inc., $1.8 million cash in March 2007 and is entitled to receive an additional $0.2 million currently held in escrow. As a result of the acquisition, the Company recorded a gain on investment of $2.8 million, in other income, net, and owns 1.3% interest of Cortina Systems, Inc. on a fully diluted basis.

GCT Semiconductor

In October 2004, the Company invested $3.0 million in GCT Semiconductor, Inc. This investment represents approximately a 2% interest in GCT Semiconductor, Inc., which designs, develops and markets integrated circuit products for the wireless communications industry. This investment is accounted for under the cost method.

Xalted Networks

In May 2005 and August 2005, the Company invested $2.0 million and $1.0 million, respectively, in Xalted Networks (Xalted). In March 2006 the Company invested an additional $0.3 million in Xalted. Xalted is a development stage company providing telecommunication operator customers with a comprehensive set of network systems, software solutions and service offerings. The Company has an 11% ownership interest, on a fully diluted basis, in Xalted and accounts for the investment under the cost method.

Infinera

In July 2004, the Company invested $3.0 million in 1,339,285 shares of Infinera Corporation (Infinera) Series D Preferred Stock at $2.24 per share. The investment represents an approximately 2% interest in Infinera, which develops optical telecommunications systems using photonic integrated circuits. This investment is accounted for under the cost method. In September 2004, Infinera closed a Series E Preferred Stock round at $0.60 per share. As a result of the close proximity between the Series D and Series E preferred stock financing rounds and the decrease in the share price between rounds, Infinera and the Company entered into an exchange agreement whereby the Company exchanged 669,643 shares of Series D preferred stock for 2,500,000 shares of Series E preferred stock. After the exchange, the Company owns a total of 669,643 shares Series D and 2,500,000 shares of Series E preferred stock. For the year ended December 31, 2004, the Company recorded a loss of $1.1 million to reflect the other-than-temporary decrease in the fair value of its remaining Series D shares. For additional information regarding the Company s investment in Infinera see Note 23.

Matsushita Joint Venture

In July 2002, the Company entered into a joint venture agreement with Matsushita Communication Industrial Co., Ltd. to jointly design and develop, manufacture and sell telecommunication products. The Company had a 49% ownership interest in the joint venture company, which had an original registered share capital of $10.0 million. The Company contributed $4.9 million cash in October 2002 and another $9.3 million (its 49% interest of the $19 million capital call) during the fourth quarter of 2004. The investment in and results of operations of the joint venture company were accounted for using the equity method of accounting. The Company recorded equity losses of $4.8 million and $1.9 million for the years ended December 31, 2005 and 2004, respectively. In December 2005, the joint venture board resolved to terminate the joint venture and the Company recorded a loss of $2.9 million to reflect an other-than-temporary decline in value. In 2006, the joint venture was dissolved and a final distribution was made in April 2006 that did not materially exceed the carrying value of the investment.

Restructuring Fund No. 1

During the first quarter of fiscal 2002, the Company invested $2.0 million in Restructuring Fund No. 1, a venture capital investment limited partnership established by SOFTBANK INVESTMENT CORP., an affiliate of SOFTBANK CORP. SOFTBANK America Inc., an entity affiliated with SOFTBANK CORP., is a significant stockholder of the Company. The fund focuses on leveraged buyout investments in companies in Asia undergoing restructuring or bankruptcy procedures. The fund had a separate management team, and none of the Company s employees were employed by the fund. The Company accounted for this investment under the equity method of accounting. In 2005, the Company received $1.0 million in dividends. The partnership was dissolved in July 2006 with a total cash distribution of $3.0 million to the Company during 2006. The Company has recorded a gain on investment of $1.4 million and $0.7 million, respectively, for the years ended December 31, 2006 and 2005. The Company recorded immaterial equity losses for the year ended December 31, 2004.

NOTE 10 GOODWILL AND INTANGIBLE ASSETS

Goodwill:

Intangible assets classified as goodwill and those with indefinite lives are not amortized. The Company performs an annual impairment test of its goodwill during the fourth quarter of each year. The Company also tests for impairment between annual tests if a triggering event occurs that may have the effect of reducing the fair value of a reporting unit below their respective carrying values. When conducting its goodwill impairment analysis, the Company calculates its impairment charges based on the two-step test prescribed in SFAS 142, Goodwill and Other Intangible Assets (SFAS 142). The Company uses the present value of future cash flows from the respective reporting units to determine the estimated fair value of the reporting unit and the implied fair value of goodwill.

During 2005, management held a series of planning meetings in September to assess the business forecasts for all of its reporting units. As a result of various factors, including a reduction in the rate of growth of PAS subscribers in the third quarter, a delay of the expected granting of 3G licenses in China and Japan, challenges with product quality primarily in the Company s Broadband reporting unit, a narrowing of the Company s strategic focus related to the Company s product offerings and greater than expected revenue and margin decline due to continued pricing pressures in several of the Company s key markets. The Company concluded these factors combined represented a triggering event. The Company determined that the significant adverse changes in the business outlook could indicate the carrying value of certain of its long-lived assets groups may not be recoverable and could indicate the fair value of the Company s reporting units may be below their fair value. As a result, the Company performed interim impairment tests on goodwill and certain other long-lived tangible and intangible assets. The Company performed an impairment analysis pursuant to SFAS 142 as of September 30, 2005 for all of its reporting units. The Company compared the fair value of the reporting units to their carrying value. The Company determined the fair value of each reporting unit using both present value and comparable company techniques based, in part, upon an independent valuation. Based upon the impairment assessment, the Company recorded goodwill impairment charges of $192.9 million in 2005. The impairment charges represented the excess of the carrying amount of the reporting units goodwill over the implied fair value of their goodwill. The implied fair value of goodwill is the residual fair value derived by deducting the fair value of a reporting unit s assets and liabilities from its estimated fair value based on a discounted cash flow model using revenue and profit forecasts. During 2006, the Company did not identify any instances of goodwill impairment.

A summary of changes in the Company s goodwill during the years ended December 31, 2005 and 2006 by business segment is as follows:

	January 1, 2005 (in thousands)	**Additions**	**Exchange rate changes**	**Impairment**	**December 31, 2005**
Handsets	$ 74,003	$ 15,391	$ (57)	$ (89,337)	$
Wireless	55,641		29	(55,670)	
Network Solutions	129,644	15,391	(28)	(145,007)	
PCD	24,710		2	(24,712)	
Broadband	23,210			(23,210)	
Service	3,063				3,063
Total	$ 180,627	$ 15,391	$ (26)	$ (192,929)	$ 3,063

The amount of goodwill at December 31, 2006 was unchanged from the amount reported above at December 31, 2005. The entire amount of $3.1 million was allocated to the services operating segment.

Intangible Assets:

In accordance with SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144), the Company periodically evaluates the recoverability and estimated lives of its intangible assets subject to amortization, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company s intangible assets that are subject to amortization are tested for recoverability based on undiscounted cash flows, and if impaired, written down to fair value based on either discounted cash flows or appraised values.

In 2005, the Company determined that the fair value of technology intangible assets within the Broadband and Handset asset groups as calculated using the discounted future cash flows was less than the carrying value of the net assets and, as such, the Company recorded a net asset write-off of $1.7 million. During 2006, the Company did not record any impairment charges related to technology intangible assets because there were no circumstances or events that occurred which indicated a possible impairment.

As of December 31, 2006 and 2005, intangible assets consisted of the following:

	December 31, 2006 (in thousands)	2005
Existing technology	$ 39,530	$ 39,530
Less accumulated amortization	(27,824)	(21,702)
	$ 11,706	$ 17,828
Customer relationships	$ 57,220	$ 57,220
Less accumulated amortization	(18,544)	(12,037)
	$ 38,676	$ 45,183
Supplier relationships	$ 5,300	$ 5,300
Less accumulated amortization	(5,300)	(3,092)
	$	$ 2,208
Trade names	$ 4,940	$ 4,940
Less accumulated amortization	(3,829)	(2,496)
	$ 1,111	$ 2,444
Non-compete agreement	$ 10,800	$ 10,800
Less accumulated amortization	(5,850)	(3,150)
	$ 4,950	$ 7,650
Total intangible assets	$ 56,443	$ 75,313

Amortization expense was $18.9 million, $25.9 million and $15.6 million for the years ended December 31, 2006, 2005 and 2004, respectively. The estimated aggregate amortization expense for intangibles for each of the five years beginning 2007 through 2011 is $16.0 million, $12.7 million, $6.9 million, $5.1 million and $5.1 million, respectively, and is $10.6 million in the aggregate thereafter. There is no significant foreign exchange impact related to intangible assets.

The remaining weighted average amortization period for each class of unamortized identifiable intangible assets include the following:

	Weighted Average Life (in years)
Technology	2.1
Customer relationships	6.8
Trade names	0.8
Non-compete	1.8

NOTE 11 DEBT

The following represents the outstanding borrowings at December 31, 2006 and 2005:

	December 31, 2006 (in thousands)	2005
Bank loans	$ 102,510	$ 198,826
Other, including capital lease obligations, at 4.7%-10.0%, due through 2011	809	300
Convertible subordinated notes, due March 1, 2008	274,600	274,600
Total Debt	$ 377,919	$ 473,726
Long-term debt	275,161	274,900
Short-term debt	$ 102,758	$ 198,826

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At December 31, 2006, the Company has loans with various banks totaling $102.5 million with interest rates ranging from 5.02% to 5.51% per annum. These bank loans mature during 2007 and are included in short-term debt. There are no significant covenants associated with these loans.

The Company has credit facilities totaling $698.4 million of which $571.9 million remained available for borrowing as of December 31, 2006. All of these facilities expire in 2007. There is no guarantee that these facilities will be renewed. The Company has not guaranteed any debt not included in the consolidated balance sheet. The Company had available borrowing facilities of $482.9 million as of December 31, 2005.

On March 12, 2003, the Company completed an offering of $402.5 million of 7⁄8% convertible subordinated notes due March 1, 2008 to qualified buyers pursuant to Rule 144A under the Securities Act of 1933. The notes are convertible into the Company s common stock at a conversion price of $23.79 per share and are subordinated to all present and future senior debt of the Company. Holders of the notes may convert their notes only if: (i) the price of the Company s common stock issuable upon conversion of a note reaches a specified threshold, (ii) specified corporate transactions occur, or (iii) the trading price for the notes falls below certain thresholds. At the initial conversion price, each $1,000 principal amount of notes will be convertible into approximately 42.0345 shares of common stock. Expenses associated with the convertible subordinated notes issuance were $11.7 million and have been recorded in other long-term assets and are being amortized over the life of the notes.

In 2005, the Company entered into agreements to exchange a total of 4,988,100 shares of the Company s common stock, with a fair value of approximately $37.6 million and approximately $57.1 million in cash for outstanding convertible notes with an aggregate principal amount of $127.9 million, held by five of its note holders. These exchanges were considered an early extinguishment of debt in which the aggregate fair value of the common stock and cash was less than the carrying value of the convertible notes. Accordingly, the Company recorded a gain, net of write-off of unamortized issuance expenses, of $31.4 million for the year ended December 31, 2005 on such extinguishment in accordance with the provisions of Accounting Principles Board Opinion No. 26, Early Extinguishment of Debt.

Concurrent with the issuance of the convertible notes, the Company entered into a convertible bond hedge and call option transaction at a cost of $43.8 million. In 2005, the convertible bond hedge and call option were amended as a result of the aforementioned early extinguishment of the convertible notes. As part of the amendment, the Company received proceeds of $1.4 million which was recorded against additional paid-in capital. The amended convertible bond hedge allows the Company to purchase 11.5 million shares of its common stock at $23.79 per share from the other party to the agreement. The written call option allows the holder to purchase 11.5 million shares of the Company s common stock from the Company at $32.025 per share. Both the bond hedge and call option transactions may be settled at the Company s option either in cash or net shares and expire on March 1, 2008.

