UTSTARCOM INC
Form 10-K
March 15, 2010

Use these links to rapidly review the document
TABLE OF CONTENTS
ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Table of Contents

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-K

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

**For the Fiscal Year Ended December 31, 2009**

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

**For the transition period from to**
**Commission File Number: 000-29661**

# UTSTARCOM, INC.

(Exact name of registrant as specified in its charter)

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

**(510) 864-8800**
(Registrant's telephone number, including area code)

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

| **Title of Each Class** | **Name of Exchange on which Registered** |
|---|---|
| Common Stock, $0.00125 par value | The NASDAQ Stock Market LLC |

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

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

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

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 ý No o

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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 the definitions 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 ý | Non-accelerated filer o<br>(Do not check if a<br>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). Yes o No ý

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second fiscal quarter was approximately $177,300,065 based upon the closing price of $1.63 reported for such date on The NASDAQ Stock Market, LLC. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 10% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant, have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive for other purposes.

As of March 1, 2010, the registrant had 131,142,771 outstanding shares of Common Stock.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement to be delivered to the stockholders in connection with its Annual Meeting of Stockholders, which Proxy Statement will be filed with the SEC no later than April 30, 2010, are incorporated by reference into Part III hereof.

Table of Contents

**UTSTARCOM, INC.**

**TABLE OF CONTENTS**


| | | Page |
|---|---|---|
| | Additional Information | 3 |
| PART I. | | |
| Item 1. | Business | 3 |
| Item 1A. | Risk Factors | 17 |
| Item 1B. | Unresolved Staff Comments | 42 |
| Item 2. | Properties | 43 |
| Item 3. | Legal Proceedings | 43 |
| Item 4. | Reserved | 47 |
| PART II. | | |
| Item 5. | Market for UTStarcom, Inc.'s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities | 48 |
| Item 6. | Selected Financial Data | 50 |
| Item 7. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 51 |
| Item 7A. | Quantitative and Qualitative Disclosures About Market Risk | 85 |
| Item 8. | Financial Statements and Supplementary Data | 87 |
| Item 9. | Changes in and Disagreements with Accountants on Accounting and Financial Disclosure | 151 |
| Item 9A. | Controls and Procedures | 151 |
| Item 9B. | Other Information | 155 |
| PART III. | | |
| Item 10. | Directors, Executive Officers and Corporate Governance | 155 |
| Item 11. | Executive Compensation | 155 |
| Item 12. | Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | 156 |
| Item 13. | Certain Relationships and Related Transactions and Director Independence | 156 |
| Item 14. | Principal Accounting Fees and Services | 157 |
| PART IV. | | |
| Item 15. | Exhibits and Financial Statement Schedules | 157 |
| | Exhibit Index | 157 |
| | Signatures | 163 |

Table of Contents

## ADDITIONAL INFORMATION

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

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

Unless specifically stated, information in this Annual Report on Form 10-K assumes an exchange rate of 6.83 Renminbi for one U.S. dollar, the exchange rate in effect as of December 31, 2009.

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

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

This Annual Report on Form 10-K contains forward-looking statements. Beginning on page 17 we discuss some of the risk factors that could cause our actual results to differ materially from those provided in the forward-looking statements.

# PART I

## ITEM 1 BUSINESS

### OVERVIEW

We are one of the leading global providers of Internet Protocol ("IP")-based network solutions including the integration and support services sold to telecommunications and cable operators in both emerging and established markets around the world. Our focus is to design and sell IP-based telecommunications infrastructure products including our primary product suite of Internet Protocol TV ("IPTV"), and broadband solutions along with the ongoing services relating to the installation, operation and maintenance of these products. Collectively our range of solutions is designed to expand and modernize telecommunications networks through smooth network system integration, lower operating costs and increased broadband access. We also provide the carriers with increased revenue opportunities by enhancing their subscribers' user experience. The majority of our sales have been to service providers in China and India. We also sell to service providers in selective markets in Asia, Latin America and Europe.

UTStarcom was incorporated in Delaware in 1991. Our headquarters are currently in Alameda, California, with our research and design operations primarily in China. In February 2010, we announced we will move our headquarters to Beijing, China. Our primary mailing address is 1275 Harbor Bay Parkway, Alameda, California 94502. We can be reached by telephone at (510) 864-8800 and our website address is *www.utstar.com*. All of our SEC filings can be found under the Investor Relations section of our website or at the SEC's website at *www.sec.gov* and are available free of charge. The information contained on our website is not being incorporated by reference herein.

Table of Contents

**OUR OBJECTIVE**

Our objective is to be a leading global provider of IP-based communications products and services. We seek to differentiate ourselves by developing innovative, first-to-market products that enable telecommunications operators to enhance the technological capacity of their networks, lower their operating expenses and provide new offerings to their customer base. Our products are designed to integrate multiple functionalities and deliver multiple revenue-generating services on a single technology platform, reduce network complexity and enable a migration to a new generation of network technologies. Our solutions are designed to make carrier deployments, maintenance and upgrades both economical and efficient, allowing operators to earn a high return on their investment while reducing subscriber churn and increasing average revenue per subscriber.

**OUR STRATEGY**

Our objective is to enhance our position in key infrastructure products with attractive growth potential in selective geographic markets. To achieve this goal, our strategy is focused on our core strengths and aligned with favorable long term market trends relating to IP products in the major developing economies, primarily of China and India. In 2008 and 2009, we announced initiatives to focus our resources in selective markets and high growth potential product lines which would likely drive growth and produce attractive gross margin. We further set our goal to aggressively streamline our operations and reduce our headcount and annual operating expenses. We also announced our intention to outsource our manufacturing operation to improve cash flow and operational efficiency. As we execute our strategy, we believe our carrier relationships and product innovation will be rewarded in the form of increased contract awards which are expected to have a positive impact on our financial metrics. Our strategic priorities, and the related milestones achieved in 2009, are summarized as follows:

**Focus primarily on providing a suite of IP-based solutions including our main product suite comprised of IPTV and broadband products and the related services.**

Recent macro trends indicate that telecom carriers want solutions that solve complex network problems and help them attract subscribers through an enhanced user experience. IP-based products have given an early indication of meeting this market driven demand. Product development and deployment are a core competency of ours as indicated by our historic and recent experience in successfully introducing market changing technologies for the telecommunications market.

In 2008 we streamlined our strategic focus by exiting a number of the businesses which we identified as non-core to our IP-based product strategy. We divested our wholly-owned subsidiary, UTStarcom Personal Communications LLC ("PCD"), and our Mobile Solutions Business Unit ("MSBU"). In 2009, we disbanded our Custom Solutions Business Unit ("CSBU") and substantially completed the wind-down of our worldwide handset operations.

By simplifying our company, we can now better allocate our resources to the product areas with attractive financial returns as well as where we can differentiate ourselves from the competition. We intend to expand our market position in IP-based and broadband products through innovation and continued research and development efforts.

**Maintain our leadership position in China and India while solidifying our presence in selective geographical markets in Asia. In addition, use reseller partners to manage selective markets in Latin America and Europe.**

These geographic regions are characterized as having large populations, a growing base of wealth, high acceptance rates for new technology and fewer established competitors. Additionally, carriers in these regions are relatively unencumbered by established legacy networks leading them to invest high

capital expenditure budgets in order to modernize and expand their networks. Over time these regions are expected to have higher rates of growth than the North American market.

In China and India we hold market leadership positions for certain key offerings. During 2009, we held a leadership position in IPTV market share in China and India, as well as a leading position in India's broadband market. While we continue to maintain dedicated direct sales teams in China and India, we started working with strategic partners to extend our coverage and establish new customers. During 2009, we increased our effort in the Japanese market and won the first Transport Network (TN) commercial contract with Softbank Corp. ("Softbank"). We also have an important presence across key markets in the rest of Asia. In Latin America and Europe we increased our focus on channel and OEM relationships to augment our regional sales efforts.

**Leverage our strong reputation with telecom carriers and our ability to solve complex network problems.**

Telecom carriers generally select vendors with a proven ability to innovate and reliably provide network solutions. Historically we have deployed IPTV, Next Generation Network and broadband solutions which enabled carriers to improve their network performance relating to optimal traffic management, lower operating costs and smoother network integration. The innovative features we provide, such as telemedia and digital signage help carriers attract new subscribers and increase their revenue streams.

Over time, these deployments have enhanced our understanding of carrier needs and our ability to design appropriate solutions. The reputation that we have obtained for innovation, performance and reliability provide us a competitive advantage as we seek to expand our existing and new customer relationships.

**Improve our financial position by executing announced restructuring initiatives and reducing operating expense levels.**

We recognized the urgency for us to improve our financial model in order to return the company to profitability. During 2008 we sold a number of non-core businesses to allow us to better concentrate our resources and management attention on our strategic priorities. In June 2009, we announced a series of corporate initiatives targeted at returning the company to profitability. These actions included outsourcing our manufacturing operations, optimizing our research and development ("R&D") spending by focusing on selective IP products, and continued aggressive rationalization of our facility locations and general administrative costs. During 2009 we reduced our year-over-year quarterly selling, general and administrative and research and development operating expenses by approximately 49% and reduced our headcount from 4,400 to approximately 2,400.

We have also realigned our product focus, R&D efforts and sales efforts to more effectively target the most desired customers in our selected regions. Externally, we seek to establish sales partnerships and sales channels which will improve our ability to obtain and execute contracts in certain geographic regions. Our ability to successfully implement the remainder of the restructuring actions in 2010 is a critical part of our plan to reduce operating expense levels and maintain liquidity.

We may encounter difficulties in implementing this significant change in a short time period. If we are not successful, we may not achieve the expected benefits despite having expended significant capital and human effort. We will need to continue to manage the company's resources, particularly our cash position, to ensure our ability to execute our strategic plan with an emphasis on near term return on investments and profitability.

Table of Contents

**Improve operational flexibility and cash requirements through outsourcing of manufacturing operations.**

During the last couple of years, our Global Supply Chain has been working diligently to reduce operating costs and improve our gross margin with significant achievements. In order to further our goal of operational and financial efficiency, the company decided to outsource our manufacturing operations. During January 2010, we announced the selection of an outsource partner and began the transition toward outsourcing our manufacturing operations. We believe that by outsourcing our manufacturing operations, we will improve our cash position, reduce costs, better utilize our assets and improve overall flexibility of our operations.

Completing the manufacturing change requires very careful planning and execution; we may encounter difficulties in implementing this significant change while maintaining shipments to our customers. If we are not successful, we may not achieve the expected benefits despite having expended significant capital and human effort and may experience an adverse impact on our ability to ship our products.

**KEY STRENGTHS**

Our key strengths in the implementation of our strategy include:

**Demonstrated ability to introduce and deploy innovative IP-based technologies.**

Since 2005 we have pioneered IPTV deployment in China and India. Today we are a leading IPTV provider across Asia and we recently debuted the first IPTV-based video advertising network in China. In 2008, we proved our NGN expertise as we were one of the few companies to execute Class 5 switch replacements. Our mSwitch NGN solution carried more than 500 billion minutes of usage (MoU), representing a sizable share of global Voice over IP ("VoIP") traffic. In 2009, we launched our Transport Network ("TN") Solution and secured two commercial contracts. Relative to the broadband market we have a leadership position in India and we launched the world's first all-IP-DSLAM and the first GEPON solution. Our innovation is part of our heritage dating to the early 1990s when we helped create a new telecommunications market in China based on the development of our PAS products, offering an alternative to traditional mobile telephony.

**Reputation for providing a unique customer-centric business model by solving complex problems to expand and modernize networks.**

Our product portfolio includes interactive IPTV services that generate an additional revenue opportunity with a carrier's subscriber base. The Next Generation Network and broadband products significantly reduce operating costs through better network integration and management, improved broadband access and effective network management support. We have demonstrated our ability to customize the design of our solutions to match the economic needs of our customers. As such, the carriers are able to shorten the return on investment timeframe for their network expenditures.

**Market leadership positions in China and India with an important presence in selective key markets in Asia, Latin America and Europe.**

We have leadership positions in China and India where our pioneering role in the telecommunications industry and strong brand recognition position us favorably. The majority of our business is derived from the large and developing economies in China and India. These regions have historically had high acceptance rates for new technologies, fewer established competitors and have a lack of legacy infrastructure hurdles in their existing networks. Meanwhile, many third party sources indicate that these regions are expected to have continued strong gross domestic product growth and as

a result management believes telecom capital expenditure budgets in these regions should be better able to withstand the current economic climate than the North American market.

**MARKETS AND CUSTOMERS**

Our products and services are being deployed and implemented in regions throughout the world in markets including Asia, Latin America and Europe. With the acquisition of selected assets from Audiovox Corporation in November 2004, until we divested these PCD operations in July 2008, the United States was our single largest market, representing 61% and 67% of net sales in 2008 and 2007, respectively. Subsequent to the divestiture of PCD operations, China is now our largest market, representing 46% of our net sales in 2009. Additional markets and customer information is included in the discussion of business segments below.

**Global Customers**

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

**Competition**

We compete in the telecommunications equipment market, providing IP-based core infrastructure products, and services for transporting data, voice and television traffic across IP-based networks. The markets in which we compete are characterized by rapid change, converging technologies, and a migration to IP-based networking and communications solutions that offer relative advantages to our customers and their subscribers. These market factors represent a competitive threat to UTStarcom. We compete with numerous vendors in each product and market category. The overall number of our competitors providing new products and solutions may increase. Also, the composition of competitors may change as we increase our activity in various technology markets. As we continue to expand globally, we may see new competition in different geographic regions. In particular, we have experienced price-focused competition from competitors in Asia, and we anticipate this will continue. For specific competitors, see the following discussion of our business segments in this Item 1.

We believe our competitive strengths are derived from three main factors: our ability to introduce and deploy innovative IP-based technologies; our reputation for providing a customer-centric business model and solving complex problems; and our market leadership position in China and India along with an important presence in selective key markets across Asia, Latin America and Europe.

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

**TECHNOLOGY AND PRODUCTS**

Our product focus is in two core markets: Broadband Infrastructure and Multimedia Communications. These markets leverage the high growth that is driven by the shift to IP-based

technologies, particularly in the world's developing economies. We plan to build on our demonstrated success in key regions across Asia, Latin America and Europe.

Within these two core markets, we anticipate profitable growth driven by our suite of offerings including IPTV and broadband solutions.

**Business Segments**

Our core business is comprised of the Broadband Infrastructure business unit and the Multimedia Communications business unit and the Services business unit that supports these two business units. To align the business units with our corporate strategy to focus on core businesses, on July 1, 2008 we sold PCD to PCD LLC (see Note 3 of Notes to our Consolidated Financial Statements included under Part II, Item 8 of this Annual Report on Form 10-K). Prior to July 1, 2008, PCD sold and supported handsets other than Personal Access Solution and Personal Handyphone System (collectively "PAS") handsets, mainly in the United States. Included in the Other segment are Mobile Solutions Business Unit ("MSBU") and Custom Solutions Business Unit ("CSBU"). In July 2008, we also sold MSBU which was responsible for the development, sales and service of the Company's wireless IPCDMA/IPGSM product line. In the first quarter of 2009, we completed the wind-down of CSBU and the consolidation of voice messaging technology into its Multimedia Communications segment. CSBU historically had been responsible for the development, sales and service of other non-core products. The consolidation of voice messaging technology into the Multimedia Communications segment did not have a significant impact on segment net sales or gross profit. As a result of these changes we revised our internal reporting structure, operating segments and reporting segments.

Effective January 1, 2009, our reporting segments were as follows:

Multimedia Communications Focused on development and market opportunities in IPTV solutions and Wireless infrastructure technologies.

Broadband Infrastructure Focused on the Company's portfolio of broadband products.

Handsets Focused on mobile phone business with continued focus on the PAS and CDMA handset market, as well as data cards markets. Handset sales to PCD LLC, which commenced after the July 1, 2008 sale of PCD, are included in this segment.

Services Focused on providing services and support of the Company's Broadband Infrastructure and Multimedia Communications product lines.

For net sales, segment margin and assets for these segments, see Note 14 of Notes to our Consolidated Financial Statements included under Part II, Item 8 of this Annual Report on Form 10-K, which is incorporated herein by reference.

Our Multimedia Communications segment is responsible for the development and management of IPTV and related technologies (such as IP Signage) plus our core NGN software. Our Personal Access System ("PAS") infrastructure and wireless systems teams are also a part of this segment.

Our Broadband Infrastructure segment is responsible for software and hardware products that enable end users to access high-speed, cost-effective wireline data, voice and media communication.

Our Handsets segment designs, builds and sells consumer handset devices that allow customers to access wireless services. The Handsets segment includes all handset revenues within China, including all PAS handsets. Following the disposition of PCD in July 2008, the Handsets segment also includes our Korea based handset operations, whose principal activity was supplying handsets to PCD LLC. In December 2008, we initiated action to wind down our Korea operations and in July 2009 completed the sale of our Korea operations. In the fourth quarter of 2009, we substantially completed the wind-down of our remaining China handset business.

We support the growth and operation of the installed base of our system solutions through our professional services business, UTStarcom Services. Our globally-deployed experts assist our customers with activities ranging from network planning, circuit-to-packet network migration planning, systems integration, program management, operations management and support, and knowledge transfer.

**MULTIMEDIA COMMUNICATIONS BUSINESS UNIT**

**Product Offerings**

Revenues from this segment accounted for approximately 36%, 17% and 13% of total sales in 2009, 2008 and 2007, respectively. Our Multimedia Communications segment includes our IPTV, mSwitch and PAS solutions.

***RollingStream IPTV Solution***

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

The RollingStream product family includes a storage and streaming device ("MediaStation"), a device for combining different video signals onto a unified distribution system ("Content Engine"), a device residing at the user's home or place of business, and a network management system that enables system wide operation. RollingStream products have been designed to function over standard copper telephone lines as well as cable or optical transmission lines.

RollingStream is designed to allow carriers to offer new, revenue-generating television and multi-media services. The system is also designed to help providers attract customers of cable and satellite operators by offering a more comprehensive and interactive suite of services. We continue to see industry and customer enthusiasm with key customer deployments announced in China with China Telecom and China Unicom, in India with Bharti Airtel, BSNL/Aksh and MTNL/Aksh, in Sri Lanka with Sri Lanka Telecom, and in Taiwan with Markwell.

***mSwitch NGN & Softswitch Solution***

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

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

mSwitch enables service providers to migrate from existing circuit platforms to a next generation IP-based switch architecture, or to launch new applications in "Greenfield" or new deployment environments that have no legacy infrastructure. Our mSwitch portfolio is a carrier-class next generation switching product family that enables service providers to:

- Deploy a converged core switching network that supports both wireline and wireless endpoints,
- Enable application delivery across diverse access points,

Table of Contents

Maintain consistent end user experience regardless of method of access to the applications,

Protect investment in their core infrastructure,

Deploy a scalable, modular system, and

Enjoy the benefits of an Operation Support System /Network Management System suite designed to integrate with the service provider's existing network.

***PAS Personal Access Solution***

Our Personal Access System family of wireless core infrastructure equipment, based on the PHS standards developed by The Association of Radio Industries and Telecommunication Technology Committee in Japan, is designed to help our customers create new revenue opportunities with high quality wireless voice and data services. Approximately 52%, 77% and 87% of our Multimedia Communications revenue in 2009, 2008 and 2007, respectively, was derived from our PAS infrastructure products.

With the UTStarcom IP-Based PAS (iPAS) wireless access network, operators can migrate their current wireline network to an IP-based PHS wireless network that provides wireless voice and data services within a city or community. With this new system, service providers can offer new wireless services, such as citywide mobility, same-number wireless extension, email, mobile Internet access, text messaging and location-based services. Due to the China telecommunication industry restructuring and launch of 3G services in China, the PAS services will be phased out by January 1, 2012.

**Markets and Customers**

In 2009, our largest market for Multimedia Communications products was China, which accounted for approximately 77% of revenues for the segment, primarily driven by the PAS business. We believe that China continues to be one of the largest and most important markets in the world with gross domestic product (GDP) growth averaging more than 9% each year over the past several years, though the growth has slowed during the fourth quarter of 2008 through 2009 with the global downturn in economic activity. China is currently undergoing an evolution of telecommunications technology. As such, infrastructure spending is expected to transition over the next several years from traditional wireless and wireline technologies to new technologies such as 3G and broadband-based services. While this led to an overall decline in Multimedia Communications revenues by 50% and 11% in 2009 and 2008, respectively, we expect the sales of our next generation multimedia communications systems such as Rollingstream to increase in the future.

In 2009, 2008 and 2007, the Zhejiang Province in China accounted for approximately 13%, 31% and 15%, respectively, of net sales within the Multimedia Communications business segment. In 2007, sales in the Jiangsu Province accounted for approximately 12% of total net sales for the Multimedia Communications business segment.

**Competition**

The Multimedia Communications market is marked by intense competition worldwide from numerous global and regional competitors, including some of the world's largest companies. Pricing, payment terms and brand recognition are key considerations for our customers. Specific competitors in this segment include Alcatel-Lucent, Cisco Systems, Inc., Huawei Technologies Co., Ltd., Sonus Networks, Inc., and ZTE Corporation, Inc.

Table of Contents

**BROADBAND INFRASTRUCTURE BUSINESS UNIT**

**Product Offerings**

Our Broadband Infrastructure products are designed to satisfy customer demand for high speed and cost-effective wireline-based data, voice and multimedia services. Revenues from this segment accounted for approximately 21%, 7% and 6% of total sales in 2009, 2008 and 2007, respectively. Our wireline technology enables high-speed voice, video and data transmissions over broadband IP-based networks. Our Broadband Infrastructure segment includes digital subscriber line products, multi-service access node products and fiber optics products.

***Broadband Access Products***

We have pioneered several broadband access technologies including IP-based DSLAM and GEPON. With continuous innovation, we have been able to extend our footprint across the globe with broadband access product lines.

*Multi-Service Access Node*

A Multi-Service Access Node ("MSAN") offers a wide range of services including IPTV, High-Speed Internet Access, POTS, ISDN, VoIP, over twisted pair copper and optical fiber. UTStarcom's iAN8K B1000 Multimedia Network Edge is a leading MSAN platform with over 30 million lines installed as of December 31, 2009. iAN8K B1000 offers access-gateway function for NGN Migration application by providing connectivity to existing legacy network and state-of-the-art IP-based voice network. NGN migration is the most important target market for MSAN, which is evolving into a very large global opportunity. iAN8K B1000 also offers IP-based DSLAM function based on ADSL2+ and VDSL2 standards for the still-growing broadband access market. iAN8K B1000 is based on next-generation Gigabit Ethernet architecture, in-line with our commitment to offer end-to-end IP connectivity. We continue to enrich our MSAN product by expanding the MSAN product line including iAN B1200 which was introduced in 2008. This new product is available in compact form factors and extends the coverage of our iAN8K B1000 MSAN product. iAN B1200 is targeted on FTTB/FTTC applications. iAN B1205 is first product from this series; it offers very high-density in a small form factor and is well suited for FTTC application. In 2009, we released iAN B1202; this product has smaller form factor and is designed to address FTTB applications.

*Digital Subscriber Line Products*

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

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

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

Table of Contents

*Gigabit Ethernet Passive Optical Network ("GEPON")*

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

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

***Optical Transport Products***

Our optical products include transport products based upon internationally defined optical transmission standards and access products. Our products convert and translate data, video, voice or other traffic into an optical signal that is transmitted over glass fiber. The product platform includes a multi-service management system which simultaneously processes multiple speeds ranging from 155 Megabits per second for traditional voice service to 40 Gigabits per second for data intensive services.

*Multi-Service Transport Platform ("MSTP")*

We introduced our NetRing MSTP optical product line in December 2003. While our GEPON product is designed to provide services to individual customers, our NetRing products are designed for the high bandwidth needs of a service area. Our NetRing 600 products provide voice and data services for multi-tenant buildings, office buildings and enterprise campus applications. Our mid-range NetRing 2500 products offer voice and data transport when more bandwidth and greater capacity is required. Our high-end NetRing 10000 products provide service for regional transport applications, when maximum bandwidth and capacity is required. In each application, the optical fiber is looped through the service area and connected back upon itself, providing full redundancy in the event that the fiber is severed. NetRing provides a broad range of functions for carriers to manage voice, data and video traffic with network management functions previously available only on multiple, independent platforms. In late 2008, we introduced our new state-of-art 40G product NetRing 40K which has been successfully deployed to certain key customers.

*Resilient Packet Ring ("RPR")*

In late 2007, we introduced our first Metro Ethernet product, which is MEF certified and uses RPR as the core technology for transport. This product is targeted for metro aggregation function. It is widely deployed in Bharat Sanchar Nigam Ltd.'s ("BSNL") multi-play network, for which we are turn-key providers and also have large deployment of IP-based DSLAM.

*Packet Optical Transport Networks ("PTN")*

In October 2009, we announced the debut of our expanded NetRing(TM) Transport Network product portfolio (NetRing(TM) TN), which includes new multiprotocol label switching transport profile (MPLS-TP) solutions specifically designed to overhaul existing mobile backhaul networks, provide Ethernet services and deliver broadband aggregation applications.

Our NetRing(TM) TN packet-based optical transport system is based on the latest MPLS-TP technology pre-standard being jointly defined by ITU-T and IETF. It is highly flexible, reliable, scalable and cost-effective and can be deployed for key applications such as carrier mobile backhaul, metro

Ethernet services for enterprise and digital subscriber line access multiplexer (DSLAM) and X-version of passive optical network (xPON) aggregation. It is capable of carrying time division multiplexing (TDM), asynchronous transfer mode (ATM), synchronous digital hierarchy/synchronous optical network (SDH/SONET) and Ethernet seamlessly over a reliable and scalable network, with resiliency at par with TDM networks. It also enables legacy enterprise services over Ethernet, providing 'wholesale' connectivity and an alternative for leased lines.

**Markets and Customers**

Our Broadband Infrastructure segment also targets several large markets and customers worldwide. In 2009, we won repeat business from our key broadband infrastructure customers, including in India with Bharti and BSNL, in Israel with Bezeq, in Japan with Softbank and in Taiwan with Chung-Hwa Telecom.

Our key target markets for 2009 for the deployment of our Broadband Infrastructure products were Asia, Latin America and Europe. We believe these markets provide a significant amount of opportunity going forward given their relatively low broadband penetration rates and strong consumer demand for new broadband services.

For example, according to the Census Bureau of India, as of September 1, 2007, India had a population of over 1.1 billion and according to the Telecom Regulatory Authority of India, as of October 31, 2009, India's teledensity (the number of phone lines per 100 persons) is only at approximately 45% compared to teledensity in the U.S. exceeding 100% with more than one phone per person. We currently offer our MSAN, IPDSLAM, IPTV, MSTP and GEPON, as well as a host of products and services in India. With over one million access lines deployed today, we anticipate that we will continue to implement and deploy our products and conduct trials with several operators, including Reliance Infocomm Ltd. and Bharat Sanchar Nigam Ltd.

**Competition**

The Broadband Infrastructure market is subject to intense competition worldwide from numerous global and regional competitors, including some of the world's largest companies. These companies leverage pricing, payment terms and their pre-existing customer relationships. Specific competitors in this segment include Alcatel-Lucent, ECI Telecom, Huawei Technologies Co., Ltd., LM Ericsson Telephone Company, Nortel Networks Corporation, Nokia Siemens Networks, Inc. and ZTE Corporation, Inc.

**HANDSETS BUSINESS UNIT**

**Product Offerings**

We designed, built and sold consumer handset devices that allowed customers to access wireless services. The Handsets segment included all handset revenues within China which was comprised mainly of PAS, CDMA and TD-SCDMA handsets. Prior to the disposition of PCD in July 2008, sales of our Korea based handset operations were accounted for as intercompany sales. Subsequent to the disposition of PCD, sales of our Korea based handset operations to PCD LLC were included in the Handsets business unit. In December 2008, we initiated actions to wind down our Korea based handset operations and accordingly substantially exited the business of sales to PCD LLC by the end of the fourth quarter of 2009. In October 2009, we decided to wind down and discontinue the remaining China handset business. Our Handsets business accounted for approximately 27%, 18% and 10% of revenues in 2009, 2008 and 2007, respectively. We do not expect that our handset business will have material revenue in 2010.

Table of Contents

**SERVICES BUSINESS UNIT**

In addition to our product offerings, we provide a broad range of service offerings, including technical support services. Our service offerings complement our products with a range of consulting, technical, project, quality and maintenance support-level services including 24-hour support through technical assistance centers. Technical support services are designed to help ensure that our products operate efficiently, remain highly reliable, and benefit from the most up-to-date system software. These services enable customers to protect their network investments and minimize downtime for systems running mission-critical applications. Our Services segment accounted for approximately 16%, 3% and 2% of revenues in 2009, 2008 and 2007, respectively. The market for Services is marked by intense competition worldwide from numerous global and regional competitors, including some of the world's largest companies. Pricing, payment terms and brand recognition are key considerations for our customers. Specific competitors in this segment include Alcatel-Lucent, LM Ericsson Telephone Company, Nortel Networks Corporation and Nokia Siemens Networks, Inc.

