

Starent Networks, Corp.
Form 10-Q
May 08, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009

or

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

For the transition period from to

Commission File Number: 001-33511

STARENT NETWORKS, CORP.

(Exact name of registrant as specified in its charter)

Edgar Filing: Starent Networks, Corp. - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

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

30 International Place
Tewksbury, MA 01876

(Address of principal executive offices) (zip code)

(978) 851-1100

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

As of May 4, 2009, there were 70,819,715 shares of the registrant's \$0.001 par value per share common stock outstanding.

Table of Contents

STARENT NETWORKS, CORP.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009

Table of Contents

Item	Page
<u>PART I. FINANCIAL INFORMATION</u>	
ITEM 1. <u>Condensed Consolidated Financial Statements (unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of March 31, 2009 and December 31, 2008</u>	3
<u>Condensed Consolidated Statements of Operations for the Three Months Ended March 31, 2009 and 2008</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2009 and 2008</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
ITEM 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	14
ITEM 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	27
ITEM 4. <u>Controls and Procedures</u>	27
<u>PART II. OTHER INFORMATION</u>	
ITEM 1. <u>Legal Proceedings</u>	28
ITEM 1A. <u>Risk Factors</u>	29
ITEM 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
ITEM 6. <u>Exhibits</u>	41

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****STARENT NETWORKS, CORP.****CONDENSED CONSOLIDATED BALANCE SHEETS****(unaudited and in thousands, except share and per share data)**

	March 31, 2009	December 31, 2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 387,204	\$ 369,351
Accounts receivable	58,712	53,689
Inventories	48,696	48,734
Deferred tax assets, net	8,729	3,449
Prepaid expenses and other current assets	4,583	4,709
Total current assets	507,924	479,932
Property and equipment, net	32,040	29,632
Deferred tax assets, net	11,350	9,699
Other assets	8,061	8,011
Restricted cash	810	943
Total assets	\$ 560,185	\$ 528,217
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 4,264	\$ 9,042
Accrued expenses and other current liabilities	10,532	8,164
Accrued payroll and related expenses	10,049	15,195
Accrued income taxes	15,420	1,945
Current portion of deferred revenue	151,734	141,726
Total current liabilities	191,999	176,072
Deferred revenue, net of current portion	9,153	10,959
Other long-term liabilities	2,878	2,985
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; 70,274,758 and 69,867,985 shares issued and outstanding at March 31, 2009 and December 31, 2008, respectively	70	70
Additional paid-in capital	376,831	371,655
Accumulated deficit	(20,746)	(33,524)
Total stockholders' equity	356,155	338,201

Edgar Filing: Starent Networks, Corp. - Form 10-Q

Total liabilities and stockholders' equity	\$ 560,185	\$ 528,217
--	------------	------------

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

Table of Contents**STARENT NETWORKS, CORP.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited and in thousands, except per share data)**

	Three Months Ended March 31,	
	2009	2008
Revenues:		
Product	\$ 63,130	\$ 48,887
Service	10,071	7,340
 Total revenues	 73,201	 56,227
Cost of revenues:		
Product	9,768	9,048
Service	4,546	3,910
 Total cost of revenues	 14,314	 12,958
 Gross profit	 58,887	 43,269
Operating expenses:		
Research and development	14,037	12,343
Sales and marketing	16,468	18,851
General and administrative	6,685	5,156
 Total operating expenses	 37,190	 36,350
 Income from operations	 21,697	 6,919
Interest income	466	2,285
Foreign currency exchange gain (loss)	(949)	900
Other income (expense), net	(37)	
 Income before income tax expense	 21,177	 10,104
Income tax expense	(8,399)	(450)
 Net income	 \$ 12,778	 \$ 9,654
 Net income per common share (Note 3):		
Basic	\$ 0.18	\$ 0.14
 Diluted	 \$ 0.17	 \$ 0.13
 Weighted-average shares outstanding used in computing net income per common share (Note 3):		
Basic	70,090	68,769

Edgar Filing: Starent Networks, Corp. - Form 10-Q

Diluted	74,592	74,274
---------	--------	--------

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

Table of Contents**STARENT NETWORKS, CORP.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited and in thousands)