The Company recorded these instruments at cost, and their carrying value at December 31, 2005 equaled their original cost as adjusted for amendments related to the early extinguishment of debt. The convertible bond hedge and call option transactions are expected to reduce the potential dilution from conversion of the notes. The options have been included in stockholders equity in accordance with the guidance in EITF No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock.

On November 15, 2006, the Company received a notice asserting that its failure to timely file its Quarterly Report on Form 10-Q for the period ended September 30, 2006 had caused a default under the indenture related to the convertible notes, which, if not cured within 60 days, would cause an event of default. For information regarding the subsequent solicitations of consents from the holders of the notes see Note 23 entitled Subsequent Events below.

NOTE 12 OTHER CURRENT LIABILITIES

Other current liabilities at December 31, 2006 and 2005 consist of the following:

	December 31, 2006	2005 As restated
	(in thousands)	
Accrued contract costs	$ 45,163	$ 60,332
Loss contract reserve	32,061	
Accrued payroll and compensation	66,722	59,689
Warranty costs	63,900	76,719
Accrued other taxes	13,469	31,165
Other	50,085	63,463
	$ 271,400	$ 291,368

Other current liabilities primarily consist of accrued contract costs, which relate to purchases of inventory, installation services and other testing and consulting work performed by outside vendors for which the Company has not yet received invoices, loss contract reserve costs, which relate to estimated loss on contract, accrued payroll and compensation costs, which relate to wages, bonuses, and commissions earned but not yet paid; warranty costs, which are estimated costs of equipment replacement and repair and accrued other taxes, which represent primarily value added and sales taxes payable.

NOTE 13 WARRANTY OBLIGATIONS AND OTHER GUARANTEES

Warranty obligations are as follows (in thousands):

Balance at January 1, 2004	$ 26,267
Accruals for warranties issued during the period	53,777
Warranty obligations assumed upon acquisition	6,964
Settlements made during the period	(40,412)
Balance at December 31, 2004	$ 46,596
Accruals for warranties issued during the period	70,583
Settlements made during the period	(40,460)
Balance at December 31, 2005	$ 76,719
Accruals for warranties issued during the period	38,148
Settlements made during the period	(50,967)
Balance at December 31, 2006	$ 63,900

During 2005, the Company recorded a special warranty charge for equipment sold to Softbank during 2003 and 2004. Since the agreement to repair these parts exceeded the Company s normal warranty terms, the Company recorded additional special warranty charges of $11.7 million for certain asynchronous digital subscriber line (ADSL) products, $4.0 million primarily related to NetRing equipment and $14.9 million for GEPON equipment. All of these products are in the Broadband Infrastructure segment. During 2006, the Company recorded an additional warranty charge of $5.6 million, consisting of $2.9 million for the

NetRing equipment and $2.7 million for the GEPON equipment sold to Softbank, based on the results of the Company s analysis of warranty costs incurred, and revised estimates of the remaining liability.

Certain of the Company s sales contracts include provisions under which customers would be indemnified by the Company in the event of, among other things, a third-party claim against the customer for intellectual property rights infringement related to the Company s products. There are no limitations on the maximum potential future payments under these guarantees. The Company has not accrued any amount in relation to these provisions as no such claims have been made and the Company believes it has valid, enforceable rights to the intellectual property embedded in its products.

NOTE 14 PROVISION FOR INCOME TAXES

United States and foreign income (loss) before income taxes and minority interest were as follows for the years indicated below:

	Year Ended December 31, 2006	2005 As restated	2004 As restated
	(in thousands)		
United States	$ (177,762)	$ (169,934)	$ (24,538)
Foreign	43,835	(226,859)	54,810
	$ (133,927)	$ (396,793)	$ 30,272

The components of income tax (benefit) are as follows for the years indicated below:

	Year Ended December 31, 2006	2005 As restated	2004 As restated
	(in thousands)		
Current			
Federal	$	$ 35,929	$ (18,267)
State/other	7	3,296	(2,099)
Foreign	(13,808)	(92,146)	127,321
Total current	(13,801)	(52,921)	106,955
Deferred			
Federal		36,791	(4,157)
State		5,305	(1,055)
Foreign	(1,223)	147,369	(122,035)
Total deferred	(1,223)	189,465	(127,247)
Total	$ (15,024)	$ 136,544	$ (20,292)

In establishing its deferred income tax assets and liabilities, the Company makes judgments and interpretations based on the enacted tax laws and published tax guidance applicable to its operations. The Company records deferred tax assets and liabilities and evaluates the need for valuation allowances to reduce the deferred tax assets to realizable amounts. The likelihood of a material change in the Company s expected realization of these assets is dependent on future taxable income and its ability to use foreign tax credit carryforwards and carrybacks. Changes to the Company s income tax provision or in the valuation of the deferred tax assets and liabilities may affect the annual effective income tax rate.

Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. The Company reversed a $91.7 million current deferred tax asset in the second quarter of 2005 in relation to $217.5 million of deferred revenue recorded under customer advances pertaining to several agreements entered into with Japan

Telecom Co., Ltd in 2004. The Company has delivered and received final acceptance for all equipment contemplated under those agreements in 2005 and, therefore, the $91.7 million current deferred tax asset recorded in 2004 was reversed with a corresponding increase in the deferred tax provision.

A summary of the components of net deferred tax assets is as follows for the years indicated below:

	Year Ended December 31, 2006	2005 (As restated)
	(in thousands)	
Deferred Tax Assets		
Allowances and reserves	$ 63,676	$ 52,227
Deferred revenue and customer advances, net	20,782	24,190
Net operating loss carryforward	64,047	46,858
Tax credit carryforwards	46,593	35,811
Writedown/amortization of intangible assets/goodwill	61,581	59,643
Fixed assets	10,784	7,501
Demo equipment income	8,788	7,547
Accrued warranties	14,982	16,172
Other	8,117	8,267
Total deferred tax assets	299,350	258,216
Deferred Tax Liabilities		
Prepaid expense	(2,980)	(2,474)
Deferred taxes on unremitted earnings of subsidiaries	(43,943)	0
Other	(8,400)	(4,647)
Total deferred tax liabilities	(55,323)	(7,121)
Total deferred tax assets	244,027	251,095
Less: valuation allowance	(235,564)	(244,204)
Total net deferred tax assets	$ 8,463	$ 6,891

Under APB 23 Accounting for Income Taxes Special Areas, deferred income taxes must be provided on the unremitted earnings of foreign subsidiaries unless such earnings could be deemed to be permanently reinvested outside the United States. Prior to 2006, the Company had not provided for U.S. tax on any foreign unremitted earnings because the Company did not intend to repatriate such earnings. In 2006, due to recent developments in its business, the Company determined that earnings from certain subsidiaries were not permanently reinvested outside the United States. Accordingly, the Company has recorded a U.S. deferred income tax liability of $43.9 million on foreign earnings of $206.5 million that it considers to not be permanently reinvested outside the United States.

As of December 31, 2006, the Company has undistributed earnings of approximately $69.5 million from investments in foreign subsidiaries that are considered permanently reinvested. The determination of the amount of deferred taxes on these earnings is not practicable since the computation would depend on a number of factors that cannot be known until a decision to repatriate the earnings is made.

As of December 31, 2006, U.S. federal net operating loss carryforwards were $102.7 million and expire in 2025 and 2026. As of December 31, 2006, state net operating loss carryforwards were $87.7 million and expire in varying amounts between 2012 and 2026. Management has concluded that these federal and state net operating losses did not meet the more likely than not standard contained in SFAS No. 109, Accounting for Income Taxes, (SFAS 109) and has therefore placed a $41.1 million valuation allowance against the related deferred tax assets. In the event the tax benefits related to the valuation allowance are realized, an immaterial amount would be credited to paid-in capital. As of December 31, 2006, the Company also had net operating loss carryforwards (NOLs) in China of approximately $75.3 million. The China net operating loss carryforwards will expire in varying amounts between 2010 and 2011. Management has also concluded that these China net operating losses did not meet the more likely than not standard contained in SFAS 109 and has therefore placed a $13.4 million valuation allowance against the related deferred tax assets. As of December 31, 2006, the Company had NOLs in countries other than the U.S. and China. These NOLs are approximately $54.4 million. The majority of the NOLs do not expire and can be carried forward indefinitely. However, management concluded these losses did not meet the more likely than not standard contained in SFAS 109 and has therefore placed a valuation allowance of $9.5 million against the related deferred tax assets.

As of December 31, 2006, the Company has U.S. alternative minimum tax credit carryforwards of $1.0 million which have an indefinite life. It also has U.S. research & development credit carryforwards of $13.0 million, $11.8 million of which expire in varying amounts between 2010 and 2026, and $1.2 million of which have an indefinite life. The Company has U.S. foreign tax credits of $30.4 million which expire in varying amounts between 2012 and 2016. Management has concluded that these U.S. tax credit carryforwards did not meet the more likely than not standard contained in SFAS 109 and has therefore placed a $44.4 million valuation allowance against the related deferred tax assets. As of December 31, 2006, the Company has foreign research & development credit carryforwards of $2.2 million which expire in varying amounts between 2013 and 2016.

In 2005, the Company has impaired a significant amount of goodwill and intangible assets. As a result of this impairment, it has recorded a $59.6 million deferred tax asset for the difference between the book bases and tax bases of the impaired assets in 2005.

The Company s Chinese subsidiaries were granted tax holidays, which started to phase out in 1999. Income tax exemption for two of the Company s subsidiaries ended December 31, 2004. The net impact of these tax holidays was to decrease tax expense by approximately $16.2 million and $38.0 million for the years ended December 31, 2004 and 2003, respectively.

The difference between the Company s tax expense (benefit) and the tax based upon federal statutory rate is reconciled below:

	Year Ended December 31, 2006	2005 As restated	2004 As restated
	(in thousands)		
Federal tax expense (benefit) at statutory rate	$ (46,874)	$ (138,878)	$ 10,595
State taxes expense (benefit), net of federal income tax benefit	(6,818)	(5,140)	(736)
Tax benefit of convertible debentures	(6,396)	(15,395)	(7,905)
Nondeductible goodwill impairment		12,873	
Stock compensation expense	3,577		
Effect of differences in foreign tax rates	18,133	47,101	2,813
Tax on unremitted earnings of subsidiaries	43,943		
Settlement of tax audit in China	(28,976)		
Effect of tax rate changes on deferred taxes		11,874	(30,549)
Change in deferred tax valuation allowance	13,918	237,307	4,572
Tax credits	(6,466)	(16,259)	(5,076)
Other	935	3,061	5,994
Total tax expense (benefit)	$ (15,024)	$ 136,544	$ (20,292)

In 2006, the tax on unremitted earnings of $43.9 million is attributable to recording U.S. deferred income taxes on foreign earnings of $206.5 million that the Company considers to not be permanently reinvested outside the United States.

In establishing its deferred income tax assets and liabilities, the Company makes judgments and interpretations based on the enacted tax laws and published tax guidance applicable to our operations as well as the amount and jurisdiction of future taxable income. The Company records deferred tax assets and liabilities and evaluates the need for valuation allowances to reduce the deferred tax assets to realizable amounts. As of September 30, 2005, the Company did not believe it was more likely than not that it would generate a sufficient level and proper mix of taxable income within the appropriate period to utilize all the deferred tax assets in China and the United States. As a result of the review undertaken at September 30, 2005, the Company concluded that it was appropriate to establish a full valuation allowance for the net deferred tax assets in China and the United States wherein the cumulative losses weigh heavily in the overall assessment.