**PERSONAL COMMUNICATIONS DIVISION**

We acquired the Personal Communications Division ("PCD") from Audiovox Corporation in November 2004. Revenues from this segment represented approximately 54% and 67% of our total net sales in 2008 and 2007, respectively. Verizon Wireless and Sprint Spectrum L.P. accounted for approximately 20% and 12%, respectively, of total net sales in 2008. On July 1, 2008, we sold PCD to Personal Communications Devices, LLC ("PCD LLC"). Concurrent with the closing of the sale transaction, we entered into a three-year supply agreement with PCD LLC whereby we intended to supply handset products to PCD LLC. In connection with the wind-down of our Korea based handset operations, in December 2008, we furnished PCD LLC with 180-day's notice of termination of the supply agreement. Due to the continuing direct cash flows pursuant to the supply agreement beyond the one-year assessment period starting from the date of sale, the sale of the PCD assets did not meet the criteria for presentation as discontinued operations.

**OTHER BUSINESS SEGMENT**

Included in our Other segment were MSBU and CSBU. On July 31, 2008, we sold MSBU which was responsible for the development, sales and service of our wireless IPCDMA/IPGSM product line. CSBU was responsible for the development, sales and service of other non-core products such as IP messaging, transaction gateways, and Remote Access Server ("RAS") which enables users to access network data and services from remote locations and our Packet Data Services Node ("PDSN") product line which connects CDMA cellular network infrastructure equipment to IP networks. In the first quarter of 2009, we completed the wind-down of CSBU and the consolidation of voice messaging technology into our Multimedia Communications segment.

**OPERATIONS**

**Employees**

As of December 31, 2009, we had approximately 2,400 full-time employees worldwide including approximately 2,100 employees located in China. From time to time, we also employ part-time employees and hire contractors. Of the total number of full-time employees at December 31, 2009, approximately 900 were in research and development, approximately 400 were in manufacturing, approximately 800 were in marketing, sales and support, and approximately 300 were in administration. Our employees are not represented by any collective bargaining agreement and we have never experienced a work stoppage. We believe that we have good employee relations.

Table of Contents

**Sales, Marketing and Customer Support**

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

Across the rest of Asia, Latin America and Europe, we have a combined approach that uses direct sales, original equipment manufacturers, distributors, resellers, agents and licensees. We signed a number of new partnerships in 2009.

We maintain sales and customer support offices in several countries covering the U.S., Canada, Latin America, the Caribbean, Europe, the Middle East, Africa, India and the Asia-Pacific regions.

**Manufacturing, Assembly and Testing**

During 2009, we manufactured or engaged in the final assembly and testing of our mSwitch, PAS systems, and MSAN products at our ISO 9001-2000 and ISO 14000 certified manufacturing facility in the Chinese province of Zhejiang. The manufacturing operations consisted of circuit board assembly, final system assembly, software installation and testing. We assembled circuit boards primarily using surface mount technology. Assembled boards were individually tested prior to final assembly and tested again at the system level prior to system shipment. We used internally developed functional and parametric tests for quality management and process control and have developed an internal system to track quality statistics at a serial number level. We contracted with third parties in China to perform high-volume assembly and manufacturing of our handsets and some high-volume single boards. Handset final assembly, testing and packaging were conducted at our own facilities as well as contracted to third parties. We generally use third parties for high-volume assembly of circuit boards. We also contracted with various suppliers to provide PAS wireless base station components for distribution under the UTStarcom label. In China, we performed final assembly and tested our wireless infrastructure products at our own facilities.

In June 2009, we announced our intention to outsource our manufacturing operations. In January 2010, we announced the selection of an outsource partner and began the transition toward outsourcing our manufacturing operations. We expect to complete the manufacturing change in the first half of 2010 and expect to benefit from a variable cost business model and to improve the cash flow of the company.

**Research and Development**

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

Table of Contents

In the past we have made, and expect to continue to make, significant investments in research and development. Our research and development expenditures totaled $63.2 million in 2009, $143.3 million in 2008 and $168.3 million in 2007. The decrease in R&D expenditures is primarily due to reduced spending in non-core business units and cost reductions resulting from streamlined operations.

**Intellectual Property**

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

**Seasonality**

Although we experience some seasonality typical of the telecommunications industry, such as seasonally weak first quarters, our revenues and earnings have not demonstrated consistent seasonal characteristics. In contrast, our results are generally impacted more significantly by factors such as customer concentration and the timing of revenue recognition.

**EXECUTIVE OFFICERS OF THE REGISTRANT**

Our current executive officers, and their ages as of December 31, 2009, are as follows:

| Name | Age | Position |
| --- | --- | --- |
| Peter Blackmore | 62 | Chief Executive Officer and President |
| Ying (Jack) Lu | 47 | Chief Operating Officer (since March 1, 2010) |
| Kenneth Luk | 58 | Senior Vice President and Chief Financial Officer |

Our executive officers are appointed by, and serve at the discretion of, our board of directors. Each executive officer is a full-time employee. There is no family relationship between any of our executive officers or directors.

*Peter Blackmore* has served as our Chief Executive Officer and President and as a director since July 2008, and served as our President and Chief Operating Officer from July 2007 to June 2008. From 2005 until he joined us, Mr. Blackmore served as Executive Vice President in charge of world-wide sales, marketing and technology at Unisys Corporation. Prior to joining Unisys in 2005, he served as Executive Vice President of the Customer Solutions Group at Hewlett-Packard Company from 2004 and as Executive Vice President of the Enterprise Systems Group from 2002 through 2004. From 1991 until its acquisition by Hewlett-Packard in 2002, Mr. Blackmore served in a number of senior management positions with Compaq Computer Corporation, most recently as its Executive Vice President of worldwide sales and services from 2000 through 2002. Mr. Blackmore serves on the board of MEMC Electronic Materials Inc. Mr. Blackmore holds an M.A. in Economics from Trinity College, Cambridge, U.K.

*Ying (Jack) Lu* has served as our Senior Vice President and Chief Operating Officer since March 2010. Mr. Lu has been appointed our Chief Executive Officer and President effective the later date of June 30, 2010 or three months after the closing of the investment by Beijing E-town International

Table of Contents

Investment and Development Co., Ltd ("BEIID"), an investment company established by the Beijing Municipality and two unrelated investment funds, Elite Noble Limited and Shah Capital Opportunity Fund LP. From August 2008 until joining UTStarcom, Mr. Lu worked as an entrepreneur seeking to establish a renminbi denominated investment fund to invest in high technology companies in southwest China. From July 2007 to July 2008, Mr. Lu served as Global Co-Chief Operating Officer and General Manager of China Operations for Source Photonics, Inc., an optoelectronics components company. From September 2001 until June 2007, he served in a number of senior management positions, including most recently as President and Chief Executive Officer from January 2007 to June 2007 and Chief Operating Officer from June 2006 to December 2006, with Fiberxon Inc., an optical telecom components company, which was acquired by MRV Communications Inc., a communications equipment and services company, in July 2007. From 2000 until 2001, Mr. Lu served as Director of Business Strategy Development for US Business Networks Inc. (MeetChina.com), a business-to-business portal provider. From 1988 to 1998, Mr. Lu served in a number of management positions with China National Technical Import and Export Corporation ("CNTIC"), an import/export, manufacturing and consulting firm. Mr. Lu received a B.S. in Electrical Engineering from Huazhong University of Science and Technology in China and holds an M.B.A. from the University of Southern California.

*Kenneth Luk* has served as our Senior Vice President and Chief Financial Officer since December 2009. Prior to joining us, Mr. Luk served as Chief Financial Officer for China Sunergy Company Ltd. from December 2007 to March 2009. From April 2004 until June 2007, he was Corporate Controller, Asia/Japan of Freescale Semiconductor Hong Kong Ltd., a spin-off business of Motorola. From 1990 until the business spin-off, Mr. Luk served in a number of positions with Motorola Semiconductor Hong Kong Ltd., most recently as its Sector Controller of Asia/Japan from March 2002 to March 2004. Prior to joining Motorola Semiconductor, Mr. Luk worked for A.S. Watson & Company Limited as Group Credit Manager from July 1985 to December 1989. Mr. Luk began his career at The Hong Kong & Shanghai Banking Corporation Ltd. in 1977. Mr. Luk received a B.A. in Economics from University of Toronto in Canada and holds a M.B.A. from York University, Ontario, Canada.

## ITEM 1A RISK FACTORS

## FACTORS AFFECTING FUTURE OPERATING RESULTS

## RISKS RELATED TO OUR COMPANY

***We continue to experience operating losses and may not have sufficient liquidity to execute our business plan or to continue our operations without obtaining additional funding. Our ability to obtain additional funding is not assured.***

We reported net losses attributable to UTStarcom, Inc. of $225.7 million, $150.3 million and $195.6 million for the years ended December 31, 2009, 2008 and 2007, respectively. At December 31, 2009 we had an accumulated deficit of $1,067.2 million and used $67.4 million of cash in operations during the year ended December 31, 2009.

Management has partially implemented its liquidity plan through the payment in March 2008 of $289.5 million to retire our convertible subordinated notes and related accrued interest, the sale of PCD on July 1, 2008 and the pending sale of our facility in Hangzhou, China for approximately $140 million (see Notes 3, 6 and 7 of Notes to our Consolidated Financial Statements, included under Part II, Item 8 of this Annual Report on Form 10-K). As a result, management believes we will likely have sufficient liquidity to finance our 2010 anticipated operations and capital expenditure requirements when we successfully complete the pending transaction to sell our Hangzhou facility, as well as achieve projected cash collections from customers and contain expenses and cash used in operations. However, achievement of such operating performance is not assured and management expects to continue to implement its liquidity plans, which includes reducing operating expenses. If we cannot successfully implement our liquidity plans, it may be necessary for us to make significant

Table of Contents

changes to our business plan in order to maintain adequate liquidity. In addition, various other matters may impact our liquidity such as:

- inability to achieve planned operating results that could increase liquidity requirements beyond those considered in our business plan;

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

- failure to close the pending sale of our facility in Hangzhou, China to the Zhongnan Group of Companies;

- our principal credit facilities expired in 2009; as of December 31, 2009 we had no available credit lines;

- changes in China's currency exchange control regulations that could limit our ability to access cash in China to meet liquidity requirements for our operations in China or elsewhere; and

- difficulties in performing finance and other key functions, as a result of the Company's plan to eliminate functional duplication during 2010 by consolidation of a number of such functions into our China operations, which could adversely affect cash collections and liquidity.

Although management has developed liquidity plans, we may have difficulty maintaining existing relationships, or developing new relationships, with suppliers or vendors as a result of our financial condition. Our suppliers or vendors could choose to provide supplies or services to us on more stringent payment terms than those currently in place, such as by requiring advance payment or payment upon delivery of such supplies or services, which would have an adverse impact on our short-term cash flows. As a result, our ability to retain current customers, attract new customers and maintain contracts that are critical to our operations may be adversely affected.

***Our cost-reduction initiatives and restructuring plans may not result in anticipated savings or more efficient operations. Our recently-announced restructuring may disrupt our operations and adversely affect our operations and financial results.***

On June 11, 2009, we announced a restructuring of our worldwide operations in an effort to accelerate the Company's return to profitability, strategically align our cost structure with expected revenues and reallocate resources into areas of our business that we believe have more growth potential. We may not be able to successfully complete and realize the expected benefits of our restructuring plans. Our restructuring plans may involve higher costs or a longer timetable, or they may fail to improve our results of operations and cash flows as we anticipate. Our inability to realize these benefits may result in an ineffective business structure that could negatively impact our results of operations. In addition to costs related to severance and other employee-related costs, our restructuring plans may also subject us to litigation risks and expenses.

In addition, our restructuring plans may have other adverse consequences, such as employee attrition beyond our planned reduction in workforce, the loss of employees with valuable knowledge or expertise, a negative impact on employee morale, or a gain in competitive advantage by our competitors over us. The restructuring may place increased demands on our personnel and could adversely affect our ability to attract and retain talent, to develop and enhance our products and services, to service existing customers, to achieve our sales and marketing objectives and to perform our accounting, finance and administrative functions.

We may undertake future cost-reduction initiatives and restructuring plans that may adversely impact our operations; and we may not realize all of the anticipated benefits of our prior or any future restructurings.

Table of Contents

***Market turmoil may negatively impact our business.***

Disruptions in orderly financial markets, resulting from, among other factors, severely diminished liquidity and credit availability plus volatile and declining valuations of securities and other investments, have caused business and consumer confidence to ebb, business activities to slowdown, and unemployment to increase. These factors along with the interconnectivity and interdependency of international economies have created a global downturn in economic activity.

We are unable to predict how long the economic downturn will last. A continuing economic downturn may adversely impact our business in a number of ways, such as:

**Reduced demand for our products and services.** In a period of economic uncertainty customers may adopt a strategy of deferring purchases to upgrade existing or deploy new systems until later periods when the recoverability of their investment becomes more assured. In addition, customers who must finance their capital expenditures by issuance of debt or equity securities may find the securities markets unavailable to them.

**Increased pricing pressure and lower margins.** Our competitors include a number of global enterprises with relatively greater size in terms of revenues, working capital, financial resources and number of employees, and our customers are telecommunication service providers who typically are owned, controlled, or sponsored by governments. If the size of our potential markets contract due to the global economic downturn, competition for available contracts may become more intense which could require us to offer or accept pricing, payment, or local content terms which are less favorable to remain competitive. In some cases we might be unwilling or unable to compete for business where competitive pressures make a potential opportunity unprofitable to us.

**Greater difficulty in collecting accounts receivable.** Many of our telecommunication carrier customers are either owned or controlled by governments; any changes in such governments' policies concerning the authorization or funding of payments for capital expenditures could lengthen our cash collection cycle and thereby cause our liquidity to deteriorate. Additionally, while the vast majority of our net sales are to such large, well capitalized telecommunication carriers, some sales are made to distributors or other customers whose financial resources may be more subject to rapid decline, which could expose us to losing sales, delaying revenue recognition or accepting greater collection risks due to credit quality issues.

**Greater difficulty in obtaining purchased goods and services.** We expect that many of our suppliers will face the same or more challenging circumstances as we face in the current economic downturn, which could result in an adverse effect on our cash flows and liquidity. Some suppliers or vendors could choose to provide supplies or services to us on more stringent payment terms than those currently in place, such as by requiring advance payment or payment upon delivery of such supplies or services. Additionally, some suppliers might experience a worsening financial condition causing them to either withdraw from the market or be unable to meet our expected timing for the receipt of goods ordered from them, either of which condition in turn could adversely affect our ability to serve our customers and lengthen the cycle time for transforming customer orders into cash receipts. Additionally if it is necessary to seek alternative sources of supply, the effects on our costs, cycle time for cash collections, and customer satisfaction with our Company are uncertain.

**Additional restructuring and asset impairment charges.** If we are unable to generate the level of new contract bookings, revenues, and cash flow contemplated by our business plan, management will be forced to take further action to focus our business activities and align our cost structure with anticipated revenues. These actions, if necessary, could result in additional restructuring charges and/or asset impairment charges being recognized in 2010 and beyond.

Table of Contents

***Changes in our management may cause uncertainty in, or be disruptive to, our business. Certain of our directors and management team members will have been with us in those capacities for only a short time.***

We are experiencing significant changes in our management and our board of directors in recent times. For example, our Chief Financial Officer was recently appointed as such in December 2009, we recently appointed our new Chief Operating Officer, who, assuming the closing of the private placement, will transition to Chief Executive Officer on June 30, 2010 (or if later, three months following the closing date of the private placement), and, in connection with our proposed private placement, two current directors will resign and three new directors will be added to our board of directors. Although we will endeavor to implement any director and management transition in as non-disruptive a manner as possible, any such transition might impact our business, and give rise to uncertainty among our customers, investors, vendors, employees and others concerning our future direction and performance. This could adversely affect our business, financial condition, results of operations and cash flows, and our ability to execute our business model could be impaired.

In addition, because we have or will have members of management and the board of directors serving in their capacity as such for only a short duration, we face the additional risks that these persons:

- have limited familiarity with our past practices;
- lack experience in communicating effectively within the team and with other employees;
- lack settled areas of responsibility; and
- lack an established track record in managing our business strategy.

***Our overall financial performance continues to depend in large part upon our China subsidiaries.***

Approximately 46% of our sales were generated in China in 2009, as compared to approximately 27% of our sales in 2008. Subsequent to the divestiture of PCD in July 2008, China now accounts for a larger portion of our overall sales. We have made substantial investments in China and, therefore, our business, financial condition and results of operations are to a significant degree subject to economic, political, legal and social developments and other events in China. If our business in China declines, our financial condition, results of operations and cash flows may be significantly harmed.

***We may be unable or unwilling to accept additional purchase orders from existing clients, which could damage our relationships with such clients and lead to legal and financial consequences which could harm our business.***

Due to liquidity constraints or other strategic factors, we may from time to time be unable or unwilling to accept additional purchase orders from existing clients. If an existing customer places a purchase order with us that we then refuse to accept, our relationship with such customer may be harmed. Moreover, any refusal or inability by us to accept additional purchase orders may result in legal claims by our customers, reduced collections from previous purchase orders and financial penalties, which could distract our management and harm our business. Certain of our contracts have significant performance bank guarantees that, subject to the terms in the contracts, may be paid to the customer in the event of a default by us in addition to any other remedies it may have.

***Any failure by us to successfully transition certain functions to China may lead to increased costs and adversely affect our business.***

We are currently undertaking an initiative to transition certain key functions, including headquarters and finance, to China in order to eliminate functional duplication and reduce operating expenses. Our ability to successfully complete this change in 2010 is a critical part of our plan to

achieve profitability and maintain liquidity. We may experience a higher than typical rate of employee turnover as a result of this transition and a decrease in employee morale. If we fail to attract, hire, assimilate or retain qualified personnel in China, this transition may be delayed and ultimately unsuccessful. Cash collections and liquidity may be adversely affected if we have difficulties performing finance functions during or after the transition. Information and data that we rely on may be subject to risk of loss in connection with the transition. If we are not successful in this initiative, we may not achieve the expected benefits despite having expended significant capital and human effort.

***We may have to sell our securities.***

If we cannot meet our liquidity needs through improved operating results or by obtaining loans from financial institutions, we may have to sell additional securities, which would dilute the ownership of our stockholders. Our ability to sell our securities is not assured.

***Adverse resolution of pending civil litigation may harm our operating results or financial condition.***

We are a party to lawsuits in the normal course of our business. This litigation is, and any future additional litigation could be, time consuming and expensive, could divert our management's attention away from our regular business, and if any one of these lawsuits is adversely resolved against us, could have a material adverse effect on our financial condition and liquidity. Moreover, the results of complex legal proceedings are difficult to predict. For additional information regarding certain of the matters in which we are involved, see Part I, Item 3 Legal Proceedings of this Annual Report on Form 10-K.

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

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

- the timing and size of the orders for our products;
- consumer acceptance of new products we may introduce to market;
- changes in the growth rate of customer purchases of communications services;
- the lengthy and unpredictable sales cycles associated with sales of our products;
- revenue recognition, which is based primarily on customer acceptance of delivered products, is unpredictable;
- cancellation, deferment or delay in implementation of large contracts;
- quality issues resulting from the design or manufacture of the products, or from the software used in the product;
- cash collection cycles in China and other emerging markets;
- reliance on product, software and component suppliers who may constitute a sole source of supply or may have going concern issues;

the decline in business activity we typically experience during the Chinese Lunar New Year, which leads to decreased sales and collections during our first fiscal quarter;

issues that might arise from divestiture of non-core assets or operations or the integration of acquired entities and the inability to achieve expected results from such divestitures or acquisitions;

Table of Contents

- shifts in our product mix or market focus; and

- availability of adequate liquidity to implement our business plan.

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

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

We face intense competition, and will continue to face intense competition, from both domestic and international companies in our target markets, many of which may operate under lower cost structures and have much larger sales forces than we do. Additionally, other companies not presently offering competing products may also enter our target markets. Many of our competitors have significantly greater financial, technical, product development, sales, marketing and other resources than we do. As a result, our competitors may be able to respond more quickly to new or emerging technologies and changes in service provider requirements. Our competitors may also be able to devote greater resources than we can to the development, promotion and sale of new products. These competitors may be able to offer significant financing arrangements to service providers, which may give them a competitive advantage in selling systems to service providers with limited financial resources. In many of the developing markets in which we operate or intend to operate, relationships with local governmental telecommunications agencies are important to establish and maintain through permissible means. In many such markets, our competitors may have or be able to establish better relationships with local governmental telecommunications agencies than we have, which could result in their ability to influence governmental policy formation and interpretation to their advantage. Additionally, our competitors might have better relationships with their third party suppliers and obtain component parts at reduced rates, allowing them to offer their end products at reduced prices. Moreover, the telecommunications and data transmission industries have experienced significant consolidation, and we expect this trend to continue. If we have fewer significant customers, we may be more reliant on such large customers and our bargaining position and profit margins may suffer.

Increased competition is likely to result in price reductions, reduced gross profit as a percentage of net sales and loss of market share, any one of which could materially harm our business, cash flows and financial condition if extended losses were incurred. In order to be competitive, we must continually reduce the cost of manufacturing our products through design and engineering changes and other cost control measures. We may not be successful in these efforts or in delivering our products to market in a timely manner. In addition, any redesign may not result in sufficient cost reductions to allow us to reduce the prices of our products to remain competitive or to improve or maintain our gross profit as a percentage of net sales, which would cause our financial results to suffer.

To meet competitive offerings we may accept contracts with low profitability or even enter into contracts with anticipated losses if we believe it is necessary to establish a relationship with a customer or a presence in a market that we consider important to our strategy. Accepting a contract with an anticipated loss requires us to recognize a provision for the entire loss in the period in which it becomes evident rather than in later periods in which contract performance occurs. Accepting contracts with low gross margins adversely affects our reported results when the revenues from such contracts are recognized; in some cases revenue recognition must be deferred until all revenue recognition criteria have been met, and this would result in recognizing the adverse effects of low gross margin contracts in periods subsequent to when contract performance occurred.

Table of Contents

***The average selling prices of our products may decrease, which may reduce our revenues and our gross profit.***

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

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

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

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

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

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

the level of customer service available to support new products; and

Table of Contents

- the timing of new product introductions meeting demand patterns.

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

***We depend on a third party contract manufacturer for the manufacture and supply of our products. If we cannot secure from our contract manufacturer timely delivery of our products, high quality manufacture, or competitive prices, or if our contract manufacturer ceases to exist, then our competitive position, reputation and business could be harmed.***

Our growth and ability to meet customer demands depends in part on our ability to obtain timely deliveries of quality products from our contract manufacturers. The fact that we do not own or operate the bulk of our manufacturing facilities and that we are reliant on our contract manufacturer could have an adverse impact on the supply of our products and on our business and operating results:

- failure to receive timely delivery of our products could cause delay in our ability to timely fulfill customer orders;

- failure to receive good quality products from our contract manufacturer could affect our ability to fulfill customer orders and damage our relationship with our customers;

- failure to estimate customer demand and properly place product orders could result in excess inventory or insufficient inventory;

- any financial problems of either our contract manufacturer or their component suppliers could either limit the products we receive or increase our costs; and

- reservation of manufacturing capacity at our contract manufacturer by other companies could either limit supply or increase costs.

Supply chain issues, including financial problems of our contract manufacturer or their component suppliers, or a shortage of adequate component supply or manufacturing capacity could increase our costs or cause a delay in our ability to fulfill orders and have an impact on our customers, could have an adverse affect on our business and operating results and gross margins. A reduction or interruption in supply; a significant increase in the price of one or more components; a failure to adequately authorize procurement of inventory by our contract manufacturer; a failure to appropriately cancel, reschedule, or adjust our requirements based on our business needs; or a decrease in demand for our products could materially adversely affect our business, operating results, and financial condition and could materially damage customer relationships. If our contract manufacturer ceases to do business, our revenue and gross margins could suffer until another contract manufacturing source can be developed. Our operating results could also be adversely affected if, anticipating greater demand than actually develops, we commit to the purchase of more products than we need, or if we fail to estimate adequate customer demand, resulting in a lack of products to sell to customers, either of which is more likely to occur in a period of demand uncertainties such as we are currently experiencing. We may not be able to diversify sources in a timely manner, which could harm our ability to deliver products to customers and seriously impact present and future sales.

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

We have contracts with a limited group of suppliers to purchase certain components and materials used in our products. If any supplier is unwilling or unable to provide us with high-quality components and materials in the quantities required and at the costs specified by us, we may not be able to find

alternative sources on favorable terms, in a timely manner, or at all. For example, chipsets used in certain of our handsets are provided by a sole source supplier. If we had to begin using chipsets from another supplier for any reason, we would have to re-engineer our handsets to be compatible with the new chipset, which could cause delays in the manufacturing and shipping of our handsets. Further, a supplier could market its products directly to our customers. The possibility of a supplier marketing its own products would create direct competition and may affect our ability to obtain adequate supplies. Our inability to obtain or to develop alternative sources if and as required could result in delays or reductions in manufacturing or product shipments. From time to time, there could be shortages of certain products or components. Moreover, our suppliers may supply us with inferior quality products. If an inferior product supplied by a third party is embedded in our end product and causes a problem, it might be difficult to identify the source of the problem as being due to the component parts. If any of these events occur, our competitive position, reputation and business could suffer.

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

***Our global diversification strategy has strained our resources and subjects us to various economic, political, regulatory and legal risks.***

We market and sell our products globally. Our existing multinational operations require significant management attention and financial resources. To continue to manage our global business, we will need to take various actions, including:

- enhancing management information systems, including forecasting procedures;
- further developing our operating, administrative, financial and accounting systems and controls;
- managing our working capital and sources of financing;
- maintaining close coordination among our engineering, accounting, finance, marketing, sales and operations organizations;
- successfully consolidating a number of functions in China in 2010 to eliminate functional duplication;
- retaining, training and managing our employee base;
- reorganizing our business structure to more effectively allocate and utilize our internal resources;
- improving and sustaining our supply chain capability; and
- managing both our direct and indirect sales channels in a cost-efficient and competitive manner.

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

Table of Contents

Furthermore, multinational operations are subject to a variety of risks, such as:

- the complexity of complying with a variety of foreign laws and regulations in each of the jurisdictions in which we operate;
- the complexity of complying with anti-corruption laws in each of the jurisdictions in which we operate. These include United States regulations for foreign operations, such as the Foreign Corrupt Practices Act, as well as the anti-bribery and anti corruption laws of China and India where we conduct substantial operations. There is rigorous enforcement of anti corruption laws in the United States and in China, the violation of these laws may result in substantial monetary and even criminal sanctions;
- difficulty complying with continually evolving and changing global product and communications standards and regulations for both our end products and their component technology;
- market acceptance of our new products, including longer product acceptance periods in new markets into which we enter;
- reliance on local original equipment manufacturers ("OEMs"), third party distributors and agents to effectively market and sell our products;
- unusual contract terms required by customers in developing markets;
- changes to import and export regulations, including quotas, tariffs, licensing restrictions and other trade barriers;
- the complexity of compliance with complex and varying taxation requirements of multiple jurisdictions;
- evolving and unpredictable nature of the economic, regulatory, competitive and political environments;
- reduced protection for intellectual property rights in some countries;
- longer accounts receivable collection periods; and
- difficulties and costs of staffing, monitoring and managing multinational operations, including but not limited to internal controls and compliance.

In addition, many of the global markets are less developed, presenting additional economic, political, regulatory and legal risks unique to developing economies, such as the following:

- customers that may be unable to pay for our products in a timely manner or at all;
- new and unproven markets for our products and the telecommunications services that our products enable;

- lack of a large, highly trained workforce;
- difficulty in controlling local operations from our headquarters;
- variable ethical standards and an increased potential for fraud;
- unstable political and economic environments; and
- lack of a secure environment for our personnel, facilities and equipment.

In particular, these factors create the potential for physical loss of inventory and misappropriation of operating assets. We have in the past experienced cases of vandalism and armed theft of our equipment that had been or was being installed in the field. If disruptions for any of these reasons

Table of Contents

become too severe in any particular market, it may become necessary for us to terminate contracts and withdraw from that market and suffer the associated costs and lost revenue.

***Our success depends on continuing to hire and retain qualified personnel, including senior managers. If we are not successful in attracting and retaining these personnel and in managing key employee turnover, our business will suffer.***

The success of our business depends in significant part upon the continued contributions of key technical and senior management personnel, many of whom would be difficult to replace. The loss of a key employee, the failure of a key employee to perform satisfactorily in his or her current position or our failure to attract and retain other key technical and senior management employees could have a significant negative impact on our operations.

Notwithstanding our recent workforce restructurings, to effectively manage our operations, we will need to recruit, train, assimilate, motivate and retain qualified employees, especially in China. Competition for qualified employees is intense, and the process of recruiting personnel in all fields, including technology, research and development, sales and marketing, administration and management with the combination of skills and attributes required to execute our business strategy can be difficult, time-consuming and expensive. We must implement hiring and training processes that are capable of quickly deploying qualified local residents to knowledgeably support our products and services. Alternatively, if there is an insufficient number of qualified local residents available, we might incur substantial costs importing expatriates to service new global markets. For example, we have historically experienced and continue to experience difficulty finding qualified accounting personnel knowledgeable in both U.S. and Chinese accounting standards who are Chinese residents. In addition, we made changes within our senior management team in China. We have retained our key R&D talent, but may need to strengthen our China sales force through recruitment and training. If our current senior management in China cannot maintain and /or establish key relationships with customers, governmental entities and others in China, our business in China may decline significantly. If we fail to attract, hire, assimilate or retain qualified personnel, our business would be harmed. Our recent layoffs also have an adverse effect on our ability to attract and retain critical staff. Competitors and others have in the past, and may in the future, attempt to recruit our employees. In addition, companies in the telecommunications industry whose employees accept positions with competitors frequently claim that the competitors have engaged in unfair hiring practices. We may be the subject of these types of claims in the future as we seek to hire qualified personnel. Some of these claims may result in material litigation and disruption to our operations. We could incur substantial costs in defending ourselves against these claims, regardless of their merit.

