Starent Networks, Corp.
Form 10-Q
November 07, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2008

or

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

For the transition period from to

Commission File Number: 001-33511

STARENT NETWORKS, CORP.

(Exact name of registrant as specified in its charter)

Delaware	**04-3527533**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

30 International Place
Tewksbury, MA 01876

(Address of principal executive offices) (zip code)

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

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

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

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

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

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

As of November 4, 2008, there were 70,085,178 shares of the registrant s $0.001 par value per share common stock outstanding.

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STARENT NETWORKS, CORP.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

STARENT NETWORKS, CORP.

CONDENSED CONSOLIDATED BALANCE SHEETS

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

	September 30, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 356,387	$ 223,987
Short-term investments		9,612
Accounts receivable	56,183	56,363
Inventories	42,527	29,638
Deferred tax assets, net	2,463	
Prepaid expenses and other current assets	4,932	6,656
Total current assets	462,492	326,256
Property and equipment, net	29,158	20,452
Deferred tax assets, net	6,274	
Other assets	2,031	1,955
Restricted cash	738	716
Total assets	$ 500,693	$ 349,379
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 9,752	$ 7,448
Accrued expenses	7,316	6,163
Accrued payroll and related expenses	14,777	15,568
Accrued income taxes	2,844	1,075
Current portion of deferred revenue	143,333	52,733
Total current liabilities	178,022	82,987
Deferred revenue, net of current portion	6,973	10,670
Other long-term liabilities	2,515	783
Commitments and contingencies (Note 7)		
Stockholders equity:		

Preferred stock, $0.001 par value, 5,000,000 shares authorized and no shares outstanding				
Common stock, $0.001 par value, 250,000,000 shares authorized, 69,757,366 and 68,252,858 shares issued and outstanding at September 30, 2008 and December 31, 2007, respectively		70		68
Additional paid-in capital		364,144		348,917
Accumulated other comprehensive income				2
Accumulated deficit		(51,031)		(94,048)
Total stockholders equity		313,183		254,939
Total liabilities and stockholders equity	$	500,693	$	349,379

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

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STARENT NETWORKS, CORP.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited and in thousands, except per share data)

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007
Revenues:				
Product	$ 55,450	$ 31,588	$ 156,497	$ 81,160
Service	10,611	5,103	26,960	14,026
Total revenues	66,061	36,691	183,457	95,186
Cost of revenues:				
Product	10,151	7,422	28,697	18,176
Service	4,107	2,723	11,823	6,052
Total cost of revenues	14,258	10,145	40,520	24,228
Gross profit	51,803	26,546	142,937	70,958
Operating expenses:				
Research and development	13,750	10,612	38,594	28,263
Sales and marketing	17,894	11,940	52,918	27,876
General and administrative	6,129	4,164	17,215	10,405
Total operating expenses	37,773	26,716	108,727	66,544
Income (loss) from operations	14,030	(170)	34,210	4,414
Interest income	1,940	2,038	6,232	3,637
Foreign currency exchange gain (loss)	(1,308)	84	(556)	(6)
Income before income tax benefit (expense)	14,662	1,952	39,886	8,045
Income tax benefit (expense)	4,926	(329)	3,131	(736)
Net income	19,588	1,623	43,017	7,309
Accretion of redeemable convertible preferred stock				(3,445)
Income allocated to preferred stockholders				(1,703)
Net income applicable to common stockholders	$ 19,588	$ 1,623	$ 43,017	$ 2,161
Net income per share applicable to common stockholders (Note 3):				
Basic	$ 0.28	$ 0.03	$ 0.62	$ 0.07
Diluted	$ 0.26	$ 0.02	$ 0.58	$ 0.06
Weighted-average shares used in computing net income per common share (Note 3):				
Basic	69,683	64,039	69,328	32,108
Diluted	74,192	70,685	74,343	38,260

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

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STARENT NETWORKS, CORP.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited and in thousands)

	Nine Months Ended September 30, 2008	2007
Cash flows from operating activities:		
Net income	$ 43,017	$ 7,309
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation and amortization expense	8,090	4,343
Share-based compensation	12,430	8,520
Foreign currency losses (gains)	695	(118)
Loss on disposal of fixed assets	36	
Benefit from deferred income taxes, net	(6,622)	
Changes in operating assets and liabilities:		
Accounts receivable	(390)	(21,227)
Inventories	(12,901)	(10,008)
Prepaid expenses and other current assets	1,133	(2,433)
Other assets	(116)	(307)
Accounts payable	2,399	5,375
Accrued expenses	753	6,081
Accrued income taxes	1,821	306
Deferred revenue	86,920	(13,900)
Net cash provided by (used in) operating activities	137,265	(16,059)
Cash flows from investing activities:		
Purchases of property and equipment	(16,820)	(11,749)
Purchases of short-term investments		(18,896)
Proceeds from maturities of short-term investments	9,610	40,380
Change in restricted cash	(43)	451
Net cash (used in) provided by investing activities	(7,253)	10,186
Cash flows from financing activities:		
Proceeds from public offerings, net of expenses	(87)	115,955
Proceeds from exercises of stock options	2,683	1,314
Proceeds from issuance of restricted common stock		347
Net cash provided by financing activities	2,596	117,616
Effect of exchange rate changes on cash and cash equivalents	(208)	189
Net increase in cash and cash equivalents	132,400	111,932
Cash and cash equivalents, beginning of period	223,987	24,010

Cash and cash equivalents, end of period	$	356,387	$	135,942

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

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STARENT NETWORKS, CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Overview

Business Description

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

Basis of Presentation

The accompanying interim condensed consolidated financial statements presented herein have been prepared by the Company, are unaudited and, in the opinion of management, include all adjustments, consisting only of normal, recurring adjustments and accruals, necessary for a fair statement of the Company s financial position at September 30, 2008, results of operations for the three and nine months ended September 30, 2008 and 2007 and cash flows for the nine months ended September 30, 2008 and 2007 in accordance with accounting principles generally accepted in the United States. Interim results are not necessarily indicative of results for any other interim period or a full year. The condensed consolidated balance sheet presented as of December 31, 2007 has been derived from the audited consolidated financial statements as of that date.

The condensed consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain all of the information that is included in the annual financial statements and notes of the Company. The condensed consolidated financial statements and notes presented herein should be read in conjunction with the financial statements and notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2007.

Significant Estimates and Assumptions

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

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

Concentrations of Risk and Off-Balance-Sheet Risk

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

The Company had two customers for the three and nine months ended September 30, 2008, respectively, that each accounted for more than 10% of revenues and in the aggregate accounted for 79% and 80% of revenues for each of the respective periods. The Company had four customers for the three and nine months ended September 30, 2007 that accounted for more than 10% of revenues and in the aggregate accounted for 88% of revenues for each of the respective periods.