In 2006, the change in deferred tax valuation allowance of $13.9 million is primarily attributable to the tax expense related to continuing to provide a full valuation allowance on our net deferred tax assets at December 31, 2006 in the United States and China.

In 2005, the change in deferred tax valuation allowance of $237.3 million is primarily attributable to the tax expense related to providing a full valuation allowance on the Company s net deferred tax assets at December 31, 2005 in the United States and China. The $11.9 million increase in tax expense is due to the revaluation of deferred tax assets recorded in 2005 because of statutory rate changes for certain of the Company s subsidiaries in China.

In 2006, the Company recorded a $29.0 million income tax benefit related to the settlement of a tax audit in China for the 2003 through 2005 tax years for UTStarcom Telecom Co., Ltd. (HUTS) and Hangzhou UTStarcom Telecom Co., Ltd (HSTC), two of its subsidiaries in China and the acceptance of its tax holiday for HSTC.

The Company s income tax returns for 2003 through 2005 are currently under audit by the Internal Revenue Service. The Company is also under audit by the taxing authorities in China on a recurring basis. The Company provides tax reserves for federal, state and international exposures relating to audit results, tax planning initiatives and compliance responsibilities. The development of these reserves requires judgments about tax issues, potential outcomes and timing, and is a critical estimate. Although the outcome of these tax audits is uncertain, in management s opinion, adequate provisions for income taxes have been made as a result of these reviews. If actual outcomes differ materially from these estimates, they could have a material impact on the Company s results of operations.

On March 16, 2007, China s top legislature, the National People s Congress, passed the China Corporate Income Tax Law (CIT Law). CIT Law will be effective on January 1, 2008. Under the CIT Law, China s dual tax system for domestic enterprises and foreign investment enterprises (FIEs) would be effectively replaced by a unified system. The new law establishes a tax rate of 25% for most enterprises and a reduced tax rate of 15% for certain qualified high technology enterprises.

Prior to this change in tax law, certain subsidiaries and joint ventures located in China enjoyed tax benefits in China which are generally available to FIEs. The tax holidays/incentives for FIEs were applicable or potentially applicable to UTStarcom ChongQing Telecom Co. Ltd. (CUTS), UTStarcom Telecom Co., Ltd. (HUTS), Hangzhou UTStarcom Telecom Co., Ltd. (HSTC) and UTStarcom China Co., Ltd. (UTSC), the Company s active subsidiaries in China, because these entities may qualify as accredited technologically advanced enterprises.

CIT Law targets certain industries for the reduced 15% tax rate for certain qualified high technology enterprises. For FIEs established before the promulgation of the new law who currently enjoy lower tax rates, any increase in their tax rates would be gradually phased in over five years. Significant regulations regarding the interpretation and implementation of the new tax law are still pending. There is potential risk that the Company s subsidiaries may not qualify for the reduced 15% tax rate. Therefore, the new law may have an adverse impact on its future tax expense in China.

NOTE 15 COMMON STOCK AND STOCK INCENTIVE PLANS

Stock Option Plans

2006 Equity Incentive Plan:

The 2006 Equity Incentive Plan (2006 Plan) was implemented on July 21, 2006 after being adopted by the Board of Directors on June 6, 2006 and approved by the Company s stockholders on July 21, 2006. The 2006 Plan replaces the 1997 Plan, the 2001 Plan, and the 2003 Plan (collectively, the Prior Plans) and no further awards will be granted pursuant to the Prior Plans. The 2006 Plan provides for the grant of the following types of incentive awards: (i) stock options, (ii) stock appreciation rights, (iii) restricted stock, (iv) restricted stock units, (v) performance shares and performance units, and (vi) and other stock or cash awards (Award, collectively, Awards). Those who are eligible for Awards under the 2006 Plan include employees, directors and consultants who provide services to the Company and its affiliates.

The maximum aggregate number of shares that may be awarded and sold under the 2006 Plan is 4,500,000 shares plus (i) any shares that have been reserved but remain unissued under the Prior Plans as of July 21, 2006, and (ii) any shares subject to stock options or similar awards granted under the Prior Plans that expire or become exercisable without having been exercised in full and shares issued pursuant to awards granted under the Prior Plans that are forfeited to or repurchased by the Company. As of December 31, 2006, the number of shares transferred from the Prior Plans to the 2006 plan totaled 6,800,545. As of December 31, 2006, options to purchase 62,650 shares of common stock were outstanding under the 2006 Plan.

The Board of Directors or the Compensation Committee of the Board (Compensation Committee)administers the 2006 Plan (Administrator). Subject to the terms of the 2006 Plan, the Administrator has the sole discretion to select the employees, consultants, and directors who will receive Awards, determine the terms and conditions of Awards, and to interpret the provisions of the 2006 Plan and outstanding Awards. Options granted under the 2006 Plan generally vest and become exercisable over four years.

Awards granted under the 2006 Plan are generally not transferable, and all rights with respect to an Award granted to a participant generally may be exercised during a participant s lifetime only by the participant; provided, however, that with the Administrator s approval, a participant may (i) transfer an Award to a participant s spouse or former spouse pursuant to a court-approved domestic relations order which relates to the provision of child support, alimony payments or marital property rights, or (ii) transfer an Award by gift to or for the benefit of the participant s immediate family.

The exercise price of all stock options and stock appreciation rights granted under the 2006 Plan must be at least equal to 100% of the fair market value of the Common Stock on the date of grant (or at least 110% of such fair market value for an incentive stock option (ISO) granted to a stockholder with greater than 10% voting power of the Company s stock). The maximum term of a stock option granted to any participant must not exceed seven years from the date of grant (or five years for an ISO granted to a stockholder with greater than 10% of the voting power of the Common Stock). The Administrator will determine the terms and conditions of all other Awards granted under the Plan.

In the event of a change in control of the Company, each outstanding Award will be assumed or an equivalent option or right substituted by the successor corporation or a parent or subsidiary of the successor corporation. In the event that the successor corporation, or the parent or subsidiary of the successor corporation, refuses to assume or substitute for the Award, the participant will fully vest in and have the right to exercise all of his or her outstanding options or stock appreciation rights, including shares as to which such Awards would not otherwise be vested or exercisable, all restrictions on restricted stock will lapse, and, with respect to restricted stock units, performance shares and performance units, all performance goals or other vesting criteria will be deemed achieved at target levels and all other terms and conditions met. In addition, if an option or stock appreciation right is not assumed or substituted for in the event of a change of control, the Administrator will notify the participant in writing or electronically that the option or stock appreciation right will be fully vested and exercisable for a period of time determined by the Administrator in its sole discretion, and the option or stock appreciation right will terminate upon the expiration of such period.

Prior Plans The 1997 Stock Plan, 2001 Director Option Plan, and 2003 Non-Statutory Stock Option Plan:

The 1997 Stock Plan

Prior to the implementation of the 2006 Plan on July 21, 2006, officers, employees and consultants of the Company and its affiliates were eligible to receive options to purchase shares of common stock and stock purchase rights under the 1997 Stock Plan (1997 Plan). On January 31, 1997, the Board of Directors adopted, and the Company s stockholders approved, the 1997 Plan. In December 1999, the Board of Directors amended the 1997 Plan, which the Company s stockholders approved in February 2000. The 1997 Plan was terminated in July 2006 effective upon stockholder approval of the 2006 Plan. As of December 31, 2006, there were options to purchase 18,290,317 shares of common stock outstanding under the 1997 Plan.

Options granted under the 1997 Plan prior to July 21, 2006 were either ISOs intended to qualify for favorable federal income tax treatment under the provisions of Section 422 of the Internal Revenue Code of 1986, as amended, or non-qualified stock options (NSOs), which did not so qualify. The Compensation Committee oversaw the selection of eligible persons for option grants and determined the grant date, amounts, exercise prices, vesting periods and other relevant terms of the options, including whether the options would be ISOs or NSOs. The exercise price of ISOs granted under the 1997 Plan could not be less than 100% of the fair market value of common stock on the grant date (or at least 110% of such fair market value for an ISO granted to a stockholder with greater than 10% voting power of the Company s stock), while the exercise price of NSOs could be determined by the Compensation Committee in its discretion. Options granted under the 1997 Plan were generally not transferable during the life of the optionee.

Under the 1997 Plan, options vest and become exercisable as determined by the Compensation Committee, generally over four years. Options may generally be exercised at any time after they vest and before their expiration date as determined by the Compensation Committee. However, no option may be exercised more than ten years after the grant date (or five years for ISOs granted to a stockholder with greater than 10% voting power of the Common Stock). Options will generally terminate (i) 12 months after the death or permanent disability of an optionee and (ii) there months after termination of employment for any other reason. The aggregate fair market value of the shares of common stock represented by ISOs that become exercisable in any calendar year by any one option holder may not exceed $100,000. Options in excess of this limit are treated as NSOs.

Prior to the implementation of the 2006 Plan, the Company could also grant stock purchase rights to eligible participants under the 1997 Plan. Under the 1997 Plan, any shares purchased pursuant to stock purchase rights were subject to a restricted stock purchase agreement. Unless the Compensation Committee determined otherwise, this agreement granted the Company a right to repurchase the restricted stock upon the voluntary or involuntary termination of the employee for any reason, including death or disability prior to vesting. The purchase price for repurchased shares was the original price paid and could be paid by cancellation of any indebtedness owed to the Company. The Company s repurchase right lapsed at a rate determined by the Compensation Committee.

In the event the Company is merged with or into another corporation, or all or substantially all of the Company s assets are sold, each outstanding option and stock purchase rights will be assumed or an equivalent option or stock purchase right will be substituted by the successor corporation or its parent or subsidiary. If the successor corporation refuses to assume or substitute for the option or stock purchase right, the option or right will automatically vest and become exercisable in full for a period of at least fifteen days, after which time the option or right will terminate.

2001 Director Option Plan:

Prior to the implementation of the 2006 Plan on July 21, 2006, those directors who were not employees of the Company (Outside Directors) were eligible to receive options to purchase shares of common stock under the 2001 Director Option Plan (2001 Plan). The 2001 Plan was adopted by the Board of Directors on March 2, 2001 and was approved by the Company s stockholders in May 2001. In July 2001, the Board of Directors amended the 2001 Plan. The 2001 Plan was terminated in July 2006 effective upon stockholder approval of the 2006 Plan. As of December 31, 2006, there were options to purchase 360,000 shares of common stock outstanding under the 2001 Plan. The Compensation Committee has been the administrator of the 2001 Plan.

Under the terms of the 2001 Plan, each Outside Director was automatically granted an option to purchase eighty thousand shares of common stock (First Option) on the date on which such person first became an Outside Director (Anniversary Date). A director who was an employee of the Company and ceased employment with the Company to become an Outside Director could receive an option to purchase twenty thousand shares of common stock (a Subsequent Option) at the Company s first annual meeting of stockholders following such conversion to an Outside Director and at each subsequent annual stockholder meeting thereafter, provided that he or she was serving as an Outside Director on each such date. As such time as each Outside Director s First Option was fully vested, each Outside Director was automatically granted a Subsequent Option on the Anniversary Date of each year provided that he or she was then an Outside Director.

Under the terms of the 2001 Plan, the exercise price of each option granted equaled the market value of the common stock on the date of grant. Such options have terms of ten years, but terminate earlier if the individual ceases to serve as a director. The First Option grants vest as to 25% of shares subject to the First Option on each of the first four anniversaries of its date of grant, subject to the Outside Director continuing to serve as a director on such dates. The Subsequent Option grants vest as to 100% of the shares subject to the Subsequent Option on the first anniversary of its date of grant.