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

Our business is subject to risk from changing foreign exchange rates because we conduct a substantial part of our business in a variety of currencies other than the U.S. Dollar. Historically, a substantial portion of our sales have been made in China and denominated in Renminbi. We also have made significant sales denominated in Japanese Yen, Euros, Indian Rupees and Canadian Dollars. Additionally, we have exposures to emerging market currencies, which can have extreme currency volatility. Adverse movements in currency exchange rates may negatively affect our cash flow and operating results. For example, during 2008, we incurred an approximately $9.9 million foreign currency loss attributed to adverse movements in currency exchange rates. Though we recorded a net foreign currency gain in 2009, we could experience foreign currency losses in the future. Although we could attempt to manage foreign currency exposures using forward and option contracts to hedge against the risk of foreign currency rate fluctuation in the eventual net cash inflows and outflows resulting from foreign currency denominated transactions with customers, suppliers, and non-U.S. subsidiaries, we are not currently hedging such transactions. Furthermore, we would be limited in our ability to hedge our

Table of Contents

exposure to rate fluctuations in certain currencies, including the Renminbi, on account of governmental currency exchange control regulations that restrict currency conversion and remittance.

Thus, even if we engage in hedging activities in the future, there is no assurance that we would be successful in minimizing the impact of foreign currency fluctuations. As a result, fluctuations in foreign currencies may have a material impact on our business, results of operations and financial condition.

***We may not be able to take advantage of acquisition opportunities or achieve the anticipated benefits of completed acquisitions.***

We have in the past acquired certain businesses, products and technologies. We will continue to evaluate acquisition prospects that would complement our existing product offerings, augment our market coverage, enhance our technological capabilities, or that may otherwise offer growth opportunities. To the extent we may desire to raise additional funds for purposes not currently included in our business plan, such as to take advantage of acquisition opportunities or otherwise develop new or enhanced products, respond to competitive pressures or raise capital for strategic purposes, there is no assurance that additional financing for these or other purposes would be available on acceptable terms or at all. If we raise additional funds through the issuance of equity securities, our stockholders will experience dilution of their ownership interest, and the newly issued securities may have rights superior to those of common stock. If we raise additional funds by issuing debt, our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control, we may be subject to limitations on our operations, and our leverage may increase. In addition, acquisitions involve numerous risks, including difficulties in the assimilation of operations, technologies, products and personnel of the acquired company, diversion of management's attention from other business concerns, risks of entering markets in which we have no direct or limited prior experience, the potential loss of key employees of the acquired company, unanticipated costs and, in the case of the acquisition of financially troubled businesses, challenges as to the validity of such acquisitions from third party creditors of such businesses.

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

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

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

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

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

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

***We are subject to risks related to our financial and strategic investments in third party businesses.***

From time to time we make financial and/or strategic investments in third party businesses. We cannot be certain that such investments will be successful. In certain instances we have lost part or all of the value of such investments, resulting in a financial loss and/or the loss of potential strategic opportunities. If we have to write-down or write-off such investments, or if potential strategic opportunities do not develop as planned, our financial performance may suffer. Moreover, these investments are often illiquid, such that it may be difficult or impossible for us to monetize such investments.

In certain cases, we have invested in third party businesses that are outside of the United States. In such cases, even if we are able to successfully liquidate such investments, it may be difficult for us to repatriate the proceeds of such investments to the United States in a prompt manner due to restrictions imposed by the local laws of the jurisdictions in which we invest. If we are unable to repatriate the proceeds of our investments promptly as needed, our business could suffer.

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

Our handset products are subject to a wide range of environmental, health and safety laws, including laws relating to the use, disposal and clean up of, and human exposure to, hazardous substances. Compliance with existing or future environmental, health and safety laws could cause us to incur substantial costs relating to such compliance, including the expense of modifying product designs and manufacturing processes. In addition, restrictions on the use of certain materials in our facilities or products in the future could have a negative impact on our operations.

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

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

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

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

***Product defect or quality issues may divert management's attention from our business and/or result in costs and expenses that could adversely affect our operating results.***

Product defects or performance quality issues could cause us to lose customers and revenue or to incur unexpected expenses. Many of our products are highly complex and may have quality deficiencies resulting from the design or manufacture of such product, or from the software or components used in the product. Often these issues are identified prior to the shipment of the products and may cause delays in market acceptance of our products, delays in shipping products to customers, or the cancellation of orders. In other cases, we may identify the quality issues after the shipment of products. In such cases, we may incur unexpected expenses and diversion of resources to replace defective products or correct problems. Such pre-shipment and post-shipment quality issues could result in delays in the recognition of revenue, loss of revenue or future orders, and damage to our reputation and customer relationships. In addition, we may be required to pay damages for failed performance under certain customer contracts, and may receive claims from customers related to the performance of our products.

***Business interruptions could adversely affect our business.***

Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, external interference with our information technology systems, incidents of terrorism and other events beyond our control that affect us, either directly or indirectly through one or more of our key suppliers. For example, our Hangzhou facility has in the past been subject to power shortages, which

Table of Contents

has affected our ability to produce and ship sufficient products. Also, our operations in Alameda, California and China are located in areas prone to earthquakes. We do not have a detailed disaster recovery plan, and the occurrence of any events like these that disrupt our business could harm our business and operating results.

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

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

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

***The failure of our enhanced version of our enterprise resource planning system to operate appropriately could result in material financial misstatements and/or cause delays in our filings.***

During the first quarter of 2008, we implemented an enhanced version of our enterprise resource planning system. In 2009, we continued to implement and enhance modules of this enterprise resource planning system. We depend on this system in order to timely and accurately process and report key components of our results of operations, financial position and cash flows. The Company and its stockholders are subject to the risks associated with late filings, material misstatements to the quarterly and annual consolidated financial statements and/or financial restatements, any of which could cause investors to lose confidence in our reported financial information and lead to a decline in our stock price, if the enterprise planning system fails to operate appropriately.

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

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

We have in the past and as of December 31, 2009 identified material weaknesses in our internal control over financial reporting and have concluded that our internal controls over financial reporting were not effective. The requirements of Section 404 of the Sarbanes-Oxley Act are ongoing and also apply to future years. We expect that our internal control over financial reporting will continue to evolve as we continue in our efforts to transform our business. Although we are committed to continue to improve our internal control processes and we will continue to diligently and vigorously review our

Table of Contents

internal control over financial reporting in order to ensure compliance with the Section 404 requirements, any control system, regardless of how well designed, operated and evaluated, can provide only reasonable, not absolute, assurance that its objectives will be met. In addition, successful remediation of the noted control deficiencies is dependent on the Company's ability to hire and retain qualified personnel. Therefore, we cannot be certain that we will be able to successfully remediate our existing material weaknesses or that in the future additional material weaknesses or significant deficiencies will not exist or otherwise be discovered.

**RISKS RELATED TO CONDUCTING BUSINESS IN CHINA**

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

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

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

- the promulgation of new laws and regulations and the interpretation of those laws and regulations;
- inconsistent enforcement and application of the telecommunications industry's rules and regulations by the Chinese government between foreign and domestic companies;
- the restructuring of telecommunications carriers in China, including policy making governing next generation network infrastructure and licensing;
- restrictions on IPTV license grants, which could limit the potential market for our products;
- the introduction of measures to control inflation or stimulate growth;
- the introduction of new guidelines for tariffs and service rates, which affect our ability to competitively price our products and services;
- changes in the rate or method of taxation;
- the imposition of laws, rules or regulations affecting the direct or indirect nationalization of assets controlled by non-governmental persons or entities;

the imposition of additional restrictions on currency conversion and remittances abroad; or

any actions that limit our ability to develop, manufacture, import or sell our products in China, or to finance and operate our business in China.

Table of Contents

In addition to modifying the existing telecommunications regulatory framework, the Chinese government is currently preparing a draft of a standard, national telecommunications law ("Telecommunications Law") to provide a uniform regulatory framework for the telecommunications industry. Currently, Telecommunications Law has been included in the law legislation plan of the Standing Committee of the 11$^{th}$ National People's Congress. We do not yet know the final nature or scope of the regulations that would be created if the Telecommunications Law is passed. Accordingly, we cannot predict whether it will have a positive or negative effect on us or on some or all aspects of our business.

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

***China's currency exchange control and government restrictions on dividends may impact our ability to transfer funds outside of China.***

A significant portion of our business is conducted in China where the currency is the Renminbi. Regulations in China permit foreign owned entities to freely convert the Renminbi into foreign currency for transactions that fall under the "current account," which includes trade related receipts and payments, interest and dividends. Accordingly, our Chinese subsidiaries may use Renminbi to purchase foreign exchange for settlement of such "current account" transactions without pre-approval. However, pursuant to applicable regulations, foreign-invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations. In calculating accumulated profits, foreign investment enterprises in China are required to allocate at least 10% of their accumulated profits each year, if any, to fund certain reserve funds, including mandated employee benefits funds, unless these reserves have reached 50% of the registered capital of the enterprises.

Transactions other than those that fall under the "current account" and that involve conversion of Renminbi into foreign currency are classified as "capital account" transactions; examples of "capital account" transactions include repatriations of investment by or loans to foreign owners, or direct equity investments in a foreign entity by a China domiciled entity. "Capital account" transactions require prior approval from China's State Administration of Foreign Exchange (SAFE) or its provincial branch to convert a remittance into a foreign currency, such as U.S. dollars, and transmit the foreign currency outside of China.

This system could be changed at any time and any such change may affect the ability of us or our subsidiaries in China to repatriate capital or profits, if any, outside China. Furthermore, SAFE has a significant degree of administrative discretion in implementing the laws and has used this discretion to limit convertibility of current account payments out of China. Whether as a result of a deterioration in the Chinese balance of payments, a shift in the Chinese macroeconomic prospects or any number of other reasons, China could impose additional restrictions on capital remittances abroad. As a result of these and other restrictions under PRC laws and regulations, our China subsidiaries are restricted in their ability to transfer a portion of their net assets to the parent. We have no assurance that the relevant Chinese governmental authorities in the future will not limit further or eliminate the ability of our Chinese subsidiaries to purchase foreign currencies and transfer such funds to us to meet our liquidity or other business needs. Any inability to access funds in China, if and when needed for use by the Company outside of China, could have a material and adverse effect on our liquidity and our business.

Table of Contents

***Fluctuations in the value of the Renminbi relative to the U.S. dollar could affect our operating results.***

We prepare our financial statements in U.S. dollars, while our underlying businesses operate in two currencies, U.S. dollars and Chinese Renminbi. It is anticipated that we will conduct our operations in China primarily in Renminbi. The conversion of financial information using a functional currency of Renminbi will be subject to risks related to foreign currency exchange rate fluctuations. The value of Renminbi against the U.S. dollar and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions and supply and demand in local markets. As we have significant operations in China, and will rely principally on revenues earned in China, any significant revaluation of the Renminbi could materially and adversely affect our financial results.

The value of the Renminbi has fluctuated within a narrow and managed band against a basket of certain foreign currencies since 2005. However, the Chinese government has come under increasing U.S. and international pressure to revalue the Renminbi or to permit it to trade in a wider band, which many observers believe would lead to substantial appreciation of the Renminbi against the U.S. dollar and other major currencies. There can be no assurance that Renminbi will be stable against the U.S. dollar.

***If China imposes economic restrictions to reduce inflation, future economic growth in China could be severely curtailed, reducing the profitability of our operations in China.***

Rapid economic growth can lead to growth in the supply of money and rising inflation. If prices for any products or services in China are unable, for any reason, to increase at a rate that is sufficient to compensate for any increase in the costs of supplies, materials or labor, it may have an adverse effect on our operations in China. In order to control inflation in the past, China has imposed controls on bank credits, limits on loans for fixed assets and restrictions on state bank lending and could adopt additional measures to further combat inflation. Such measures could harm the economy generally and hurt our business by (i) limiting the income of our customers available to spend on our products and services, (ii) forcing us to lower our profit margins, and (iii) limiting our ability to obtain credit or other financing to pursue our expansion plans or maintain our business. We cannot predict with any certainty the degree to which our business will be adversely affected by slower economic growth in China.

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

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

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

China's economic environment has been changing as a result of China's entry, in December of 2001, into the World Trade Organization ("WTO"). Foreign investment in the telecommunications sector is regulated by the "Provisions on Administration of Foreign Invested Telecommunications Enterprises" promulgated by the State Council in December 2001 and effective as of January 1, 2002, which was amended on September 10, 2008. The provisions brought foreign equity limits into

conformity with China's WTO commitments, allowing foreign investors to own equity generally up to 49% for basic telecom services enterprises and up to 50% for value-added telecom services enterprises.

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

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

We conduct our business in China primarily through our wholly owned subsidiaries incorporated in China. Our subsidiaries are generally subject to laws and regulations applicable to foreign investment in China. Accordingly, our business might be affected by China's developing legal system. Since 1978, many new laws and regulations covering general economic matters have been promulgated in China, and the overall effect of legislation over the past 30 years has enhanced the protections afforded to various forms of foreign investment in China. However, foreign investors may be adversely affected by new laws, frequent changes to existing laws (or interpretations thereof) and preemption of provincial or local regulations by national laws or regulations. In addition, certain government policies and internal rules promulgated by governmental agencies may not be published in time, or at all. As a result, we may operate our business in violation of new rules and policies without having any knowledge of their existence. The Chinese legal system is based on written statutes, and prior court decisions have limited precedential value. Because many laws, rules and policies in China are relatively new and the Chinese legal system is still evolving, the interpretation and enforcement of laws, rules and policies in China are not always uniform and involve uncertainties. The Chinese government has broad discretion in dealing with violations of laws, rules and policies, including levying fines, revoking business and other licenses and requiring actions necessary for compliance, and enforcement of existing laws or contracts based on existing law may be sporadic; therefore, it may be difficult to predict the effect of existing or new Chinese laws, rules or policies on our businesses and it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction. Any litigation in China may be protracted and result in substantial costs and diversion of resources and management's attention.

***A significant portion of our assets is located in the PRC, and investors may not be able to enforce federal securities laws or their other legal rights.***

A substantial portion of our assets is located in the PRC. As a result, it may be difficult for investors in the U.S. to enforce their legal rights, to effect service of process upon certain of our directors or officers or to enforce judgments of U.S. courts predicated upon civil liabilities and criminal penalties against our directors and officers located outside of the U.S.

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

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

Table of Contents

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

The CIT Law targets certain industries for the reduced 15% tax rate, which will be available for certain qualified high technology enterprises. For FIEs established before the promulgation of the new law who currently enjoy lower tax rates, any increase in their tax rates would be gradually phased in over five years. During the fourth quarter of 2008, two of the Company's China subsidiaries, HUTS and UTSC, were approved for the reduced 15% tax rate. The approval lasts for three years and is retroactive to January 1, 2008.

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

***Under the CIT Law, we may be classified as a "resident enterprise" of the PRC, which could result in unfavorable tax consequences to us and to non-PRC stockholders.***

Under the CIT Law, an enterprise established outside of China with "de facto management bodies" within China is considered a "resident enterprise," meaning that it can be treated in a manner similar to a Chinese enterprise for enterprise income tax purposes. The implementing rules of the CIT Law define de facto management as "substantial and overall management and control over the production and operations, personnel, accounting, and properties" of the enterprise. The CIT Law and its implementing rules are relatively new and ambiguous in terms of some definitions, requirements and detailed procedures, and currently no official interpretation or application of this new "resident enterprise" classification, other than for enterprises established outside of China whose main holding investor/s is/are enterprise/s established in China, is available; therefore, it is unclear how tax authorities will determine tax residency based on the facts of each case.

If the PRC tax authorities determine that we are a "resident enterprise" for PRC enterprise income tax purposes, the PRC could impose a 10% PRC tax on dividends we pay to our non-PRC stockholders and gains derived by our non-PRC stockholders from transferring our shares, if such income is considered PRC-sourced income by the relevant PRC authorities. In addition, we could be subject to a number of unfavorable PRC tax consequences, including: (a) we could be subject to enterprise income tax at a rate of 25% on our worldwide taxable income, as well as PRC enterprise income tax reporting obligations; and (b) although under the CIT Law and its implementing rules, dividends paid to us from our PRC subsidiaries through our sub-holding companies may qualify as "tax-exempt income," we cannot guarantee that such dividends will not be subject to withholding tax. Any increase in the taxation of our PRC-based revenues could materially and adversely affect our business, operating results and financial condition.

***The PAS market will decline rapidly over the next year.***

We believe the PAS market has matured. PAS is available in most of the provinces throughout China and competition from mobile operators has increased in cities where PAS is deployed. Mobile operators offering special promotional pricing or incentives to customers, such as free incoming calls or free mobile-to-mobile calls, have reduced PAS subscription growth. The expansion of mobile operators

Table of Contents

in China is likely to have a material adverse effect on our pricing and harm our business or results of operations.

MIIT has granted 3G mobile licenses to China Telecom, China Mobile and China Unicom. As a result, in the future they are likely to re-allocate capital expenditures to construct 3G networks, and as a consequence, significantly reduce capital expenditures relating to PAS networks that utilize our existing products. In addition, on January 9, 2009, in connection with the granting of 1900-1920 MHz frequency 3G licenses to the mobile communication companies in China, the MIIT officially issued a notice to unconditionally phase out the Personal Handy-phone System ("PHS") by the end of 2011 to guarantee the bandwidth for China's 3G services using TD-SCDMA technology, and requested China Telecom and China Netcom (both PAS service providers in China) to formulate a phase-out plan for their PHS services, and to cease the registration of new PHS users and expansion of the network. This may lead to the shutting down of PAS networks by such time.

Historically, China's telecommunications sector has been subject to a number of state-mandated restructurings. In 2008, China announced plans to restructure the six main telecom operators in China. This restructuring includes the acquisition of the CDMA network of China Unicom by China Telecom, the merger of China Netcom into China Unicom, the acquisition of the basic telecommunications business of China Satcom by China Telecom and the merger of ChinaTietong into China Mobile. This substantial integration of telecom operators in China may further accelerate the decline in the PAS market. In addition, any future restructurings in the telecommunications industry may result in delay or cancellation of telecommunications-related capital expenditures, which may have an adverse effect on our business.

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

We only have trial licenses for our PAS systems and handsets. We have applied for, but have not yet received, a final official network access license for our PAS systems and handsets. Based upon communication with MIIT, we understand that our PAS systems and handsets are considered to still be in the trial period and sales of our PAS systems and handsets may continue to be made by us during this trial period, but that licenses will ultimately be required. If we fail to obtain the required licenses, we could be prohibited from making further sales of the unlicensed products, including our PAS systems and handsets, in China, which would substantially harm our business, financial condition and results of operations through December 31, 2011, when we expect to complete the phase-out of our PAS products. The regulations implementing these requirements are not very detailed, have not been applied by a court and may be interpreted and enforced by regulatory authorities in a number of different ways. Our external legal counsel in China has advised us that China's governmental authorities may interpret or apply the regulations with respect to which licenses are required and the ability to sell a product while a product is in the trial period in a manner that is inconsistent with our current understanding, and either of these conditions could have a material adverse effect on our business, financial condition and results of operations.

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

Most Chinese carriers have three levels of operations: the central headquarters level, the provincial level and the local city/county level. Both central and provincial levels have their own corporate mandate. The purchasing decision-making process may take various forms for different projects and may also differ significantly from carrier to carrier. In the case of PAS systems, we negotiate and enter into all China Unicom contracts with the provincial operators. However, the central headquarters of China Telecom has chosen to exert its influence in the purchasing decision-making process by negotiating contractual terms, such as purchase price, payment terms, and acceptance clauses at the central level. The provincial operator then further negotiates the contract based on the guidelines

Table of Contents

provided by the headquarters. We enter into final contracts with the provincial operator. If this trend of centralized decision-making expands to unified purchasing, resulting in the negotiation and execution of contracts at the central headquarter level, there may be a concentration of customers which could have a significant impact on our business. If China Unicom follows China Telecom and exerts the headquarters' influence in price negotiation, it may give downward pressure to the margin of our PAS system products to China Unicom.

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

Broadcasting television over the internet has only recently begun in China. SARFT, the central government's regulatory body, issued a measure in July 2004 to regulate the broadcasting of audio-visual programs through the information network, which includes our Internet Protocol television (IPTV) business. SARFT categorized the information network into the mobile telecommunication network, fixed communications network, microwave communication network, cable television network, satellite or other metropolitan area network, wide area network, local area network and other information networks categories. The equipment that receives information from these networks includes computers, television sets, mobile phones and other electronic products. In December 2007, MIIT and SARFT jointly issued a measure to regulate the service of audio-visual programs on the internet, which also includes our IPTV business. This measure requires the entities engaged in the services of audio-visual program on the internet to be owned or controlled by the State owned entities. However, on February 3, 2008, SARFT and MIIT jointly held a press conference in response to inquiries related to such measure, during which SARFT and MIIT officials indicated that service providers of audio-video program established prior to the promulgation date of such measure that do not have any regulatory non-compliance records can apply for such permit to continue their business. After the conference, the two authorities published a press release that confirmed the above guidelines. While regulating the IPTV business, SARFT is encouraging development in China of the digital television business, a business that may be competitive with IPTV in the target market. Digital television and IPTV target complementary markets and the extent of support SARFT will provide for IPTV in setting regulations is not clear. On February 3, 2010, the SARFT agreed to allow China Telecom to apply to SARFT for approval of an IPTV license to expand its IPTV trial to more cities and industries. Because the IPTV industry relates to both television and telecom sectors, it may be subject to regulation by different governmental authorities, including MIIT. However, due to a lack of uniform regulation on the development of the IPTV industry, we cannot predict that our IPTV business will operate smoothly in China. Our business may suffer if the law or policy in China does not encourage the IPTV industry.

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

Under the measures issued by SARFT in July 2004, entities intending to engage in the IPTV operator service business should obtain a license from SARFT and foreign investment enterprises are prohibited from engaging in the IPTV operator service business. The new measure jointly issued by MIIT and SARFT indicates that SARFT will only grant such licenses to state-owned companies. However, on February 3, 2008, SARFT and MIIT jointly held a press conference in response to inquiries related to such measure, during which SARFT and MIIT officials indicated that service providers of audio-video program established prior to the promulgation date of such measure that do not have any regulatory non-compliance records can apply for such permit to continue their business. After the conference, the two authorities published a press release that confirmed the above guidelines. Since we are the technical service and equipment provider in this field, our business development will depend on the cooperation of license holders and network operators. Our business may suffer if we fail

Table of Contents

to cooperate with license holders or network operators, or if the license holder(s) we are cooperating with lose their licenses.

***Recent PRC regulations relating to offshore investment activities by PRC residents and employee stock options granted by overseas-listed companies may increase our administrative burden. If our shareholders who are PRC residents, or our PRC employees who are granted or exercise stock options, fail to make any required registrations or filings, we may be unable to distribute profits and may become subject to liability under PRC laws.***

The State Administration of Foreign Exchange ("SAFE") has promulgated regulations that require PRC residents and PRC corporate entities to register with local branches of SAFE in connection with their direct or indirect offshore investment activities. Under the SAFE regulations, PRC residents who make, or have previously made, direct or indirect investments in offshore companies will be required to register those investments. In addition, any PRC resident who is a direct or indirect shareholder of an offshore company is required to file or update the registration with the local branch of SAFE with respect to that offshore company any material change involving its round-trip investment, capital variation, such as an increase or decrease in capital, transfer or swap of shares, merger, division, long-term equity or debt investment or creation of any security interest. If any PRC shareholder fails to make the required SAFE registration or file or update the registration, the PRC subsidiaries of that offshore parent company may be prohibited from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation to their offshore parent company, and the offshore parent company may also be prohibited from injecting additional capital into its PRC subsidiaries. Moreover, failure to comply with the various SAFE registration requirements described above could result in liability under PRC laws for evasion of applicable foreign exchange restrictions.

We cannot provide any assurances that all of our shareholders who are PRC residents will make or obtain any applicable registrations or approvals required by these SAFE regulations. The failure or inability of our PRC resident shareholders to comply with the registration procedures set forth therein may subject us to fines and legal sanctions, restrict our cross-border investment activities, or limit our PRC subsidiaries' ability to distribute dividends or obtain foreign-exchange-denominated loans to our company.

On March 28, 2007, SAFE promulgated the Application Procedure of Foreign Exchange Administration for Domestic Individuals Participating in Employee Stock Holding Plan or Stock Option Plan of Overseas Listed Company (the "Stock Option Rule"), to regulate foreign exchange procedures for PRC individuals participating in employee stock holding and stock option plans of overseas companies. Under the Stock Option Rule, a PRC domestic individual must comply with various foreign exchange procedures through a domestic agent institution when participating in any employee stock holding plan or stock option plan of an overseas listed company. Certain domestic agent institutions, such as the PRC subsidiaries of an overseas listed company, a labor union of such company that is a legal person or a qualified financial institution, among others things, shall file with SAFE and be responsible for completing relevant foreign exchange procedures on behalf of PRC domestic individuals, such as applying to obtain SAFE approval for exchanging foreign currency in connection with owning stock or stock option exercises. Concurrent with the filing of such applications with SAFE, the PRC subsidiary, as a domestic agent, must obtain approval from SAFE to open a special foreign exchange account at a PRC domestic bank to hold the funds in connection with the stock purchase or option exercise, any returns based on stock sales, any stock dividends issued and any other income or expenditures approved by SAFE. The PRC subsidiary also is required to obtain approval from SAFE to open an overseas special foreign exchange account at an overseas trust bank to hold overseas funds used in connection with any stock purchase.

Under the Stock Option Rule, all proceeds obtained by PRC domestic individuals from sales of stock shall be fully remitted back to China after relevant overseas expenses are deducted. The foreign

Table of Contents

exchange proceeds from these sales can be converted into RMB or transferred to the individual's foreign exchange savings account after the proceeds have been remitted back to the special foreign exchange account opened at the PRC domestic bank. If the stock option is exercised in a cashless exercise, the PRC domestic individuals are required to remit the proceeds to the special foreign exchange account. We and our PRC employees who have been granted stock options are subject to this stock option rule. If we or our PRC employees holding options fail to comply with these regulations, we or our employees may be subject to fines and legal sanctions.

**RISKS RELATED TO OUR STOCK PERFORMANCE**

***Our stock price is highly volatile.***

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

- actual or anticipated fluctuations in operating results, actual or anticipated gross profit as a percentage of net sales, levels of inventory, our actual or anticipated rate of growth and our actual or anticipated earnings per share;
- changes in expectations as to future financial performance or changes in financial estimates or buy/sell recommendations of securities analysts;
- changes in governmental regulations or policies in China and other developing countries in which we do business;
- our, or a competitor's, announcement of new products, services or technological innovations;
- the operating and stock price performance of other comparable companies; and
- news and commentary emanating from the media, securities analysts or government bodies in China relating to us and to the industry in general.

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

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

***The market price of our common stock may decline as a result of future sales of the shares that we propose to issue in a private placement.***

On February 1, 2010, we entered into agreements with Beijing E-town International Investment and Development Co., Ltd, Elite Noble Limited and Shah Capital Opportunity Fund LP. (collectively, the "Investors") providing for the issuance of approximately 22 million shares of our common stock in the aggregate to the Investors, representing approximately 17% of our common stock outstanding as of December 31, 2009. We are unable to predict the potential effects of the Investors' ownership of our common stock on the trading activity in and market price of our common stock. Pursuant to stockholder agreements between us and the Investors, we have agreed to grant to them registration rights for the resale of the shares of our common stock issued in the private placement. Although the

Table of Contents

Investors will be subject to transfer restrictions for nine months following the closing of the private placement, these registration rights will facilitate the resale of such securities into the public market, and any such resale would increase the number of shares of our common stock available for public trading. Sales by the Investors of a substantial number of shares of our common stock in the public market, or the perception that such sales might occur, could have a material adverse effect on the price of our common stock.

***Our proposed private placement is subject to certain conditions to closing that could result in the transaction not being consummated or being delayed, either of which could negatively impact the market price of our common stock, our liquidity and our business and operating results.***

Consummation of the private placement is subject to a number of conditions, including, but not limited to, the receipt of certain authorizations, approvals or permits from various government agencies of China. There is no assurance that we will receive such authorizations, approvals or permits or satisfy the other conditions necessary for closing of the private placement. If any of the conditions to the private placement are not satisfied or, where waiver is permissible, not waived, the private placement will not be consummated. Failure to complete the private placement could result in a number of adverse effects, including:

- a decline in the market price of our common stock to the extent the market price of our common stock reflects a market assumption that the private placement will occur;

- requiring us to incur significant transaction costs without the benefit of the private placement; and

- loss of anticipated benefits relating to the location of our headquarters in the Beijing Economic and Technology Development Zone which is affiliated with Beijing E-town International Investment and Development Co., Ltd.

No assurance can be given that the private placement will be consummated, that there will be no delay in the consummation of the private placement or that the private placement will be consummated on the terms contemplated by the parties.

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

SOFTBANK CORP. and its related entities, including SOFTBANK America Inc. (collectively, "SOFTBANK"), beneficially owned approximately 11% of our outstanding stock as of December 31, 2009. As a result, SOFTBANK has the ability to influence all matters submitted to our stockholders for approval, as well as our management and affairs. Matters that could require stockholder approval include:

- election and removal of directors;

- our merger or consolidation with or into another entity; and

- sale of all or substantially all of our assets.