	Three Months Ended March 31,	
	2009	2008
Cash flows from operating activities:		
Net income	\$ 12,778	\$ 9,654
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,805	2,353
Share-based compensation	3,992	3,370
Loss on disposal of property and equipment	26	
Benefit from deferred income taxes, net	(6,930)	
Changes in operating assets and liabilities:		
Accounts receivable	(5,029)	(25,337)
Inventories	40	(3,784)
Prepaid expenses and other current assets	170	753
Other assets	(49)	(98)
Accounts payable	(4,761)	(154)
Accrued expenses and other liabilities	(2,190)	(4,439)
Accrued income taxes	13,359	(141)
Deferred revenue	8,046	74,805
Net cash provided by operating activities	23,257	56,982
Cash flows from investing activities:		
Purchases of property and equipment	(6,261)	(6,641)
Proceeds from maturities of short-term investments		7,106
Change in restricted cash	125	(45)
Net cash provided by (used in) investing activities	(6,136)	420
Cash flows from financing activities:		
Proceeds from exercises of stock options	1,120	1,223
Additional expenses from public offerings		(87)
Net cash provided by financing activities	1,120	1,136
Effect of exchange rate changes on cash and cash equivalents	(388)	431
Net increase in cash and cash equivalents	17,853	58,969
Cash and cash equivalents, beginning of period	369,351	223,987
Cash and cash equivalents, end of period	\$ 387,204	\$ 282,956

Edgar Filing: Starent Networks, Corp. - Form 10-Q

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

Table of Contents

STARENT NETWORKS, CORP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Overview

Business Description

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

Basis of Presentation

The accompanying interim condensed consolidated financial statements 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 March 31, 2009, results of operations for the three months ended March 31, 2009 and 2008 and cash flows for the three months ended March 31, 2009 and 2008 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, 2008 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, 2008.

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.

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.

Reclassification

Certain prior year amounts related to the classification of foreign currency gains or losses in the condensed consolidated statements of cash flows have been reclassified to conform to the current year presentation. These reclassifications had no impact on previously reported results of operations.

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 equivalents, accounts receivable and inventories. The Company's cash equivalents are principally maintained with one commercial bank.

The Company had one customer for the three months ended March 31, 2009 that accounted for 75% of revenues. The Company had two customers for the three months ended March 31, 2008 that each accounted for more than 10% of revenues and in the aggregate accounted for

91% of revenues.

Table of Contents

At March 31, 2009, the Company had two customers that accounted for 60% of accounts receivable. At December 31, 2008, the Company had two customers that accounted for 76% of accounts receivable.

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

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

2. Share-Based Compensation

The Company accounts for share-based compensation in accordance Statement of Financial Accounting Standard, or SFAS, 123R, *Share-Based Payment*, which it adopted on January 1, 2006. SFAS 123R requires companies to expense the fair value of employee stock options and other forms of share-based compensation. 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, the Company will continue to apply Accounting Principles Board, or APB, Opinion 25, *Accounting for Stock Issued to Employees*, and related interpretations in future periods to equity awards outstanding prior to the date of its adoption of SFAS 123R. The Company has elected to use the Black-Scholes option pricing model to determine the grant-date fair value of its share-based option awards, except in those situations where an alternative method is required. For restricted stock and restricted stock units, the quoted market price of our common stock at the time of grant is used to estimate the fair value. In accordance with SFAS 123R, the Company will recognize the compensation cost of share-based awards on a graded vesting basis over the requisite service period of each award, which is generally the vesting period.

The fair value of options granted for the three months ended March 31, 2009 and 2008 was estimated at the date of grant using the following assumptions:

	Three Months Ended March 31,	
	2009	2008
Risk-free interest rates	2.14%	3.01%
Expected dividend yield	0%	0%
Expected life	6.25 years	6.25 years
Expected volatility	58%	56%

The expected life was calculated based on the simplified method as permitted by the SEC's Staff Accounting Bulletin 110, *Share-Based Payment*. The Company currently uses the simplified method to estimate the expected term for share option grants as it does not have enough historical experience to provide a reasonable estimate due to the limited period the Company's common stock has been publicly traded. In 2008, the Company modified its computation of expected volatility to base it on the combination of historical trading activity of the Company's common stock, the Company-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 modification, 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 is 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 makes an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

Table of Contents

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

	Three Months Ended March 31,	
	2009	2008
Share-based compensation included in:		
Cost of revenues	\$ 348	\$ 313
Total share-based compensation included in cost of revenues	348	313
Research and development	1,400	1,304
Sales and marketing	1,245	927
General and administrative	999	826
Total share-based compensation included in operating expenses	3,644	3,057
Total share-based compensation	\$ 3,992	\$ 3,370