The 2003 Nonstatutory Stock Option Plan:

Prior to the implementation of the 2006 Plan on July 21, 2006, directors, officers, employees and consultants of the Company and its affiliates were eligible to receive options to purchase shares of the Company s common stock under the 2003 Nonstatutory Stock Option Plan (2003 Plan). The 2003 Plan was adopted by the Board of Directors on April 15, 2003. Only nonstatutory stock options, which would not qualify for favorable federal income tax treatment under the provisions of Section 422 of the Internal Revenue Code of 1986, as amended, could be granted under the 2003 Plan. The 2003 Plan was terminated in July 2006 effective upon stockholder approval of the 2006 Plan. As of December 31, 2006, options to purchase 909,310 shares of common stock were outstanding under the 2003 Plan.

The 2003 Plan has been administered by the Compensation Committee. The Compensation Committee oversaw the selection of the eligible persons to whom options would be granted and determined the number of shares subject to the option, exercise prices, vesting periods and other terms applicable to each option.

Options granted under the 2003 Plan generally vest and become exercisable over four years, and may be exercised at any time after they vest but before their expiration date. Options will generally terminate (i) 12 months after the death or employment termination due to disability of an option holder and (ii) three months after termination of an option holder s service for any other reason other than for disability or due to the option holder s death. No option, however, may be exercised more than ten years after the grant date.

In the event of the Company s change in control, the 2003 Plan provides for each outstanding option to be assumed or an equivalent option or right to be substituted by the successor corporation or its parent or subsidiary. If the successor corporation refuses to assume or substitute for the option, the option will automatically vest and become exercisable in full for a period determined by the compensation committee, after which time the option will terminate.

Issanni Communications, Inc. Incentive Program:

The Issanni plan was established for the issuance of up to a total of 39,876 shares of UTStarcom s common stock to specified former employees of Issanni Communications, Inc. (Issanni) who became UTStarcom s employees in connection with UTStarcom s acquisition of Issanni. The Issanni plan is administered by the Board of Directors or the Compensation Committee. A participant in the Issanni plan is eligible to earn and vest in a designated number of shares that are subject to the award of shares made to a participant under the plan, based upon the attainment of one of six milestones related to the amount of revenue generated from Issanni products in 2002 and 2003 and subject to the participant s continued employment with Issanni, the Company or one of their subsidiaries through the day of the determination that the applicable milestone has been satisfied. In addition, each participant is entitled to receive the unearned shares, if any, on the fifth anniversary of the acquisition of Issanni if the employee continues to be employed with Issanni, the Company or any of their subsidiaries on such date regardless of whether any milestone is attained. The shares subject to an award will in any event become issuable, whether or not the milestones were achieved and whether or not the five-year vesting schedule has elapsed, upon (i) the sale or the discontinuation of the Company or UTStarcom International Products Inc., (ii) the sale of substantially all or any of the technology acquired by UTStarcom International Products Inc. in connection with the acquisition of Issanni, or (iii) the employment termination of certain Issanni principals.

If, prior to the date on which all of a participant s shares are earned, the participant s service with Issanni, the Company or one of their subsidiaries is terminated (i) voluntarily or for cause, the Company may exercise its repurchase option with respect to any of the participant s unearned shares, (ii) other than voluntarily or for cause, death or disability, the participant will be entitled to receive the shares that the participant would have otherwise earned with respect to milestones achieved within 24 months of the participant s termination, or (iii) as a result of death or disability, the participant (or his estate) will be entitled to receive the unearned portion of his shares with respect to all milestones.

Advanced Communication Devices Corporation Incentive Program:

In February, 2006 the Company sold substantially all of the assets and selected liabilities of its semiconductor design operations, including the assets related to its prior acquisition of ACD. As a result, all participants service with the Company was voluntarily terminated and all shares subject to award that were not yet earned or distributed were cancelled.

Stock Award and Stock Option Activity

A summary of activity under all Plans follows:

	Shares Available for Grant	Number of shares outstanding	Weighted average exercise price
Options Outstanding, January 1, 2004	4,462,903	14,617,129	$ 18.97
Options Authorized in 2004	4,178,874		
Options Granted	(5,875,197)	5,875,197	$ 27.48
Options Exercised		(1,191,877)	$ 15.54
Options Forfeited or Expired	811,503	(811,503)	$ 24.75
Options Outstanding, December 31, 2004	3,578,083	18,488,946	$ 21.62
Options Authorized in 2005	4,590,555		
Options Granted	(5,605,623)	5,605,623	$ 9.08
Options Exercised		(348,450)	$ 3.42
Options Forfeited or Expired	3,782,752	(3,838,109)	$ 21.96
Options Outstanding, December 31, 2005	6,345,767	19,908,010	$ 18.34
Options Authorized in 2006	4,900,000		
Options Granted	(5,430,957)	5,430,957	$ 6.14
Options Exercised		(281,077)	$ 1.39
Options Forfeited or Expired	5,424,040	(5,424,040)	$ 19.04
Options Outstanding, December 31, 2006	11,238,850	19,633,850	$ 15.01

The Company granted restricted stock awards to its employees under the 2006 and 1997 Plans. Such awards generally vest over a period of one to four years from the date of grant. The restricted stock awards have the voting rights of common stock and the shares underlying the restricted stock awards are considered issued and outstanding. The Company expenses the cost of the restricted stock awards, which is determined to be the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapse. The grant of restricted stock awards is deducted from the shares available for grant under the Company s stock option plan. Nonvested restricted stock as of December 31, 2006 and changes during the year ended December 31, 2006 is summarized below:

	Shares	Weighted average grant date fair value
Restricted shares granted under 2006 and 1997 Plans		
Nonvested at December 31, 2005	150,000	$ 8.15
Granted	174,884	7.69
Vested	(72,442)	7.81
Forfeited		
Nonvested at December 31, 2006	252,442	$ 7.93
Restricted stock related to a 2002 acquisition included in issued and outstanding	282,878	$ 17.50
Total nonvested at December 31, 2006	535,320	$ 12.99

During the year ended December 31, 2005, the Company granted 150,000 shares of restricted stock with a weighted average grant date fair value of $8.15, all of which was nonvested as of December 31, 2005. The shares of restricted stock are subject to the Company s right of repurchase, which lapse over a period of one to four years. Repurchased shares are recorded as treasury stock on an average cost basis. During the year ended December 31, 2006, 174,844 shares of restricted stock subject to such repurchase right of the Company were purchased by employees and directors. The total intrinsic value of restricted stock vested during the year ended December 31, 2006 was $0.6 million. The Company also granted rights to purchase 301,133 shares of restricted stock to executive officers of the Company which were allowed to lapse unexercised in March 2006. In their place, in February 2007, the Compensation Committee of the Board of Directors of the Company determined that certain executive officers, based on their level of performance during the Company s 2006 fiscal year, are eligible to receive 203,000 shares of common stock in the aggregate. The Committee s determination is subject to compliance with applicable law, and the Committee will approve the issuance of the Performance Stock at a later date The Performance Stock is included in the Company s computation of stock-based compensation expense for the year ended December 31, 2006.

In connection with the October 2002 acquisition of Shanghai Yi Yun Telecom Technology Co. Ltd. (Shanghai Yi Yun), the Company issued 514,290 shares of restricted stock valued at that time at $9.0 million to the Shanghai Yi Yun employees that were hired by one of the Company s subsidiaries. Such shares of restricted stock cliff vests over five years through 2007, with accelerated vesting upon the achievement of specified milestones. The Company has treated these 514,290 shares of restricted stock as deferred compensation. During 2003, 226,302 of these shares vested upon achievement of specified milestones. As of December 31, 2006, 5,110 shares have been forfeited resulting in 282,878 remaining shares outstanding. No further vesting has occurred through December 31, 2006.

Information regarding the stock options outstanding at December 31, 2006, is summarized below:

		Options Outstanding				Options Exercisable		
Range of exercise price		Outstanding at December 31, 2006	Weighted average exercise price	Intrinsic value (in thousands)	Weighted average remaining contractual life (in years)	Exercisable at December 31, 2006	Weighted average exercise price	Intrinsic value (in thousands)
$0.06	$ 4.50	775,586	$ 3.78	$ 3,855	2.2	775,586	$ 3.78	$ 3,855
4.71	6.25	4,134,317	6.24	10,361	9.2	4,126	5.54	13
6.31	7.50	2,106,843	6.63	4,457	8.9	494,268	6.63	1,043
7.52	11.07	2,631,672	9.95	434	8.0	1,243,186	9.86	212
11.11	16.34	2,118,907	14.20		4.9	1,965,685	14.20	
16.54	20.25	3,019,698	19.25		6.0	2,717,237	19.41	
20.48	26.34	2,637,358	25.32		6.7	2,595,394	25.37	
26.34	37.46	2,041,149	31.25		6.7	2,040,774	31.25	
37.49	43.02	118,320	40.13		6.6	118,320	40.13	
45.21	45.21	50,000	45.21		6.6	50,000	45.21	
$ 0.06	$ 45.21	19,633,850	15.01	$ 19,107	7.2	12,004,576	$ 19.64	$ 5,123
Options exercisable and expected to vest December 31, 2006		18,787,739	$ 15.35	$ 17,536				

The intrinsic value represents the total pre-tax intrinsic value and is calculated as the difference between the market value as reported by NASDAQ on December 31, 2006 of $8.75 and the exercise price of the in-the-money shares. During the years ended December 31, 2006, 2005 and 2004, the total pre-tax intrinsic value of options exercised was $0.5 million, $0.8 million and $18.6 million, respectively, determined as of the date of the exercise. The weighted average remaining contractual life of options exercisable was 6.0 years, and the weighted average remaining contractual life of options expected to vest was 8.9 years as of December 31, 2006.

2000 Employee Stock Purchase Plan:

In February 2000, the Company s stockholders approved the 2000 Employee Stock Purchase Plan (ESPP). The purchase plan is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code.

The Company had reserved 1,914,934 shares of common stock for sale under the stock purchase plan at December 31, 2006. The number of shares reserved for sale under the plan will be increased annually on the first day of each fiscal year beginning in 2001 by an amount equal to 2.0 million shares, or 2% of the outstanding shares of the Company s common stock on that date, or a lesser amount determined by the Board of Directors. The stock purchase plan is administered by the Board or a committee appointed by the Board.

The stock purchase plan is implemented by concurrent offering periods, the duration of which may not exceed 24 months. An offering period may contain up to four interim purchase periods. Shares purchased under the stock purchase plan will be held in separate accounts for each participant. The first offering period began in March 2000 and ended on the last trading day before April 30, 2002. During 2006, no purchases were made on the scheduled purchase dates in May and November as the Company suspended participation in the ESPP prior to the scheduled purchase dates as a result of the Company not being current with its SEC filings on Form 10-K for the year ended December 31, 2005 and quarterly report on Form 10-Q for the quarter ended September 30, 2006, respectively. As of December 31, 2006, the offering periods that commenced on November 1, 2005 and June 29, 2006 are currently under suspension and employees who remain participants in their respective offering periods will resume participation once the suspension is lifted.

Employees will be eligible to participate in the stock purchase plan if they are employed by the Company for more than 20 hours per week and more than five months in a calendar year. The stock purchase plan permits eligible employees to purchase the Company s common stock through payroll deductions, which may not exceed 15% of the employee s total compensation. Stock may be purchased under the plan at a price equal to 85% of the fair market value of the Company s stock on either the date of purchase or the first day of the offering period, whichever is lower. However, the Board of Directors may in its discretion provide that the price at which shares of common stock are purchased under the plan shall be 85% of the fair market value of the Company s shares on the date of purchase. Participants may not purchase shares of common stock having a value greater than $25,000 during any calendar year.