At September 30, 2008, the Company had one customer that accounted for 45% of accounts receivable. At December 31, 2007, the Company had two customers that accounted for 74% of accounts receivable.

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

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

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2. Share-Based Compensation

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Risk-free interest rates	3.30%	4.50%	3.01% - 3.30%	4.50 4.76%
Expected dividend yield	0%	0%	0%	0%
Expected life	6.25 years	6.25 years	6.25 years	6.25 years
Expected volatility	56%	62%	54% - 56%	62 - 68%

The expected life was calculated based on the simplified method as permitted by the SEC s Staff Accounting Bulletin 110, *Share-Based Payment*. During the third quarter of 2008, the computation of expected volatility was based on the historical trading activity of the Company s common stock, implied volatility and an analysis of comparable companies from a representative peer group selected based on industry and market capitalization in order to derive an expected volatility. Prior to the third quarter of 2008, the computation of expected volatility was based on the historical volatility of comparable companies from a representative peer group selected based on industry and market capitalization. The risk-free interest rate was based on a U.S. Treasury instrument whose term is consistent with the expected life of the stock options. In addition to the assumptions above, as required under SFAS 123R, management made an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
Share-based compensation included in:				
Cost of revenues	$ 376	$ 221	1,070	$ 419
Total share-based compensation in cost of revenues	376	221	1,070	419

Research and development	1,594	1,947	4,701	4,088
Sales and marketing	1,457	650	3,750	1,643
General and administrative	1,115	948	2,909	2,370
Total share-based compensation in operating expenses	4,166	3,545	11,360	8,101
Total share-based compensation	$ 4,542	$ 3,766	$ 12,430	$ 8,520

3. Net Income per Share

Basic and diluted net income per share applicable to common stockholders is presented in conformity with SFAS 128, *Earnings per Share* and the related interpretation in Emerging Issues Task Force 03-06, *Participating Securities and the Two-Class Method under FASB Statement No. 128.* Basic net income per share applicable to common stockholders is computed by dividing net income applicable to common stockholders by the weighted-average number of common shares outstanding during the period, excluding the dilutive effects of common stock equivalents. Income applicable to common stockholders includes accretion of redeemable convertible preferred stock and earnings allocated to participating preferred stockholders. Common stock equivalents include stock options, restricted stock and, in certain circumstances, convertible securities such as the convertible preferred stock. Diluted net income per share assumes the conversion of the convertible preferred stock using the if converted method, if dilutive, and includes the dilutive effect of stock options and restricted stock under the treasury stock method. The following table presents the calculation of basic and diluted net income per share (in thousands, except per share data):

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	Three Months Ended September 30, 2008	2007	Nine Months Ended September 30, 2008	2007
Net income	$ 19,588	$ 1,623	$ 43,017	$ 7,309
Accretion of redeemable convertible preferred stock				(3,445)
Income allocated to preferred stockholders				(1,703)
Net income applicable to common stockholders	$ 19,588	$ 1,623	$ 43,017	$ 2,161
Weighted-average common shares outstanding basic	69,683	64,039	69,328	32,108
Dilutive effect of stock options and restricted stock	4,509	6,646	5,015	6,152
Weighted-average common shares outstanding dilutive	74,192	70,685	74,343	38,260
Net income per share:				
Basic	$ 0.28	$ 0.03	$ 0.62	$ 0.07
Diluted	$ 0.26	$ 0.02	$ 0.58	$ 0.06

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

	Three Months Ended September 30, 2008	2007	Nine Months Ended September 30, 2008	2007
Options to purchase common stock and restricted common stock subject to repurchase	3,361	587	2,544	896
Convertible preferred stock (as converted basis)				25,308

4. Fair Value Measurements

On January 1, 2008, the Company adopted the provisions of SFAS 157 (SFAS 157), *Fair Value Measurements,* for its financial assets and liabilities. As permitted by FASB Staff Position No. SFAS 157-2, *Effective Date of FASB Statement No. 157*, the Company elected to defer until January 1, 2009 the adoption of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of this accounting pronouncement did not have a material effect on the Company s consolidated financial statements for financial assets and liabilities and any other assets and liabilities carried at fair value. The Company is currently in the process of evaluating the impact of adopting this pronouncement for other non-financial assets or liabilities.
SFAS 157 provides a framework for measuring fair value under generally accepted accounting principles in the United States and requires expanded disclosures regarding fair value measurements. SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. SFAS 157 also establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs, where available, and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

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

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

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

At September 30, 2008, the Company s financial assets and liabilities that were measured at fair value on a recurring basis included money market funds of $333.1 million, which were level 1 financial assets. The Company did not have any non-financial assets or liabilities that were measured or disclosed at fair value on a recurring basis at September 30, 2008. As required by SFAS 157, assets and liabilities measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability.

5. Inventories

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

	September 30, 2008	December 31, 2007
Raw materials	$ 2,065	$ 4,632
Work in process	7,114	5,551
Finished goods	33,348	19,455
	$ 42,527	$ 29,638

6. Income Taxes

On January 1, 2007, the Company adopted the provisions of FASB Interpretation, or FIN, No. 48, *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS 109. The new standard defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authorities based solely on the technical merits of the position.

The Company s income tax provision for the three and nine months ended September 30, 2008 included (i) a tax benefit of $6.6 million recorded upon the Company s decision in the third quarter of 2008 to release a substantial portion of the valuation allowance recorded against net deferred tax assets and (ii) a provision of $0.2 million to reserve an uncertain tax position in a foreign jurisdiction under FIN 48. Excluding the effect of this one-time tax benefit and tax reserve, the Company s remaining income tax provisions for the three and nine months ended September 30, 2008 and 2007 were primarily attributable to federal and state income taxes in the U.S. and taxes related to foreign jurisdictions. The federal and state tax provisions for those periods included amounts in relation to the Company s income generated in the U.S., partially reduced by the utilization of available net operating loss (NOL) carryforwards and tax credits that were recorded on its balance sheet with a full valuation allowance prior to their utilization.

At June 30, 2008, a full valuation allowance was recorded against the Company s net deferred tax assets. Based upon the Company s operating results over recent years and through September 30, 2008 as well as an assessment of the Company s expected future results of operations, the Company determined in the third quarter of 2008 that it had become more likely than not that a substantial portion of its deferred tax assets will be realized. As a result, the Company reduced the valuation allowance during the quarter ended September 30, 2008, resulting in recognition of a deferred tax asset of $8.6 million, a one-time income tax benefit of $6.6 million (noted above) and a $2.0 million reserve for uncertain tax positions in the U.S., which is recorded in other long-term liabilities.