3. Net Income per Common Share

Basic and diluted net income per common share is presented in conformity with SFAS 128, *Earnings per Share*. Basic net income per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the period, excluding the dilutive effects of common stock equivalents. Common stock equivalents include stock options and unvested restricted stock. Diluted net income per common share 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 common share (in thousands, except per share data):

	Three Months Ended March 31,	
	2009	2008
Net income	\$ 12,778	\$ 9,654
Weighted-average common shares outstanding - basic	70,090	68,769
Dilutive effect of stock options and unvested restricted stock	4,502	5,505
Weighted-average common shares outstanding - diluted	74,592	74,274
Net income per common share:		
Basic	\$ 0.18	\$ 0.14
Diluted	\$ 0.17	\$ 0.13

Table of Contents

The following outstanding options and unvested restricted common stock subject to repurchase were excluded from the computation of diluted net income per common share for the periods presented as their effect would have been antidilutive (in thousands):

	Three Months Ended	
	March 31,	
	2009	2008
Options to purchase common stock and unvested restricted common stock subject to repurchase	3,247	1,345

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 measured at fair value on a recurring basis. On January 1, 2009, as permitted by FASB Staff Position No. SFAS 157-2, *Effective Date of FASB Statement No. 157*, the Company adopted the remaining provisions of SFAS 157 for all non-financial assets and non-financial liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. The adoption of this accounting pronouncement did not have a material effect on the Company's consolidated financial statements for financial and non-financial assets and liabilities and any other assets and liabilities carried at fair value.

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 March 31, 2009 and December 31, 2008, the Company's Level 1 assets and liabilities included the Company's money market funds included in cash and cash equivalents.
- 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 March 31, 2009 and December 31, 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 March 31, 2009 and December 31, 2008, the Company had no Level 3 assets or liabilities.

At March 31, 2009 and December 31, 2008, the Company's financial assets and liabilities that were measured at fair value on a recurring basis included money market funds of \$348.7 million and \$348.2 million, respectively. The money market funds were Level 1 financial assets. The Company did not have any non-financial assets or liabilities that were measured or disclosed at fair value as of March 31, 2009. 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 principally include the cost of raw materials and subassemblies, the cost of third-party contract manufacturers and cost of sales deferred until such time as related revenue is recognized. Deferred costs of sales are included as a component of finished goods. Inventories consisted of the following (in thousands):

	March 31,	December 31,
	2009	2008
Raw materials	\$ 2,642	\$ 2,656

Edgar Filing: Starent Networks, Corp. - Form 10-Q

Work in process	5,976	7,545
Finished goods	40,078	38,533
	\$ 48,696	\$ 48,734

Table of Contents**6. Income Taxes**

The Company's effective income tax rate was 39.7% and 4.5% for the three months ended March 31, 2009 and 2008, respectively. The effective income tax rate is based upon the estimated income for the year, the estimated composition of the income in different jurisdictions and adjustments, if any, in the applicable quarterly periods for potential tax consequences, benefits, resolution of tax audits or other tax contingencies. For the three months ended March 31, 2009, the effective income tax rate varied from the U.S. federal statutory tax rate of 35% primarily due to the effects of accounting for share-based compensation in accordance with SFAS No. 123R. The tax rate in the first quarter of 2009 was nearer the statutory tax rate than in the same quarter of 2008, due to the Company reversing the full valuation allowance recorded against its deferred tax assets in the third quarter of 2008. The Company's income tax provision for the three months ended March 31, 2008 consisted primarily of taxes owed in relation to income generated by its foreign subsidiaries. The federal and state provision for that period included amounts in relation to the Company's income generated in the U.S., reduced by the utilization of available net operating loss (NOL) carryforwards and tax credits that were recorded on the balance sheet with a full valuation allowance prior to their utilization.