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

Table of Contents

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

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

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

***Our failure to timely file periodic reports with the Securities and Exchange Commission could result in the delisting of our common stock from the NASDAQ Global Select Market and cause us to default on covenants contained in contractual arrangements.***

If we are unable to maintain compliance with the conditions for continued listing required by NASDAQ, then our shares of common stock may be subject to delisting from the NASDAQ Global Select Market. For example, as a result of our failure to timely file with the Securities and Exchange Commission our Quarterly Report on Form 10-Q for the quarter ended September 30, 2006, our Annual Report on Form 10-K for the fiscal year ended December 31, 2006, our Quarterly Report on Form 10-Q for the quarter ended March 31, 2007, and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2007, we were not in full compliance with NASDAQ Marketplace Rule 5250(c)(1), which requires us to make, on a timely basis, all filings with the Securities and Exchange Commission required by the Securities Exchange Act of 1934. While we returned to full compliance with NASDAQ's listing requirements on October 19, 2007, we are required to comply with NASDAQ Marketplace Rule 5250(c)(1) as a condition for our common stock to continue to be listed on the NASDAQ Global Select Market. If our shares of common stock are delisted from the NASDAQ Global Select Market, our common stock may not be eligible to trade on any national securities exchange or the over-the counter market. If our common stock is no longer traded through a market system, the liquidity of our common stock may be greatly reduced, which could negatively affect its price. In addition, we may be unable to obtain future equity financing, or use our common stock as consideration for mergers or other business combinations. A delisting from the NASDAQ Global Select Market may also have other negative implications, including the potential loss of confidence by suppliers, customers and employees, the loss of institutional investor interest, and fewer business development opportunities.

## ITEM 1B UNRESOLVED STAFF COMMENTS

None.

Table of Contents

## ITEM 2 PROPERTIES

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

The headquarters for our China operations are located in Hangzhou. In 2001, we purchased the rights to use 49 acres of land located in Zhejiang Science and Technology Industry Garden of Hangzhou Hi-tech Industry Development Zone and have built a 2.7 million square foot facility on this site. The facility was occupied in October 2004 and is used for manufacturing operations, research and development and administrative offices. In December 2009, we entered into a Property Transfer and Leaseback Agreement for the intended sale of our manufacturing, research and development, and administrative offices facility in Hangzhou, China to another party with leaseback of a portion of the facility. On February 1, 2010, we entered into a lease agreement with respect to the leaseback of approximately 83,027 square meters (approximately 0.9 million square feet) which represents approximately one-third of the facility. The lease term expires in 2016. The sale transaction is subject to customary closing conditions and is expected to close between the end of March and April 2010.

We lease approximately 0.6 million square feet of property, of which 0.2 million square feet are properties in China and 0.3 million square feet are properties in North America. We maintain 15 sales and customer support offices in 9 countries covering the United States, Canada, Latin America, the Caribbean, Europe, the Middle East, India, and the Asia-Pacific region. We lease sales offices in 27 locations in China.

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

## ITEM 3 LEGAL PROCEEDINGS

*Securities Class Action Litigation*

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

On June 2, 2006, we and the individual defendants filed a motion to dismiss the Second Amended Complaint. On March 21, 2007, the Court granted defendants' motion and dismissed plaintiffs' Second Amended Complaint. The Court granted plaintiffs leave to file a Third Amended Complaint, which plaintiffs filed on May 25, 2007. On July 13, 2007, we and the individual defendants filed a motion to dismiss and a motion to strike the Third Amended Complaint. On March 14, 2008, the Court granted defendants' motion and dismissed plaintiffs' Third Amended Complaint. The Court granted plaintiffs leave to file a Fourth Amended Complaint, which plaintiffs filed on May 14, 2008. On June 13, 2008, consistent with the Court's March 14, 2008 dismissal order, we and the individual defendants filed objections to the form and content of the Fourth Amended Complaint. On July 24, 2008, the Court overruled the objections. On September 8, 2008, we and the individual defendants filed a motion to dismiss and a motion to strike certain allegations from the Fourth Amended Complaint. On March 27,

Table of Contents

2009, the Court denied defendants' motion to dismiss and granted defendants' motion to strike. Discovery and motion practice are ongoing in this litigation. No trial date has been set.

Plaintiffs, the individual defendants and we have signed a stipulation of settlement providing for the settlement of the case. Defendant Softbank is not a party to the settlement. The settlement is contingent on approval by the court. Under the terms of the settlement, the individual defendants' and our insurers would pay the full amount of the settlement. The Court has scheduled a preliminary approval hearing for May 10, 2010. There is no assurance that the settlement will receive court approval. Accordingly, we are unable at this time to estimate the effects of this lawsuit on our financial position, results of operations, or cash flows.

*Governmental Investigations*

In December 2005, the U.S. Embassy in Mongolia informed us that it had forwarded to the Department of Justice (the "DOJ") allegations that an agent of our Mongolia joint venture had offered payments to a Mongolian government official in possible violation of the Foreign Corrupt Practices Act (the "FCPA"). We, through our Audit Committee, authorized an independent investigation into possible violations of the FCPA, and we have been in contact with the DOJ and U.S. Securities and Exchange Commission (the "SEC") regarding the investigation. The investigation identified possible FCPA violations in Mongolia, Southeast Asia, India, and China, as well as possible violations of U.S. immigration laws. The DOJ requested that we voluntarily produce documents related to the investigation, the SEC subpoenaed us for documents, and we received a Grand Jury Subpoena requiring the production of documents related to one aspect of the DOJ investigation, that is, travel we had sponsored. We have resolved the investigations with the DOJ and the SEC. On December 21, 2009, as part of the resolution of these investigations, we executed a consent pursuant to which, without admitting or denying the SEC's allegations, we agreed to a judgment in favor of the SEC of $1.5 million, and agreed to certain reporting obligations for up to four years. The SEC has approved that resolution. On December 31, 2009, we entered into a non-prosecution agreement with the DOJ, pursuant to which we have paid an additional $1.5 million and agreed to undertake a three-year reporting obligation and to review and, where appropriate, strengthen our compliance, bookkeeping and internal controls standards and procedures. Under the non-prosecution agreement, subject to compliance with its terms, the DOJ has agreed not to criminally prosecute us for crimes (other than criminal tax violations) relating to certain travel arrangements we provided to customers in China.

*Shareholder Derivative Litigation*

On November 17, 2006, a shareholder derivative complaint captioned *Ernesto Espinoza v. Ying Wu et al.*, Case No. RG06298775, was filed against certain of our current and former officers and directors in the Superior Court of the County of Alameda, California. The complaint alleges that the individual defendants, among other things, breached their duties, were unjustly enriched, and violated the California Corporations Code in connection with the timing of stock option grants. The complaint names us as a nominal defendant and seeks unspecified monetary damages against the individual defendants and various forms of injunctive relief. On February 2, 2007, we and the individual defendants filed demurrers against the complaint. On April 11, 2007, the Court sustained the individual defendants' demurrer, overruled our demurrer, ordered the plaintiff to file an amended complaint, and ordered us to answer the original complaint. The plaintiff filed an amended complaint and we have filed an answer to the amended complaint. On August 21, 2007, the individual defendants filed demurrers against the amended complaint. The Court sustained the individual defendants' demurrers and ordered the plaintiff to file a second amended complaint. On September 26, 2008, plaintiff filed his second amended complaint. On November 21, 2008, we and the individual defendants filed demurrers against the second amended complaint. On February 27, 2009, the Court sustained our demurrer and ordered the plaintiff to file a third amended complaint. On March 20, 2009, plaintiff filed his third

Table of Contents

amended complaint. On May 5, 2009, we and the individual defendants filed demurrers against the third amended complaint. On August 11, 2009, the Court sustained our demurrer without leave to amend. On October 13, 2009, plaintiffs filed a notice of appeal.

The parties have signed a binding Memorandum of Understanding providing for the settlement of the case. The settlement requires completion of final settlement documentation. The settlement is contingent on approval by the court. Under the terms of the settlement, the individual defendants' insurer would pay the full amount of the monetary portion of the settlement. There is no assurance that the settlement will receive court approval. Accordingly, we are unable at this time to estimate the effects of this lawsuit on our financial position, results of operations, or cash flows.

*IPO Allocation*

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

In 2007, a settlement that had been pending with the Court since 2004 was terminated by stipulation of the parties to the settlement, after a ruling by the Second Circuit Court of Appeals in six test cases in the coordinated proceeding (the action involving us is not one of the test cases) made it unlikely that the settlement would receive final Court approval. Plaintiffs filed amended master allegations and amended complaints in the six test cases, which the defendants in those cases moved to dismiss. In 2008, the Court largely denied the defendants' motion to dismiss the amended complaints.

The parties have reached a global settlement of the litigation. On October 5, 2009, the Court entered an Opinion and Order granting final approval of the settlement. Under the settlement the insurers will pay the full amount of the settlement share allocated to us, and we will bear no financial liability. We, as well as the officer and director defendants who were previously dismissed from the action pursuant to tolling agreements, will receive complete dismissals from the case. Certain objectors have appealed the Court's October 5, 2009 order. If for any reason the settlement does not become effective, we believe we have meritorious defenses to the claims and intend to defend the action vigorously.

*UTStarcom, Inc. v. Starent Patent Infringement Litigations*

On February 16, 2005, we filed a suit against Starent for patent infringement in the U.S. District Court for the Northern District of California. In the Complaint, we assert that Starent infringes UTStarcom patent U.S. Reg. No. 6,829,473 through Starent's development and testing of a software upgrade for its customer's installed ST-16 Intelligent Mobile Gateways. We seek, inter alia, declaratory and injunctive relief. Starent filed its answer and counterclaims, on May 31, 2005, denying our allegations and seeking a declaration that the patent-in-suit is not infringed, is invalid, and is unenforceable. On June 16, 2005, we filed a motion to strike Starent's affirmative defense and dismiss

Starent's counterclaim alleging inequitable conduct. On July 19, 2005, the parties stipulated that Starent would file an amended answer and counterclaim by July 27, 2005 and that we would withdraw our motion to strike. We withdrew our motion to strike and on July 27, 2005, Starent filed its amended answer and counterclaim. On August 10, 2005, we responded to Starent's amended counterclaim. In early December 2006, we filed a reissue application for the '473 patent with the United States Patent and Trademark Office. Starent has also filed for reexamination of the '473 patent. The reexamination and reissue were then consolidated. Both UTStarcom and Starent have responded to the first Office Action mailed on December 22, 2008 by the Patent and Trademark Office in the consolidated proceedings.

On May 8, 2007, we filed an additional suit against Starent and sixteen individual defendants (who were all former employees of 3Com's CommWorks division, of which we acquired certain assets in May of 2003) in the Northern District of Illinois. The causes of action include claims for patent infringement, misappropriation of trade secrets, intentional interference with business relations and prospective economic advantage and declarations of ownership of certain patent rights. We seek compensatory damages, punitive damages and injunctive relief. After the court denied the defendant's motion to dismiss the misappropriation of trade secrets claims, on August 30, 2007, Defendants answered our complaint, denying our allegations and asserting a number of affirmative defenses and counterclaims. We filed an Amended Complaint to allege additional related causes of action. Starent moved to dismiss certain causes of action of the Amended Complaint. On May 30, 2008, we amended our complaint to remove from suit U.S. patent 6,978,128, and to add additional factual allegations relating to all defendants in the case. On July 23, 2008, the Court dismissed our trade secret and contract-based counts. We asked the Court to clarify that ruling and filed a motion for leave to file a Fourth Amended Complaint containing the trade secret and contract-based counts. After initially granting Defendants' motion to strike that complaint, the Court reconsidered its order and granted us leave to file it. The Fourth Amended Complaint has been filed. On October 14, 2008, Defendants moved to dismiss various counts of that Complaint, including again seeking to have the trade secret claims dismissed. On March 24, 2009, the Court ruled on Defendants' Motion. The Court denied Defendants' motion to dismiss our trade secret claims. However, to the extent our claims against Defendants for intentional interference with business relations are based on misappropriation of our trade secrets, the Court partially dismissed those claims, based upon the doctrine of preemption. The Court also dismissed, as not yet ripe for adjudication, one of the patent claims brought by us. Finally the Court also dismissed contract-based claims and related claims against individual defendants who had previously been employed by the 3Com's CommWorks division. On March 25, 2009, the Court denied the motion of Starent co-founder Anthony Schoener to dismiss him individually based upon lack of personal jurisdiction. On April 21, 2009, Defendants answered the remaining claims against them.

On August 27, 2008, we moved to dismiss Starent's counterclaims. On December 5, 2008, the Court partially granted this motion. On January 9, 2009, Starent filed amended counterclaims for non-infringement, invalidity and unenforceability of the asserted patents, tortuous interference with prospective economic advantage and trade secret misappropriation. On January 26, 2009, we filed an answer to the counterclaims and asserted various affirmative defenses. On April 21, 2009, in connection with Defendants' answers to our claims that remained after the Court's March 24, 2009 ruling on Defendants' motion to dismiss the Fourth Amended Complaint, Starent and four of the Individual Defendants asserted counterclaims for non-infringement, invalidity and unenforceability of the asserted patents, tortuous interference with prospective economic advantage and trade secret misappropriation. On May 14, 2009, we filed an answer to the counterclaims and asserted various affirmative defenses.

On June 10, 2009, the parties entered into a Stipulation whereby we agreed to dismiss our claims for misappropriation of trade secrets against fifteen of the eighteen Individual Defendants (but not against Starent and three Individual Defendants), intentional interference with business relations (against all defendants), and four of the patent-related claims against the four Individual Defendants

Table of Contents

named in those claims. The Stipulation also includes an agreement whereby the patent-related counterclaims asserted against us by the four Individual Defendants are dismissed. The fifteen Individual Defendants also agreed not to file any future claims or counterclaims against us (or our successors or assignees) relating to this action unless we file further claims against them. On July 10, 2009, the parties entered into a Stipulation whereby we agreed to dismiss our claim for copyright infringement against Starent.

Starent filed motions for summary judgment of non-infringement of U.S. Patent 7,173,905, U.S. Patent 6,684,256, and U.S. Patent 6,765,900. Starent also filed a motion for partial summary judgment concerning our trade secret claim. Starent filed a motion for summary judgment of invalidity of claim 6 of U.S. Patent 6,963,582. On September 16, 2009, the Special Master recommended to the District Court that Starent's motion for summary judgment of non-infringement of U.S. Patent 7,173,905 be granted. On September 30, 2009, the Court adopted the Special Master's recommendations and granted Starent's motion for summary judgment of non-infringement of U.S. Patent 7,173,905.

On October 14, 2009, the parties executed a settlement agreement, pursuant to which Starent paid us a one time sum of $3.5 million in exchange for a perpetual royalty free license to our patents, and we and Starent will dismiss with prejudice all claims, counterclaims and defenses asserted in these actions.

*Other Litigation*

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

**ITEM 4 RESERVED**

Table of Contents

## PART II

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

| | High | Low |
|---|---|---|
| ***Fiscal 2009*** | | |
| First Quarter | $ 2.18 | $ 0.63 |
| Second Quarter | $ 2.43 | $ 0.74 |
| Third Quarter | $ 2.54 | $ 1.39 |
| Fourth Quarter | $ 2.38 | $ 1.65 |
| ***Fiscal 2008*** | | |
| First Quarter | $ 3.19 | $ 2.23 |
| Second Quarter | $ 5.94 | $ 2.79 |
| Third Quarter | $ 5.69 | $ 2.52 |
| Fourth Quarter | $ 3.41 | $ 1.35 |

Our common stock has been traded on The NASDAQ Stock Market, LLC ("NASDAQ") under the symbol UTSI since our initial public offering on March 2, 2000. The preceding table sets forth the high and low sales prices per share of our common stock as reported on NASDAQ for the periods indicated. As of February 26, 2010, we had approximately 117 stockholders of record.

To date, we have not paid any cash dividends on our common stock. We currently anticipate that we will retain any available funds to finance the growth and operation of our business and we do not anticipate paying any cash dividends in the foreseeable future. Certain present or future agreements may limit or prevent the payment of dividends on our common stock. Additionally, our cash held in foreign countries may be subject to certain control limitations or repatriation requirements, limiting our ability to use this cash to pay dividends. See further discussion in the "Liquidity" section of Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operation.

Table of Contents

**COMPANY'S STOCK PERFORMANCE**

The graph below compares the cumulative 5-year total return of holders of UTStarcom, Inc.'s common stock with the cumulative total returns of the NASDAQ Composite index and the NASDAQ Telecommunications index. The graph tracks the performance of a $100 investment in our common stock and in each of the indexes (with the reinvestment of all dividends) from December 31, 2004 to December 31, 2009.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN***

Among UTStarcom, Inc., The NASDAQ Composite Index
And The NASDAQ Telecommunications Index

| | 12/04 | 12/05 | 12/06 | 12/07 | 12/08 | 12/09 |
|---|---|---|---|---|---|---|
| **UTStarcom, Inc.** | **100.00** | **36.39** | **39.50** | **12.42** | **8.35** | **9.89** |
| **NASDAQ Composite** | **100.00** | **101.33** | **114.01** | **123.71** | **73.11** | **105.61** |
| **NASDAQ Telecommunications** | **100.00** | **91.66** | **119.67** | **132.55** | **77.09** | **107.17** |

*The stock price performance included in this graph is not necessarily indicative of future stock price performance.*

The information required by Item 5 with respect to securities authorized for issuance under equity compensation plans is incorporated by reference in Part III, Item 12 of this Form 10-K.

Table of Contents

## ITEM 6 SELECTED FINANCIAL DATA

The information set forth below is not necessarily indicative of results of future operations and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and the Consolidated Financial Statements and notes thereto included in Item 8, "Financial Statements and Supplementary Data," of this Form 10-K, which are incorporated herein by reference, in order to understand further the factors that may affect the comparability of the financial data presented below.

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2007 | 2006 | 2005 |
| | (in thousands, except per share amounts) | | | | |
| **Consolidated Statement of Operations Data:** | | | | | |
| Net sales(1) | $ 386,344 | $ 1,640,449 | $ 2,466,970 | $ 2,458,861 | $ 2,871,110 |
| Gross profit | $ 64,979 | $ 261,242 | $ 321,451 | $ 385,744 | $ 435,836 |
| Operating loss(2) | $ (218,688) | $ (176,216) | $ (212,045) | $ (138,160) | $ (456,714) |
| Net loss attributable to UTStarcom, Inc.(3) | $ (225,688) | $ (150,316) | $ (195,575) | $ (117,345) | $ (532,645) |
| Net loss per share attributable to UTStarcom, Inc. Basic and Diluted | $ (1.77) | $ (1.22) | $ (1.62) | $ (0.97) | $ (4.55) |

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2007 | 2006 | 2005 |
| | (in thousands) | | | | |
| **Consolidated Balance Sheet Data:** | | | | | |
| Cash and cash equivalents | $ 265,843 | $ 309,603 | $ 437,449 | $ 661,623 | $ 645,571 |
| Working capital | $ 94,591 | $ 312,072 | $ 389,750 | $ 800,356 | $ 834,126 |
| Total assets | $ 929,111 | $ 1,310,806 | $ 1,984,588 | $ 2,383,305 | $ 2,551,331 |
| Total short-term debt | | | $ 322,829 | $ 102,758 | $ 198,826 |
| Long-term debt | | | $ 333 | $ 275,161 | $ 274,900 |
| Total UTStarcom, Inc. stockholders' equity | $ 255,359 | $ 466,834 | $ 617,976 | $ 774,360 | $ 826,649 |

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(1) On July 1, 2008, we completed our divestiture of PCD. Revenue for the years ended December 31, 2008, 2007, 2006, and 2005 related to PCD was $880 million, $1,664 million, $1,339 million and $1,369 million, respectively. In July 2009, we sold our Korea operations and at December 31, 2009, we have substantially completed the wind-down of our worldwide handset operations.

(2) The operating loss includes the following items:

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2007 | 2006 | 2005 |
| | (in thousands) | | | | |
| Impairment of goodwill and other long-lived assets | $ 33,287 | $ 27,220 | $ 19,912 | | $ 218,094 |
| Restructuring | $ 46,495 | $ 13,059 | $ 14,474 | | $ 29,669 |
| Net gain on divestitures | $ (100) | $ (7,782) | $ (4,271) | $ (12,291) | |

(3) Net loss attributable to UTStarcom, Inc. for the year ended December 31, 2009 included no significant non-operating income or expense items. In addition to the items included in the operating losses discussed above, net loss attributable to UTStarcom, Inc. for the year ended December 31, 2008 included $47.9 million gain from sale of certain investments and liquidation of investment in a variable interest entity. Net loss attributable to UTStarcom, Inc. for the year ended December 31, 2007 included $53.7 million gain from sale of certain investments. Net loss attributable to UTStarcom, Inc. for the year ended December 31, 2006 included a $13.5 million

Table of Contents

charge associated with the other-than-temporary impairment of a long-term investment. Net loss attributable to UTStarcom, Inc. for the year ended December 31, 2005 included a gain of $47.2 million from the sale of a long term investment to Softbank Corp., a related party. Net loss attributable to UTStarcom, Inc. for the year ended December 31, 2005 also included a $31.4 million gain on extinguishment of subordinated notes and income tax expense of $136.5 million, which included a valuation allowance of $237.3 million on our net deferred tax assets.

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

### FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements regarding future events and our future results that are subject to the safe harbors created under the Securities Act of 1933 and the Securities Exchange Act of 1934. Forward-looking statements are based on current expectations, estimates, forecasts and projections about us, our future performance and the industries in which we operate as well as on our management's assumptions and beliefs. Such statements relate to, among other things, our business plan, expected financial results, new accounting pronouncements, liquidity and access to credit facilities and cash in our China subsidiary. Statements that contain words like "expects," "anticipates," "may," "will," "targets," "projects," "intends," "plans," "believes," "seeks," "estimates," or variations of such words and similar expressions are also forward-looking statements.

Readers are cautioned that these forward-looking statements are only predictions and are subject to risks and uncertainties related to, among other things, our ability to execute on our business plan, China's control of currency exchanges, the decline in the PAS market, ongoing litigation and other items discussed in "Part I, Item 1A-Risk Factors" of this Form 10-K. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We do not guarantee future results, and actual results, developments and business decisions may differ from those contemplated by the forward-looking statements. We undertake no obligation to update these forward-looking statements to reflect events or circumstances occurring after the date of this Form 10-K.

### OVERVIEW

We are one of the leading global providers of Internet Protocol ("IP")-based network solutions including the integration and support services sold to telecommunications operators in both emerging and established markets around the world. Our focus is to design and sell IP-based telecommunications infrastructure products including our primary product suite of Internet Protocol TV ("IPTV"), and broadband solutions along with the ongoing services relating to the installation, operation and maintenance of these products. Collectively our range of solutions is designed to expand and modernize telecommunications networks through smooth network system integration, lower operating costs and increased broadband access. We also provide the carriers with increased revenue opportunities by enhancing their subscribers' user experience. The majority of our sales have been to service providers in China and India. We also sell to service providers in selective markets in Asia, Latin America and Europe.

We differentiate ourselves with products designed to reduce network complexity, integrate high performance capabilities and allow a simple transition to next generation networks. We design our products to facilitate cost-effective and efficient deployment, maintenance and upgrades.

Because our products are IP-based, our customers can more easily integrate our products with other industry standard hardware and software. Additionally, we believe we can introduce new features and enhancements that can be cost-effectively added to our customers' existing networks. IP-based

Table of Contents

devices can be changed or upgraded in modules, saving our customers the expense of replacing their entire system installation. Our strategic priorities are summarized as follows:

- Focus primarily on providing a suite of IP-based solutions including our main product suite comprised of IPTV and broadband products and related services.

- Maintain our leadership position in China and India while solidifying our presence in selective geographical markets in Asia, Latin America and Europe.

- Leverage our strong reputation with telecom carriers and our ability to solve complex network problems.

- Improve our financial position by executing announced restructuring initiatives and reducing operating expense levels.

- Improve operational flexibility and cash requirements through outsourcing of manufacturing operations.

**Pending Sale of Hangzhou Building and Impairment Charge**

In June 2009, we announced our intention to consider a potential sale of our manufacturing, research and development, and administrative offices facility in Hangzhou, China. In December 2009, we entered into a Property Transfer and Leaseback Agreement (the "Sale Leaseback Agreement") for the intended sale of the property to another party for approximately $140 million. Under the terms of the agreement, we will lease back approximately 83,027 square meters, or approximately 0.9 million square feet, of the property through 2016. The transaction is expected to close between the end of March and April 2010, subject to customary closing conditions, including completion of required regulatory approvals. We recorded a non-cash impairment charge related to the Hangzhou facility of $33.3 million during the fourth quarter of 2009. See Note 6 of Notes to our Consolidated Financial Statements included under Part II, Item 8 of this Annual Report on Form 10-K.

**Sale of Non-Core Assets**

On July 1, 2008, we sold UTStarcom Personal Communications LLC, a wholly-owned subsidiary of the Company ("PCD"), to an entity controlled by AIG Global Investment Group and certain other investors for a total sale consideration of approximately $237.7 million. Additionally, on July 31, 2008, we completed the divestiture of our Mobile Solutions Business Unit ("MSBU") to a global private equity firm. On July 31, 2009, the Company completed a sale of its Korea operations to an entity founded by a former employee and received total consideration of approximately $2.0 million.

**Restructuring Programs**

On June 9, 2009, our Board of Directors approved a restructuring plan (the "2009 Restructuring Plan") designed to reduce our operating costs. The 2009 Restructuring Plan includes a worldwide reduction in force of approximately 50% of our headcount, or approximately 2,300 employees located primarily in China and the United States and, to a lesser degree, other international locations. During 2009, we recorded restructuring costs of approximately $46.5 million related to the 2009 Restructuring Plan and prior year restructuring plans. We will continue our efforts to evaluate certain operations and will consider opportunities to divest additional non-core assets and may incur additional costs associated with future actions to further align our business operations and streamline our business processes.

Table of Contents

**Investments**

During the first quarter of 2008, we sold our remaining investment in Gemdale Co., Ltd ("Gemdale") for approximately $32.9 million and recognized a gain of $32.4 million in other income, net. We also sold our investment in Infinera Corporation ("Infinera") for approximately $9.2 million and recognized a gain of $7.3 million in other income, net. During 2009, we recorded approximately $5.5 million of other-than-temporary impairment charges related to our investments in MRV Communications ("MRV") and Xalted Networks ("Xalted"). During the fourth quarter of 2009, we sold our investment in MRV for approximately $1.0 million and recognized a gain of approximately $0.4 million. See Note 4 of Notes to our Consolidated Financial Statements included under Part II, Item 8 of this Annual Report on Form 10-K.

**Decline in PAS Business and Wind-down of Handset Segment**

We expect PAS networks will be phased out by January 1, 2012. MIIT has granted 3G mobile licenses to China Telecom, China Mobile and China Unicom. On January 9, 2009, the MIIT officially issued a notice to unconditionally phase out the Personal Handy-phone System ("PHS") by the end of 2011 to guarantee the bandwidth for China's 3G services. Consequently, in the fourth quarter of 2009, we have determined the remaining expected period of support as 2 years and hence deferred revenue associated with PAS infrastructure will be recognized ratably through the fourth quarter of 2011. For additional discussion see "Results of Operations-Net Sales" section of this Item 7.

We have substantially completed the wind-down of our worldwide handset operations and do not expect our handset segment to have significant contribution to our revenue and gross margin in 2010 and beyond.

**Potential Effects of Current Global Economic Conditions on Sales, Operations, and Liquidity**

Disruptions in orderly financial markets in 2008, resulting from, among other factors, severely diminished liquidity and credit availability plus volatile and declining valuations of securities and other investments, caused business and consumer confidence to ebb, business activities to slowdown, and unemployment to increase. These factors along with the interconnectivity and interdependency of international economies which continued throughout 2009 created a global downturn in economic activity which was sufficiently without precedent. The governments of many leading nations have taken actions designed to counter the worst effects and severity of the recent economic conditions.

We are unable to predict how long the economic downturn will last. A continuing economic downturn may adversely impact our business in a number of ways, such as:

- Reduced demand for our products and services.
- Increased pricing pressure and lower margins.
- Greater difficulty in collecting accounts receivable.
- Additional restructuring and asset impairment charges.

**Strategic Investment and Changes in Management and the Board of Directors**

On February 1, 2010, we entered into agreements for a strategic relationship with Beijing E-town International Investment and Development Co., Ltd ("BEIID"), an investment company established by the Beijing Municipality which includes an investment of $48.5 million in the common stock of the Company by BEIID and two unrelated investment funds, Elite Noble Limited and Shah Capital Opportunity Fund LP. As part of the investment, we will issue approximately 22 million shares of common stock at a price of $2.20 per share in a private placement transaction. We intend to use the proceeds for working capital and general corporation purposes.

Table of Contents

In connection with the transaction and in furtherance of our strategic goals in China, Ying (Jack) Lu has been appointed our new Chief Executive Officer and President effective the later date of three months after the closing of the investment or June 30, 2010. From March 1, 2010, until he assumes the CEO position, he will be the Company's Chief Operating Officer. Peter Blackmore will retire as our CEO and President upon Ying (Jack) Lu's assumption of the CEO position. Upon the closing of the transaction, three new members will be appointed as directors to our board of directors, and two current board members will resign at that time. The total number of directors on the board will be increased from six to seven in connection with the transaction.

We also announced we will move our headquarters to Beijing, China as part of an agreement with Beijing Development Area, which is also related to Beijing Municipality. That agreement will be effective upon closing of the investment. As part of the agreement, we will be able to apply to Beijing Development Area for tax incentives and other financial and non-financial assistance to the Company. We plan to retain all our operations in Hangzhou and Shenzhen.