As of the end of the third quarter of 2008, the Company has a remaining valuation allowance of $5.2 million which will be released in the fourth quarter of 2008 in accordance with the requirements under SFAS 109 to use an annualized effective tax rate for each interim period during the year in which a valuation allowance release has occurred, including any interim period after the valuation allowance release has been released.

7. Litigation

The Company is presently defending two patent infringement lawsuits brought against it by UTStarcom, Inc. In February 2005, UTStarcom filed a complaint against the Company in the United States District Court for the Northern District of California seeking unspecified damages and injunctive relief. The complaint alleges infringement by the Company of UTStarcom s U.S. Patent No. 6,829,473, entitled Roaming and Hand-Off Support for Prepaid Billing for Wireless Data Networks, which the Company refers

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to as the 473 patent. In May 2005, the Company answered the complaint, denied the infringement allegations contained in the complaint, and filed counterclaims against UTStarcom seeking a declaratory judgment that the Company did not infringe the 473 patent and that the 473 patent was invalid and unenforceable. In July 2005, the Company filed an amended answer and counterclaims to the 473 patent complaint. In December 2006, UTStarcom filed a reissue patent application relating to the 473 patent. In January 2007, by agreement of the parties, the District Court stayed the case pending the outcome of UTStarcom s reissue application relating to the 473 patent. In June 2007, the Company filed a request for *inter partes* re-examination of all claims of the 473 patent with the United States Patent and Trademark Office on sixteen different grounds. In August 2007, the Patent and Trademark Office granted the Company s request for *inter partes* re-examination of all claims on all sixteen grounds. In November 2007, the Patent and Trademark Office merged the reissue and re-examination proceedings. A first office action has not yet been issued. The Company believes that it has meritorious defenses against any resulting reissued patent, and the Company is prepared to vigorously defend the 473 patent case through trial.

In May 2007, UTStarcom filed an additional complaint against the Company and a number of its employees and former employees in the United States District Court for the Northern District of Illinois alleging violations of the Illinois trade secrets act, infringement of five patents assigned to UTStarcom, intentional interference with UTStarcom s business relations and declarations of ownership relating to one of the Company s patents and three of its patent applications. The complaint contains allegations, among others, that a number of former employees of a business unit UTStarcom acquired, who subsequently worked for the Company, took UTStarcom s trade secrets with them and improperly used those trade secrets to develop, manufacture and market the Company s 3G wireless products, and that such products incorporate various UTStarcom confidential technical information, including UTStarcom s proprietary virtual private network and EV-DO features. UTStarcom further alleges that the Company has disclosed UTStarcom s trade secrets in one of its patents and three of its patent applications, and that this patent and these patent applications legally belong to UTStarcom based on the inventors previous work at the business unit acquired by UTStarcom. In August 2007, the Company and the current and former employee defendants filed their answers to the complaint. The Company also filed counterclaims for tortious interference with prospective economic advantage, malicious prosecution, a declaration that the patents-in-suit are invalid and not infringed, and a declaration that one of the patents-in-suit is unenforceable due to inequitable conduct. In December 2007, UTStarcom filed an amendment to the complaint, which added new claims for declaration of ownership of four more of the Company s patent applications, copyright infringement, breach of restrictive covenants against the employee and former employee defendants, and aiding and abetting the employee and former employee defendants breaches of the duty of loyalty and the employment agreements. The amendment to the complaint also added another employee as a defendant. On January 4, 2008, the Company filed a motion to dismiss, or in the alternative for a more definite statement regarding, the trade secret, copyright, breaches of restrictive covenants, and aiding and abetting claims of the amendment to the complaint. UTStarcom filed its opposition to this motion on January 22, 2008, and the Company filed its reply on January 29, 2008. On May 20, 2008 the Court granted the Company s motion, in-part, and ordered UTStarcom to provide a more definite statement of its claims. On May 30, 2008, UTStarcom filed a Third Amended Complaint. On June 9, 2008, the Company moved to dismiss the trade secret, copyright, breaches of restrictive covenants, and aiding and abetting claims (Counts I, VI, and VIII-XV) of the Third Amended Complaint, for failure to comply with the Court s Order to provide a more definite statement of those claims. On July 23, 2008, the Court granted the Company s motion and dismissed those claims. On August 1, 2008, UTStarcom filed a Motion for Leave to Amend the Complaint to Provide a More Definite Statement and Clarification of the 7/23 Order. On August 11, 2008, the Court granted UTStarcom leave to file a Fourth Amended Complaint. UTStarcom filed a Fourth Amended Complaint on August 27, 2008. In addition, on August 26, 2008, the Company filed a motion for summary judgment of noninfringement of U.S. Patent No. 7,173,905, which the Court has taken under advisement. On August 27, 2008, UTStarcom filed a motion to dismiss Starent s third, fourth, and fifth counterclaims for unenforceability of the asserted patents, tortious interference with prospective economic advantage, and malicious prosecution, respectively.

The Company filed a motion to strike and dismiss the Fourth Amended Complaint on September 15, 2008. The Court granted the Company s motion to strike the Fourth Amended Complaint on September 24, 2008, and, on the same day, granted UTStarcom leave to re-file the version of the Fourth Amended Complaint which was previously attached as an exhibit to its motion for leave to amend the complaint filed on August 1, 2008. UTStarcom re-filed this version of its Fourth Amended Complaint on September 25, 2008. The Company filed a motion to dismiss certain counts of UTStarcom s latest Fourth Amended Complaint on October 14, 2008. The Court set a briefing schedule for the motions to dismiss filed by UTStarcom and the Company, and stated that it would rule on the motions on December 3, 2008. Discovery is proceeding. No trial date has been set. In this lawsuit, UTStarcom seeks unspecified monetary damages, punitive damages, injunctive relief, declarations of ownership relating to the specified patent and patent applications owned by the Company, findings of misappropriation of trade secrets, patent infringement and copyright infringement, costs and attorneys fees. The Company believes it has meritorious defenses to each of UTStarcom s claims in this lawsuit and it is prepared to vigorously defend the lawsuit.

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

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8. Business Segments

SFAS 131, *Disclosures About Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments in annual financial statements and requires selected information of segments to be presented in financial reports issued to stockholders. Operating segments are defined as components of an enterprise about which separate financial information is available and that is evaluated regularly by the chief operating decision maker, or decision making group, in determining how to allocate resources and assess performance. The Company s chief operating decision maker, as defined under SFAS 131, is the chief executive officer. The Company views its operations and manages its business as one operating segment.