7. Litigation

The Company is presently defending two lawsuits brought against it by UTStarcom, Inc. In February 2005, UTStarcom filed a complaint against the Company in the United States District Court for the Northern District of California seeking unspecified damages and injunctive relief. The complaint alleges infringement by the Company of UTStarcom's U.S. Patent No. 6,829,473, entitled "Roaming and Hand-Off Support for Prepaid Billing for Wireless Data Networks," which the Company refers to as the "473 patent." In May 2005, the Company answered the complaint, denied the infringement allegations contained in the complaint, and filed counterclaims against UTStarcom seeking a declaratory judgment that the Company did not infringe the "473 patent" and that the "473 patent" was invalid and unenforceable. In July 2005, the Company filed an amended answer and counterclaims to the "473 patent" complaint. In December 2006, UTStarcom filed a reissue patent application relating to the "473 patent." In January 2007, by agreement of the parties, the District Court stayed the case pending the outcome of UTStarcom's reissue application relating to the "473 patent." In June 2007, the Company filed a request for *inter partes* re-examination of all claims of the "473 patent" with the 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 was issued on December 22, 2008, and responses to the office action have been submitted. 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

Table of Contents

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. On December 5, 2008, the Court granted UTStarcom's motion to dismiss in part, dismissing the Company's counterclaim for malicious prosecution and denying UTStarcom's motion to dismiss the Company's third and fourth counterclaims for unenforceability of the asserted patents and tortious interference with prospective economic advantage. On January 6, 2009, the Company moved to amend its counterclaims to add a claim for trade secret misappropriation against UTStarcom. The Court granted this motion, and UTStarcom answered the counterclaim on January 26, 2009. On March 20, 2009, the Company filed a motion for summary judgment on UTStarcom's copyright count. On March 24, 2009, the Court granted, in-part, the Company's and individual defendants' motion to dismiss certain counts of UTStarcom's Fourth Amended Complaint, dismissing nine of UTStarcom's counts, including its counts for declaration of ownership of seven patent applications and one patent, breach of restrictive covenants prohibiting disclosure of confidential and proprietary trade secret information, breach of restrictive covenants prohibiting solicitation of Carrier Unit employees, breach of restrictive covenants prohibiting solicitation of Carrier Unit customers, breach of restrictive covenants concerning the assignment of inventions, breach of the duty of loyalty, inducement of the breach of the duty of loyalty, inducement of the breach of the employment agreements, and conspiracy to misappropriate trade secrets. The Court also dismissed, in part, UTStarcom's count for intentional interference with UTStarcom's business relations. The Court denied the Company's motion to dismiss UTStarcom's trade secret count, determining that the allegations were sufficient at the pleading stage. On April 7, 2009, UTStarcom filed a motion to reconsider the Court's dismissal of certain counts, which motion was denied by the Court on April 20, 2009. On April 21, the Company answered the Fourth Amended Complaint, and re-asserted its counterclaims. Discovery is proceeding. No trial date has been set. In this lawsuit, UTStarcom seeks unspecified monetary damages, punitive damages, injunctive relief, findings of misappropriation of trade secrets, patent infringement and copyright infringement, costs and attorneys fees. The Company believes it has meritorious defenses to each of UTStarcom's claims in this lawsuit and it is prepared to vigorously defend the lawsuit.

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

8. Business Segments

SFAS 131, *Disclosures About Segments of an Enterprise and Related Information*, establishes standards for reporting information about operating segments in annual financial statements and requires selected information of segments to be presented in financial reports issued to stockholders. Operating segments are defined as components of an enterprise about which separate financial information is available and that is evaluated regularly by the chief operating decision maker, or decision making group, in determining how to allocate resources and assess performance. The Company's chief operating decision maker, as defined under SFAS 131, is the chief executive officer. The Company views its operations and manages its business as one operating segment. Revenue by geography is based on the billing address of the customer. The following tables set forth revenue and long-lived assets by geographic area (in thousands).

Table of Contents**Revenues**

	Three Months Ended	
	March 31,	
	2009	2008
United States and Canada	\$ 69,959	\$ 53,935
Japan	1,368	1,139
Korea	998	963
Rest of world	876	190
Total	\$ 73,201	\$ 56,227

Long-lived Assets

	March 31,	December 31,
	2009	2008
United States	\$ 23,619	\$ 21,059
India	7,794	7,857
Rest of world	627	716
Total	\$ 32,040	\$ 29,632

9. Comprehensive Income

Comprehensive income consisted of the following (in thousands):

	Three Months Ended	
	March 31,	
	2009	2008
Net income	\$ 12,778	\$ 9,654
Unrealized gain on short-term investments		3
Comprehensive income	\$ 12,778	\$ 9,657

10. Recent Accounting Pronouncements

On January 1, 2009, the Company adopted FASB Staff Position (FSP) 157-2, *Effective Date of FASB Statement No. 157*. FSP 157-2 delayed the effective date of SFAS 157, *Fair Value Measurement*, for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of the first quarter of fiscal 2009. The adoption of FSP 157-2 on January 1, 2009 did not have a material impact on the Company's consolidated financial statements.