Management believes these strategic changes are consistent with our growth strategy of focusing on selective IP-based infrastructure products and services in high growth regions of Asia, particularly China. Management believes our growth strategy is in good alignment with the series of guidelines recently issued by China's State Council to push forward network convergence among telecom, cable television, and internet companies. We believe this relationship will contribute significant financial and strategic value, including strengthening our relationships and presence in China, and better positioning us to achieve profitable growth in the future.

**RESULTS OF OPERATIONS**

To align the business units with our corporate strategy to focus on core businesses, on July 1, 2008 we sold our Personal Communications Division ("PCD") to PCD LLC (see Note 3 of Notes to our Consolidated Financial Statements included under Part II, Item 8 of this Annual Report on Form 10-K). Prior to July 1, 2008, PCD sold and supported handsets other than PAS handsets, mainly in the United States.

Included in the Other segment were Mobile Solutions Business Unit ("MSBU") and Custom Solutions Business Unit ("CSBU"). On July 31, 2008, we sold MSBU which was responsible for the development, sales and service of our wireless IPCDMA/IPGSM product line. In the first quarter of 2009, we completed the wind-down of CSBU and the consolidation of voice messaging technology into our Multimedia Communications segment. CSBU historically had been responsible for the development, sales and service of other non-core products. The consolidation of voice messaging technology into the Multimedia Communications segment did not have a significant impact on segment net sales or gross profit. As a result of these changes we revised our internal reporting structure, operating segments and reporting segments.

Effective January 1, 2009, our reporting segments were as follows:

- Multimedia Communications
- Broadband Infrastructure
- Handsets
- Services

Our Multimedia Communications segment is responsible for the development and management of internet protocol television ("IPTV") and related technologies plus our core Next Generation Network ("NGN") software. Our Personal Access System ("PAS") infrastructure and wireless systems teams are also a part of this segment.

Table of Contents

Our Broadband Infrastructure segment is responsible for software and hardware products that enable end users to access high-speed, cost effective wireline data, voice and media communication.

Our Handsets segment designs, builds and sells mobile phones with continued focus on the PAS and CDMA handset market, as well as data cards markets. Handset sales to PCD LLC, which commenced after the July 1, 2008 sale of PCD, are included in this segment. In December 2008, we initiated action to wind down our Korea operations and in July 2009 completed the sale of our Korea operations. In the fourth quarter of 2009, we substantially completed the wind-down of our remaining worldwide handset business.

Our Service segment is responsible for providing services and support of our Broadband Infrastructure and Multimedia Communications product lines with activities ranging from network planning, circuit-to-packet network migration planning, systems integration, program management, operations management and support, and knowledge transfer.

**NET SALES**

| | Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2009 | % of net sales | 2008 | % of net sales | 2007 | % of net sales |
| | (in thousands, except percentages) | | | | | |
| ***Net Sales by Segment*** | | | | | | |
| Multimedia Communication | $ 140,446 | 36% | $ 280,391 | 17% | $ 315,515 | 13% |
| Broadband Infrastructure | 80,941 | 21% | 110,862 | 7% | 157,118 | 6% |
| Handsets | 102,000 | 27% | 287,607 | 18% | 234,468 | 10% |
| Service | 62,957 | 16% | 57,911 | 3% | 53,214 | 2% |
| PCD | | | 879,588 | 54% | 1,664,147 | 67% |
| Other | | | 24,090 | 1% | 42,508 | 2% |
| | $ 386,344 | 100% | $ 1,640,449 | 100% | $ 2,466,970 | 100% |
| ***Net Sales by Region*** | | | | | | |
| United States | $ 78,806 | 21% | $ 1,003,072 | 61% | $ 1,665,021 | 67% |
| China | 177,147 | 46% | 435,846 | 27% | 560,548 | 23% |
| India | 62,859 | 16% | 28,166 | 2% | 36,167 | 2% |
| Other | 67,532 | 17% | 173,365 | 10% | 205,234 | 8% |
| | $ 386,344 | 100% | $ 1,640,449 | 100% | $ 2,466,970 | 100% |

*Fiscal 2009 vs. 2008*

Net sales decreased by 76%, or $1,254.1 million for 2009 compared to 2008. The decrease was primarily due to disposal of PCD and MSBU in 2008 and disbandment of the operations formerly included in the Other segment in the first quarter of 2009. The PCD and Other segments accounted for $903.7 million of the decrease. Net sales for the segments other than the PCD and Other decreased by $350.4 million or 48%. Multimedia Communications net sales decreased by $139.9 million, or 50% for 2009 compared to 2008, mainly due to continued weakening demand for our PAS Infrastructure products, decrease in NGN and TD-SCDMA sales partially offset by increase in IPTV related products and IP messaging product sales, as well as recognition of additional revenue related to our PAS Infrastructure product due to the acceleration of deferred revenue amortization. Broadband Infrastructure segment net sales decreased by $29.9 million or 27% for 2009 compared to 2008, mainly due to decrease in sales of all major product lines except of GEPON. Handsets segment net sales decreased by $185.6 million, or 65% primarily due to the declines of our PAS handsets sales, GSM handsets sales and CDMA handsets sales to PCD LLC, partially offset by the increase of CDMA

handsets sales in China. Service segment net sales increased by $5.0 million or 9% primarily due to higher international maintenance service revenue partially offset by the decrease in China service sales after the China telecommunications industry restructuring.

For additional discussion, see the "Segment Reporting" section of this Item 7.

In 2010 and beyond, we expect a continued decline in demand for our PAS handsets and infrastructure equipment. We review assumptions regarding the estimated post contract support periods on a regular basis. Due to the China telecommunication industry restructuring and launch of 3G services in China, the Ministry of Industry and Information Technology of China announced that PAS services in China will be phased out by January 1, 2012. In the second and third quarter of 2009, we streamlined our sales, service and research and development operations for PAS handsets and infrastructure equipment. We do not perform any new research and development of PAS products and we maintain a small support team to assist our customers with warranty matters. In the later part of the third quarter 2009 and early part of the fourth quarter 2009, we contacted our PAS infrastructure customers and held discussions with them on the PAS products future. In October 2009, we notified our PAS infrastructure customers in China that we will no longer provide upgrades or support of PAS products beyond December 31, 2011. Consequently, we have determined the remaining expected period of support as 2 years and hence deferred revenue associated with PAS infrastructure is being recognized ratably beginning in the fourth quarter of 2009 through the fourth quarter of 2011. As a result of this change, net sales and gross profit in the fourth quarter of 2009 increased by approximately $6 million and $2 million, respectively. As of December 31, 2009, we have approximately $186.4 million of deferred revenue associated with PAS infrastructure sales for which we accelerated the amortization period of support. In each of fiscal 2010 and 2011, total net sales and gross profit associated with the amortization of this PAS-related deferred revenue will approximate $93 million and $33 million, respectively.

The economic uncertainty that we are operating in today could adversely impact our business. However, the majority of our business is based in China and India  two countries that are still projected to have economic growth in 2010. We currently offer and have initial market acceptance of our IPTV products in China, India, Taiwan and other geographic regions. We believe that the IPTV market presents a meaningful growth opportunity in these regions as well as other regions where we have targeted to expand our IPTV offerings.

*Fiscal 2008 vs. 2007*

Net sales decreased by 34%, or $826.5 million for 2008 compared to 2007. Revenue was lower in all segments except Handsets and Services. The decrease was primarily due to PCD being sold in July 2008. The net sales of the disposed PCD segment decreased by $784.6 million.

Multimedia Communications segment net sales decreased by $35.1 million, or 11%, during 2008 compared to 2007, mainly due to continued weakening demand for our PAS infrastructure products. Broadband Infrastructure segment net sales decreased by $46.3 million or 29% during 2008 compared to 2007. This decrease was mainly due to lower CPE and MSAN sales. Due to the customer concentration in this segment, revenues fluctuate based upon the magnitude and timing of revenue recognition on certain contracts. Handsets sales increased by $53.1 million, or 23%, during 2008 primarily due to handsets sold to PCD LLC aggregating $126.0 million during the second half of 2008, partially offset by continued price and volume declines of our PAS handsets sold in 2008 as compared to 2007.

Table of Contents

**GROSS PROFIT**

| | Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2009 | Gross Profit % | 2008 | Gross Profit % | 2007 | Gross Profit % |
| | (in thousands, except percentages) | | | | | |
| ***Gross profit (loss) by Segment*** | | | | | | |
| Multimedia Communication | $ 55,150 | 39% | $ 127,112 | 45% | $ 109,706 | 35% |
| Broadband Infrastructure | 2,981 | 4% | (3,516) | (3)% | 6,512 | 4% |
| Handsets | (18,982) | (19)% | 39,015 | 14% | 76,219 | 33% |
| Service | 25,830 | 41% | 17,407 | 30% | 8,923 | 17% |
| PCD | | | 69,005 | 8% | 94,215 | 6% |
| Other | | | 12,219 | 51% | 25,876 | 61% |
| | $ 64,979 | 17% | $ 261,242 | 16% | $ 321,451 | 13% |

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

Our gross profit has been affected by average selling prices, material costs, product mix, the impact of warranty charges and contract loss provisions, as well as inventory write-downs and release of deferred revenues and related costs pertaining to prior years. Our gross profit, as a percentage of net sales, varies among our product families. We expect that our overall gross profit, as a percentage of net sales, will fluctuate in the future as a result of shifts in product mix, stage of product life cycle, decreases in average selling prices and our ability to reduce cost of sales.

*Fiscal 2009 vs. 2008*

Gross profit was $65.0 million, or 17% of net sales for 2009, compared to $261.2 million, or 16% of net sales for 2008. The overall gross profit decrease in absolute dollars was primarily due to overall decrease in sales and the disposal of PCD and MSBU in 2008 and disbandment of the operations formerly included in the Other segment in the first quarter of 2009. PCD and Other segments in aggregate accounted for $81.2 million decrease in gross profit for 2009. Gross profit for the segments other than PCD and Other decreased by $115.0 million for 2009 as compared to 2008. This decrease was primarily due to decrease in sales, additional inventory write-downs and claim settlement related to certain handsets sold to PCD LLC for the Handsets segments, and decrease in sales of higher margin Multimedia Communications products during 2009, partially offset by an $8.5 million decrease to cost of sales in the Handsets segment resulting from the amortization of the Marvell Technology Group Ltd. ("Marvell") supply agreement during the first quarter of 2009 (See Note 3 of Notes to our Consolidated Financial Statements included under Part II, Item 8 of this Annual Report on Form 10-K.)

For additional discussion, see "Segment Reporting" section of this Item 7.

*Fiscal 2008 vs. 2007*

Gross profit was $261.2 million, or 16% of net sales for 2008, compared to $321.5 million, or 13% of net sales for 2007. The overall gross profit decrease in absolute dollars was primarily due to the disposition of PCD in July 2008, inventory charge related to cancellation of an order of a CDMA

handset model, higher loss contract provision in the Broadband Infrastructure segment, as well as lower volume and gross margin percentage of our PAS handset sales. The decrease was offset by increased sales of higher margin products of the Multimedia Communications and Services segments as well as a $5.1 million supplier rebate recognized in 2008. The overall gross profit as a percentage of sales increased mainly due to the disposition of PCD in July 2008 which had relatively lower gross profit percentages as compared to our other segments. Gross profit for 2008 includes $3.4 million of contract loss charges relating to costs that should have been included in the calculation of the Broadband Infrastructure segment gross profit in prior periods. The impact of recording these prior-period charges on the prior and current periods is not material.

Excluding PCD and Other segments, our gross profit was $180.0 million, or 24% of net sales for 2008, compared to $201.3 million, or 26% for 2007.

**OPERATING EXPENSES**

The following table summarizes our operating expenses:

| | Years Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2009 | % of net sales | 2008 | % of net sales | 2007 | % of net sales |
| | (in thousands, except percentages) | | | | | |
| Selling, general and administrative | $ 140,742 | 36% | $ 257,559 | 16% | $ 319,145 | 13% |
| Research and development | 63,243 | 16% | 143,291 | 9% | 168,275 | 7% |
| Amortization of intangible assets | | | 4,111 | 0% | 15,961 | 1% |
| Impairment of goodwill and other long-lived assets | 33,287 | 9% | 27,220 | 2% | 19,912 | 1% |
| Restructuring | 46,495 | 12% | 13,059 | 1% | 14,474 | 1% |
| Net gain on divestitures | (100) | 0% | (7,782) | (1)% | (4,271) | (1)% |
| Total operating expenses | $ 283,667 | 73% | $ 437,458 | 27% | $ 533,496 | 22% |

Selling, general and administrative expenses ("SG&A") include compensation and benefits, professional fees, sales commissions, provision for doubtful accounts receivable and travel and entertainment costs. Research and development expenses consist primarily of compensation and benefits of employees engaged in research, design and development activities, costs of parts for prototypes, equipment depreciation and third party development expenses. We believe that continued and prudent investment in research and development is critical to our long-term success, and we will aggressively evaluate appropriate investment levels. A portion of our costs are fixed and are difficult to quickly reduce in periods of lower sales.

*SELLING, GENERAL AND ADMINISTRATIVE*

*Fiscal 2009 vs. 2008*

SG&A expenses were $140.7 million for 2009, a decrease of $116.8 million as compared to $257.6 million for 2008. The decrease in SG&A expense was primarily due to a $14.4 million decrease in SG&A expenses related to divested operations, primarily PCD and MSBU, a $41.8 million decrease in personnel related expenses due to continuous streamlining of operations and recent cost reduction measures, a $14.7 million reduction in legal and accounting fees as a result of a $3.5 million receipt related to a legal settlement of the Starent patent litigation during the fourth quarter of 2009 as well as reduced activity in investigations and litigation, a $9.7 million decrease in depreciation expense due to assets impairment write-offs in 2008, a $10.4 million savings from reduction in the use of outside services, a $7.9 million decrease in travel related expenses due to reduced travel activity and cost containment efforts, a $7.3 million reduction in advertising and marketing, sales promotions, as well as

Table of Contents

shows and exhibits expenses due to reduced sales activities, a $2.9 million decrease in facility related expense, a $1.0 million increase in recovery of doubtful account as a result of continued effort in collection, a $1.2 million increase in net gain on disposed assets, a $2.1 million reduction in other taxes, fees, licenses, a $1.2 million reduction in insurance premium and a $1.2 million decrease in equipment expense as we continued to streamline our operations.

*Fiscal 2008 vs. 2007*

SG&A expenses were $257.6 million for 2008, a decrease of 19% as compared to $319.1 million for 2007. Of the decrease of $61.5 million, $14.9 million was related to the disposal of PCD and MSBU in July 2008. The decrease was also due to a $15.7 million decrease in legal and accounting fees as a result of reduced activity in investigations and litigation, a $7.6 million savings from reduction in the use of outside services primarily due to our accounting restatement in 2007 and the implementation of the upgrade of our enterprise resource planning ("ERP") system, a $7.1 million decrease in personnel related expenses and bonuses due to continuous streamlining of operations and recent cost reduction measures, a $3.2 million decrease due to the deconsolidation of a variable interest entity and certain fixed assets being fully amortized in early 2008, a $2.3 million decrease in advertising & marketing expense due to reduced sales activities, a $2.3 million reduction in commission expense due to decrease in overall revenue, a $2.5 million decrease in tax and licenses due to reduced business taxes in China resulting from a tax refund from the government and a $1.8 million decrease in travel related expenses due to reduced travel activity and cost containment efforts. The decrease is partially offset by a $3.1 million decrease in recovery of bad debt in 2008.

*RESEARCH AND DEVELOPMENT*

*Fiscal 2009 vs. 2008*

R&D expenses decreased by $80.0 million during 2009 compared to 2008. In July 2008, we sold PCD and MSBU which resulted in aggregated R&D savings of $10.4 million for 2009. In addition, the decrease was also due to a $41.4 million decrease in personnel related expenses as we continued to streamline our R&D operations and reduced spending in non-core business units, a $12.0 million savings from reduction in use of outside services primarily due to wind-down of the Korea operation, a $3.7 million decrease in travel related expenses due to reduced travel activity, a $3.8 million decrease in facility related expense, a $3.4 million decrease in depreciation and a $4.8 million decrease in software license and parts expenses as we continued to streamline our operations.

*Fiscal 2008 vs. 2007*

R&D expenses decreased by $25.0 million during 2008 compared to 2007. During the second half of 2008, we sold PCD and MSBU which resulted in aggregated R&D savings of $8.3 million. In addition, the decrease was also attributed to a $11.6 million decrease in personnel related expenses as we continued to transfer R&D functions from the United States to China, and reduced spending in non-core business units, a $2.3 million decrease in depreciation and a $2.0 million decrease in software license expense as we continued to streamline our operations, as well as a $2.0 million decrease related to the recognition of the sale of a patent in 2008 offset by an increase of $1.9 million in consulting and testing expense related to new handset introductions during 2008.

Table of Contents

*STOCK-BASED COMPENSATION EXPENSE*

At December 31, 2009, there was approximately $8.5 million of total unrecognized compensation cost, as measured, related to non-vested stock options and restricted stock and restricted stock units, which is expected to be recognized over a weighted-average period of 1.7 years. The following table summarizes the stock-based compensation expense in our consolidated statement of operations:

| | Years ended December 31, | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | | **(in thousands)** | |
| Cost of net sales | $ 662 | $ 1,306 | $ 697 |
| Selling, general and administrative | 7,146 | 15,652 | 7,988 |
| Research and development | 1,509 | 3,607 | 4,107 |
| Restructuring | 2,777 | | |
| Total | $ 12,094 | $ 20,565 | $ 12,792 |

*Fiscal 2009 vs. 2008*

The decrease in stock-based compensation expense in 2009 compared to 2008 was primarily due to the reduced headcount as a result of workforce reductions in the second half of 2008 and throughout 2009, higher valued equity awards becoming fully vested in 2009, and the decrease in equity awards granted in 2009. Based on the foregoing factors, we expect stock-based compensation expense will continue to decrease for fiscal 2010.

*Fiscal 2008 vs. 2007*

The increase in stock-based compensation expense during 2008 compared to 2007 was primarily due to the recognition of expense in 2008 for awards granted in the fourth quarter of 2007 and during 2008, including annual merit equity awards granted in November 2007 and February 2008, compared with the same period in 2007 when no awards were granted as we were delinquent in the filing of our reports with the SEC. The 2008 stock-based compensation expense attributable to selling, general and administrative includes approximately $1.5 million resulting from award modifications related to the retirement of one of the Company's executives. The fourth quarter of 2008 includes a charge of $2.5 million relating to prior periods resulting from the correction of the forfeiture rate application. The impact of recording this prior-period charge on the prior and current periods is not material.

*AMORTIZATION OF INTANGIBLE ASSETS*

*Fiscal 2009 vs. 2008*

There was no amortization of intangible assets in 2009 compared to $4.1 million in 2008. An impairment charge of $4.9 million was recorded in the fourth quarter of 2008 to fully write-off the remaining carrying value of intangible assets at December 31, 2008.

*Fiscal 2008 vs. 2007*

Amortization of intangible assets was $4.1 million in 2008 as compared to $16.0 million in 2007. Amortization of intangible assets declined primarily due to the impairment of intangible assets with a carrying value of $15.7 million in the fourth quarter of 2007, the disposition of intangible assets with a carrying value of $15.8 million in the third quarter of 2008 in connection with the sale of PCD, and due to the fact that several intangible assets became fully amortized during the preceding twelve months.

Table of Contents

*ASSET IMPAIRMENT*

In June 2009, we announced our intention to consider a potential sale of our manufacturing, research and development, and administrative offices facility in Hangzhou, China. In December 2009, we entered into a Sale Leaseback Agreement for the intended sale of the property to another party for approximately $140 million and the leaseback of a portion of the property through 2016. The transaction is expected to close between the end of March and April 2010, subject to customary closing conditions, including completion of required regulatory approvals.

During the third quarter of 2009, we contracted with a commercial real estate agent to assist in evaluating a potential sale of the facility. Furthermore, in October 2009, we initiated actions to consolidate our use of the facility to reduce our operating costs that revised our projected occupancy needs. In light of these developments, we performed a recoverability assessment of the facility as of September 30, 2009. Impairment testing performed by us for the third quarter of 2009, utilizing an income approach, indicated that the fair value approximated the carrying value of the Hangzhou facility as of September 30, 2009 of $160.5 million, and no impairment was recorded with respect to this property. The income approach was used as a result of the lack of preliminary offers and available comparable market transaction activity to place reliance on the market valuation approach. However, during the fourth quarter of 2009, the Sale Leaseback Agreement received from the buyer gave us a better indication of the property's fair value, and revealed that the value of the property to an interested third party was lower than the fair value we had previously estimated using the income approach. The building is approximately 2.7 million square feet and unique in its design. Based on the uniqueness of the building and the fact that only a single offer for the building had been received after having it on the market for several months management determined that a third party offer was a better indication of the fair value than other methods because the offer was specific to the property representing direct evidence of the fair value. Based on this offer, we determined that the property had a net book value in excess of its fair value. Due to the apparent decline in value, we conducted a recoverability test for this entity-wide asset and determined the carrying value of our net assets exceeded the undiscounted cash flows expected to result from the use and eventual disposition of the asset group. In our assessment of fair value, management has placed primary reliance on the market approach (the third party offer). The result of this analysis reduced our overall assessment of fair value of the property by $33.3 million. Accordingly, we recorded a non-cash impairment charge of $33.3 million during the fourth quarter of 2009. The adjusted carrying value of $125.7 million of the property was lower than the pending sales price because the valuation performed factored in the above-market rental rates to be paid by the Company as stipulated in the leaseback agreement accompanying the sale. Our overall assessment of fair value of the property was based on Level 2 inputs, defined as inputs other than quoted market prices in active markets that are observable either directly or indirectly.

At December 31, 2009, the long-lived asset to be sold was classified as held for use as we expect to retain more than a minor portion of the use of the property through a six-year leaseback. We expect the transaction to qualify for sale-leaseback accounting upon closing. Any potential gain realized on the sale leaseback is expected to be deferred and amortized over the leaseback term.

*Fiscal 2008*

We performed a recoverability test on our property, plant and equipment assets as of December 31, 2008 due to recurring operating losses, the continuing challenging business environment, a sustained decline in the Company's stock price, and because our estimates of future cash flows developed during the 2009 budgeting process indicated that each of our business segments had an inability to recover the carrying value of each segment's assets. We made various estimates, which management believes to be both reasonable and appropriate, in determining the estimated fair values of the property, plant and equipment at December 31, 2008. In concluding on fair values we also

Table of Contents

considered, in part, the results of appraisals made as of December 31, 2008 by valuation firms of the fair value of our facility in Hangzhou, China and of certain of our equipment and furniture, software, automobiles and leasehold improvements, which we obtained to confirm the reasonableness of its estimates.

Our most significant long-lived asset in terms of carrying value is our manufacturing, research and development, and administrative offices facility in Hangzhou, China. Using the income capitalization approach, we determined the estimated fair value of the facility and related improvements at December 31, 2008 to be approximately $183.2 million, which exceeded its net book value by approximately $15.8 million. As a result, we concluded the headquarters for our China operations was not impaired.

We tested individually significant equipment and furniture, software, automobiles, and leasehold improvement assets located in China, India, Japan, Korea, and the United States for impairment, primarily using the cost approach to estimate related fair values. Adjustment factors were applied to the original cost of each tested asset first to estimate current replacement cost and then to account for deterioration and obsolescence from all causes as well as de-installation costs to determine each item's estimated fair value at December 31, 2008. As a result of this analysis, we recorded an impairment charge of approximately $22.3 million in operating expenses, which consisted of $11.9 million for our ERP system, $6.7 million for equipment and furniture and $3.7 million primarily for capitalized software.

In addition, in the fourth quarter of 2008, we decided to disband our Custom Solutions Business Unit which provided customized telecommunications solutions and recorded a charge of approximately $4.9 million to write-off the unamortized balance of a customer relationships intangible asset arising from our previous acquisition of Commworks. As a result, our consolidated balance sheet at December 31, 2008 contains no balances for finite-lived purchased intangible assets subject to amortization.

*Fiscal 2007*

In light of the then current market conditions, we conducted an in-depth strategic analysis, which was completed in the fourth quarter of 2007, to then define a new corporate strategy. In our review we reevaluated the key assumptions of our overall strategic business and manufacturing capacity plans in light of continued declines in our revenues, excluding PCD, which appeared to be persistent. As a result, we revised our near and medium term revenue expectations downward significantly taking into account persistent weak global and industry economic conditions, the new strategic direction, as well as the declines in revenues the Company had experienced. The material changes in our outlook and plans, which we were first able to quantify in the fourth quarter of 2007 as a result of the strategic review and its 2008 budgeting process, triggered an impairment review of its long-lived assets.

Based upon its 2007 goodwill impairment assessment, we recorded goodwill impairment charges of approximately $3.1 million during the year ended December 31, 2007. As a result, our consolidated balance sheets at December 31, 2008 and 2007 contained no balances for goodwill.

We also determined that estimated undiscounted cash flows within the Other segment were not sufficient to recover the carrying value of certain long-lived assets. We calculated the estimated fair values of intangible assets subject to amortization in the Other segment, using expected discounted future cash flows, and recorded an asset impairment charge of approximately $15.7 million for the customer relationships and existing technology intangible assets. An approximate $1.1 million impairment charge was recorded to recognize impairment in the carrying value of certain equipment in the Other segment as well.

Table of Contents

*RESTRUCTURING*

*Fiscal 2009*

On June 9, 2009, our Board of Directors approved a restructuring plan (the "2009 Restructuring Plan") designed to reduce our operating costs. The 2009 Restructuring Plan includes a worldwide reduction in force of approximately 50% of our headcount, or approximately 2,300 employees located primarily in China and the United States and, to a lesser degree, other international locations. During the year ended December 31, 2009, we recorded total restructuring costs of approximately $46.5 million of which $40.0 million related to the 2009 Restructuring Plan and $6.5 million related to prior year plans. The $40.0 million charge related to the 2009 Restructuring Plan was comprised primarily of approximately $38.1 million of severance and benefits and $1.9 million of lease costs. The $6.5 million charge in 2009 related to prior year plans consisted primarily of severance and benefits related to the transition of certain key functions, including finance, to China and the divestiture of the Company's Korea operations and additional lease costs, net of approximately $0.5 million of reversal of charges recorded in fiscal year 2008.

*Fiscal 2008*

On December 16, 2008, our Board of Directors approved a restructuring plan (the "2008 Plan") designed to reduce operating costs. The plan included, among other things, winding down certain non-core operations and implementing a worldwide reduction in force of approximately 10% of our headcount. The reduction in force affected approximately 750 employees in China, Korea and other locations including the United States. In connection with the 2008 Plan, during the fourth quarter of 2008 we incurred a restructuring charge of $13.1 million comprised largely of one-time severance benefits.

*Fiscal 2007*

On October 2, 2007, our Board of Directors approved a restructuring plan (the "2007 Plan") to reduce operating costs, which included a worldwide reduction in force of approximately 12% of our headcount. The workforce reduction was primarily in the United States and China. We incurred a restructuring charge in connection with the Plan of $14.5 million during the fourth quarter of 2007, comprised largely of cash payments associated with one-time severance benefits.

At December 31, 2009, the remaining restructuring liability related to all plans was approximately $21.7 million. The majority of the remaining cash expenditures related to the 2009 and 2008 Restructuring Plans are expected to be paid in 2010. The remaining liabilities related to lease obligations are expected to be settled over the remaining lease term. We expect to incur additional restructuring charges in 2010 as we continue to execute the 2009 and 2008 Restructuring Plans. We expect to realize annual cost savings in salary and compensation related expenses of approximately $112 million upon the complete implementation of the 2009 and 2008 Plans, part of this reduction in salary and compensation related expense is reflected in our consolidated statements of operations for the years ended December 31, 2009 and 2008. For more information on our restructuring charges, see Note 16 to the Consolidated Financial Statements in Item 8.

*NET GAIN ON DIVESTITURES*

*Fiscal 2009*

Net gain on divestiture in 2009 of $0.1 million is comprised of a $1.4 million gain on sale of PCD assets resulting from an adjustment to reflect actual transaction-related costs, partially offset by a $1.3 million loss from the divestiture of our Korea operations.

*Fiscal 2008*

The $7.8 million net gain on divestitures in 2008 consisted primarily of a $3.8 million gain on the sale of PCD and a $3.9 million gain on the sale of MSBU. For further discussion of divestitures, see Note 3 of Notes to our Consolidated Financial Statements contained in Item 8 of this Annual Report on Form 10-K.

*Fiscal 2007*

In February 2006, we sold substantially all of the assets and selected liabilities of our semiconductor design operations, including the assets related to the prior acquisition of Advanced Communications Devices Corporation, to Marvell Technology Group Ltd. We recognized a $4.3 million gain on sale of these assets in 2007 upon achieving the defined milestones.

**OTHER INCOME (EXPENSE)**

*INTEREST INCOME*

*Fiscal 2009 vs. 2008*

Interest income was $2.1 million and $7.5 million for 2009 and 2008, respectively. The decrease in interest income was primarily due to the effect of lower average cash balances in 2009 and due to a decline in the average interest rate.

*Fiscal 2008 vs. 2007*

Interest income was $7.5 million and $14.5 million for 2008 and 2007, respectively. The decrease in interest income was primarily due to the decrease in cash balances available for investment and due to lower interest rates earned during 2008 compared with 2007.