Participants may increase or decrease their payroll deductions at any time during an offering period, subject to limits imposed by the Board of Directors. If a participant withdraws from the stock purchase plan, any contributions that have not been used to purchase shares shall be refunded. A participant who has withdrawn may not participate in the stock purchase plan again until the next offering period. In the event of retirement or cessation of employment for any reason, any contributions that have not yet been used to purchase shares will be refunded to the participant, or to the participant s designated beneficiary in the case of death, and a certificate will be issued for the full shares in the participant s account.

The Board of Directors may terminate or amend the stock purchase plan, subject to stockholder approval in some circumstances. Unless terminated earlier by the Board, the stock purchase plan will have a term of ten years.

Stock-Based Compensation

SFAS 123(R) requires the use of option-pricing models that were not developed for use in valuing employee stock options. The Company has used the Black-Scholes option pricing model (Black-Scholes model) method of valuation for share-based awards granted prior to December 31, 2005, and has continued to use the Black-Scholes model for subsequent share-based payment awards. The Black-Scholes model was developed for use in estimating the fair value of short-lived exchange traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions, including the expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The Company uses historical volatility as management believes it is more representative of future stock price trends than implied volatility due to the relatively small number of actively traded options on our common stock available to determine implied volatility. The Company estimates an expected term of options granted based upon the Company s historical exercise and cancellation data for vested options. In addition, separate groups of employees that have similar exercise behavior are considered separately. The expected term of employee stock purchase plan shares is the average of the remaining purchase periods under each offering period. The Company bases the risk free interest rate used in the option valuation model on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. Prior to January 1, 2006, stock-based payment awards were amortized on an accelerated basis by treating each vested tranche as a separate stock option grant (graded vesting). Upon adoption of SFAS 123(R) on January 1, 2006 all stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods.

The fair value of share based payment awards was estimated using the Black-Scholes option pricing model with the following assumptions:

	Year ended December 31,		
Stock Options:	**2006**	**2005**	**2004**
Expected term in years	4.0	4.0	3.0
Weighted average risk-free interest rate	4.66 %	4.01 %	2.78 %
Expected dividend rate	0.0 %	0.0 %	0.0 %
Volatility	57 %	61 %	56 %

	Year ended December 31,		
ESPP Shares:	**2006**	**2005**	**2004**
Expected term in years	0.5 to 2.0	0.5 to 2.0	0.5 to 2.0
Weighted average risk-free interest rate	4.42 %	2.69 %	1.15 %
Expected dividend rate	0.0 %	0.0 %	0.0 %
Volatility	63 %	52 %	47 %

On December 31, 2004, a sub-committee of the Company s Board of Directors (the Board) approved an immediate and full acceleration of vesting of all stock options outstanding under the Company s 1997 Stock Option Plan with a per share exercise price greater than $22.15 (the Acceleration). The Company amended all relevant option agreements to reflect the Acceleration. The Company adopted the Acceleration in anticipation of the impact of SFAS 123(R). As a result of the Acceleration, options to purchase approximately 6.4 million shares of the Company s common stock became immediately exercisable as of December 31, 2004. The Acceleration had the effect of decreasing 2004 pro forma net income by approximately $33 million. The Acceleration had no impact on the financial statements as of and for the year ended December 31, 2004. The estimated aggregate SFAS 123(R) expense that was eliminated as a result of the Acceleration of the vesting of these options was approximately $35 million, assuming no material change in employee retention behavior.

At December 31, 2006, there was $29.9 million of total unrecognized compensation cost, as measured, related to non-vested stock options and restricted stock, which is expected to be recognized over a weighted-average period of 2.6 years. The weighted average fair value of options granted under the stock option plans during the years ended December 31, 2006, 2005 and 2004 was $3.07, $4.25 and $10.52 per share, respectively.

The total stock-based compensation cost recognized for the year ended December 31, 2006 was as follows:

	Year Ended December 31, 2006 (in thousands)
Stock-based compensation expense by type of award:	
Employee stock options	$ 14,108
Employee stock purchase plan	712
Restricted stock	4,165
Forfeitures related to disposal of a component of a business	(2,393)
Tax effect	
Total	$ 16,592

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Stock-based compensation expense for the year ended December 31, 2006 was reduced by $2.4 million related to options forfeited in connection with the disposal of the Company s semiconductor design operations discussed in Note 5. As a result of adopting SFAS 123(R) on January 1, 2006, the Company s income before income taxes and net income for the year ended December 31, 2006 were approximately $10.3 million lower than if it had continued to account for stock incentive compensation under the intrinsic value method. Had the Company continued to use the intrinsic value method, the effect on basic and diluted earnings per share would have been an increase of approximately $0.09 per share.

NOTE 16 401(K) PLAN

On January 1, 2000, the Company adopted the UTStarcom, Inc. 401(k) Savings Plan (401(k) Plan), a cash-or-deferred arrangement, which covers the Company s eligible employees who have attained the age of 21. The 401(k) Plan is intended to qualify under Sections 401(a), 401(m) and 401(k) of the Internal Revenue Code of 1986, as amended (Code), and the 401(k) Plan trust is intended to qualify under Section 501(a) of the Code. All contributions to the 401(k) Plan by eligible employees or by the Company, and the investment earnings thereon, are not taxable to such employees until withdrawn, and any contributions the Company may make are expected to be deductible by the Company. The Company s eligible employees may elect to reduce their current eligible compensation by one percent (1%) up to one hundred percent (100%), subject to the maximum statutorily prescribed annual limit of $15,000 for participants under age 50 and $20,000 for participants age 50 and over for the year ended December 31, 2006, and to have such salary reductions contributed on their behalf to the 401(k) Plan. The 401(k) Plan permits, but does not require, the Company to make matching contributions on behalf of all eligible employees who make salary reduction contributions to the 401(k) Plan. Commencing with the plan year beginning January 1, 2001, the Company elected to begin making matching contributions on behalf of qualified employees who participate in the 401(k) Plan. The Company will contribute $0.50 for each dollar contributed by qualified employees to the 401(k) Plan, to a maximum of $5,500 for the 2006 and 2005 plan years. The Company s matching contributions are subject to a five-year vesting schedule based upon longevity of employee service with the Company. Matching contributions were $2.7 million, $3.2 million, and $2.7 million for 2006, 2005, and 2004, respectively.

NOTE 17 COMMITMENTS AND CONTINGENCIES

Leases:

The Company leases certain facilities under non-cancelable operating leases that expire at various dates through 2013. In addition, the Company has entered into non-cancelable capital leases having expiration dates through 2011. The minimum future lease payments under the leases at December 31, 2006 were as follows:

Years ending December 31:	**Capital (in thousands)**	**Operating**
2007	$ 286	$ 15,340
2008	286	10,833
2009	247	7,932
2010	57	2,430
2011 and after	47	1,665
Total minimum lease payments	$ 923	$ 38,200
Less: amount representing interest	(114)	
Present value of minimun payments	809	
Less: current portion of capital lease obligations	(248)	
Capital lease obligations, non-current	561	

Rent expense for the years ended December 31, 2006, 2005 and 2004 was $21.3 million, $22.5 million, and $17.3 million, respectively.

Contractual obligations and commercial commitments:

As of December 31, 2006 the Company s obligations under contractual obligations and commercial commitments were as follows:

	Payments Due by Period		
	Total	Less than 1 year	1-3 years
	(in thousands)		
Bank loans	$ 102,510	$ 102,510	$
Convertible subordinated notes	$ 274,600	$	$ 274,600
Interest payable on debt	$ 35,216	$ 30,239	$ 4,977
Letters of credit	$ 56,569	$ 40,100	$ 16,469
Long-term purchase obligations	$ 3,777	$	$ 3,777

Letters of credit

The Company issues standby letters of credit primarily to support international sales activities outside of China. When the Company submits a bid for a sale, often the potential customer will require that the Company issue a bid bond or a standby letter of credit to demonstrate its commitment through the bid process. In addition, the Company may be required to issue standby letters of credit as guarantees for advance customer payments upon contract signing or performance guarantees. The standby letters of credit usually expire without being drawn by the beneficiary thereof. Finally, the Company may issue commercial letters of credit in support of purchase commitments.

Long-term purchase obligations

At December 31, 2006, long-term purchase obligations include non-cancelable agreements to purchase components, primarily in connection with last time buy agreements. As of December 31, 2006, total commitments under these agreements were approximately $3.8 million. Additionally, in connection with the sale of assets to Marvell, the Company has agreed to purchase from Marvell certain chipsets that will be included in the Company s PAS handsets through 2011. These chipsets will be included in certain handset products designed and manufactured by the Company.

Investment commitments:

As of December 31, 2006, the Company had invested a total of $2.6 million in Global Asia Partners L.P., a fund formed to make private equity investments in private or pre-IPO technology and telecommunications companies in Asia. The Company had a commitment to invest up to a maximum of $5.0 million, but as the result of a reorganization of capital contributions by the partners, reached in April 2005, the Company s capital contribution of $0.6 million in April 2005 was the final capital contribution to be made. In addition, the agreement allows the partnership to re-invest up to $2.5 million that otherwise would have been available to us as future distributions.

Intellectual property:

Certain sales contracts include provisions under which customers would be indemnified by us in the event of, among other things, a third party claim against the customer for intellectual property rights infringement related to our products. There are no limitations on the maximum potential future payments under these guarantees. The Company has not accrued any amounts in relation to these provisions as no such claims have been made and the Company believes it has valid enforceable rights to the intellectual property embedded in its products.

Litigation

Securities Class Action Litigation

Beginning in October 2004, several shareholder class actions alleging federal securities violations were filed against the Company and various officers and directors of the Company. The actions have been consolidated in United States District Court for the Northern District of California under the caption *In re UTStarcom, Inc. Securities Litigation*, Master File No. C-04-4908-JW(PVT). The lead plaintiffs in the case filed a First Amended Consolidated Complaint on July 26, 2005. The First Amended Complaint alleged violations of the Securities Exchange Act of 1934, and was brought on behalf of a putative class of shareholders who purchased our stock after April 16, 2003 and before September 20, 2004. On April 13, 2006, the lead plaintiffs filed a Second Amended Complaint adding new allegations and extending the end of the class period to October 6, 2005. In addition to the Company defendants, the plaintiffs are also suing Softbank. Plaintiffs complaint seeks recovery of damages in an unspecified amount.

On June 2, 2006, the Company and the individual defendants filed a motion to dismiss the Second Amended Complaint. On March 21, 2007, the Court granted defendants motion and dismissed plaintiffs Second Amended Complaint. The Court granted plaintiffs leave to file a Third Amended Complaint, which plaintiffs filed on May 25, 2007. On July 13, 2007, the Company and the individual defendants filed a motion to dismiss and a motion to strike the Third Amended Complaint.

On September 4, 2007, a second shareholder class action complaint captioned *Peter Rudolph v. UTStarcom, et al.*, Case No. C-07-4578 SI, was filed in the United States District Court for the Northern District of California against the Company and some of the Company s current and former directors and officers. The complaint alleges violations of the Securities Exchange Act of 1934 through undisclosed improper accounting practices concerning the Company s historical equity award grants. Plaintiff seeks unspecified damages on behalf of a purported class of purchasers of the Company s common stock between July 24, 2002 and September 4, 2007.