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

Revenues

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	**2007**	**2008**	**2007**
United States and Canada	$ 54,977	$ 26,863	$ 164,619	$ 63,799
Japan	6,788	4,522	11,927	18,046
Korea	3,427	4,129	5,501	10,402
Rest of world	869	1,177	1,410	2,939
Total	$ 66,061	$ 36,691	$ 183,457	$ 95,186

Long-lived Assets

	September 30, 2008	December 31, 2007
United States	$ 21,083	$ 15,614
India	7,553	4,676
Rest of world	522	162
Total	$ 29,158	$ 20,452

9. Comprehensive Income

Comprehensive income consists of the following (in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2008		2007		2008		2007	
Net income	$	19,588	$	1,623	$	43,017	$	7,309
Change in unrealized loss on short-term investments				3		(2)		(4)
Comprehensive income	$	19,588	$	1,626	$	43,015	$	7,305

10. Recent Accounting Pronouncements

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

In June 2008, the FASB issued FASB Staff Position (FSP) EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities.* This FSP provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data)

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to conform with the provisions in this FSP. This FSP will be effective for the Company on January 1, 2009. The Company has not yet determined the impact, if any, of this FSP on its consolidated financial statements.

In May 2008, the FASB released SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles.* SFAS 162 establishes the GAAP hierarchy and identifies the sources of accounting principles and the framework for selecting principles used in the preparation of financial statements. SFAS 162 will be effective for the Company on November 15, 2008. The Company has not yet determined the impact, if any, of this statement on its consolidated financial statements.

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

In December 2007, the FASB released SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. This statement will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. This statement will be effective for the Company on January 1, 2009. As of September 30, 2008, the Company did not have any minority interests.

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

Cautionary Statement

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

- *our ability to attract and retain customers;*
- *our financial performance;*
- *our development activities;*
- *the advantages of our technology as compared to that of others;*
- *our ability to establish and maintain intellectual property rights;*
- *our ability to retain and hire necessary employees and appropriately staff our operations;*
- *our ability to manage growth, both in the United States and internationally;*
- *the spending of our proceeds from public offerings of our common stock; and*

• *our cash needs.*

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

Overview

Starent Networks is a leading provider of infrastructure hardware and software products and services that enable mobile operators to deliver multimedia services to their subscribers. We have created hardware and software products that provide network functions and services, including access from a wide range of radio networks to the operator s packet core network. Our products and services also provide management of subscriber sessions moving between networks and application of billing and other session policies. Our products and services provide high performance and system intelligence by combining significant computing power, memory and traffic handling capabilities with a flexible, high availability operating system and other proprietary software. Our products integrate multiple network functions and services needed for the delivery of advanced multimedia services, such as video, Internet access, voice-over-IP, e-mail, mobile TV, photo sharing and gaming.

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

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

In November 2007, we completed an underwritten public offering of 8,000,000 shares of our common stock at a price to the public of $24.00 per share. We received total net proceeds from the November 2007 public offering of approximately $88.1 million, after deducting underwriting discounts and commissions and estimated offering expenses.

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We maintain our corporate headquarters in Tewksbury, Massachusetts, and have sales and development offices in various locations worldwide. We conduct our research and development activities at two locations in India and two locations in the United States. As of September 30, 2008, we had 739 employees worldwide. Our revenues for the year ended December 31, 2007 were $145.8 million, and $66.1 million and $183.5 million for the three and nine months ended September 30, 2008, respectively. Our net income for the year ended December 31, 2007 was $11.5 million, and $19.6 million and $43.0 million for the three and nine months ended September 30, 2008, respectively.

Revenues

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

- maintenance and technical support associated with our software;
- hardware repair and maintenance services; and
- implementation, training and professional services.

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

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

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

In 2004, we entered into OEM agreements with Nortel Networks relating to the CDMA and GSM/UMTS markets. Sales to Nortel Networks, all of which were made under the CDMA agreement, accounted for more than 40% of our revenues in 2006. In December 2006, we terminated both

OEM agreements. Under the terms of the CDMA agreement, Nortel Networks has a right to continue to purchase our CDMA products for delivery through December 2008. Although the termination of the CDMA agreement could disrupt our relationships with CDMA mobile operators formerly serviced by Nortel Networks, we have established and will continue to seek to establish additional direct sales relationships with some of the CDMA operators formerly serviced by Nortel Networks. In addition, in May 2008, we established a new reseller relationship with Nortel Networks. As a result, we do not believe that the termination of the Nortel Networks OEM agreements will significantly impact our revenues.

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

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

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

The variability of our revenues directly impacts our operating performance in any particular period since a significant portion of our operating costs, such as personnel costs, depreciation expense and sales commissions, are either fixed in the short-term or may not vary proportionately with recorded revenues.

Cost of Revenues

Cost of revenues consists of costs of products sold and services provided. Cost of products consists primarily of payments to a third party manufacturer for purchased materials and services and internal costs, such as salaries and benefits related to personnel,

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provision for inventory obsolescence and related overhead. The use of an outsourced manufacturer enables us to conserve working capital, adjust to fluctuations in demand and provide for timely delivery to our customers. Cost of services consists primarily of salaries and benefits related to professional services and technical support personnel, product repair costs, depreciation and related overhead.

Gross Profit

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

Operating Expenses

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

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

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

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

Other Income (Expense)

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

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

Application of Critical Accounting Policies and Use of Estimates

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

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

Revenue Recognition

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

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may be significant. In addition, in certain circumstances, pricing considerations must be assessed to determine whether the price is fixed or determinable.

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

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

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

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

Share-Based Compensation

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

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

Since January 1, 2006, we account for equity instruments issued to nonemployees in accordance with the provisions of SFAS 123R (the requirements of which are consistent with those previously utilized under SFAS 123) and EITF Issue 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*.

Several key assumptions are made in determining the grant date fair value of our stock options, including: the grant date market value of our common stock, the rate of volatility, the risk-free interest rate and the rate of expected forfeitures. As there was no public market for our common stock prior to our initial public offering, the determination of the fair market value of our common stock was determined by our board of directors. Due to the limited trading history of our common stock, we have determined the volatility for options granted after January 1, 2006 based on an analysis of reported data for a peer group of companies that issued options with substantially similar terms. The expected volatility of options granted has been determined using an average of the historical trading activity of our common stock, implied volatility and the historical volatility measures of this peer group of companies. The expected life of options has been determined utilizing the simplified method as prescribed by the SEC s Staff Accounting Bulletin No. 110, *Share-Based Payment*, resulting in an expected life for the three and nine months ended September 30, 2008 and 2007 of 6.25 years. The risk-free interest rate is based on a U.S. treasury instrument whose term is consistent with the expected life of the stock options. We have not paid, and do not anticipate paying, cash dividends on our shares of common stock; therefore, the expected dividend yield

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was assumed to be zero. In addition, SFAS 123R requires companies to utilize an estimated forfeiture rate when calculating the expense for the period. As a result, we applied an estimated forfeiture rate of 3%, based on a review of our historical forfeitures, to determine the expense recorded in our consolidated statements of operations. Significant changes in these assumptions, especially the expected life of options, forfeiture rate and volatility could have a significant impact on our results of operations.