*INTEREST EXPENSE*

*Fiscal 2009 vs. 2008*

Interest expense was $0.6 million and $10.4 million for 2009 and 2008, respectively. The decrease in interest expense for 2009 compared to 2008 was primarily attributable to the repayment of $274.6 million of convertible subordinated notes due March 1, 2008 and $48.0 million of other bank loan repayments during 2008.

*Fiscal 2008 vs. 2007*

Interest expense was $10.4 million and $32.7 million for 2008 and 2007, respectively. The decrease in interest expense for 2008 compared to 2007 was primarily attributable to the repayment of $274.6 million of convertible subordinated notes on March 1, 2008 and $48.0 million of other bank loan repayments during 2008. Interest expense for 2008 included approximately $2.5 million of debt issuance costs related to the $75 million secured revolving credit facility. For the period from January 1, 2008 through maturity on March 1, 2008, the convertible subordinated notes had a stated interest rate of 10.875% in accordance with the Second Supplemental Indenture. The stated interest rate of our convertible subordinated notes was 7.625% from January 9, 2007 through July 25, 2007 and 10.875% from July 26, 2007 through December 31, 2007. Prior to January 9, 2007, our convertible subordinated notes accrued interest at $^7/_8$% per annum.

Table of Contents

*OTHER INCOME, NET*

*Fiscal 2009 vs. 2008*

Other income, net was $2.3 million in 2009 as compared to $35.4 million in 2008. Other income, net of $2.3 million for 2009 consisted of $6.3 million foreign currency gain, $0.4 million gain on sale of MRV and $1.2 million of other miscellaneous income, partially offset by $5.5 million other-than-temporary impairment of two equity investments, MRV and Xalted. Other income, net for 2008 consisted primarily of a $32.4 million gain on the sale of the investment in Gemdale, a $7.3 million gain on the sale of the investment in Infinera, and an $8.2 million gain on the liquidation of an investment in a variable interest entity, offset partially by a $9.9 million foreign currency loss and $4.3 million in write-downs of long-term investments.

*Fiscal 2008 vs. 2007*

Other income, net was $35.4 million in 2008 as compared to $64.8 million in 2007. Other income, net for 2008 consisted primarily of a $32.4 million gain on the sale of the investment in Gemdale, a $7.3 million gain on the sale of the investment in Infinera, and an $8.2 million gain on the liquidation of an investment in a variable interest entity, offset partially by a $9.9 million foreign currency loss and $4.3 million in write-downs of long-term investments. Other income, net for 2007 included a $53.7 million gain from the sale of part of our investment in Gemdale and a $5.7 million gain on the sale of our investments in ImmenStar, Inc. ("ImmenStar") and Fiberxon Inc. ("Fiberxon").

*INCOME TAX EXPENSE (BENEFIT)*

FASB ASC 740-10 establishes criteria for recognizing or continuing to recognize only more-likely-than-not tax positions, which may result in income tax expense volatility in future periods. While we believe that we have adequately provided for all tax positions, amounts asserted by taxing authorities could be greater than our accrued position. Accordingly, additional provisions on income tax related matters could be recorded in the future as revised estimates are made or the underlying matters are settled or otherwise resolved.

For a full reconciliation of our effective tax rate to the U.S. federal statutory rate of 35% and further explanation of our provision for taxes, see Note 9 to the consolidated financial statements in Item 8, which is incorporated herein by reference.

*Fiscal 2009 vs. 2008*

Income tax expense was $10.9 million in 2009 compared to tax expense of $7.1 million in 2008.

The Company made an assessment of the realizability of its deferred tax assets in Korea, which are included in the Handsets segment, and believe that it will not generate sufficient income to realize its deferred tax assets in Korea. The income tax associated with establishing the valuation allowance is $1.4 million.

During the first quarter of 2009, the Company recorded a tax benefit of $2.8 million related to the recognition of previously unrecognized tax benefits and the reversal of interest and penalties due to the statute of limitations expirations and income tax audit settlements.

Without the $1.4 million of tax expense related to establishing the Korea valuation allowance, and the $2.8 million tax benefit related to the statute of limitation expiration and income tax audit settlements mentioned above, we have tax expense of $12.3 million in 2009. There are two primary reasons why we have tax expense despite incurring pretax losses. First we have not provided any tax benefit on the current year losses incurred and tax credits generated in the United States and other countries, because we believe it is more likely than not that the tax benefit associated with these losses

Table of Contents

will not be realized. Second, we continue to accrue tax expense in jurisdictions where we have been historically profitable.

In 2008, as discussed below, we recorded a $11.7 million income tax benefit related to the reversal of deferred tax liabilities related to the unremitted earnings of our subsidiaries, and $1.8 million tax expense associated with establishing a valuation allowance in Canada.

*Fiscal 2008 vs. 2007*

Income tax expense was $7.1 million in 2008 compared to tax expense of $32.9 million in 2007.

The China Corporate Income Tax Law (the "CIT Law") became effective on January 1, 2008. As a result of the enactment of new regulations during the first quarter of 2008 which address the CIT Law, we recorded an income tax benefit of $11.7 million in the first quarter of 2008 related to reversing a deferred tax liability on foreign withholding taxes related to the unremitted earnings of our subsidiaries which we determined to no longer be permanently reinvested outside the United States. We also have accrued $3.2 million of foreign withholding taxes in the first quarter of 2008 related to the realized gain on the sale of our investment in Gemdale.

Due to the sale of PCD, we believe that we will not generate sufficient income in Canada to realize our deferred tax assets in Canada. Therefore, we have established a valuation allowance on our remaining net deferred tax assets in Canada. The income tax expense associated with establishing the valuation allowance is $1.8 million.

Without the $11.7 million tax benefit related to the reversal of deferred tax liabilities, the $3.2 million of tax expense related to accrued foreign withholding taxes and the $1.8 million of tax expense related to establishing the Canada deferred tax asset valuation allowance mentioned above, we have tax expense of $13.8 million in 2008. There are two primary reasons why we have tax expense despite incurring pretax losses. First, we have not provided any tax benefit on the current year losses incurred and tax credits generated in the United States and other countries, because we believe it is more likely than not that the tax benefit associated with these losses will not be realized. Second, we continue to accrue tax expense in jurisdictions where we have been historically profitable.

In 2007, we recorded $17.1 million of income tax expense related to establishing an $11.7 million deferred tax liability on unremitted earnings and accruing $5.4 million of withholding taxes related to the realized gain on the sale of our investment in Gemdale.

**SEGMENT REPORTING**

We make financial decisions based on information we receive from our internal management system and currently evaluate the operating performance of and allocate resources to the segments based on segment revenue and gross profit. Cost of sales and direct expenses in relation to production are assigned to the segments. The accounting policies used in measuring segment assets and operating performance are the same as those used at the consolidated level.

***Multimedia Communications***

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (in thousands, except percentages) | | |
| Net sales | $ 140,446 | $ 280,391 | $ 315,515 |
| Gross profit | $ 55,150 | $ 127,112 | $ 109,706 |
| Gross profit as a percentage of net sales | 39% | 45% | 35% |

Table of Contents

*Fiscal 2009 vs. 2008*

Sales for 2009 decreased by 50% or $139.9 million. The decrease was mainly due to the declines of our PAS equipment sales by 86%, as well as decrease in sales of NGN product by 54% partially offset by increase in sales of IPTV related products, IP messaging product and accelerated amortization of deferred revenue related to PAS equipment during 2009. PAS equipment sales including the amortization of deferred revenue comprised approximately 52% and 77% of our Multimedia Communications sales for 2009 and 2008, respectively.

The gross profit percentage decreased to 39% for 2009 from 45% for 2008. During 2009, gross profit benefited $6.1 million from sales of product that was previously written down to zero carrying value. During 2008, gross profit benefited $4.5 million from the impact of the release of accrued third party commissions, compared with $0.8 million for 2009. The decrease in gross profit percentage was also due to decreased sales of our higher margin PAS infrastructure equipment and NGN products as well as increase in lower margin revenue related to the accelerated amortization of PAS deferred revenue.

We expect future PAS infrastructure spending to decline rapidly in 2010 and beyond as China launched its 3G networks. We review assumptions regarding the estimated post contract support periods on a regular basis. Due to the China telecommunication industry restructuring and launch of 3G services in China, the Ministry of Industry and Information Technology of China announced that PAS services in China will be phased out by January 1, 2012. In the second and third quarter of 2009, we streamlined our sales, service and research and development operations for PAS handsets and infrastructure equipment. We do not perform any new research and development of PAS products and we maintain a small support team to assist our customers with warranty matters. In the later part of the third quarter 2009 and early part of the fourth quarter 2009, we contacted our PAS infrastructure customers and held discussions with them on the PAS products future. In October 2009, we notified our PAS infrastructure customers in China that we will no longer provide upgrades or support of PAS products beyond December 31, 2011. Consequently, we have determined the remaining expected period of support as 2 years and hence deferred revenue associated with PAS infrastructure is being recognized ratably beginning in the fourth quarter of 2009 through the fourth quarter of 2011. As a result of this change, net sales and gross profit in the fourth quarter of 2009 were increased by approximately $6 million and $2 million, respectively. As of December 31, 2009, we have approximately $186.4 million of deferred revenue associated with PAS infrastructure sales for which we accelerated the amortization period of support. In each of fiscal 2010 and 2011, total net sales and gross profit associated with the amortization of all PAS-related deferred revenue will approximate $93 million and $33 million, respectively.

We plan to aggressively pursue opportunities for our IPTV product portfolios in multiple markets. However, we do not anticipate that these sales will fully offset the anticipated decline in PAS sales in 2010 and beyond. We believe that the IPTV market presents a meaningful growth opportunity. We currently offer and have initial market acceptance of our IPTV products in China, India, Taiwan and other geographic regions.

*Fiscal 2008 vs. 2007*

Sales for 2008 decreased by 11%, or $35.1 million as compared to 2007. The decrease was mainly due to lower PAS system sales and 3G related product sales in 2008 as we exited 3G related product lines in early 2007. The decrease was partially offset by higher Set Top Box ("STB") and NGN sales. Worldwide PAS system sales including the amortization of deferred revenue decreased by 21% and contributed to approximately 77% of our Multimedia Communications sales for 2008 compared to 87% for 2007.

Table of Contents

The gross profit percentage increased to 45% for 2008 from 35% for 2007 primarily due to lower warranty and inventory costs as well as the impact of the reduction of $4.5 million of previously accrued third party commissions in the third quarter of 2008 and $9.1 million of 3G product sales with low margins in 2007, offset in part by increased sales of lower margin STB products in 2008. The reduction in accrued third party commissions in the third quarter of 2008 resulted from the determination that such aged accruals were no longer needed as the statute of limitations with respect to such unclaimed commissions had expired and we had exhausted all efforts to extinguish these liabilities in accordance with established Company procedures.

***Broadband Infrastructure***

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (in thousands, except percentages) | | |
| Net sales | $ 80,941 | $ 110,862 | $ 157,118 |
| Gross profit (loss) | $ 2,981 | $ (3,516) | $ 6,512 |
| Gross profit (loss) as a percentage of net sales | 4% | (3)% | 4% |

*Fiscal 2009 vs. 2008*

Broadband Infrastructure sales decreased by 27%, or $29.9 million for 2009 as compared to 2008. The decrease was mainly due to decrease in sales of most of the major product lines in 2009. Softbank in Japan, one of our largest infrastructure customers, represented approximately 11% and 23% of total Broadband Infrastructure sales in 2009 and 2008, respectively. During 2009, we began recognizing revenue ratably on a significant customer contract over a seven year period. Broadband Infrastructure included $14.5 million of revenue and insignificant gross profit related to this contract during 2009.

During 2009, gross profit benefited $1.4 million from sales of product that was previously written down to zero carrying value. Gross profit percentage increased to 4% for 2009 from negative 3% for 2008. The increase in gross profit percentage was primarily due to lower provision for anticipated contract losses in 2009 compared to 2008.

We may incur additional warranty expense and inventory write-downs as we introduce new products and may be required to accrue additional contract losses for certain fixed price contracts as these contracts progress. These accruals may result in negative impacts on our future gross margins, results of operations and financial position.

*Fiscal 2008 vs. 2007*

Sales decreased due to a decline in our CPE and MSAN product lines as Softbank in Japan completed its current phase of ADSL expansion. Softbank in Japan represented approximately 23% and 34% of total Broadband Infrastructure sales in 2008 and 2007, respectively. This decline was partially offset by higher sales in Optical products.

Gross profit decreased by $10.0 million for 2008 when compared to 2007. The decreased gross profit in 2008 was primarily due to approximately $18.4 million contract loss provisions as well as approximately $7.1 million increased inventory costs related to our optical products in China in 2008. The decrease was partially offset by the sale of higher margin MSAN products in 2008. Gross profit for 2008 includes $3.4 million of contract loss charges relating to costs that should have been included in the calculation of gross profit in prior periods. The impact of this out of period item was not material to 2008 or prior periods. In 2007, we recorded a $6.2 million additional contract loss on an infrastructure deployment contract.

Table of Contents

***Handsets***

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (in thousands, except percentages) | | |
| Net sales | $ 102,000 | $ 287,607 | $ 234,468 |
| Gross profit (loss) | $ (18,982) | $ 39,015 | $ 76,219 |
| Gross profit (loss) as a percentage of net sales | (19)% | 14% | 33% |

*Fiscal 2009 vs. 2008*

Net sales decreased by 65%, or $185.6 million for 2009 compared to 2008. The decrease was primarily due to the declines of PAS handsets sales, GSM handsets sales and CDMA handsets sales to PCD LLC, partially offset by the increase of CDMA handsets sales in China. The sale of PAS handsets accounted for 23% and 50% of total handset sales for 2009 and 2008, respectively. Our PAS handset sales declined significantly since the first quarter of 2009 as China moved toward the 3G network deployment.

Gross profit as a percentage of net sales decreased from 14% in 2008 to negative 19% in 2009. The decrease was mainly due to inventory clearing sales of PAS and CDMA handsets at very low margins, additional inventory write-downs of PAS, CDMA and TDSCDMA handsets in China. In addition, gross profit was also reduced by approximately $24.6 million as a result of certain transactions with PCD LLC consisting of a claim settlement of $11.1 million for product-related liability disputes and product returns, and $26.0 million in inventory write-downs to net realizable value, write-downs of excess inventory and warranty reserves in 2009, partially offset by $12.5 million benefit related to sales of CDMA handsets to PCD LLC during 2009 that were previously written down to zero carrying value in the fourth quarter of 2008.

We have substantially completed the wind down of our worldwide handset operations and do not expect our handset segment to have significant contribution to our revenue and gross margin in 2010 and beyond.

*Fiscal 2008 vs. 2007*

Net sales increased 23% for the year 2008 as compared to the same periods in 2007. The majority of our handset sales were historically in China, where we have experienced a decline in volume and price for our PAS handsets. After the disposition of our PCD operations on July 1, 2008, our handset sales to PCD LLC totaled $126.0 million and contributed approximately 44% of total handset sales for 2008.

The PAS handset units sold in China declined to 3.6 million units for 2008 compared to 4.8 million units for 2007. The 25% volume decline was primarily attributed to lower demand for our PAS handsets resulting from a decline in PAS subscribers as service providers reduced marketing efforts for PAS handsets in anticipation for next generation technology networks and the restructuring of China telecommunication industry. The average selling price per unit in the PAS products declined 9.4% in 2008 compared to 2007 due to competitive pricing pressures and increased sales through distributor channels.

Gross profit as a percentage of net sales for our Handsets segment decreased in 2008 compared to 2007. The decrease was primarily due to losses from our GSM products as we reduced inventory of older models, costs related to cancelation of an order for a CDMA model and higher inventory cost of our PAS data card business, as well as continued price erosion and a decrease in demand of our PAS product lines. The increased sales of lower gross margin CDMA handsets to PCD LLC also contributed

Table of Contents

to the decline of gross profit percentage. The decrease in gross margin was partially offset by a $5.1 million supplier rebate in 2008.

***Services***

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (in thousands, except percentages) | | |
| Net sales | $ 62,957 | $ 57,911 | $ 53,214 |
| Gross profit | $ 25,830 | $ 17,407 | $ 8,923 |
| Gross profit as a percentage of net sales | 41% | 30% | 17% |

*Fiscal 2009 vs. 2008*

Our Services segment's revenue increased by 9%, or $5.0 million for 2009 as compared to 2008. The increase was primarily due to higher international maintenance service revenue partially offset by the decrease in China service sales after the China telecommunications industry restructuring.

Gross profit as a percentage of net sales increased from 30% for 2008 to 41% for 2009. The increase in gross profit in absolute dollars was primarily due to increased international sales and overall cost reduction efforts for the service divisions, including headcount reductions and the consolidation of service locations.

*Fiscal 2008 vs. 2007*

Our Services segment's revenue from external customers increased by 9% for 2008 as compared to 2007. The increase was mainly due to the continued growth of our China service sales resulting from increased service contracts for maintenance services and value added services. The previously allocated revenues into the Service segment of $7.8 million from Multimedia Communications and $0.3 million from Broadband Infrastructure segment sales in China were reclassified into the respective segments for 2007 to conform to the current year's segment presentation.

Gross profit increased from 17% for 2007 to 30% for 2008. The increase was primarily due to China service sales increases without corresponding increases in associated cost by utilizing excess capacity.

***Personal Communication Devices (PCD)***

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (in thousands, except percentages) | | |
| Net sales | $ | $ 879,588 | $ 1,664,147 |
| Gross profit | $ | $ 69,005 | $ 94,215 |
| Gross profit as a percentage of net sales | | 8% | 6% |

*Fiscal 2009 vs. 2008*

On July 1, 2008, we sold our PCD operations (See Note 3 of Notes to our Consolidated Financial Statements included under Part II, Item 8 of this Annual Report on Form 10-K).

Table of Contents

*Fiscal 2008 vs. 2007*

Net sales for PCD decreased by $784.6 million as compared to 2007 due to the disposition of PCD on July 1, 2008. Gross profit increased from 6% in 2007 to 8% in 2008 primarily due to sales of higher margin products in 2008.

***Other***

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (in thousands, except percentages) | | |
| Net sales | $ | $ 24,090 | $ 42,508 |
| Gross profit | $ | $ 12,219 | $ 25,876 |
| Gross profit as a percentage of net sales | | 51% | 61% |

*Fiscal 2009 vs. 2008*

Our Other segment consists of Mobile Solutions ("MSBU") and Custom Solutions ("CSBU") business units. We disposed of our MSBU unit in July 2008 and completed the disbandment of the CSBU unit in the first quarter of 2009. The remaining IP Messaging product line has been integrated into the Multimedia Communication segment and remaining services related contracts have been integrated into the Service segment.

*Fiscal 2008 vs. 2007*

Revenue decreased by $18.4 million, or 43% for 2008 as compared to 2007. Of the total $18.4 million decrease in sales, $7.7 million was due to the disposition of MSBU in July 2008 and $4.6 million was related to recognition of revenue of a higher margin product sales in 2007. In the fourth quarter of 2008, we initiated actions to disband CSBU.

Gross profit percentage decreased to 51% for 2008 from 61% for 2007. The decrease was primarily due to higher inventory write-downs and higher overhead expenses in 2008 offset by the effect of the disposition of MSBU which had lower gross margin sales.

**RELATED PARTY TRANSACTIONS**

*Softbank and affiliates*

We recognize revenue with respect to sales of telecommunications equipment to affiliates of Softbank, a significant stockholder of our company. Softbank offers ADSL coverage throughout Japan, which is marketed under the name "YAHOO! BB." We support Softbank's fiber-to-the-home service through sales of our carrier class GEPON product as well as our NetRing product. In addition, we support Softbank's new internet protocol television ("IPTV"), through sales of our RollingStream product.

During 2009, 2008 and 2007, we recognized revenue of $23.1 million, $38.3 million and $67.8 million, respectively, for sales of telecommunications equipment and services to affiliates of Softbank. Included in accounts receivable at December 31, 2009 and 2008 were $5.5 million and $9.2 million, respectively, related to these transactions.

Sales to Softbank include a three year service period and a penalty clause if product failure rates exceed a certain level over a seven year period. As of December 31, 2009 and 2008, the customer advance balance related to Softbank agreements was $0.2 million and $0.7 million, respectively. The current deferred revenue balance related to Softbank was $1.4 million and $4.0 million as of

December 31, 2009 and December 31, 2008, respectively. As of December 31, 2009, the noncurrent deferred revenue balance related to Softbank was $8.8 million compared to $9.2 million as of December 31, 2008.

As of December 31, 2009, Softbank beneficially owned approximately 11% of our outstanding stock.

*Audiovox*

Prior to the sale of PCD on July 1, 2008, Phillip Christopher, one of our former officers, served as a director for Audiovox Corporation ("Audiovox"). During 2008 and 2007, we paid approximately $0.8 million and $2.1 million, respectively, for IT services provided by Audiovox.

**Liquidity and Capital Resources**

The following sections discuss the effects of changes in our balance sheet and cash flows, contractual obligations and other commitments on our liquidity and capital resources.

***Balance Sheet and Cash Flows***

*Cash and Cash Equivalents and Short-term Investments*

| | December 31, 2009 | December 31, 2008 | Change |
|---|---|---|---|
| | | (in thousands) | |
| Cash and cash equivalents | $ 265,843 | $ 309,603 | $ (43,760) |
| Bank notes | 1,038 | 4,262 | (3,224) |
| Total | $ 266,881 | $ 313,865 | $ (46,984) |

| | Year ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | | (in thousands) | |
| Cash used in operating activities | $ (67,448) | $ (55,164) | $ (225,093) |
| Cash provided by investing activities | 21,318 | 246,046 | 29,438 |
| Cash used in financing activities | (388) | (332,612) | (58,105) |
| Effect of exchange rate changes on cash and cash equivalents | 2,758 | 13,884 | 29,586 |
| Net decrease in cash and cash equivalents | $ (43,760) | $ (127,846) | $ (224,174) |

Cash and cash equivalents, consisting primarily of bank deposits and money market funds, are recorded at cost which approximates fair value because of the short-term nature of these instruments. At December 31, 2009, cash and cash equivalents approximating $131.2 million was held by our subsidiaries in China.

The Chinese government imposes currency exchange controls on all cash transfers out of China. Regulations in China permit foreign owned entities to freely convert the Renminbi into foreign currency for transactions that fall under the "current account," which includes trade related receipts and payments, interest and dividends. Accordingly, our Chinese subsidiaries may use Renminbi to purchase foreign exchange for settlement of such "current account" transactions without pre-approval. However, pursuant to applicable regulations, foreign-invested enterprises in China may pay dividends only out of their accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations. In calculating accumulated profits, foreign investment enterprises in China are required to allocate at least 10% of their accumulated profits each year, if any, to fund certain

reserve funds, including mandated employee benefits funds, unless these reserves have reached 50% of the registered capital of the enterprises.

Other transactions that involve conversion of Renminbi into foreign currency are classified as "capital account" transactions; examples of "capital account" transactions include repatriations of investments by or loans to foreign owners, or direct equity investments in a foreign entity by a China domiciled entity. "Capital account" transactions require prior approval from China's State Administration of Foreign Exchange (SAFE) or its provincial branch to convert a remittance into a foreign currency, such as U.S. dollars, and transmit the foreign currency outside of China. As a result of these and other restrictions under PRC laws and regulations, our China subsidiaries are restricted in their ability to transfer a portion of their net assets to the parent.

***2009 Cash flows***

Net cash used in operating activities for 2009 was $67.4 million. During the year ended December 31, 2009, our operating activities were significantly impacted by the following:

Net loss of $225.7 million offset by non-cash charges of approximately $58.0 million which resulted in a net use of cash of $167.7 million. The non-cash charges included $33.3 million impairment of Hangzhou facility, $13.1 million of depreciation and amortization, $12.1 million stock-based compensation, $5.5 million other-than-temporary impairment of two equity investments, and $0.9 impairment of variable interest entity, partially offset by recovery for doubtful accounts of $6.8 million.

Changes in operating assets and liabilities providing net cash of $100.2 million. The decrease in sales activity in 2009 was the primary driver of the changes in operating assets and liabilities. Cash from operations benefited by $123.3 million from a decrease in accounts receivable, $72.8 million from a decrease in inventory and deferred costs, $83.1 million from a decrease in other assets consisting primarily of working capital items, and $4.2 million from an increase in deferred revenue, offset partially by a decrease in accounts payable using cash of $127.7 million, a decrease in customer advances of $29.2 million and a decrease in other liabilities of $24.6 million.

Cash provided by investing activities during 2009 was $21.3 million. Cash provided from investing activities in 2009 included $10.0 million of cash proceeds released from escrow in July 2009 related to sale of PCD, $1.5 million cash proceeds from the divestiture of our Korea operations, $7.3 million deposit received on pending sale of our China headquarters, $2.6 million from the sale of our investment interests in PCD LLC and MRV, net proceeds of $3.2 million from the sale of other short-term investments, offset partially by $2.0 million cash used to purchase property, plant and equipment and $2.0 million change in restricted cash.

Cash used in financing was immaterial during 2009.

***2008 Cash flows***

Net cash used in operating activities for 2008 was $55.2 million. During the year ended December 31, 2008, our operating activities were significantly impacted by the following:

Net loss of $150.8 million adjusted for gains on sale of investments of $40.2 million, the $8.2 million gain on liquidation of ownership interest in a variable interest entity, the $7.8 million gain on divestitures and non-cash charges of $78.4 million, which resulted in a net use of cash of $128.5 million. The non-cash charges of $78.4 million included $38.0 million in depreciation and amortization, $20.6 million in stock-based compensation expense, $27.2 million impairment of long-lived assets and $4.3 million impairment of long-term investments, partially offset by recovery for doubtful accounts of $5.2 million and deferred tax benefit of $6.4 million.

Table of Contents

The deferred tax benefit is primarily due to an $11.7 million benefit resulting from a change in the China Corporate Income Tax Law, offset partially by tax expense including $1.8 million of expense related to placing a valuation allowance on our Canadian deferred tax assets.

Changes in net operating assets and liabilities providing net cash of $73.4 million, which was primarily the result of management of working capital, in part necessitated by the repayment of the convertible subordinated notes due March 1, 2008. Cash from operations benefited $58.9 million from a decrease in accounts receivable during 2008 which primarily occurred in the PCD business segment during the first quarter of 2008 due to strong collection efforts and from a $128.9 million increase in accounts payable primarily due to timing of payments to vendors. Partially offsetting this was a $64.9 million use of cash resulting from a decrease in customer advances due to timing of bookings and related revenue recognition. Customer advances represent cash deposits we have received from our customers for orders that have not yet received final acceptance.

Net cash provided by investing activities during the year ended December 31, 2008 of $246.0 million included approximately $214.1 million in net proceeds from the sale of PCD and MSBU, $12.9 million net proceeds from the sale of short-term investments, net of purchases, $33.4 million proceeds from the sale of investment interests, net of purchases of long term investment interests and $7.7 million from the repayment of a loan by a variable interest entity, partially offset by $14.2 million used to purchase property, plant and equipment, and a $8.2 million change in restricted cash. The $33.4 million proceeds from the sale of investment interests, net of purchases of long term investment interests was comprised of $42.1 million proceeds from the sale of Gemdale offset by $8.7 million used to purchase long term investment interests.

Net cash used in financing activities during year ended December 31, 2008 of $332.6 million related primarily to the repayment of the convertible subordinated notes of $274.6 million on March 1, 2008 and the net repayment of $48.0 million of other bank loans during 2008.

***2007 Cash flows***

Net cash used in operating activities for 2007 was $225.1 million. During the year ended December 31, 2007, our operating activities were significantly impacted by the following:

Net loss of $198.4 million adjusted for the gains on sale of investments of $53.7 million, the $4.3 million gain on divestiture and non-cash charges of $92.5 million, which resulted in a net use of cash of $163.9 million. Non-cash charges for 2007 included $57.4 million of depreciation and amortization, $12.8 million of stock-based compensation expense and $19.9 million of impairment charges of long-lived assets.

Changes in net operating assets and liabilities using net cash of $61.2 million. During 2007, accounts payable decreased $172.0 million due to a decrease in purchases of inventory during 2007 and a change in the timing of payments to vendors beginning in the first quarter of 2007 to comply with accelerated vendor payment terms. In addition, deferred revenue decreased $40.7 million primarily due to the recognition of revenue that was deferred from prior periods, other assets increased by $21.2 million primarily due to advance payments to suppliers and customer advances decreased by $48.1 million for 2007. Upon subsequent receipt of final acceptances and revenue recognition, customer advances are reduced and revenue and cost of sales is recorded. Customer advances represent cash deposits we have received from our customers for orders that have not yet received final acceptance. The cash used in operating activities was partially offset by a reduction in accounts receivable of $93.9 million, inventory and deferred costs of $121.2 million. The reduction in accounts receivable was as a result of strong cash collections and the high percentage of revenue in 2007 from PCD which generally has experienced a shorter collection period on related receivables. Days sales outstanding was 48 days at December 31, 2007 as compared to 60 days at December 31, 2006. The decrease in inventory and deferred cost was primarily due to a decrease in purchases of inventory during 2007.

Table of Contents

Net cash provided by investing activities for 2007 totaled $29.4 million. Cash of $83.1 million was received from the proceeds of the sale of short-term and long-term investments, $4.3 million was received in connection with achieving certain milestones related to the sale of certain semiconductor assets in 2006 and $6.6 million was the result of a change in restricted cash balances representing a release of restricted cash. Cash outflows from investing activities included $37.9 million for the purchase of short-term investments as well as $27.3 million for the purchase of property, plant and equipment.