Due to the preliminary status of these lawsuits and uncertainties related to litigation, the Company is unable to evaluate the likelihood of either a favorable or unfavorable outcome. Accordingly, the Company is unable at this time to estimate the effects of these complaints on the Company s financial position, results of operations, or cash flows.

Governmental Investigations

The Company has received notice of a formal inquiry by the staff of the Securities & Exchange Commission (SEC) into certain aspects of the Company s financial disclosures during prior reporting periods and certain other issues. In addition, in December 2005, the U.S. Embassy in Mongolia informed the Company that it had forwarded to the Department of Justice (DOJ) allegations that an agent of the Company s Mongolia joint venture had offered payments to a Mongolian government official in possible violation of the Foreign Corrupt Practices Act (the FCPA). The Company through our Audit Committee, authorized an independent investigation into possible violations of the FCPA, and the Company has been in contact with the DOJ and SEC regarding the investigation. The investigation has identified possible FCPA violations in Mongolia, Southeast Asia, India, and China, as well as possible violations of U.S. immigration laws. The DOJ has requested that the Company voluntarily produce documents related to the investigation and the SEC has subpoenaed the Company for documents. The Company has executed tolling agreements extending the statute of limitations for the FCPA issues under investigation by the SEC and DOJ and the immigration issues under investigation by the DOJ. At this time, the Company cannot predict when any inquiry will be completed or what the outcome of any inquiry will be.

Shareholder Litigation

On November 17, 2006, a shareholder derivative complaint captioned *Ernesto Espinoza v. Ying Wu et al.*, Case No. RG06298775, was filed against certain of the Company s current and former officers and directors in the Superior Court of the County of Alameda, California. The complaint alleges that the individual defendants, among other things, breached their duties, were unjustly enriched, and violated the California Corporations Code in connection with the timing of stock option grants. The complaint names the Company as a nominal defendant and seeks unspecified monetary damages against the individual defendants and various forms of injunctive relief. On February 2, 2007, the Company and the individual defendants filed demurrers against the complaint. On April 11, 2007, the Court sustained the individual defendants demurrer, overruled the Company s demurrer, ordered the plaintiff to file an amended complaint, and ordered the Company to answer the original complaint. The plaintiff filed an amended complaint and the Company has filed an answer to the amended complaint. On August 21, 2007, the individual defendants filed demurrers against the amended complaint. The Court sustained the individual defendants demurrers and ordered the plaintiff to file a second amended complaint.

Due to the preliminary status of this complaint and uncertainties related to litigation, the Company is unable to evaluate the likelihood of either a favorable or unfavorable outcome. Accordingly, the Company is unable at this time to estimate the effects of this complaint on the Company s financial position, results of operations, or cash flows.

IPO Allocation

On October 31, 2001, a complaint was filed in United States District Court for the Southern District of New York against the Company, some of the Company s directors and officers and various underwriters for the Company s initial public offering. Substantially similar actions were filed concerning the initial public offerings for more than 300 different issuers, and the cases were coordinated as *In re Initial Public Offering Securities Litigation*, 21 MC 92 for pretrial purposes. In April 2002, a consolidated amended complaint was filed in the matter against the Company, captioned *In re UTStarcom, Initial Public Offering Securities Litigation*, Civil Action No. 01-CV-9604. Plaintiffs allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 through undisclosed improper underwriting practices concerning the allocation of IPO shares in exchange for excessive brokerage commissions, agreements to purchase shares at higher prices in the aftermarket and misleading analyst reports. Plaintiffs seek unspecified damages on behalf of a purported class of purchasers of the Company s common stock between March 2, 2000 and December 6, 2000. The Company s directors and officers have been dismissed without prejudice pursuant to a stipulation. On February 19, 2003, the Court granted in part and denied in part a motion to dismiss brought by defendants including the Company. The order dismissed all claims against the Company except for a claim brought under Section 11 of the Securities Act of 1933, which alleges that the registration statement filed in accordance with the IPO was misleading. In June 2004, a stipulation of settlement and release of claims against the issuer defendants, including the Company, was submitted to the court for approval. The terms of the settlement, if approved, would have dismissed and released all claims against the participating defendants (including the Company). In August 2005, the Court preliminarily approved the settlement. In December 2006, the Court of Appeals for the Second Circuit reversed the Court s October 2004 order certifying a class in six test cases that were selected by the underwriter defendants and plaintiffs in the coordinated proceedings. The Company s case is not one of the test cases. Because class certification was a condition of the settlement, it was unlikely that the settlement would receive final Court approval. On June 25, 2007, the Court entered an order terminating the proposed settlement based on a stipulation among the parties to the settlement. Plaintiffs have filed amended master allegations and amended complaints in the six test cases. It is unclear whether there will be any revised or future settlement. If the litigation proceeds, the Company believes that the Company has meritorious defenses and intend to defend the action vigorously. The total amount of the loss associated with the above litigation is not determinable at this time. Therefore, the Company is unable to currently estimate the loss, if any, associated with the litigation.

Passave Litigation

In November 2005, the Company filed suit in the Superior Court of California, County of Santa Clara, against Passave, Inc. (Passave) for breaches of contract and warranties in connection with a semiconductor device sold by Passave, Ltd. (Passave s wholly-–owned subsidiary) to the Company. The Company s complaint alleges that the Passave device, known as the PAS5001M3 chip, has exhibited certain operational malfunctions within some of our Fiber-to-the-Home product line, and has thereby caused damage to the Company. The parties entered into a settlement agreement, dated August 7, 2007, and have since dismissed all claims with prejudice.

UTStarcom, Inc. v. Starent Patent Infringement Litigations

The Company brought suit against Starent Networks Corporation (Starent) for patent infringement in the U.S. District Court for the Northern District of California. The Complaint was filed on March 22, 2004, and later amended. In this action, the Company asserted that Starent infringed the Company s patent U. S. Reg. No. 6,628,671 through the manufacture, use, offer, for sale, and sale of Starent s ST-16 Intelligent Mobile Gateway. The Company sought damages and injunctive relief. Starent filed its answer to the Amended Complaint and counterclaims, denying our allegations and seeking a declaration that the patent-in-suit is not infringed, is invalid, and is unenforceable. A motion for a preliminary injunction against the making, using or selling of infringing products and methods was brought, but the Court denied it on June 17, 2005. After a claims construction hearing and order, on September 20, 2005, Starent filed a motion for summary judgment of non-infringement and the Company filed a motion for summary judgment that Starent is estopped from asserting invalidity and unenforceability. On December 6, 2005, the Court granted Starent s motion for summary judgment. On February 2, 2006, the Court entered judgment in favor of Starent and dismissed the case. On March 2, 2006 the Company filed an appeal to the Federal Circuit. On April 6, 2007, after reviewing the parties briefs and hearing oral argument on April 2, 2007, the Federal Circuit, without a written opinion, affirmed the District Court s judgment and dismissal of the case. Although the Federal Circuit ruled against the Company, this decision will not have a material adverse effect on the business, financial condition, or results of its operations.

On February 16, 2005, the Company filed a second suit against Starent for patent infringement in the U.S. District Court for the Northern District of California. In the Complaint, the Company asserts that Starent infringes UTStarcom patent U.S. Reg. No. 6,829,473 (the 473 patent) through Starent s development and testing of a software upgrade for its customer s installed ST-16 Intelligent Mobile Gateways. The Company seeks declaratory and injunctive relief. Starent subsequently filed its answer and counterclaims, denying the Company s allegations and seeking a declaration that the patent-in-suit is not infringed, is invalid, and is unenforceable. On June 16, 2005, the Company filed a motion to strike Starent s affirmative defense and dismiss Starent s counterclaim alleging inequitable conduct. On July 19, 2005, the parties stipulated that Starent would file an amended answer and counterclaim by July 27, 2005 and that the Company would withdraw the Company s motion to strike. On August 10, 2005, the Company responded to Starent s amended counterclaim filed on July 27, 2005. In early December 2006, the Company filed a reissue application for the 473 patent with the United States Patent and Trademark Office. Starent has also filed for reexamination of the 473 patent. The reexamination and reissue are currently copending. The litigation is still in a preliminary stage and its outcome cannot be predicted, although the Company believes the litigation has merit. Nonetheless, the Company believes that any adverse judgment on Starent s counterclaims will not have a material adverse effect on the Company s business, financial condition, or results of operations.

On May 8, 2007, the Company filed a third suit against Starent and sixteen individual defendants (who were all former employees of 3Com s CommWorks division which the Company acquired certain assets of in May of 2003) in the Northern District of Illinois. The causes of action include claims for patent infringement, misappropriation of trade secrets, intentional interference with business relations and prospective economic advantage and declarations of ownership of certain patent rights. In its Complaint, the Company asserts that Starent infringes UTStarcom patents U. S. Reg. Nos. 7,173,905; 6,978,128; 6,963,582; 6,975,900; and 6,684,256 through the manufacture, use, offer, for sale, and sale of Starent s ST16 Intelligent Mobile Gateway and ST40 multimedia code platform, that the individual Defendants and Starent have misappropriated valuable Company trade secrets by improperly taking and using the Company s confidential and proprietary information for the benefit of Starent, that the individual defendants and Starent have interfered with the Company s business relations and prospective economic advantage by using the misappropriated information to obtain and enhance sales of Starent s products, and that several of Starent s patent applications and one issued patent are based on information obtained by the former employees while at the Company (CommWorks) and on that basis belong to UTStarcom. The Company seeks compensatory damages, punitive damages and injunctive relief. After the court denied the defendants motion to dismiss the misappropriation of trade secrets claims, on August 30, 2007, Starent answered the Company s complaint, denying the Company s allegations and asserting a number of affirmative defenses and counterclaims, including non-infringement of the subject patents and alleged tortious interference with prospective economic advantage. The Company has filed a motion to dismiss most of the counterclaims and the court has ordered appointment of a special master to handle discovery, which is just beginning. The Company believes that any adverse judgment on Starent s counterclaims will not have a material adverse effect on the Company s business, financial condition or results of operations.

Telemetrix, Inc. Arbitration

On October 19, 2006, Telemetrix, Inc. (Telemetrix) filed a formal Request for Arbitration against the Company to the World Intellectual Property Organization (WIPO) in Geneva, Switzerland. The Request for Arbitration sought unspecified damages arising from a contract between Telemetrix and Telos Technology, Inc., dated October 22, 2003. The Company assumed Telos rights and obligations under this contract pursuant to the Company s purchase of Telos assets on May 19, 2004. Telemetrix alleged nine causes of action, including breach of contract, fraud, negligent misrepresentation, interference with contractual relations, and interference with prospective economic advantage. In December 2006, the Company filed a formal response to the Request for Arbitration, denying all material factual allegations asserted by Telemetrix. An arbitrator was selected by the parties, and, on August 2, 2007, the arbitrator granted a pleading motion in favor of the Company due to Telemetrix s failure to allege sufficient facts in support of a majority of its causes of action. On August 17, 2007, Telemetrix filed an Amended Statement of Claim, alleging six causes of action, including breach of contract, fraud, interference with contractual relations and interference with prospective economic advantage. The previous hearing date of December 11-13 has been vacated. No hearing date has been rescheduled. Discovery has begun.