For the three and nine months ended September 30, 2008, we recorded expense of $4.5 million and $12.4 million in connection with share-based awards. As of September 30, 2008, we had $22.6 million of unrecognized expense related to non-vested options that is expected to be recognized over a weighted average period of 1.5 years.

Inventory

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

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

Income Taxes

We are subject to income taxes in both the United States and foreign jurisdictions and we use estimates in determining our provisions for income taxes. We account for income taxes in accordance with SFAS 109, *Accounting for Income Taxes*, which is the asset and liability method for accounting and reporting for income taxes. Under SFAS 109, deferred tax assets and liabilities are recognized based on temporary differences between the financial reporting and income tax bases of assets and liabilities using statutory rates. We provide for income taxes during interim periods based on the estimated effective tax rate for the full fiscal year, and record a cumulative adjustment to the tax provision in an interim period in which a change in the estimated annual effective tax rate is determined.

For the three and nine months ended September 30, 2008, our effective tax rates were (33.6%) and (7.8%), respectively. The net tax benefit recorded in the three and nine months ended September 30, 2008 was primarily due to (i) a tax benefit of $6.6 million recorded upon our decision in the third quarter of 2008 to release a substantial portion of the valuation allowance recorded against net deferred tax assets and (ii) a provision of $0.2 million to reserve an uncertain tax position in a foreign jurisdiction. For the three and nine months ended September 30, 2007, our effective tax rates were 16.9% and 9.1%, respectively. Those effective tax rates were lower than the statutory federal income tax rate of 35% due primarily to our use of net operating loss carryforwards, or NOLs, and research and development tax credits to offset our U.S. taxable income (which reduced the valuation allowance we had previously recorded against those NOLs), partially offset by the impact of taxes owed in relation to the income generated by our foreign subsidiaries.

As of the end of the second quarter of 2008, a full valuation allowance was recorded against our net deferred tax assets. Based upon our operating results over recent years and through September 30, 2008 as well as an assessment of our expected future results of operations, we determined in the third quarter of 2008 that it had become more likely than not that we will realize a substantial portion of our deferred tax assets in the U.S. As a result, we reduced our valuation allowance during the third quarter of 2008, which resulted in recognition of a deferred tax asset of $8.6 million, a one-time income tax benefit of $6.6 million (noted above) and a $2.0 million reserve for uncertain tax positions in the U.S., which is recorded in other long-term liabilities.

As of the end of the third quarter of 2008, we have a remaining valuation allowance of $5.2 million which will be released in the fourth quarter of 2008 in accordance with the requirements under SFAS 109 to use an annualized effective tax rate for each interim period during the year in which a valuation allowance release has occurred, including any interim period after the valuation allowance release has been released.

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

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

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On January 1, 2007, we adopted the provisions of FASB Interpretation, or FIN, No. 48, *Accounting for Uncertainty in Income Taxes*, *an interpretation of SFAS 109*. The new standard defines the threshold for recognizing the benefits of tax return positions in the financial statements as more-likely-than-not to be sustained by the taxing authorities based solely on the technical merits of the position. If the recognition threshold is met, the tax benefit is measured and recognized as the largest amount of tax benefit, in our judgment, which is greater than 50% likely to be realized. We did not recognize any change in our reserves for uncertain tax positions as a result of the adoption of this standard. At the adoption date of January 1, 2007, we had $0.1 million of unrecognized tax benefits, the benefit of which, if recognized, would favorably affect the income tax rate in future periods. At September 30, 2008, we had a liability of approximately $2.5 million of unrecognized tax benefits. If recognized, the benefit of $1.9 million of this amount would favorably affect the income tax rate in future periods.

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

Research and Development Expense

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

Results of Operations

Revenues

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

	Three Months Ended September 30, 2008		2007		Period-to-Period Change	
	Amount	**% of Revenues**	**Amount**	**% of Revenues**	**Amount**	**Percentage**
			(dollars in thousands)			
Revenues:						
Product	$ 55,450	84%	$ 31,588	86%	$ 23,862	76%
Service	10,611	16	5,103	14	5,508	108
Total revenues	$ 66,061	100%	$ 36,691	100%	$ 29,370	80%
Revenues by Customer Type:						
Direct	$ 54,070	82%	$ 26,076	71%	$ 27,994	107%

Indirect		11,991	18		10,615	29		1,376	13
Total revenues	$	66,061	100%	$	36,691	100%	$	29,370	80%
Revenues by Geography:									
United States and Canada	$	54,977	83%	$	26,863	73%	$	28,114	105%
Japan		6,788	10		4,522	12		2,266	50
Korea		3,427	5		4,129	11		(702)	(17)
Rest of world		869	1		1,177	3		(308)	(26)
Total revenues	$	66,061	100%	$	36,691	100%	$	29,370	80%

Revenues increased $29.4 million, or 80%, in the quarter ended September 30, 2008 compared to the same quarter in 2007, primarily due to increased product revenues of $23.9 million. Product revenues increased primarily due to product shipments in the United States and Canada for which we received customer acceptances and recognized revenue in the third quarter of 2008 versus the same period of 2007 and to a lesser extent due to the higher sales price of our ST40 platform as compared to our ST16 platform. Japan revenues increased $2.3 million, or 50%, in the quarter ended September 30, 2008 compared to the same quarter in 2007, primarily due to customer acceptances received in the current quarter.

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The $5.5 million increase in service revenues in the third quarter of 2008 compared to the same period in 2007 was due to an increased amount of our products installed at mobile operators, which is generally the basis of maintenance and service fees, as compared to the same period in 2007.

Indirect revenue increased $1.4 million, or 13%, in the third quarter of 2008 compared to the third quarter of 2007 due primarily to an increase in OEM sales.