Net cash used in financing activities was $58.1 million, primarily due to net repayment on our lines of credit of $61.6 million.

*Accounts Receivable, Net*

Accounts receivable decreased $116.0 million from $158.4 million at December 31, 2008 to $42.3 million at December 31, 2009. The decrease in accounts receivable is primarily due to the decrease in sales during 2009 resulting from the divestiture of non-core operations. At December 31, 2009, our allowance for doubtful accounts was $26.1 million on gross receivables of $68.4 million. We assess collectability of receivables based on a number of factors including analysis of creditworthiness, our customer's historical payment history and current economic conditions, our ability to collect payment and on the length of time an individual receivable balance is outstanding. We have certain accounts receivable in China that have been outstanding for a significant period of time. We provide allowances for these receivables based on the criteria discussed above. While we believe we have sufficient experience and knowledge of the China market and customer payment patterns to reasonably estimate such allowances, actual payment patterns and customer behavior could differ from our expectations.

*Inventories and Deferred Costs*

The following table summarizes our inventories and deferred costs:

| | December 31, 2009 | December 31, 2008 | Increase (Decrease) |
|---|---|---|---|
| | | (In thousands) | |
| Inventories: | | | |
| Raw materials | $ 18,863 | $ 15,545 | $ 3,318 |
| Work in process | 12,881 | 33,524 | (20,643) |
| Finished goods | 40,556 | 140,763 | (100,207) |
| Total inventories | $ 72,300 | $ 189,832 | $ (117,532) |
| Short-term deferred costs | $ 130,453 | $ 114,884 | $ 15,569 |
| Long-term deferred costs | $ 184,978 | $ 149,258 | $ 35,720 |

Inventories consist of product held at our manufacturing facility and warehouses, as well as finished goods at customer sites for which the customer has taken possession, but based on specific contractual terms, title has not yet passed to the customer. Finished goods at customer sites were approximately $33.8 million and $138.0 million at December 31, 2009 and 2008, respectively. Inventories decreased approximately $117.5 million primarily as a result of the wind-down of our worldwide handset operations, completion of a significant customer contract, and the reclassification of $72.8 million of cost from finished goods at customer sites to deferred costs related to this same customer contract. Deferred costs consist of product shipped to the customer where the rights and obligations of ownership have passed to the customer, but revenue has not yet been recognized. The $15.6 million increase in short-term deferred costs and the $35.7 million increase in long-term deferred costs was primarily the result of the $72.8 million reclassification from finished goods at customer sites to deferred costs upon completion of the significant customer contract mentioned above, offset in part

by revenue recognition on long-term contracts and the accelerated amortization of deferred costs associated with PAS deferred revenue.

***Liquidity***

We have incurred net losses attributable to UTStarcom, Inc. of $225.7 million, $150.3 million and $195.6 million during the years ended December 31, 2009, 2008 and 2007, respectively. We have recorded operating losses in 19 of the 20 consecutive quarters in the period ended December 31, 2009. At December 31, 2009, we have an accumulated deficit of $1,067.2 million. We incurred net cash outflows from operations of $67.4 million, $55.2 million and $225.1 million in 2009, 2008 and 2007 respectively. While operating results are expected to improve in 2010 compared with prior years, we expect to continue to incur losses in 2010.

At December 31, 2009, we had cash and cash equivalents of $265.8 million, of which $131.2 million was held by our subsidiaries in China. The amount of cash available for transfer from the China subsidiaries for use by our non-China subsidiaries is limited both by the liquidity needs of the subsidiaries in China and by Chinese-government mandated limitations including currency exchange controls on transfers of funds outside of China.

Our China subsidiaries paid an aggregate $150 million in dividends to our U.S. parent company during the year ended December 31, 2007 and another $100 million in February 2008. While these cash transfers are offset and eliminated in preparing our consolidated cash flow statements, they have been a principal source of funding of our non-China operations during the periods in which they were made. In February 2009, our China subsidiaries paid an additional $50 million in dividends to our U.S. parent company. However, going forward, the amount of cash available for transfer from the China subsidiaries will be limited both by the liquidity needs of the subsidiaries in China and the restriction on currency exchange by Chinese-government mandated requirements including currency exchange controls on certain transfers of funds outside of China.

During 2009, approximately $322.1 million in credit facilities in China expired and were not renewed. At December 31, 2009, we had no available credit facilities.

Global economies have experienced a significant downturn driven by a financial and credit crisis that will continue to challenge such economies for some period of time. Under the current macroeconomic environment there are significant risks and uncertainties inherent in management's ability to forecast future results. The operating environment confronting us, both internally and externally, raises significant uncertainties.

In 2009 and 2008, we took a number of actions to improve our liquidity. In March 2008, we paid $289.5 million to retire our convertible subordinated notes and related accrued interest. On July 1, 2008, we completed the sale of PCD. In addition, we divested our Mobile Solutions Business Unit in July 2008. In the fourth quarter of 2008, management initiated actions to disband our Customs Solutions Business Unit, to wind down our Korea based handset operations, and announced initiatives including efforts to eliminate functional duplications by consolidation of a number of functions into our China operations. In June 2009, management expanded the initiatives to include a worldwide reduction in workforce, outsourcing of manufacturing operations and optimizing research and development spending with a focus on selected products. Our year-to-year quarterly selling, general and administrative and research and development operating expenses decreased significantly in 2009 compared with 2008 and management believes the continuing efforts to stream-line operations will enable our fixed cost base to be better aligned with operations, market demand and projected sales levels. If projected sales do not materialize, we will need to take further actions to reduce costs and expenses or explore other cost reduction options.

Table of Contents

In December 2009, we entered into a Sales Leaseback Agreement for the intended sale of our manufacturing, research and development, and administrative offices facility in Hangzhou, China to another third party for approximately $140 million with leaseback of a portion of the facility. To date, we have received proceeds of approximately $13.9 million on the transaction. On March 8, 2010, we obtained an irrevocable bank guarantee letter from the buyer for the remaining amount of the cash proceeds from the Sale Leaseback Agreement. The agreement is expected to close between the end of March and April 2010 and will provide additional cash for working capital and general purposes.

Management believes that both our China and non-China operations will have sufficient liquidity to finance working capital and capital expenditure needs during the next 12 months. If we are not able to execute our plan successfully, we may need to obtain funds from equity or debt financings. There can be no assurance that additional financing, if required, will be available on terms satisfactory to us or at all, and if funds are raised in the future through issuance of preferred stock or debt, these securities could have rights, privileges or preference senior to those of our common stock and newly issued debt could contain debt covenants that impose restrictions on our operations. Further, any sale of newly issued debt or equity securities could result in additional dilution to our current shareholders.

*Income taxes*

The China Corporate Income Tax Law ("CIT Law") became effective on January 1, 2008. Under the CIT Law, China's dual tax system for domestic enterprises and foreign investment enterprises ("FIEs") was effectively replaced by a unified system. The new law establishes a tax rate of 25% for most enterprises and a reduced tax rate of 15% for certain qualified high technology enterprises.

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

The CIT Law targets certain industries for the reduced 15% tax rate for certain qualified high technology enterprises. For FIEs established before the promulgation of the new law who had previously enjoyed lower tax rates, any increase in their tax rates would be gradually phased in over five years. During the fourth quarter of 2008, two of our China subsidiaries, HUTS and UTSC, were approved for the reduced 15% tax rate. The approval lasts for three years and is retroactive to January 1, 2008.

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

*Off balance sheet arrangements*

At December 31, 2009 and 2008, we had no off balance sheet arrangements.

***Contractual obligations and other commercial commitments***

The following table summarizes our significant contractual obligations as of December 31, 2009:

| | Payments Due by Period | | | | |
|---|---|---|---|---|---|
| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
| | (in thousands) | | | | |
| Operating leases | $ 12,035 | $ 6,590 | $ 4,900 | $ 545 | $ |
| Letters of credit | 28,107 | 17,557 | 10,550 | | |
| Purchase commitments | 43,061 | 41,074 | 1,987 | | |
| Total | $ 83,203 | $ 65,221 | $ 17,437 | $ 545 | $ |

Table of Contents

*Operating leases*

We lease certain facilities under non-cancelable operating leases that expire at various dates through 2013. In connection with the Sale Leaseback Agreement, on February 1, 2010, we entered into a Lease Contract (the "Lease") with respect to the leaseback of a portion of the Hangzhou facility. The Lease becomes effective upon the closing of the sale transaction. The Lease terms require total cash payments of approximately $11.5 million in each of years 1 and 2, $13.4 million in each of years 3 and 4, and $14.2 million in each of years 5 and 6.

*Letters of credit*

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

*Purchase commitments*

We are obligated to purchase raw materials and work-in-process inventory under various orders from various suppliers, all of which should be fulfilled without adverse consequences material to our operations or financial condition. Purchase commitments in the table above include agreements that are cancelable without penalty.

*Intellectual property*

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

*Uncertain tax positions*

As December 31, 2009, we had $90.6 million of gross unrecognized tax benefits. If recognized, the portion of gross unrecognized tax benefits that would decrease the provision for income taxes and decrease our net loss is $12.8 million. The impact on net loss reflects the gross unrecognized tax benefits net of certain deferred tax assets and the federal tax benefit of state income tax items totaling $77.8 million. We have not included these amounts in the table of contractual obligations and commercial commitments because of the difficulty in making reasonably reliable estimates of the timing of cash settlements with the respective taxing authorities.

*Third party commissions*

We record accruals for commissions payable to third parties in the normal course of business. Such commissions are recorded based on the terms of the contracts between us and the third parties and paid pursuant to such contracts. Consistent with our accounting policies, these commissions are recorded as operating expense in the period in which the liability is incurred. As of December 31, 2009, approximately $6.4 million of such accrued commissions had not been claimed by the third parties for more than three years. Management has performed, and continues to perform, follow-up procedures with respect to these accrued commissions. Upon completion of such follow-up procedures, if the

accrued commissions have not been claimed and the statute of limitations, if any, has expired or a reasonable period of time has elapsed, we reduce such accruals. Such reduction is recorded in the consolidated statement of operations during the period management determines that certain accruals are no longer necessary. During the years ended December 31, 2009 and 2008, respectively, we reduced approximately $0.8 million and $4.5 million of accrued commissions payable and such reduction was recorded in cost of net sales. During the year ended December 31, 2007, no significant accruals related to third party commissions were reversed. We expect approximately $5.9 million of these third party commissions to be reversed and recorded as a reduction in cost of net sales in 2010.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

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

***Revenue Recognition***

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

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

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

Table of Contents

Where multiple elements exist in an arrangement that includes software, and the software is considered more than incidental to the equipment or services in the arrangement, software and software related elements are recognized in accordance with the specific guidance for recognizing software revenue. We allocate revenues to each element of software arrangements based on vendor specific objective evidence ("VSOE") of fair value. VSOE of fair value of each element is based on the price charged when the same element is sold separately. We use the residual method to recognize revenue when an arrangement includes one or more elements to be delivered at a future date and VSOE of the fair value of all the undelivered elements exists. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the contract price is recognized as revenue when all other revenue recognition criteria are met. If VSOE of fair value of one or more undelivered elements does not exist, all revenue for delivered and undelivered elements is deferred until delivery of all elements occurs or when VSOE of fair value of the undelivered elements can be established. In some cases we have agreed to give software upgrade rights on a "when and if made available" basis for equipment sold for no additional consideration and for an unspecified period which could extend over the term of the contract. This additional contract obligation is an element of "post-contract support." We have not established VSOE for such contract element. Accordingly, the revenues from such contracts are recognized ratably over the period during which the post contract support is expected to be provided. The expected period of support is generally the term of the contract. In some cases where there is no stated contractual term, revenue is recognized ratably over the estimated period of support. We review assumptions regarding the estimated post-contract support periods on a regular basis. If we determine that it is necessary to revise our estimates of the support periods, the amount of revenue recognized over the life of the contract would not be affected. However, to the extent the new assumptions regarding the post-contract support periods were different from the original assumptions, the contract revenues would be recognized over the remaining expected period of support. As discussed in "Results of Operations-Net Sales" in this Item 7, due to the China telecommunication industry restructuring and launch of 3G services in China, we have determined the remaining expected period of support for PAS infrastructure as 2 years and hence deferred revenue associated with PAS infrastructure is being recognized ratably beginning in the fourth quarter of 2009 through the fourth quarter of 2011.

Revenue from fixed priced contracts that include a requirement for significant software modification or customization is recognized using the completed contract method of accounting, whereby no revenue is recognized prior to the completion of the project, because for contracts involving unique requirements we are unable to make reasonably dependable estimates of progress towards meeting contractual requirements. In the event estimated total project costs exceed estimated total project revenues, the entire estimated loss is charged to operations in the period in which the loss becomes probable and can be reasonably estimated. The complexity of the estimation process and judgments about internal and external factors including labor utilization, changes to specifications and testing requirements, time required for performance and resulting incurrence of contract penalties, and the performance of subcontractors affect the estimation process. During the years ended December 31, 2009, 2008 and 2007, we recorded $4.9 million, $18.4 million and $6.2 million contract loss on a fixed price contract, respectively.

We recognize revenue for system integration, installation and training upon completion of performance and if all other revenue recognition criteria are met. Other service revenue, principally related to maintenance and support contracts, is recognized ratably over the maintenance term.

We also sell products through resellers. Revenue is generally recognized when the standard price protection period, which ranges from 30 to 90 days, has lapsed. If collectability cannot be reasonably assured in a reseller arrangement, revenue is recognized upon sell-through to the end customer and receipt of cash. There may be additional obligations in reseller arrangements such as inventory rotation,

or stock exchange rights on the product. In most cases, we have developed reasonable estimates for stock exchanges based on historical experience with similar types of sales of similar products.

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

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

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

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

***Restructuring Liabilities, Litigation and Other Contingencies***

We account for the Company's restructuring plans using the guidance provided in Accounting Standard Codifications ("ASC") 420 "Exit or Disposal Cost Obligations" and ASC 712 "Compensation Nonretirement Postemployment Benefits". We account for litigation and contingencies in accordance with ASC 450, "Contingencies", which requires that we record an estimated loss from a loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated.

***Stock-Based Compensation***

Stock-based compensation expense for all share-based payment awards granted is determined based on the grant-date fair value. Stock-based compensation expense for restricted stock awards is measured based on the closing fair market value of our common stock on the date of grant. Stock-based compensation expense for stock options is estimated at the grant date based on each option's fair value as calculated by the Black-Scholes option pricing model ("Black-Scholes model"). Stock-based compensation is expensed ratably on a straight-line basis over the requisite service period, which is generally the vesting term of the share-based payment awards.

Table of Contents

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

***Product Warranty***

We provide a warranty on our equipment and handset sales for a period generally ranging from one to two years from the time of final acceptance. Very rarely, we have entered into arrangements to provide limited warranty services for periods longer than two years. We provide for the expected cost of product warranties at the time that revenue is recognized based on an assessment of past warranty experience and when specific circumstances dictate. From time to time, we may be subject to additional costs related to non-standard warranty claims from our customers. If and when this occurs, we estimate additional accruals based on historical experience, communication with our customers and various assumptions that we believe to be reasonable under the circumstances. Such additional warranty accruals are recorded in the period in which the additional costs are identified.

***Variable Interest Entities***

The accounting guidance requires that if an entity is the primary beneficiary of a variable interest entity, ("VIE"), the assets, liabilities, and results of operations of the VIE should be included in the consolidated financial statements of the entity. We evaluate our investments periodically or when "triggering" events occur.

***Receivables***

Although we evaluate customer credit worthiness prior to a sale, we provide an allowance for doubtful accounts for the estimated loss on trade and notes receivable when collection may no longer be reasonably assured. We assess collectability of receivables based on a number of factors including analysis of creditworthiness, our customer's historical payment history and current economic conditions, our ability to collect payment and on the length of time an individual receivable balance is outstanding. Our policy for determining the allowance for doubtful accounts includes both specific allowances for balances known to be uncollectible and a formula-based portfolio approach, based on aging of the accounts receivable, as a precursor to a management review of the overall allowance for doubtful accounts. This formula-based approach involves aging of our accounts receivable and applying a percentage based on our historical experience; this approach results in the allowance being computed based on the aging of the receivables. We evaluate the percentages applied to each category of aged accounts receivable periodically based on actual history of write-offs and collections and refine this formula-based approach accordingly for use in future periods.

Table of Contents

We have certain accounts receivable in China that have been outstanding for a significant period of time. We provide allowances for these receivables based on the criteria discussed above. While we believe we have sufficient experience and knowledge of the China market and customer payment patterns to reasonably estimate such allowances, actual payment patterns and customer behavior could differ from our expectations. We use actual collection experience to periodically adjust the percentages used in applying the formula-based portfolio approach as discussed above.

***Inventories***

Inventories consist of product held at our manufacturing facility and warehouses, as well as finished goods at customer sites for which the customer has taken possession, but based on specific contractual terms, title has not yet passed to the customer. We may ship inventory to existing customers that require additional equipment to expand their existing networks prior to the signing of an expansion contract. Our inventories are stated at the lower of cost or market value, based on the FIFO method of accounting. Write-downs are based on our assumptions about future market conditions and customer demand, including projected changes in average selling prices resulting from competitive pricing pressures. We continually monitor inventory valuation for potential losses and obsolete inventory at our manufacturing facilities as well as at customer sites. If actual market conditions are less favorable than those projected by management, additional write-downs may be required. If actual market conditions are more favorable than anticipated, inventory previously written down may be sold to customers, resulting in lower cost of sales and higher income from operations than expected in that period.

***Deferred costs***

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

***Research and Development and Capitalized Software Development Costs***

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

***Income Taxes***

We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining its provision for income taxes. During the ordinary course of business, there are many transactions and calculations for

which the ultimate tax determination is uncertain. We recognize the tax benefit (expense) from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. We recognize interest expense and penalties related to income tax matters as part of the provision for income taxes.

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

We provide U.S. taxes on foreign undistributed earnings that are not considered to be permanently reinvested outside the United States.

***Long-Lived Assets Including Finite-Lived Purchased Intangible Assets***

We amortize purchased intangible assets with finite lives over the estimated economic lives of the assets. Purchased intangible assets are carried at cost, less accumulated amortization.

We assess the recoverability of our long-lived assets by determining whether the carrying value of such assets will be recovered through undiscounted future cash flows. Asset impairments primarily consist of intangible assets with finite lives and property, plant and equipment and are based on an estimate of the amounts and timing of future cash flows related to the expected future remaining use and ultimate sale or disposal of property, plant and equipment net of costs to sell. During 2009, we incurred $33.3 million of plant and equipment impairment charges. During 2008, we incurred $4.9 million and $22.3 million of intangible assets and property, plant and equipment impairment charges, respectively. During 2007, we incurred $15.7 million and $1.1 million of intangible assets and property, plant and equipment impairment charges, respectively. See Note 6 of Notes to our Consolidated Financial Statements included under Part II, Item 8 of this Annual Report on Form 10-K for additional discussion.

The process of evaluating the potential impairment of long-lived assets is highly subjective and requires significant judgment. In order to estimate the fair value of long-lived assets, we typically make various assumptions about the future prospects for the business that the asset relates to, consider market factors specific to that business and estimate future cash flows to be generated by that business. Based on these assumptions and estimates, we determine whether we need to recognize an impairment charge to reduce the value of the asset stated on our balance sheet to reflect its estimated fair value. Assumptions and estimates about future values and remaining useful lives are complex and often subjective. They can be affected by a variety of factors, including external factors such as the real estate market, industry and economic trends, and internal factors such as changes in our business strategy and our internal forecasts. Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, changes in assumptions and estimates could materially impact our reported financial results.

***Investments***

Our investments consist principally of bank notes and equity securities of publicly traded and privately held companies. Our investments in publicly traded equity securities are accounted for under ASC 320, "Investment, Debt and Equity Securities." and are classified as available-for-sale. These investments are recorded at fair value with the unrealized gains and losses included as a separate component of accumulated other comprehensive income, net of tax. During 2009, we sold our

remaining investment in publicly traded equity securities. The investments in equity securities of privately held companies in which we hold less than 20% voting interest and on which we do not have the ability to exercise significant influence are accounted for under ASC 325, "Investments-Other" using the cost method. Under the cost method, these investments are carried at the lower of cost or fair market value.

We recognize an impairment charge when the decline in the fair value of our publicly traded equity securities and our cost-method investments below their cost basis are judged to be other-than-temporary. Significant judgment is used to identify events or circumstances that would likely have a significant adverse effect on the future use of the investment. We consider various factors in determining whether an impairment is other-than-temporary, including the severity and duration of the impairment, forecasted recovery, the financial condition and near-term prospects of the investee, and our ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

**RECENT ACCOUNTING PRONOUNCEMENTS**

See Note 2 of Notes to our Consolidated Financial Statements contained in Item 8 of this Annual Report on Form 10-K for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition, which is incorporated herein by reference.

**ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

*Interest Rate Risk:*

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The fair value of our investment portfolio would not be significantly affected by either a 10% increase or decrease in interest rates due mainly to the short term nature of most of our investment portfolio. However, our interest income can be sensitive to changes in the general level of U.S and China interest rates since the majority of our funds are invested in instruments with maturities of less than one year. In a declining interest rate environment, as short term investments mature, reinvestment occurs at less favorable market rates. Given the short term nature of certain investments, anticipated declining interest rates will negatively impact our investment income.

We maintain an investment portfolio of various holdings, types and maturities. We do not use derivative financial instruments. We place our cash investments in instruments that meet high credit quality standards, as specified in our investment policy guidelines. Our policy is to limit the risk of principal loss and to ensure the safety of invested funds by generally attempting to limit market risk. Funds in excess of current operating requirements are mostly invested in money market funds which are rated AAA. Our cash and cash equivalents are not subject to significant interest rate risk due to the short maturities of these instruments. As of December 31, 2009, the carrying value of our cash and cash equivalents approximated fair value.

Table of Contents

The table below represents carrying amounts and related weighted-average interest rates of our investment portfolio at December 31, 2009 and 2008:

| | December 31, | |
|---|---|---|
| | 2009 | 2008 |
| | (in thousands) | |
| Cash and cash equivalents | $ 265,843 | $ 309,603 |
| Average interest rate | 0.55% | 1.34% |
| Restricted cash short term | $ 26,448 | $ 16,840 |
| Average interest rate | 0.05% | 1.07% |
| Short-term investments | $ 1,038 | $ 4,262 |
| Average interest rate | 0.36% | 1.52% |
| Restricted cash long-term | $ 10,550 | $ 18,228 |
| Average interest rate | 0.03% | 1.65% |
| Total investment securities | $ 303,879 | $ 348,933 |
| Average interest rate | 0.49% | 1.35% |

*Equity Investment Risk:*

We have invested in several privately-held companies as well as investment funds which invest primarily in privately held companies, many of which can still be considered in the start-up or development stages. These investments are inherently risky, as the market for the technologies or products they have under development is typically in the early stages and may never materialize.

*Foreign Exchange Rate Risk:*

As a multinational company, we conduct our business in a wide variety of currencies and are therefore subject to market risk for changes in foreign exchange rates. We expect to continue to expand our business globally and, as such, expect that an increasing proportion of our business may be denominated in currencies other than U.S. Dollars. As a result, fluctuations in foreign currencies may have a material impact on our business, results of operations and financial condition.

Historically, the majority of our foreign-currency denominated sales have been made in China, denominated in Renminbi. Additionally, during 2006, 2007 and through 2008, we made significant sales in Japanese Yen, Euros, Indian Rupees and Canadian Dollars. Due to China's currency exchange control regulations, we are limited in our ability to convert and repatriate Renminbi, as well as in our ability to engage in foreign currency hedging activities in China. The balance of our cash and cash equivalents held in China was $131.2 million at December 31, 2009. Since China un-pegged the Renminbi from the U.S. Dollar in July 2005 through December 31, 2009, the Renminbi has strengthened by more than 15% versus the U.S. Dollar. However, it is uncertain what further adjustments may be made in the future.

We may manage foreign currency exposures using forward and option contracts to hedge and thus minimize exposure to the risk of the eventual net cash inflows and outflows resulting from foreign currency denominated transactions with customers, suppliers, and non-U.S. subsidiaries; however, we are not currently hedging any such transactions. As our foreign currency balances are not currently hedged, any significant revaluation of our foreign currency exposures may materially and adversely affect our business, results of operation and financial condition. We do not enter into foreign exchange forward or option contracts for trading purposes.

Given our exposure to international markets, we regularly monitor all of our material foreign currency exposures. We use sensitivity analysis to measure our foreign currency risk by computing the potential decrease in cash flows that may result from adverse or beneficial changes in foreign exchange rates, relative to the functional currency with all other variables held constant. The analysis covers all of our underlying exposures for foreign currency denominated financial instruments. The foreign currency exchange rates used were based on market rates in effect at December 31, 2009. The sensitivity analysis indicated that a hypothetical 10% adverse or beneficial movement in exchange rates would have resulted in a loss or gain in the fair values of our foreign currency denominated financial instruments of $18.7 million at December 31, 2009.

Table of Contents

## ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL STATEMENT SCHEDULES


| | Page |
|---|---|
| Financial Statements: | |
| Report of Independent Registered Public Accounting Firm | 88 |
| Consolidated Balance Sheets at December 31, 2009 and 2008 | 90 |
| Consolidated Statements of Operations for the years ended December 31, 2009, 2008 and 2007 | 91 |
| Consolidated Statements of Stockholders' Equity for the years ended December 31, 2009, 2008 and 2007 | 92 |
| Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007 | 93 |
| Notes to Consolidated Financial Statements | 94 |
| Quarterly Financial Data (Unaudited) | 149 |
| Financial Statement Schedules: | |
| I Condensed Financial Information of Registrant | 164 |
| II Valuation and Qualifying Accounts and Reserves | 168 |


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

Table of Contents

**Report of Independent Registered Public Accounting Firm**

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

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of UTStarcom, Inc. and its subsidiaries at December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the accompanying index present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also, in our opinion, the Company did not maintain, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") because material weaknesses in internal control over financial reporting related to 1) the lack of effective controls over estimating and recording the reserves for losses on customer contracts, 2) the lack of effective controls over the appropriate and timely analysis and monitoring of the underlying information related to period end financial reporting process and preparation of consolidated financial statements, and 3) the lack of effective controls over the recording and review of revenue and deferred revenue accounts and associated cost of sales, existed as of that date. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The material weaknesses referred to above are described in Management's Annual Report on Internal Control over Financial Reporting appearing under Item 9A. We considered these material weaknesses in determining the nature, timing, and extent of audit tests applied in our audit of the latest year consolidated financial statements, and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in management's report referred to above. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the Company changed the manner in which it accounts for noncontrolling interests in 2009.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the

maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

/s/ PricewaterhouseCoopers Zhong Tian CPAs Limited Company
Shanghai, the People's Republic of China
March 16, 2010

Table of Contents

**UTSTARCOM, INC.**

**CONSOLIDATED BALANCE SHEETS**

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| | (In thousands, except par value) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 265,843 | $ 309,603 |
| Short-term investments | 1,038 | 4,262 |
| Accounts receivable, net of allowances for doubtful accounts of $26,065 and $37,359, respectively | 42,346 | 158,376 |
| Notes receivable | 1,427 | 11,120 |
| Inventories | 72,300 | 189,832 |
| Deferred costs | 130,453 | 114,884 |
| Prepaids and other current assets | 47,906 | 127,675 |
| Short-term restricted cash | 26,448 | 16,840 |
| Total current assets | 587,761 | 932,592 |
| Property, plant and equipment, net | 130,612 | 175,287 |
| Long-term investments | 8,402 | 17,691 |
| Long-term deferred costs | 184,978 | 149,258 |
| Long-term deferred tax assets | 4,822 | 13,464 |
| Other long-term assets | 12,536 | 22,514 |
| Total assets | $ 929,111 | $ 1,310,806 |
| **LIABILITIES AND EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 54,115 | $ 176,384 |
| Income taxes payable | 1,130 | 7,162 |
| Customer advances | 120,364 | 144,700 |
| Deferred revenue | 170,777 | 117,584 |
| Deferred tax liabilities | 3,890 | 11,644 |
| Other current liabilities | 142,894 | 163,046 |
| Total current liabilities | 493,170 | 620,520 |
| Long-term deferred revenue | 160,932 | 210,050 |
| Other long-term liabilities | 18,858 | 12,594 |
| Total liabilities | 672,960 | 843,164 |
| Commitments and contingencies (Note 12) | | |
| UTStarcom, Inc. stockholders' equity: | | |
| Common stock: $0.00125 par value; 750,000 authorized shares; 130,095 and 126,566 shares issued and outstanding at December 31, 2009 and December 31, 2008, respectively | 153 | 152 |
| Additional paid-in capital | 1,251,532 | 1,239,074 |
| Accumulated deficit | (1,067,174) | (841,486) |
| Accumulated other comprehensive income | 70,848 | 69,094 |
| Total UTStarcom, Inc. stockholders' equity | 255,359 | 466,834 |
| Noncontrolling interests | 792 | 808 |

| | | | | |
|---|---|---|---|---|
| Total equity | | 256,151 | | 467,642 |
| Total liabilities and equity | $ | 929,111 | $ | 1,310,806 |

See accompanying notes to consolidated financial statements.