Telos Technology, Inc. Litigation

On November 22, 2005, plaintiffs Telos Technology, Inc., Telos Technology (Canada), Inc., Telos Technology (Bermuda) Ltd., and Telos Engineering Limited (collectively, the Telos Plaintiffs) filed a Complaint against the Company in the Superior Court of California, County of Santa Clara. The Complaint alleges five causes of action, including breach of contract, breach of the implied covenant of good faith and fair dealing, fraudulent inducement, intentional misrepresentation and negligent misrepresentation, all of which arise from the Asset Purchase Agreement between the parties dated April 21, 2004. The Telos Plaintiffs assert that the Company breached the express and implied terms of the Asset Purchase Agreement and made representations to the Telos Plaintiffs during negotiations that it never intended to fulfill. The Telos Plaintiffs sought at least $19 million in damages, unspecified punitive damages and attorneys fees. The parties executed a settlement agreement in the amount of $4.5 million on August 20, 2007 and the case was dismissed on September 26, 2007 with prejudice.

Other Litigation

The Company is a party to other litigation matters and claims that are normal in the course of operations, and while the results of such litigation matters and claims cannot be predicted with certainty, the Company believes that the final outcome of such matters will not have a material adverse impact on the Company s financial position, results of operations or cash flows.

NOTE 18 OPERATING RISKS

Financial Risks:

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash, cash equivalents, short-term investments and accounts and notes receivable. The Company places its temporary cash and short-term investments with several financial institutions. Approximately $523.7 million and $523.8 million of the Company s cash and short-term investments were on deposit in foreign accounts at December 31, 2006 and 2005, respectively. The Company invests excess cash in highly liquid investments with original maturities of twelve months or less, such as certificates of deposit, government sponsored entities notes, commercial paper, floating rate corporate bonds, fixed income corporate bonds, and money market funds, which the Company believes have limited exposure to risk.

Concentration of Credit Risk and Major Customers:

Most Chinese carriers have three levels of operations: the central headquarters level, the provincial level and the local city/county level. Both central and provincial levels are independent legal entities and have their own corporate mandate. The purchasing decision making process may take various forms for different projects and may also differ significantly from carrier to carrier. The Company groups all China customers together by province and treats each province as one customer since that is the level at which purchasing decisions are made.

At December 31, 2006 Jiangsu province had an accounts receivable balance of approximately 11% of the total accounts receivable for the Company. At December 31, 2005, Softbank had a balance of approximately 16% of the Company total balance of accounts receivable. At December 31, 2004, Hebei province had an account receivable balance of approximately 15% of the Company total accounts receivable balance.

The following customers accounted for 10% or more of the Company s net revenues:

	For the year ended December 31,		
	2006	2005	2004
Verizon	14 %	12 %	
T-Mobile	11 %		
Softbank		14 %	
Guangdong			13 %
Jiangsu			10 %

Approximately 23%, 22%, and 72% of the Company s net sales during 2006, 2005, and 2004, respectively, were to entities affiliated with the government of China. Accounts receivable balances from these China government affiliated entities or state owned enterprises were $170.4 million and $268.8 million, respectively, as of December 31, 2006 and 2005. The Company extends credit to its customers in China generally without requiring collateral. In global sales outside of China, the Company may require letters of credit from its customers. The Company monitors its exposure for credit losses and maintains allowances for doubtful accounts.

Country Risks:

Approximately 32%, 30%, and 79% of the Company s sales for the year ended December 31, 2006, 2005, and 2004, respectively, were made in China. Accordingly, the political, economic and legal environment, as well as the general state of China s economy may influence the Company s business, financial condition and results of operations. The Company s operations in China are subject to special considerations and significant risks not typically associated with companies in the United States. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company s results may be adversely affected by, among other things, changes in the political, economic and social conditions in China, and by changes in governmental policies with respect to laws and regulations, changes in China s telecommunications industry and regulatory rules and policies, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation.

Approximately 5%, 17%, and 6% of the Company s sales for the year ended December 31, 2006, 2005, and 2004, respectively, were made in Japan. Accordingly, the political, economic and legal environment and the general state of Japan s economy may influence the Company s business, financial condition and results of operations.

NOTE 19 SEGMENT REPORTING

From the inception through 2003 the Company managed its business as a single reportable segment. During 2004, the Company continued to expand its focus on markets and operations outside of China. Effective with the fourth quarter of 2004, it was determined that the Company s chief operating decision makers, in accordance with SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, were evaluating performance, making operating decisions and allocating resources based on two operating segments, (i) China and (ii) all other regions referred to as International (International).

On November 1, 2004, the Company acquired selected assets of the wireless handset division of Audiovox Corporation. The acquired business has been integrated into the Company as a separate and distinct operating division referred to as the Personal Communications Division (PCD). As the Company determined to evaluate performance and allocate resources to this division, it was considered a third operating segment. As a result, as of December 31, 2004, the Company was organized, principally based on geographical market locations, in three operating segments, (i) China, (ii) International and (iii) PCD, and each segment consisted of one reporting unit.

Effective in the first quarter of 2005, the Company elected to reorganize its business based principally upon product family and realigned its business into five operating units, (i) Broadband Infrastructure, (ii) Wireless Infrastructure, (iii) Personal Communications Division (PCD) (iv) Handsets, and (v) Services. The Company announced that effective July 1, 2006, a newly created operating unit; Network Solutions would begin offering products and services through the combination of the Broadband Infrastructure and the Wireless Infrastructure reporting segments. Each reporting segment and operating unit is responsible for managing its own performance.

The Company currently evaluates operating performance of and allocates resources to the reporting segments based on segment gross profit. Cost of sales and direct expenses in relation to production are assigned to the reporting segments. The accounting policies used in measuring segment assets and operating performance are the same as those used by corporate and are consistently applied across all segments.

Summarized below are the Company s segment sales and gross profit for the years ended December 31, 2006, 2005 and 2004 based on the current reporting segment structure:

	Years Ended December 31, 2006 (in thousands)	% of net sales	2005 (As restated)	% of net sales	2004 (As restated)	% of net sales
Net Sales by Segment						
Broadband Infrastructure	$ 219,557	9 %	$ 507,978	18 %	$ 232,442	9 %
Wireless Infrastructure	427,400	17 %	436,016	15 %	1,268,850	49 %
Network Solutions	646,957	26 %	943,994	33 %	1,501,292	58 %
PCD	1,339,496	55 %	1,369,324	48 %	277,410	11 %
Handsets	395,812	16 %	473,472	16 %	749,073	29 %
Services	76,596	3 %	84,320	3 %	51,640	2 %
	$ 2,458,861	100 %	$ 2,871,110	100 %	$ 2,579,415	100 %

	Years Ended December 31, 2006 (in thousands)	Gross profit %	2005 (As restated)	Gross Profit %	2004 (As restated)	Gross profit %
Gross profit by Segment						
Broadband Infrastructure	$ (3,019)	-1 %	$ 157,890	31 %	$ 45,585	20 %
Wireless Infrastructure	206,193	48 %	121,077	28 %	364,028	29 %
Network Solutions	203,174	31 %	278,967	30 %	409,613	27 %
PCD	39,932	3 %	52,812	4 %	11,866	4 %
Handsets	118,459	30 %	58,166	12 %	131,708	18 %
Services	24,179	32 %	45,891	54 %	16,345	32 %
	$ 385,744	16 %	$ 435,836	15 %	$ 569,532	22 %

Assets by segment are as follows:

	December 31, 2006 (in thousands)	2005
Long-lived assets		
Broadband Infrastructure	$ 43,157	$ 47,480
Wireless Infrastructure	79,691	87,673
Network Solutions	122,848	135,153
PCD	2,377	1,512
Handsets	43,596	47,963
Services	44,334	48,775
	$ 213,155	$ 233,403

	December 31, 2006 (in thousands)	2005 (As restated)
Total assets		
Broadband Infrastructure	$ 438,190	$ 473,181
Wireless Infrastructure	909,450	1,015,699
Network Solutions	1,347,640	1,488,880
PCD	414,295	420,191
Handsets	505,693	546,910
Services	106,322	95,350
	$ 2,373,950	$ 2,551,331

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Sales are attributed to a geographical area based upon the location of the customer. Sales data by geographical areas are as follows:

	Years ended December 31,					
	2006	% of net sales	2005 (As restated)	% of net sales	2004 (As restated)	% of net sales
	(in thousands)					
United States	$ 1,351,839	55 %	$ 1,332,213	46 %	$ 341,517	13 %
China	785,525	32 %	870,612	30 %	2,028,194	79 %
Japan	136,877	6 %	479,114	17 %	156,416	6 %
Other	184,620	7 %	189,171	7 %	53,288	2 %
Total net sales	$ 2,458,861	100 %	$ 2,871,110	100 %	$ 2,579,415	100 %

Long-lived assets, consisting of property, plant and equipment, by geographical area are as follows:

	December 31, 2006	2005
	(in thousands)	
U.S.	$ 14,354	$ 16,676
China	191,517	204,630
Other	7,284	12,097
Total long-lived assets	$ 213,155	$ 233,403

NOTE 20 TRANSACTIONS WITH RELATED PARTIES AND CERTAIN INVESTEES

Softbank

The Company recognized revenue of $130.8 million, $475.3 million and $143.7 million during the years ended December 31, 2006, 2005 and 2004, respectively, with respect to sales of telecommunications equipment to affiliates of SOFTBANK CORP. (Softbank), a significant stockholder of the Company. Softbank offers asynchronous digital subscriber line (ADSL) coverage throughout Japan, which is marketed under the name YAHOO! BB. In 2006, the Company determined that certain sales to third party resellers are, in substance, sales to Softbank and therefore, the Company has included these amounts in related party sales. Prior year amounts have been reclassified to conform to the current period presentation. The Company supports Softbank s fiber-to-the-home service through sales of its carrier class Gigabit Ethernet Passive Optical Network (GEPON) product as well as its multi-service optical transport product (NetRing™). In addition, the Company supports Softbank s new internet protocol television (IPTV), through sales of its RollingStream™ product. Included in revenue for the year ended December 31, 2006 is a fee of $31.2 million charged for the cancellation of orders for broadband products and $10.0 million charged for the cancellation of orders for wireless products.

Included in accounts receivable at December 31, 2006 and December 31, 2005 were $29.9 million and $83.4 million, respectively, related to these transactions. During 2006 and 2005, sales to Softbank include a three year service period and a penalty clause if product failure rates exceed a certain level over a seven year period. There was $11.5 million and $19.6 million included in long term deferred revenue with respect to these agreements at December 31, 2006 and 2005, respectively. Additionally, there was $11.6 million and $8.0 million included in current deferred revenue at December 31, 2006 and 2005, respectively. As of December 31, 2005, $5.4 million was included in customer advances related to other Softbank agreements.

During August 2004, the Company entered into several agreements with Japan Telecom Co., Ltd (JT), a wholly owned subsidiary of Softbank. These agreements relate to the sale of *i*AN-8000 equipment with specified value and delivery dates, as well as an oral agreement which subsequently converted into specific service contracts to manage a sales promotional program for JT. The Company determined that the service activities revenue should be recorded net of expected promotional spending.

Because the Company had not provided these activities in the past and could not estimate the fair value of these services, the Company determined under the guidance of SAB 104 that all revenue related to these agreements could not be recognized until all goods and services were delivered. The Company delivered and received final acceptance for all equipment contemplated under these agreements in the quarter ended March 31, 2005.

The promotional services discussed above involved contracting with third party promotional vendors, who in turn, facilitated the marketing and subscriber recruitment for the JT fiber-to-the-home program. During the fourth quarter of 2004, the Company determined that it would end its involvement with the JT promotional program after completion of the contract discussed above. Accordingly, late in the fourth quarter of 2004 and during the first quarter of 2005, the Company either cancelled or assigned to another party all third party contracts with promotional vendors related to the JT contract. Such termination or assignment of all third party promotional agreements, as well as effective satisfaction of the Company s obligations with JT under such agreements, satisfied the revenue recognition criteria for these agreements and as such, the net value of the promotional services and the value of equipment delivered, which totaled $204.8 million, was reported in the quarter ended March 31, 2005.