	Nine Months Ended September 30,						
	2008			2007		Period-to-Period Change	
		Amount	% of Revenues	Amount	% of Revenues	Amount	Percentage
	(dollars in thousands)						
Revenues:							
Product	$	156,497	85%	$ 81,160	85%	$ 75,337	93%
Service		26,960	15	14,026	15	12,934	92
Total revenues	$	183,457	100%	$ 95,186	100%	$ 88,271	93%
Revenues by Type:							
Direct	$	163,391	89%	$ 55,169	58%	$ 108,222	196%
Indirect		20,066	11	40,017	42	(19,951)	(50)
Total revenues	$	183,457	100%	$ 95,186	100%	$ 88,271	93%
Revenues by Geography:							
United States and Canada	$	164,619	90%	$ 63,799	67%	$ 100,820	158%
Japan		11,927	7	18,046	19	(6,119)	(34)
Korea		5,501	3	10,402	11	(4,901)	(47)
Rest of world		1,410	1	2,939	3	(1,529)	(52)
Total revenues	$	183,457	100%	$ 95,186	100%	$ 88,271	93%

Revenues increased $88.3 million, or 93%, in the nine months ended September 30, 2008 as compared to the same period in 2007, primarily due to increased product sales to existing customers. Product revenues, which include hardware and software sales, increased $75.3 million for the nine months ended September 30, 2008 as compared to the same period in 2007 due primarily to increased sales to major mobile operators in the United States and Canada. The increase in revenues was partially offset by the decrease in revenues in Japan and Korea. The decreases in Japan and Korea were related primarily to lower acceptances and shipments in the current year.

Cost of Revenues and Gross Profit

The following table sets forth our cost of revenues and gross profit.

	Three Months Ended September 30,					
	2008		2007		Period-to-Period Change	
	Amount	% of Related Revenues	Amount	% of Related Revenues	Amount	Percentage

				(dollars in thousands)					
Cost of revenues:									
Product	$	10,151	18%	$	7,422	23%	$	2,729	37%
Services		4,107	39		2,723	53		1,384	51
Total cost of revenues	$	14,258	22%	$	10,145	28%	$	4,113	41%
Gross Profit:									
Product	$	45,299	82%	$	24,166	77%	$	21,133	87%
Services		6,504	61		2,380	47		4,124	173
Total gross profit	$	51,803	78%	$	26,546	72%	$	25,257	95%

Product gross margin increased 5 percentage points to 82% in the third quarter of 2008 as compared to the same period in 2007. Both periods included higher levels of software-only transactions, resulting in gross margins higher than our historical amounts.

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Service gross margin increased 14 percentage points to 61% in the third quarter of 2008 as compared to the same period in 2007. The increase was due to a 108% increase in service revenues compared to a 51% increase in expenses. During the third quarter of 2008, the $1.4 million, or 51%, increase in cost of services was primarily due to higher personnel and overhead costs associated with additional customer support and training personnel that were added since the third quarter of 2007. We anticipate cost of services will increase in future periods as we continue to expand our customer support organization geographically in future periods.

	Nine Months Ended September 30,								
	2008			2007			Period-to-Period Change		
		Amount	% of Related Revenues		Amount	% of Related Revenues		Amount	Percentage
	(dollars in thousands)								
Cost of revenues:									
Product	$	28,697	18%	$	18,176	22%	$	10,521	58%
Services		11,823	44		6,052	43		5,771	95
Total cost of revenues	$	40,520	22%	$	24,228	25%	$	16,292	67%
Gross Profit:									
Product	$	127,800	82%	$	62,984	78%	$	64,816	103%
Services		15,137	56		7,974	57		7,163	90
Total gross profit	$	142,937	78%	$	70,958	75%	$	71,979	101%

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

The $5.8 million increase in cost of services was primarily due to higher personnel costs, depreciation expense and overhead costs associated with additional customer support and training personnel that were added during 2008 and in the second half of 2007. We anticipate cost of services will increase in future periods as we continue to increase the number of customer support personnel we employ and continue to expand our customer support testing facilities.

Gross profit on services decreased 1% during the first nine months of 2008 as a result of the increased costs of services described above.

Operating Expenses

The following table sets forth our operating expenses.

	Three Months Ended September 30,								
	2008			2007			Period-to-Period Change		
		Amount	% of Revenues		Amount	% of Revenues		Amount	Percentage
	(dollars in thousands)								
Research and development	$	13,750	21%	$	10,612	29%	$	3,138	30%
Sales and marketing		17,894	27		11,940	33		5,954	50

General and administrative		6,129	9		4,164	11		1,965	47
Total operating expenses	$	37,773	57%	$	26,716	73%	$	11,057	41%

	Nine Months Ended September 30,								
	2008			2007			Period-to-Period Change		
	Amount		% of Revenues	Amount		% of Revenues	Amount		Percentage
	(dollars in thousands)								
Research and development	$	38,594	21%	$	28,263	30%	$	10,331	37%
Sales and marketing		52,918	29		27,876	29		25,042	90
General and administrative		17,215	9		10,405	11		6,810	65
Total operating expenses	$	108,727	59%	$	66,544	70%	$	42,183	63%

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Personnel Costs. Personnel costs are our largest expense, representing 63% and 64% of our total operating expenses for the three and nine months ended September 30, 2008, respectively. These costs consist of cash and stock components. The cash component of compensation included in each expense category is set forth below.

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Change	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007	Change
	(dollars in thousands)					
Research and development	$ 6,177	$ 5,162	$ 1,015	$ 18,761	$ 14,631	$ 4,130
Sales and marketing	11,172	7,433	3,739	33,217	16,966	16,251
General and administrative	2,097	1,313	784	5,762	3,579	2,183
Total cash-based compensation in operating expenses	$ 19,446	$ 13,908	$ 5,538	$ 57,740	$ 35,176	$ 22,564

The increases in personnel costs above were due primarily to a higher number of employees and higher sales commissions in the three and nine months ended September 30, 2008 compared to the same periods of 2007. We added 164 employees since September 30, 2007, 80 in research and development (primarily in India), 37 in sales and marketing, 27 in support, 15 in general and administrative and 5 in operations, resulting in total employees of 739 at September 30, 2008. The increase in commissions was due to our high sales volume in the latter half of 2007 for which commissions were earned during 2008 and our higher level of sales activity in 2008. We anticipate sales commissions as a percentage of revenues to decrease in the fourth quarter of 2008.

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

	Three Months Ended September 30, 2008	Three Months Ended September 30, 2007	Change	Nine Months Ended September 30, 2008	Nine Months Ended September 30, 2007	Change
	(dollars in thousands)					
Research and development	$ 1,594	$ 1,947	$ (353)	$ 4,701	$ 4,088	$ 613
Sales and marketing	1,457	650	807	3,750	1,643	2,107
General and administrative	1,115	948	167	2,909	2,370	539
Total share-based compensation in operating expenses	$ 4,166	$ 3,545	$ 621	$ 11,360	$ 8,101	$ 3,259

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

Research and development. Research and development expenses increased $3.1 million, or 30%, in the third quarter of 2008 compared to the same quarter in 2007. The increase was due to increases in cash compensation of $1.0 million, higher depreciation expense of $1.5 million and higher consulting expense of $0.9 million, partially offset by a decrease in share-based compensation of $0.4 million. The increase in cash compensation was primarily due to the addition of employees, as discussed above. The increase in consulting expenses was due primarily to the interoperability testing of our products with other vendors network elements. The increase in depreciation was due to our research and development capital expenditures primarily utilized in our quality assurance and customer lab testing facilities.