On January 1, 2009, the Company adopted FSP EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based*

Table of Contents

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. The adoption of FSP EITF 03-6-1 did not have a material impact on the Company's consolidated financial statements.

On January 1, 2009, SFAS 141 (revised 2007), *Business Combinations* (SFAS 141R) became effective for the Company. This statement significantly changes 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. SFAS 141R may have a material impact on the Company's consolidated financial statements if or when it enters into a business combination.

On January 1, 2009, SFAS 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of ARB No. 51* became effective for the Company. This statement changes 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 significantly changes the accounting for transactions with minority interest holders. As of March 31, 2009, the Company did not have any minority interests.

In April 2009 the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*. This FSP amends SFAS 107, *Disclosures about Fair Value of Financial Instruments*, to require disclosures about fair value of financial instruments in interim as well as in annual financial statements. This FSP also amends APB 28, *Interim Financial Reporting*, to require those disclosures in all interim financial statements. This standard is effective for periods ending after June 15, 2009. The Company is currently evaluating the impact that this standard may have on its financial statements.

In April 2009, the FASB issued FSP FAS 157-4, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*, which provides guidelines for making fair value measurements more consistent with the principles presented in SFAS 157, *Fair Value Measurement*. FSP FAS 157-4 provides additional authoritative guidance in determining whether a market is active or inactive, and whether a transaction is distressed, is applicable to all assets and liabilities (i.e., financial and nonfinancial) and will require enhanced disclosures. This standard is effective for periods ending after June 15, 2009. The Company currently anticipates that the adoption of FSP FAS 157-4 will not have an impact on its consolidated financial statements.

In April 2009, the FASB issued FSP FAS 115-2 and FSP FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*, which amends the other-than-temporary impairment guidance for debt and equity securities. This standard is effective for periods ending after June 15, 2009. The Company currently anticipates the adoption of FSP FAS 115-2 and FSP FAS 124-2 will not have an impact on its consolidated financial statements.

Table of Contents

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

Cautionary Statement

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

our ability to attract and retain customers;

our financial performance;

our development activities;

the advantages of our technology as compared to that of others;

our ability to establish and maintain intellectual property rights;

our ability to retain and hire necessary employees and appropriately staff our operations;

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, 2008.

References to Starent Networks, Corp. , registrant , we , us , our and similar pronouns refer to Starent Networks, Corp. and its consolidated subsidiaries.

Table of Contents

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 core 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.

Consumers and professionals are increasingly using mobile phones and other multimedia handheld devices to stay connected to each other, to access the Internet, to utilize business applications and for entertainment. At the same time, mobile operators are experiencing declining profits from voice services and increasing competitive pressures. To address these changes, mobile operators are deploying or planning to deploy next-generation wireless networks, such as third generation and fourth generation, or 3G/4G, networks, that are capable of delivering high quality, mobile multimedia services to subscribers. In deploying these new networks, mobile operators are seeking packet core network products and services that can deliver higher performance and functionality than has been available from products repurposed from wireline applications.

We have developed our multimedia core network hardware platforms, the ST16 and the ST40, and our proprietary software specifically to address the needs of packet-based mobile networks. Our products are designed to provide mobile operators with new revenue opportunities while also reducing their costs. Our products possess a high degree of system intelligence that allows a mobile operator to understand the details of each subscriber session, enabling individual subscriber management and network traffic flow control. Our products also offer high performance capabilities, such as high capacity, significant data processing rates and high transaction rates, which increase the efficiency of the network and enhance the mobile subscriber's experience. To increase reliability, our platforms employ hardware redundancy and high-availability software techniques. By integrating several network functions into a single element, we allow mobile operators to simplify their networks. We designed our products to be access independent so they can function across a range of 2.5G, 3G and 4G mobile and wireless radio access networks.

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. We were founded in 2000 and our products were first used commercially by a mobile operator in the first quarter of 2003. Since 2003, our products have been deployed by over 95 mobile operators in over 40 countries.

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 March 31, 2009, we had 849 employees worldwide. Our revenues for the year ended December 31, 2008, were \$254.1 million and for the three months ended March 31, 2009 were \$73.2 million. Our net income for the year ended December 31, 2008 was \$60.5 million and \$12.8 million for the three months ended March 31, 2009.