The Company also entered into an agreement with JT during the third quarter of 2004 to supply chassis equipment. The equipment shipped under this agreement is considered linked to the *i*AN-8000 sale noted above and as such, was also deferred until the completion of the above-mentioned promotional activities. The revenue recognition criteria related to the sale of the *i*AN- 8000 equipment was satisfied in the first quarter of 2005 and as such, the revenue related to the chassis sale of $66.5 million was reported in the quarter ended March 31, 2005. During the year ended December 31, 2006 and 2005, sales to Softbank included $6.7 million and $280.1 million, respectively, with regards to sales of telecommunications equipment and service sold to JT, and none for 2004.

The Company has invested in Restructuring Fund No.1, a venture capital investment limited partnership established by Softbank. The partnership was dissolved in July 2006 with a total cash distribution of $3.0 million to the Company during 2006. The Company has recorded a gain on investment of $1.4 million and $0.7 million, respectively, for the year ended December 31, 2006 and 2005. The Company recorded an immaterial equity loss for the year ended December 31, 2004.

On July 17, 2003, the Company entered into a Mezzanine Loan Agreement with BB Modem Rental PLC (BB Modem), an affiliate of SOFTBANK CORP. Under the terms of the agreement, the Company loaned BB Modem $10.1 million at an effective interest rate of 12.01% per annum, for the purpose of investing in a portfolio of ADSL modems and associated modem rental agreements, from Softbank. Softbank will continue to service such modems and modem rental agreements. The Company s loan is subordinated to certain senior lenders of BB Modem, and repayments are payable to the Company over a 42-month period through January 31, 2007, with a substantial portion of the principal amount of the loan repaid during the last 16 months of this period. During the year ended 2006, 2005 and 2004, the Company recorded $0.6 million, $1.3 million and 1.3 million, respectively in interest income in respect to this loan. The loan receivable at December 31, 2006 was approximately $1.0 million included in prepaids and other current assets. At December 31, 2005 the loan balance was approximately $9.0 million and was included in other long-term assets. The note receivable was paid in full in January 2007.

As of December 31, 2006, Softbank beneficially owned approximately 12% of the Company s outstanding stock.

Acoustek Int l Corp.

In 2005 and 2006, the Company received consulting services from Acoustek Int l Corp. (Acoustek), which employed Minnie Huang, spouse of William Huang, the Company s former Senior Vice President and Chief Technology Officer. Mr. Haung s employment with the Company terminated on December 31, 2006. The Company paid $0.1 million in each of the years of 2006 and 2005 for consulting services provided by Acoustek.

Audiovox

One of the Company s officers also serves as a director for Audiovox Corporation (Audiovox). During the year ended 2006 and 2005, the Company paid approximately $1.4 million and $0.7 million, respectively, for IT services from Audiovox.

Cellon

In September 2001, the Company invested $2.0 million in Cellon International Holdings Corporation (Cellon) and made additional investments of $3.0 million each in April and December 2002. Cellon designs wireless terminals and related technology for handset manufacturers and private distributors. In November 2005, the Company and Cellon entered into an agreement under which the Company received consideration in the form of preferred stock and warrants of Cellon valued at $5.5 million in exchange for the transfer of fixed assets with a net book value of $3.0 million, a facilities lease and a workforce in place consisting of 156 employees. This transaction was completed on May 31, 2006 and a gain on sale of assets of $2.5 million was recorded in other income. As of December 31, 2006, with the additional shares obtained in the purchase transaction, the Company had an 11% ownership interest in Cellon. In the fourth quarter of 2006, the Company s review of this investment included, but was not limited to, a review of Cellon s cash position, recent financing activities, financing needs, earnings/revenue outlook, operational performance, management/ownership changes, and competition. Based on the deterioration of Cellon s financial condition, the Company determined that the carrying value of the investment was at an amount above the fair value of the investment, and the decline was other-than temporary. As of December 31, 2006, the Company had recorded a $13.5 million other-than-temporary impairment charge for this investment in other income, net.

In November 2005, the Company entered into a Development Service Agreement with Cellon in which $5.0 million was prepaid in exchange for future product development. Approximately $2.0 million of the prepaid amount was used in year ended December 31, 2006 as payments for design services. The Company may also use the prepayment in satisfaction of royalties Cellon may earn from sales by the Company of products Cellon designs under the Development Services Agreement. This agreement also obligates Cellon to pay the Company a royalty if certain technology shared by the Company to Cellon is used in products developed and sold to customers other than the Company through November 2007. During 2006, no royalty was earned by the Company related to product developed and sold to customers other than the Company. During the fourth quarter of 2006, the Company recorded an operating expense of $3.0 million to write-off this prepayment in connection with the Company s assessment of the financial condition of Cellon as discussed above. For additional information regarding the Company s investment in Cellon see Note 23.

Fiberxon

The Company had an outstanding purchase commitment with Fiberxon, in which the Company has a 7% ownership interest, to purchase component parts for optical networking products. In addition, the Company provided a letter of credit for $5.0 million to purchase raw materials for the manufacture of these component parts. This commitment expired during 2005. There was no such commitment arrangement for 2006. Purchases from Fiberxon totaled $2.6 million, $9.7 million and $15.1 million during the years ended December 31, 2006, 2005 and 2004, respectively and the Company had $0.4 million and $0.3 million in accounts payable to Fiberxon at December 31, 2006 and 2005, respectively. For additional information regarding the Company s investment in Fiberxon see Note 23.

GCT Semiconductor

The Company has an outstanding purchase commitment with GCT Semiconductor, Inc. (GCT), in which the Company has a 2% ownership interest, to purchase component parts. Purchases from GCT totaled $6.3 million and $1.9 million for the years ended December 31, 2006 and 2005, respectively. The Company had $1.1 million in accounts payable to GCT at both December 31, 2006 and 2005.

Global Asia Partners L.P.

Global Asia Partners L.P. is a venture capital fund formed to make private equity investments in private or pre-IPO technology and telecommunications companies in Asia. The general partner of this fund was also a sales agent of the Company until the third quarter 2006. Between June 2002 and April 2005, the Company invested a total of $2.6 million in the fund. As of December 31, 2006 the Company owned 49% of the fund s outstanding partnership units. The Company had a commitment to invest up to a maximum of $5.0 million, but as the result of a reorganization of capital contributions by the partners, reached in April 2005, the Company s capital contribution of $0.6 million in April 2005 was the final capital contribution to be made. In addition, the agreement allows the partnership to re-invest up to $2.5 million that otherwise would have been available to us as future distributions. For additional information regarding the Company s investment in Global Asia Partners L.P. see Note 23.

Matsushita Joint Venture

In July 2002, the Company entered into a joint venture agreement with Matsushita Communication Industrial Co., Ltd. to jointly design and develop, manufacture and sell telecommunication products. The Company had a 49% ownership interest in the joint venture company. The Company performed engineering services for the joint venture for approximately $2.8 million which was recognized as revenue during 2005. As of December 31, 2005, the Company had a receivable of $0.1 million. In December 2005, the partners agreed to dissolve the joint venture and the dissolution was completed during 2006.

MDC Holding, Ltd.

The Company had an outstanding accounts receivable balance with MDC Holding, Inc. (MDC) related to a PAS system purchase of $1.3 million at December 31, 2006. There was no accounts receivable balance at December 31, 2005. Certain employees of the Company were shareholders of MDC as of December 31, 2006. MDC is in the business of providing value-added services, such as short message, voicemail or ring-tone services for PAS telecom networks.

ORG, Inc.

The Company has a 49% ownership in Global Asia Partners L.P. which in turn is a significant shareholder in ORG, Inc. The Company had sales of $1.6 million and $0.5 million to ORG, Inc. during 2006 and 2005, respectively. The Company had accounts receivable of $1.0 million and $0.2 million from ORG, Inc. as of December 31, 2006 and 2005, respectively. There was no deferred revenue at December 31, 2006 and there was $0.1 million in deferred revenue at December 31, 2005.

Starcom Products, Inc.

The Company obtains engineering consulting and employee placement services from Starcom Products, Inc. (Starcom), which is 31% owned by an individual related to one of the Company s former officers who was also a member of the Company s Board of Directors. The Company paid less than $0.1 million in 2006, $0.7 million in 2005 and $1.1 million in 2004 for engineering consulting and employee placement services provided by Starcom.

Xalted Networks

In May 2005 and August 2005, the Company invested $2.0 million and $1.0 million, respectively, in Xalted Networks (Xalted). In March 2006 the Company invested an additional $0.3 million in Xalted. Xalted is a development stage company providing telecommunication operator customers with a comprehensive set of network systems, software solutions and service offerings, in which the Company has a 11% ownership interest. The Company received purchase orders from Xalted Networks totaling approximately $1.3 million in 2005 for telecommunications equipment that is for product not typically sold by the Company to other customers. The Company charges a ten percent procurement fee to Xalted for obtaining and reselling these products. The equipment was delivered during 2005 but revenue has not been recognized as the revenue recognition process had not been completed.

NOTE 21 RESTRUCTURING COSTS

In the second quarter of fiscal 2005, the Company announced and initiated a restructuring plan to rationalize cost structure in response to the decline in demand for certain products. In addition, the restructuring plan was designed to allow the Company to reduce operating costs for each product line. The primary goal of these improvements was to lower the cost structure for the Company.

In 2005 the Company incurred $35.3 million in expenses in relation to the restructuring plan actions, primarily consisting of (i) $15.2 million related to severance payments (ii) $14.5 million in asset impairments primarily related to the write-off of equipment and licenses associated with discontinued products, which are included in operating expenses and (iii) $5.6 million in inventory write-off associated with discontinued products. Included in severance is a $1.8 million non-cash reversal of a housing allowance accrual in China. Restructuring expense related to the inventory write-off is included in cost of sales in the consolidated statements of operations. As a result of these actions, approximately 1,595 employees were terminated or placed in the workforce reduction programs during fiscal 2005. As of December 31, 2005, headcount reductions from this plan were completed.

For the year ended December 31, 2006, the Company recorded a reduction of $1.1 million to the restructuring plan accrual, primarily consisting of (i) $0.8 million in asset impairment/exit cost and (ii) $0.3 million related to severance payments. Included in asset impairment/exit cost is a $0.4 million non-cash reversal related to the E&O reserve for discontinued products and $0.1 million related to higher than expected sublease income for the Company s New Jersey facility. As of December 31, 2006, the Company s restructuring reserve balance of $0.1 million primarily consists of the remaining lease liability for the New Jersey facility. The Company expects the remaining balance to be paid through fiscal year 2007.

A summary of changes in the Company s restructuring accrual during the years ended December 31, 2006 and 2005 is as follows:

	Year ended December 31, 2005 Charges (in thousands)	Cash payment	Non-cash settlement	Balance December 31, 2005	Year ended December 31, 2006 Cash payment	Non-cash settlement	Balance December 31, 2006
Wireless							
Severance payments	$ 2,139	$ (2,559)	$ 420	$	$	$	$
Asset impairment	12,236	(110)	(12,126)				
Inventory write-off	5,543		(5,543)				
Broadband							
Severance payments	3,472	(3,503)	81	50	(50)		
Asset impairment	1,095	(50)	(1,045)				
Inventory write-off	53		(53)				
Handsets							
Severance payments	1,056	(1,127)	100	29	(29)		
Asset impairment	350			350		(350)	
Inventory write-off							
PCD							
Severance payments							
Asset impairment							
Inventory write-off							
Service							
Severance payments	2,135	(2,488)	353				
Asset impairment							
Inventory write-off							