Research and development expenses increased $10.3 million, or 37%, for the nine months ended September 30, 2008 compared to the same period in 2007. The increase was due to increases in cash and share-based compensation of $4.1 million and $0.6 million, respectively, higher depreciation expense of $4.0 million, higher consulting expense of $2.0 million and a $1.3 million decrease related to reimbursements for non-recurring engineering projects which are recorded as a reduction of research and development expense, partially offset by lower prototype and related equipment expenses of $2.6 million. The increase in cash compensation was primarily due to the addition of employees, as discussed above. The increases in consulting and depreciation are due largely to the same reasons noted above.

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

Sales and marketing. Sales and marketing expenses increased $6.0 million, or 50%, in the third quarter of 2008 as compared to the same period in 2007 and decreased as a percentage of revenues. This increase was due primarily to higher cash compensation of $3.7 million and share-based compensation of $0.8 million and travel expenses of $0.2 million. Cash compensation increased primarily due to the addition of employees, as discussed above.

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Sales and marketing expenses increased $25.0 million, or 90%, for the nine months ended September 30, 2008 as compared to the same period in 2007, but remained consistent as a percentage of revenues. This increase was due primarily to higher cash compensation of $16.3 million and share-based compensation of $2.1 million, consulting expense of $2.1 million, demonstration expenses of $0.7 million and travel expenses of $0.9 million. Cash compensation increased primarily due to the addition of employees, as discussed above. Consulting expenses increased due to arrangements we have with third party consultants whose fees are earned as we receive orders from specific customers, and the increase in travel expense was due primarily to our employee additions. Demonstration expenses increased as a result of the expansion of our sales activities geographically.

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

General and administrative. General and administrative expenses increased $2.0 million, or 47%, in the third quarter of 2008 as compared to the same period in 2007 due primarily to higher cash compensation of $0.8 million and share-based compensation of $0.2 million and professional fees of $0.9 million. The increase in cash compensation was primarily due to the addition of employees, as discussed above. The increases in professional fees were due primarily to the UTStarcom litigation and fees associated with the compliance requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

General and administrative expenses increased $6.8 million, or 65%, for the nine months ended September 30, 2008 as compared to the same period in 2007 due primarily to higher cash compensation of $2.2 million and share-based compensation of $0.5 million and professional fees of $3.5 million. The increase in cash compensation was primarily due to the addition of employees, as discussed above. The increase in professional fees was due primarily to costs associated with our defense in the UTStarcom litigation.

We expect general and administrative expense to increase in future periods as we invest in infrastructure to support continued growth and incur additional costs related to operating as a publicly traded company, including increased audit and legal fees, costs of compliance with securities and other regulations, investor relations and higher insurance premiums. In addition, we expect to continue to incur costs associated with patent litigation discussed in Part II Item 1 Legal Proceedings .

Interest income. Interest income consisted of income generated from the investment of our cash balances and short-term investments. Interest income decreased $0.1 million in the third quarter of 2008, primarily due to lower rates of return, as compared to the same period in 2007. Interest income increased $2.6 million for the nine months ended September 30, 2008, primarily due to higher average cash and investment balances during 2008 partially offset by lower rates of return as compared to the same periods in 2007. The increase in our cash and short-term investment balances was due primarily to the receipt of approximately $204.1 million of net proceeds from public offerings of our common stock in 2007 and cash generated from operations.

Income tax expense. For the three and nine months ended September 30, 2008, we recorded an income tax benefit of $4.9 million and $3.1 million, respectively, compared to income tax expense of $0.3 million and $0.7 million in the same periods of 2007. The net tax benefit recorded in the three and nine months ended September 30, 2008 was primarily due to a one-time tax benefit of $6.6 million recorded based on our decision in the third quarter of 2008 to release a substantial portion of the valuation allowance recorded against net deferred tax assets in the U.S. as well as a tax provision of $0.2 million to reserve an uncertain tax position in a foreign jurisdiction. Our effective tax rates for the three and nine months ended September 30, 2008 were lower than the statutory federal income tax rate of 35% due primarily to the one-time tax items noted above as well as our use of net operating loss carryforwards, or NOLs, and research and development tax credits to offset our U.S. taxable income, partially offset by the impact of taxes owed in relation to the income generated by our foreign subsidiaries. Our effective tax rates for the three and nine months ended September 30, 2007 were lower than the statutory federal income tax rate of 35% due primarily to the use of NOLs and research and development tax credits to offset our U.S. taxable income (which reduced the valuation allowance we had previously recorded against those NOLs), partially offset by the impact of taxes owed in relation to the income generated by our foreign subsidiaries.

We expect that our effective tax rate for the fourth quarter of 2008 will remain relatively consistent with our effective tax rate (excluding the impact of discrete items) of the third quarter and first nine months of 2008, as we will release our remaining tax asset valuation allowance of $5.2 million in the fourth quarter of 2008 in accordance with the requirements of SFAS 109 to use an annualized effective tax rate for each interim period during the year in which a valuation allowance release has occurred.

Foreign Currency Exchange Gain (Losses). For the three months ended September 30, 2008, we recorded foreign currency losses of $1.3 million, compared to a foreign currency gain of $84,000 in the same period of 2007. For the nine months ended September 30, 2008, we recorded foreign currency losses of $0.6 million, compared to a foreign currency loss of $6,000 in the same

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period of 2007. The difference in the 2008 periods was due to an increase in the amount of our assets, primarily cash and accounts receivable, denominated in foreign currencies, primarily Euros, which are translated at the end of the reporting period and to the weakening of the US dollar that occurred in the three and nine months ended September 30, 2008.

Net income. Net income increased approximately $18.0 million and $35.7 million for the three and nine months ended September 30, 2008, respectively, compared to the same period of 2007 due to the items discussed above.

Liquidity and Capital Resources

Resources

We funded our operations from 2000 through 2004 primarily with net proceeds of issuances of convertible preferred stock of approximately $100.0 million. Since 2005, we have funded our operations principally with cash provided by operating activities, which was driven mainly by our revenue growth. In June and November 2007, we completed public offerings of our common stock, which raised approximately $204.1 million in net proceeds.