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.

Edgar Filing: Starent Networks, Corp. - Form 10-Q

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.

Table of Contents

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.

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. These 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 results 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 as well as internal costs, such as salaries and benefits related to personnel, provisions for inventory obsolescence, related overhead and share-based compensation. 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, benefits and share-based compensation 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, the volume and costs of manufacturing our hardware products and the cost associated with implementing our products in our customer networks.

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

Edgar Filing: Starent Networks, Corp. - Form 10-Q

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 expenses.

Table of Contents

Other Income and Expense Items

Interest Income

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

Foreign Currency Exchange Gain (Loss)

Foreign currency gain (loss) primarily consists of 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 of these foreign subsidiaries are remeasured into U.S. dollars using the exchange rates in effect at the balance sheet date, with the exception of certain non-monetary items which are remeasured at historical rates. Revenues and expenses of these foreign subsidiaries are remeasured into U.S. dollars at the average rates in effect during the year.

Income Tax Expense

Our income tax expense consists of provisions for income taxes in both the United States and foreign jurisdictions. 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. We provide for income taxes during interim periods based on the estimated effective tax rate for the full fiscal year and record certain discrete items in the period in which they occur, for example tax deductions associated with share-based compensation transactions.

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.

Our critical accounting policies are those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Our critical accounting policies are described in the Management's Discussion and Analysis of Financial Condition and Results of Operations section included in our Annual Report on Form 10-K for the year ended December 31, 2008. There have been no significant changes to our critical accounting policies since December 31, 2008.

Table of Contents**Results of Operations***Revenues*

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

	Three Months Ended March 31,		Period-to-Period Change	
	2009	2008 (dollars in thousands)	\$	%
Revenues:				
Product	\$ 63,130	\$ 48,887	\$ 14,243	29%
<i>Percentage of revenues</i>	86%	87%		
Service	10,071	7,340	2,731	37
<i>Percentage of revenues</i>	14%	13%		
Total revenues	\$ 73,201	\$ 56,227	\$ 16,974	30%
Revenues by Customer Type:				
Direct	\$ 70,205	\$ 53,717	\$ 16,488	31%
<i>Percentage of revenues</i>	96%	96%		
Indirect	2,996	2,510	486	19
<i>Percentage of revenues</i>	4%	4%		
Total revenues	\$ 73,201	\$ 56,227	\$ 16,974	30%
Revenues by Geography:				
United States and Canada	\$ 69,959	\$ 53,935	\$ 16,024	30%
<i>Percentage of revenues</i>	96%	96%		
Japan	1,368	1,139	229	20
<i>Percentage of revenues</i>	2%	2%		
Korea	998	963	35	4
<i>Percentage of revenues</i>	1%	2%		
Rest of world	876	190	686	361
<i>Percentage of revenues</i>	1%			
Total revenues	\$ 73,201	\$ 56,227	\$ 16,974	30%

Revenues increased \$17.0 million, or 30%, in the quarter ended March 31, 2009 compared to the same quarter in 2008, due to an increase in product revenues of \$14.2 million and an increase in service revenues of \$2.7 million. Product revenues, which include hardware and software, increased primarily due to product shipments in the United States and Canada for which we received customer acceptances and recognized revenue during the three months ended March 31, 2009 as compared to the same period in 2008. The \$2.7 million increase in service revenues for the three months ended March 31, 2009 compared to the same period in 2008 was due to an increase in the amount of our products installed at mobile operators, which is generally the basis of maintenance and service fees. Direct revenues increased \$16.5 million, or 31%, primarily due to increased sales to existing customers.

Table of Contents*Cost of Revenues and Gross Profit*

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

	Three Months Ended		Period-to-Period Change	
	2009	March 31, 2008	\$	%
	(dollars in thousands)			
Cost of revenues:				
Product	\$ 9,768	\$ 9,048	\$ 720	8%
<i>Percentage of related revenues</i>	<i>15%</i>	<i>19%</i>		
Service	4,546	3,910	636	16
<i>Percentage of related revenues</i>	<i>45%</i>	<i>53%</i>		
Total cost of revenues	\$ 14,314	\$ 12,958	\$ 1,356	10%
<i>Percentage of revenues</i>	<i>20%</i>	<i>23%</i>		
Gross profit:				
Product	\$ 53,362	\$ 39,839	\$ 13,523	34%