Cash, cash equivalents and short-term investments. Our cash and cash equivalents at September 30, 2008 of $356.4 million were held for working capital purposes and were invested primarily in money market funds. We do not enter into investments for trading or speculative purposes. Restricted cash, which totaled $0.7 million at September 30, 2008 and December 31, 2007, respectively, was not included in cash and cash equivalents and was held as collateral for letters of credit related to vendor and lease agreements.

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

	Nine Months Ended September 30,	
	2008	**2007**
Net cash provided by (used in) operating activities	$ 137,265	$ (16,059)
Net cash provided by (used in) investing activities	$ (7,253)	$ 10,186
Net cash provided by financing activities	$ 2,596	$ 117,616

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

Nine months ended September 30, 2008 compared to Nine months ended September 30, 2007.

For the nine months ended September 30, 2008, net cash provided by operating activities was $137.3 million as compared to cash used in operating activities of $16.1 million for the same period in 2007. Cash received from customers increased $209.0 million in the first nine months of 2008 to $270.7 million from $61.7 million in the same period of 2007. This increase was due primarily to the timing of billing and collections of customer orders. This increase was partially offset by an increase in cash paid for payroll and related expenses of $33.1 million, which totaled $65.4 million in the first nine months of 2008 compared to $32.3 million for the same period in 2007, and higher cash paid for inventories of $25.9 million, which totaled $54.2 million in the first nine months of 2008 compared to $28.3 million for the same period in 2007. The increase in payroll and related expenses was due primarily to our increased headcount and sales commissions, as discussed above. The increase in cash paid for inventories was due primarily to our purchases to meet our higher level of customer orders, which resulted in higher inventory balances as compared to December 31, 2007.

Investing activities. Cash from investing activities consisted primarily of capital expenditures and purchases and sales of short-term investments associated with our investment balances. The $7.3 million of cash used in investing activities during the first nine months of 2008 consisted primarily of capital expenditures of $16.8 million partially offset by maturities of short-term investments of $9.6 million. The $10.2 million of cash provided by investing activities in the nine months ended September 30, 2007 was due primarily to proceeds from maturities of short-term investments of $40.4 million partially offset by capital expenditures of $11.7 million and $18.9 million of net purchases of short-term investments.

Financing activities. Cash from financing activities for the nine months ended September 30, 2008 consisted primarily of $2.7 million of cash received from the exercise of stock options. The $117.6 million of cash from financing activities for the nine months ended September 30, 2007 was due primarily to the net proceeds from our initial public offering of $116.0 million.

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

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

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

Requirements

Capital expenditures. We have made capital expenditures primarily for testing and evaluation systems and equipment to support product development and customer service, as well as for leasehold improvements and other general purposes to support our growth. Our capital expenditures totaled $16.8 million in the nine months ended September 30, 2008. We expect capital expenditures to be approximately $20-25 million for the full year of 2008, primarily related to purchases of test equipment, equipment to support product development and customer service, leasehold improvements and other general purposes to support our growth.

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

	Total	Remainder of 2008	1-3 Years	4-5 Years	More than 5 Years
	(dollars in thousands)				
Operating leases	$ 5,437	$ 677	$ 4,429	$ 331	$
Purchase obligations	17,557	17,213	344		
Total	$ 22,994	$ 17,890	$ 4,773	$ 331	$

The table above does not reflect unrecognized tax benefits of $2.5 million, the timing of which is uncertain.

Off-Balance-Sheet Arrangements

In the normal course of business, we may enter into agreements with our customers which require us to secure performance bonds that guarantee our execution of certain obligations under the agreements. For the three and nine months ended September 30, 2008, we had one bank guarantee in the amount of 3.0 million ($4.3 million). The bank guarantee is required to be renewed each year during the term of the agreement, which expires in July 2013. At the end of each calendar year, both parties to the agreement will discuss waiver of the bank guarantee.

We do not have any interests in entities referred to as variable interest entities, which includes special purpose entities and other structured finance entities.

Recent Accounting Pronouncements

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

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

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In May 2008, the FASB released SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles.* SFAS 162 establishes the GAAP hierarchy and identifies the sources of accounting principles and the framework for selecting principles used in the preparation of financial statements. SFAS 162 will be effective for us on November 15, 2008. We have not yet determined the impact, if any, of this statement on our consolidated financial statements.

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

In December 2007, the FASB released SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment of ARB No. 51*. This statement will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. This statement will be effective for us on January 1, 2009. As of September 30, 2008, we did not have any minority interests.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Foreign Currency Exchange Risk

Our international customer transactions are predominantly denominated in either U.S. dollars or Euro. Accordingly, we have exposure to changes in the exchange rates between the U.S. Dollar and the Euro. We currently do not enter into foreign currency hedging transactions. In addition, the functional currency of our foreign operations in Europe, Asia and South America is the U.S. dollar. Accordingly, all assets and liabilities of these foreign subsidiaries are remeasured into U.S. dollars using the exchange rates in effect at the balance sheet date with the exception of certain non-monetary items which are remeasured at historical rates. Revenues and expenses of these foreign subsidiaries are remeasured into U.S. dollars at the average rates in effect during the period. Any differences resulting from the remeasurement of assets, liabilities and operations of these subsidiaries are recorded within other income (expense) in our consolidated statements of operations. If the foreign currency exchange rates had fluctuated by 10% as of September 30, 2008 and December 31, 2007, our foreign exchange gain or loss would have fluctuated by approximately $1.2 million and $0.2 million, respectively.

Interest Rate Risk

At September 30, 2008, we had unrestricted cash and cash equivalents totaling $356.4 million. At December 31, 2007, we had unrestricted cash and cash equivalents and short-term investments totaling $233.6 million. These amounts were invested primarily in money market funds and high quality corporate and government securities. In periods of financial market volatility, we may hold a greater proportion of our unrestricted cash and cash equivalents in money market funds that invest solely in government securities, which may result in lower yields on these balances. The unrestricted cash and cash equivalents were held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, would reduce future investment income.

ITEM 4T. CONTROLS AND PROCEDURES

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

September 30, 2008, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are presently defending two patent infringement lawsuits brought against us by UTStarcom, Inc. In February 2005, UTStarcom filed a complaint against us in the United States District Court for the Northern District of California seeking unspecified damages and injunctive relief. The complaint alleges infringement by us of UTStarcom s U.S. Patent No. 6,829,473, entitled Roaming and Hand-Off Support for Prepaid Billing for Wireless Data Networks, which we refer to as the 473 patent. In May 2005, we answered the complaint, denied the infringement allegations contained in the complaint, and filed counterclaims against UTStarcom seeking a declaratory judgment that we did not infringe the 473 patent and that the 473 patent was invalid and unenforceable. In July 2005, we filed an amended answer and counterclaims