Table of Contents

**UTSTARCOM, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

| | Years ended December 31, | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | (In thousands, except per share amounts) | | |
| Net sales | | | |
| Products | $ 323,387 | $ 1,582,538 | $ 2,413,756 |
| Services | 62,957 | 57,911 | 53,214 |
| | 386,344 | 1,640,449 | 2,466,970 |
| Cost of net sales | | | |
| Products | 284,238 | 1,338,703 | 2,101,228 |
| Services | 37,127 | 40,504 | 44,291 |
| Gross profit | 64,979 | 261,242 | 321,451 |
| (See Note 15 for net sales and cost of net sales to related parties included above) | | | |
| Operating expenses: | | | |
| Selling, general and administrative | 140,742 | 257,559 | 319,145 |
| Research and development | 63,243 | 143,291 | 168,275 |
| Amortization of intangible assets | | 4,111 | 15,961 |
| Impairment of goodwill and other long-lived assets | 33,287 | 27,220 | 19,912 |
| Restructuring | 46,495 | 13,059 | 14,474 |
| Net gain on divestitures | (100) | (7,782) | (4,271) |
| Total operating expenses | 283,667 | 437,458 | 533,496 |
| Operating loss | (218,688) | (176,216) | (212,045) |
| Interest income | 2,093 | 7,491 | 14,460 |
| Interest expense | (552) | (10,439) | (32,676) |
| Other income, net | 2,303 | 35,427 | 64,796 |
| Loss before income taxes | (214,844) | (143,737) | (165,465) |
| Income tax expense | (10,860) | (7,087) | (32,898) |
| Net loss | (225,704) | (150,824) | (198,363) |
| Net loss attributable to noncontrollng interests | 16 | 508 | 2,788 |
| Net loss attributable to UTStarcom, Inc. | $ (225,688) | $ (150,316) | $ (195,575) |
| Net loss per share attributable to UTStarcom, Inc. Basic and Diluted | $ (1.77) | $ (1.22) | $ (1.62) |
| Weighted average shares outstanding Basic and Diluted | 127,346 | 123,490 | 121,059 |

See accompanying notes to consolidated financial statements.

Table of Contents

**UTSTARCOM INC.**
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

| | Common Stock | | | | Accumulated Other | Treasury Stock | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Additional Paid-in-Capital | (Accumulated Deficit) | Comprehensive Income | Shares | Amount | Non-controlling interest | Comprehensive Income | Total Stockholders' Equity |
| | (In thousands, except number of shares) | | | | | | | | | |
| **Balance at December 31, 2006** | **121,299,113** | **$ 152** | **$ 1,205,592** | **$ (494,244)** | **$ 62,899** | **(4,468)** | **$ (39)** | **$ 6,493** | | **$ 780,853** |
| Cumulative adjustment to reduce beginning retained earnings upon adoption of ASC 740 | | | | (1,351) | | | | | | (1,351) |
| Common stock issued upon exercise of options | 2,246 | | | | | | | | | |
| Restricted stock issued and restricted stock units released | 2,707,132 | | | | | | | | | |
| Stock-based compensation | | | 12,792 | | | | | | | 12,792 |
| Repurchases of vested restricted stock/units and cancellation | (541,287) | | (1,693) | | | 4,468 | 39 | | | (1,654) |
| Net loss | | | | (195,575) | | | | (2,788) | $ (198,363) | (198,363) |
| Other comprehensive income: | | | | | | | | | | |
| Unrealized gain on available-for-sale securities (net of tax of $8,396) | | | | | 51,667 | | | | 51,667 | 51,667 |
| Realization of previously unrealized gains (net of tax of $5,371) | | | | | (48,338) | | | | (48,338) | (48,338) |
| Foreign currency translation (net of tax of $347) | | | | | 26,075 | | | | 26,075 | 26,075 |
| Total comprehensive loss | | | | | | | | | $ (168,959) | (168,959) |
| **Balance at December 31, 2007** | **123,467,204** | **$ 152** | **$ 1,216,691** | **$ (691,170)** | **$ 92,303** | | **$** | **$ 3,705** | | **$ 621,681** |
| Common stock issued upon ESPP purchases and option exercises | 796,596 | | 1,741 | | | | | | | 1,741 |
| Restricted stock issued and restricted stock units released | 3,125,094 | | | | | | | | | |
| Restricted stock cancellation | (822,500) | | | | | | | | | |
| Stock-based compensation | | | 20,642 | | | | | | | 20,642 |
| Liquidation of ownership interest in a variable interest entity | | | | | | | | (2,389) | | (2,389) |
| Net loss | | | | (150,316) | | | | (508) | $ (150,824) | (150,824) |
| Other comprehensive income: | | | | | | | | | | |
| Unrealized (loss) on available-for-sale securities (net of tax benefit of $217) | | | | | (2,353) | | | | (2,353) | (2,353) |
| Realization of previously unrealized gains (net of tax of $3,243) | | | | | (36,909) | | | | (36,909) | (36,909) |
| Realization of previously unrealized foreign currency translation (net of tax of $0) | | | | | (3,670) | | | | (3,670) | (3,670) |
| Foreign currency translation (net of tax benefit of $140) | | | | | 19,723 | | | | 19,723 | 19,723 |
| Total comprehensive loss | | | | | | | | | $ (174,033) | (174,033) |
| **Balance at December 31, 2008** | **126,566,394** | **$ 152** | **$ 1,239,074** | **$ (841,486)** | **$ 69,094** | | **$** | **$ 808** | | **$ 467,642** |
| Common stock issued upon ESPP purchases and option exercises | 280,609 | 1 | 364 | | | | | | | 365 |
| Restricted stock issued and restricted stock units released | 3,463,240 | | | | | | | | | |
| Restricted stock cancellation | (215,254) | | | | | | | | | |
| Stock-based compensation | | | 12,094 | | | | | | | 12,094 |
| Net loss | | | | (225,688) | | | | (16) | $ (225,704) | (225,704) |
| Other comprehensive income: | | | | | | | | | | |
| Realization of previously unrealized losses (net of tax of $0) | | | | | 3,313 | | | | 3,313 | 3,313 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Realization of previously unrealized foreign currency translation (net of tax of $0) | | | | | 2,164 | | | 2,164 | 2,164 |
| Foreign currency translation (net of tax expense of $11) | | | | | (3,723) | | | (3,723) | (3,723) |
| Total comprehensive loss | | | | | | | | $ (223,950) | (223,950) |
| **Balance at December 31, 2009** | **130,094,989** | **$ 153** | **$ 1,251,532** | **$ (1,067,174)** | **$ 70,848** | **$** | **$ 792** | | **$ 256,151** |

See accompanying notes to consolidated financial statements.

Table of Contents

**UTSTARCOM, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Years ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | (In thousands) | | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net loss | $ (225,704) | $ (150,824) | $ (198,363) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | | |
| Depreciation and amortization | 13,135 | 38,018 | 57,392 |
| Gain on sale of investments and liquidation of ownership interest in a variable interest entity | (355) | (48,375) | (53,709) |
| Net gain on divestitures | (100) | (7,782) | (4,271) |
| Net (gain) loss on disposal of assets | (686) | | 4,204 |
| Net gain on long term investment | | | (6,223) |
| Impairment of goodwill and other long-lived assets | 33,325 | 27,220 | 19,912 |
| Impairment of equity investments and variable interest entity | 6,456 | 4,307 | |
| Stock-based compensation expense | 12,094 | 20,565 | 12,792 |
| Recovery for doubtful accounts | (6,757) | (5,227) | (8,664) |
| Deferred income taxes | 904 | (6,440) | 11,908 |
| Other | | | 1,140 |
| Changes in operating assets and liabilities, excluding impact of divestitures: | | | |
| Accounts receivable | 123,314 | 58,869 | 93,877 |
| Inventories and deferred costs | 72,816 | 15,825 | 121,169 |
| Other assets | 83,050 | (2,697) | (21,183) |
| Accounts payable | (127,702) | 128,921 | (172,030) |
| Income taxes payable | (1,665) | 4,558 | 9,281 |
| Customer advances | (29,154) | (64,941) | (48,142) |
| Deferred revenue | 4,177 | (13,796) | (40,718) |
| Other liabilities | (24,596) | (53,365) | (3,465) |
| Net cash used in operating activities | (67,448) | (55,164) | (225,093) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Additions to property, plant and equipment | (2,012) | (14,214) | (27,324) |
| Deposit received on pending sale of building | 7,307 | | |
| Net proceeds from divestitures | 11,508 | 214,051 | 4,271 |
| Proceeds from disposition of an investment interest, net | 2,639 | 33,429 | 57,781 |
| Proceeds from repayment of loan by a variable interest entity | | 7,728 | |
| Change in restricted cash | (1,973) | (8,216) | 6,591 |
| Purchase of short-term investments | (6,945) | (13,816) | (37,935) |
| Proceeds from sale of short-term investments | 10,159 | 26,723 | 25,359 |
| Other | 635 | 361 | 695 |
| Net cash provided by investing activities | 21,318 | 246,046 | 29,438 |

| | | | |
|---|---|---|---|
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Issuance of stock, net of expenses | 367 | 1,741 | |
| Change in bank overdrafts | (755) | (6,248) | 5,584 |
| Proceeds from borrowings | | 50,000 | 97,852 |
| Payments on borrowings | | (375,317) | (159,457) |
| Repurchase of common stock | | | (1,654) |
| Other | | (2,788) | (430) |
| Net cash used in financing activities | (388) | (332,612) | (58,105) |
| Effect of exchange rate changes on cash and cash equivalents | 2,758 | 13,884 | 29,586 |
| Net decrease in cash and cash equivalents | (43,760) | (127,846) | (224,174) |
| Cash and cash equivalents at beginning of year | 309,603 | 437,449 | 661,623 |
| Cash and cash equivalents at end of year | $ 265,843 | $ 309,603 | $ 437,449 |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid: | | | |
| Interest | $ 552 | $ 20,552 | $ 21,954 |
| Income taxes | $ 9,243 | $ 7,547 | $ 11,953 |
| Non-cash operating activities | | | |
| Accounts receivable transferred to notes receivable | $ 2,867 | $ 22,742 | $ 26,314 |

See accompanying notes to the consolidated financial statements.

Table of Contents

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### NOTE 1 BASIS OF PRESENTATION AND LIQUIDITY

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

The accompanying consolidated financial statements include the accounts of the Company and its wholly-and majority-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in the preparation of the consolidated financial statements. The noncontrolling interests in consolidated subsidiaries are shown separately in the consolidated financial statements. Certain reclassifications have been made to prior period amounts to conform to current period presentation. Such reclassifications have no effect on net income as previously reported.

The accompanying consolidated balance sheets as of December 31, 2009 and 2008, and consolidated statements of operations for each of the three years in the period ended December 31, 2009 have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and in conformity with generally accepted accounting principles in the United States of America ("GAAP").

The accompanying consolidated financial statements are presented on the basis that the Company is a going concern. The going concern assumption contemplates the realization of assets and the satisfaction of liabilities in the normal course of business.

The Company has incurred net losses attributable to UTStarcom, Inc. of $225.7 million, $150.3 million and $195.6 million during the years ended December 31, 2009, 2008 and 2007, respectively. The Company has recorded operating losses in 19 of the 20 consecutive quarters in the period ended December 31, 2009. At December 31, 2009, the Company had an accumulated deficit of $1,067.2 million. The Company incurred net cash outflows from operations of $67.4 million, $55.2 million and $225.1 million in 2009, 2008 and 2007 respectively. While operating results are expected to improve in 2010 compared with prior years, management expects the Company to continue to incur losses in 2010. At December 31, 2009, the Company had cash and cash equivalents of $265.8 million, of which $131.2 million was held by subsidiaries in China. China imposes currency exchange controls on certain transfers of funds from/to China. The amount of cash available for transfer from the China subsidiaries for use by the Company's non-China subsidiaries is limited both by the liquidity needs of the subsidiaries in China and the restriction on currency exchange by Chinese-government mandated limitations including currency exchange controls on certain transfers of funds outside of China.

During 2009, approximately $322.1 million in credit facilities in China expired and were not renewed. At December 31, 2009, the Company had no available credit facilities. Management is not certain that new credit facilities will be available on commercially reasonable terms or at all. Even if new facilities are entered into, the total available credit may be lower than previously available amounts.

Global economies have experienced a significant downturn driven by a financial and credit crisis that will continue to challenge such economies for some period of time. Under the current macroeconomic environment, there are significant risks and uncertainties inherent in management's

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 1 BASIS OF PRESENTATION AND LIQUIDITY (Continued)**

ability to forecast future results. The operating environment confronting the Company, both internally and externally, raises significant uncertainties.

In 2009 and 2008, the Company took a number of actions to improve its liquidity. In March 2008, the Company paid $289.5 million to retire the Company's convertible subordinated notes and related accrued interest. On July 1, 2008, the Company completed the sale of PCD, see Note 3. In addition, the Company divested its Mobile Solutions Business Unit in July 2008. In the fourth quarter of 2008, management initiated actions to disband its Customs Solutions Business Unit, to wind down the Company's Korea based handset operations, and announced initiatives including efforts to eliminate functional duplications by consolidation of a number of functions into the Company's China operations. In June 2009, management expanded the initiatives to include a worldwide reduction in workforce, outsourcing of manufacturing operations and optimizing research and development spending with a focus on selected products. The Company's year-to-year quarterly selling, general and administrative and research and development operating expenses decreased significantly in 2009 compared with 2008 and management believes the continuing efforts to stream-line operations will enable the Company's fixed cost base to be better aligned with operations, market demand and projected sales levels. If projected sales do not materialize, the Company will need to take further actions to reduce costs and expenses or explore other cost reduction options.

In December 2009, the Company entered into a Property Transfer and Leaseback Agreement (the "Sale Leaseback Agreement") for the intended sale of its manufacturing, research and development, and administrative offices facility in Hangzhou, China to another third party for approximately $140 million and leaseback of a portion of the facility. To date, the Company has received proceeds of approximately $13.9 million on the transaction. On March 8, 2010, the Company obtained an irrevocable bank guarantee letter from the buyer for the remaining amount of the cash proceeds from the Sale Leaseback Agreement.

On February 1, 2010, the Company entered into agreements for a strategic relationship with Beijing E-town International Investment and Development Co., Ltd ("BEIID") which includes an investment of $48.5 million in the Company's common stock by BEIID, and two unrelated investment funds, Elite Noble Limited and Shah Capital Opportunity Fund LP. These agreements are expected to close between the end of March and April 2010 and will provide additional cash for working capital and general purposes.

Management believes both the Company's China and non-China operations will have sufficient liquidity to finance working capital and capital expenditure needs during the next 12 months. If the Company is not able to execute its plan successfully, the Company may need to obtain funds from equity or debt financings. There can be no assurance that additional financing, if required, will be available on terms satisfactory to the Company or at all, and if funds are raised in the future through issuance of preferred stock or debt, these securities could have rights, privileges or preference senior to those of the Company's common stock and newly issued debt could contain debt covenants that impose restrictions on the Company's operations. Further, any sale of newly issued debt or equity securities could result in additional dilution to the Company's current shareholders.

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Use of Estimates:*

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates are used for revenue recognition, allowance for doubtful accounts and sales returns, tax valuation allowances, reserves for inventory, deferred costs, accrued product warranty costs, provisions for contract losses, recoverability of goodwill and intangible assets, other long-lived asset impairments, stock-based compensation expense, loss contingencies and restructuring expenses among others. Actual results could differ materially from those estimates.

*Cash and Cash Equivalents:*

Cash and cash equivalents consist of highly liquid instruments with original maturities of three months or less. Approximately 26% of cash and cash equivalents is held in the U.S. as of December 31, 2009. The remainder is held by the other UTStarcom entities throughout the world. At December 31, 2009, $131.2 million of the Company's cash and cash equivalents were held by its subsidiaries in China and China imposes currency exchange controls on transfers of funds outside of China. Cash and cash equivalents are invested in institutional money market funds, short-term bank deposits and similar short duration instruments with fixed maturities from overnight to three months.

*Restricted Cash:*

At December 31, 2009, the Company had short-term restricted cash of $26.4 million, and had long-term restricted cash of $10.6 million included in other long-term assets. At December 31, 2008, the Company had short-term restricted cash of $16.8 million, and had long-term restricted cash of $18.2 million included in other long-term assets. These amounts primarily collateralize the Company's issuances of standby and commercial letters of credit.

*Investments:*

The Company's investments consist principally of bank notes and equity securities of publicly traded and privately held companies. The Company's investments in publicly traded equity securities are accounted for under ASC 320, "Investment, Debt and Equity Securities" and are classified as available-for-sale. These investments are recorded at fair value with the unrealized gains and losses included as a separate component of accumulated other comprehensive income, net of tax. During 2009, the Company sold its remaining investment in publicly traded equity securities. The investments in equity securities of privately held companies in which the Company holds less than 20% voting interest and on which the Company does not have the ability to exercise significant influence are accounted for under ASC 325, "Investments-Other" using the cost method. Under the cost method, these investments are carried at the lower of cost or fair market value.

The Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. In making this determination, the Company reviews several factors to determine whether the losses are other-than-temporary, including but not limited to: (i) the length of time the investment was in an unrealized loss position, (ii) the extent to which fair value was less than cost, (iii) the financial condition and near term prospects of the issuer

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

and (iv) the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in fair value.

*Revenue Recognition:*

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

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

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

Where multiple elements exist in an arrangement that includes software, and the software is considered more than incidental to the equipment or services in the arrangement, software and software related elements are recognized in accordance with the specific guidance for recognizing software revenue. The Company allocates revenues to each element of software arrangements based on vendor specific objective evidence ("VSOE") of fair value. VSOE of fair value of each element is based on the price charged when the same element is sold separately. The Company uses the residual method to recognize revenue when an arrangement includes one or more elements to be delivered at a future date and VSOE of the fair value of all the undelivered elements exists. Under the residual method, the fair value of the undelivered elements is deferred and the remaining portion of the contract price is recognized as revenue when all other revenue recognition criteria are met. If VSOE of fair value of one or more undelivered elements does not exist, all revenue for delivered and undelivered elements is

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

deferred until delivery of all elements occurs or when VSOE of fair value of the undelivered elements can be established. In some cases the Company has agreed to give software upgrade rights on a "when and if made available" basis for equipment sold for no additional consideration and for an unspecified period which could extend over the term of the contract. This additional contract obligation is an element of "post-contract support." The Company has not established VSOE for such contract element. Accordingly, the revenues from such contracts are recognized ratably over the period during which the post-contract support is expected to be provided. The expected period of support is generally the term of the contract. In some cases where there is no stated contractual term, revenue is recognized ratably over the estimated period of support. The Company reviews assumptions regarding the estimated post contract support periods on a regular basis. If the Company determines that it is necessary to revise the Company's estimates of the support periods, the amount of revenue recognized over the life of the contract would not be affected. However, to the extent the new assumptions regarding the post-contract support periods were different from the original assumptions, the contract revenues would be recognized over the remaining expected period of support. Due to the China telecommunication industry restructuring and launch of 3G services in China, the Ministry of Industry and Information Technology of China announced that PAS services in China will be phased out by January 1, 2012. In the second and third quarter of 2009, the Company streamlined its sales, service and research and development operations for PAS handsets and infrastructure equipment. The Company does not perform any new research and development of PAS products and it maintains a small support team to assist its customers with warranty matters. In the later part of the third quarter 2009 and early part of the fourth quarter 2009, the Company contacted its PAS infrastructure customers and held discussions with them on the PAS products future. In October 2009, the Company notified its PAS infrastructure customers in China that it will no longer provide upgrades or support of PAS products beyond December 31, 2011. Consequently, the Company determined the remaining expected period of support as 2 years and hence deferred revenue associated with PAS infrastructure is being recognized ratably beginning in the fourth quarter of 2009 through the fourth quarter of 2011. As of December 31, 2009, we have approximately $186.4 million of deferred revenue associated with PAS infrastructure sales for which we accelerated the amortization period of support.

Revenue from fixed priced contracts that include a requirement for significant software modification or customization is recognized using the completed contract method of accounting, whereby no revenue is recognized prior to the completion of the project, because for contracts involving unique requirements the Company is unable to make reasonably dependable estimates of progress towards meeting contractual requirements. In the event estimated total project costs exceed estimated total project revenues, the entire estimated loss is charged to operations in the period in which the loss becomes probable and can be reasonably estimated. The complexity of the estimation process and judgments about internal and external factors including labor utilization, changes to specifications and testing requirements, time required for performance and resulting incurrence of contract penalties, and the performance of subcontractors affect the estimation process. During the years ended December 31, 2009, 2008 and 2007, the Company recorded approximately $4.9 million, $18.4 million and $6.2 million contract loss on a fixed price contract, respectively. Contract loss recorded during 2008 includes $3.4 million relating to costs that should have been recorded in prior periods. The impact of recording these prior-period costs on the prior and current periods is not material.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

The Company recognizes revenue for system integration, installation and training upon completion of performance and if all other revenue recognition criteria are met. Other service revenue, principally related to maintenance and support contracts, is recognized ratably over the maintenance term.

The Company also sells products through resellers. Revenue is generally recognized when the standard price protection period, which ranges from 30 to 90 days, has lapsed. If collectability cannot be reasonably assured in a reseller arrangement, revenue is recognized upon sell-through to the end customer and receipt of cash. There may be additional obligations in reseller arrangements such as inventory rotation, or stock exchange rights on the product. In most cases, the Company has developed reasonable estimates for stock exchanges based on historical experience with similar types of sales of similar products.

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

The assessment of collectability is also a factor in determining whether revenue should be recognized. The Company assesses collectability based on a number of factors, including payment history and the credit-worthiness of the customer. The Company does not request collateral from its customers. In international sales, the Company may require letters of credit from its customers that can be drawn on demand if the customer defaults on its payment. If the Company determines that collection of a payment is not reasonably assured, the Company defers revenue recognition until collection becomes reasonably assured, which is generally upon receipt of cash.

Occasionally, the Company enters into revenue sharing arrangements. Under these arrangements, the Company collects payment only after its customer, the telecommunications service provider, collects service revenues. When the Company enters into a revenue sharing arrangement, the Company does not recognize revenue until collection is reasonably assured.

Because of the nature of doing business in China and other emerging markets, the Company's billings and/or customer payments may not correlate with the contractual payment terms and the Company generally does not enforce contractual payment terms prior to final acceptance. Accordingly, accounts receivable are not recorded until the Company recognizes the related customer revenue. Advances from customers are recognized when the Company has collected cash from the customer, prior to recognizing revenue. Deferred revenue is recorded if there are undelivered elements after final acceptance has been obtained. The Company had current deferred revenue of $170.8 million and $117.6 million, and long-term deferred revenue of $160.9 million and $210.1 million at December 31, 2009 and 2008, respectively. Costs related to deferred revenue are also deferred until revenue is recognized. See "Deferred Costs" below.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Product Warranty:*

The Company provides a warranty on its equipment and handset sales for a period generally ranging from one to two years from the time of final acceptance. At times, the Company has entered into arrangements to provide limited warranty services for periods longer than two years. The Company provides for the expected cost of product warranties at the time that revenue is recognized based on an assessment of past warranty experience and when specific circumstances dictate. The Company assesses the adequacy of its recorded warranty liability every quarter and makes adjustments to the liabilities if necessary. From time to time, the Company may be subject to additional costs related to non-standard warranty claims from its customers. If and when this occurs, the Company estimates additional accruals based on historical experience, communication with its customers and various assumptions that the Company believes to be reasonable under the circumstances. Such additional warranty accruals are recorded in the period in which the additional costs are identified.

*Receivables:*

Although the Company evaluates customer credit worthiness prior to a sale, the Company provides an allowance for doubtful accounts for the estimated loss on trade and notes receivable when collection may no longer be reasonably assured. The Company assesses collectability of receivables based on a number of factors including analysis of creditworthiness, the Company's historical collection history and current economic conditions, its ability to collect payment and on the length of time an individual receivable balance is outstanding. The Company's policy for determining the allowance for doubtful accounts includes both specific allowances for balances known to be uncollectible and a formula-based portfolio approach, based on aging of the accounts receivable, as a precursor to a management review of the overall allowance for doubtful accounts. This formula-based approach involves aging of the Company's accounts receivable and applying a percentage based on the Company's historical experience; this approach results in the allowance being computed based on the aging of the receivables. The Company evaluates the percentages applied to each category of aged accounts receivable periodically based on actual history of write-offs and collections and refines this formula-based approach accordingly for use in future periods.

The Company has certain accounts receivable in China that have been outstanding for a significant period of time. The Company provides allowances for these receivables based on the criteria discussed above. While the Company believes it has sufficient experience and knowledge of the China market and customer payment patterns to reasonably estimate such allowances, actual payment patterns and customer behavior could differ from its expectations. The Company uses actual collection experience to periodically adjust the percentages used in applying the formula-based portfolio approach as discussed above.

*Inventories:*

Inventories consist of product held at the Company's manufacturing facility and warehouses, as well as finished goods at customer sites for which the customer has taken possession, but based on specific contractual terms, title has not yet passed to the customer. The Company may ship inventory to existing customers that require additional equipment to expand their existing networks prior to the signing of an expansion contract. Inventories are stated at the lower of cost or market value, based on the FIFO method of accounting. Write-downs are based on the assumptions about future market conditions and customer demand, including projected changes in average selling prices resulting from

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2  SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

competitive pricing pressures. The Company continually monitors inventory valuation for potential losses and obsolete inventory at its manufacturing facilities as well as at customer sites. If actual market conditions are less favorable than those projected by management, additional write-downs may be required. If actual market conditions are more favorable than anticipated, inventory previously written down may be sold to customers, resulting in lower cost of sales and higher income from operations than expected in that period.

*Deferred costs:*

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

For any post contract support services where the revenue is deferred, the entire related deferred direct costs are classified as a noncurrent asset, consistent with the definition of a current asset.

*Research and Development and Capitalized Software Development Costs:*

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

During 2009, 2008 and 2007, the Company capitalized immaterial software development costs. Amortization of capitalized software development costs was $0.2 million, $0.6 million and $1.0 million in 2009, 2008 and 2007, respectively. Direct costs of software developed for internal use are expensed during the preliminary project stage and capitalized during the application development stage.

*Property, Plant and Equipment:*

Property, plant and equipment are recorded at cost and are stated net of accumulated depreciation. Depreciation is provided for on a straight-line basis over the estimated useful lives of the related assets. Land use rights related to property leased by the Company in China are amortized over the life of the lease. Leasehold improvements are amortized on a straight-line basis over the shorter of the useful life of the improvements or the term of the lease. When assets are disposed of, the cost and related accumulated depreciation are removed from the accounts and the resulting gains or losses are included in results of operations. The Company capitalizes interest incurred related to construction of

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

property, plant or equipment until it is ready for use. No capitalized interest was recorded during the years ended December 31, 2009, 2008 and 2007. Capitalized interest primarily arose from construction of the Company's manufacturing, research and development, and administrative offices facility in Hangzhou, China and is being amortized on a straight-line basis over the life of the building.

The Company generally depreciates its assets over the following periods:

| | Years |
|---|---|
| Furniture, test or manufacturing equipment | 5 |
| Computers and software | 2 - 3 |
| Buildings | 38 |
| Automobiles | 5 |
| Land use rights | 38 |
| Leasehold improvements | Lesser of 5 years or remaining lease life |

Depreciation expense was $12.8 million, $30.4 million and $39.2 million for the years ended December 31, 2009, 2008 and 2007, respectively.

*Long-Lived Assets Including Finite-Lived Purchased Intangible Assets:*

The Company amortizes purchased intangible assets with finite lives over the estimated economic lives of the assets. Purchased intangible assets are carried at cost, less accumulated amortization.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If undiscounted expected future cash flows are less than the carrying value of the assets, an impairment loss is recognized based on the excess of the carrying amount over the fair value of the assets. See Note 6. Long-lived assets that are to be disposed of by sale are measured at the lower of book value or fair value less cost to sell.

As a result of amortization, asset sales, and impairment charges of approximately $4.9 million and $15.7 million in 2008 and 2007, respectively, the Company's consolidated balance sheet as of December 31, 2009 and 2008 contained no balances for finite-lived purchased intangible assets.

*Advertising Costs:*

The Company expenses all advertising costs as incurred. Payment to customers for marketing development costs are accounted for as a reduction of the revenue associated with customers as incurred. For the years ended December 31, 2009, 2008 and 2007, advertising costs totaled $0.8 million, $4.3 million and $7.4 million, respectively.

*Restructuring Liabilities, Litigation and Other Contingencies:*

The Company accounts for its restructuring plans using the guidance provided in ASC 420 "Exit or Disposal Cost Obligations" and ASC 712 "Compensation Nonretirement Postemployment Benefits". The Company accounts for litigation and contingencies in accordance with ASC 450, "Contingencies", which requires that the Company record an estimated loss from a loss contingency when information available prior to issuance of the Company's financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated.

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*Third Party Commissions:*

The Company records accruals for commissions payable to third parties as operating expense in the period in which the liability is incurred. Management performs follow-up procedures with respect to these accrued commission and upon completion of such follow-up procedures, if the accrued commissions have not been claimed and the statute of limitations, if any, has expired or a reasonable period of time has elapsed, reduces such accruals. These reductions are recorded in the consolidated statement of operations during the period management determines that certain accruals are no longer necessary. As of December 31, 2009, approximately $6.4 million of such accrued commissions had not been claimed by the third parties for more than three years. During the years ended December 31, 2009 and 2008, respectively, we reduced approximately $0.8 million and $4.5 million of accrued commissions payable and such reduction was recorded in cost of net sales. During the year ended December 31, 2007, no significant accruals related to third party commissions were reversed.

*Stock-Based Compensation:*

Stock-based compensation expense for all share-based payment awards granted is determined based on the grant-date fair value. Stock-based compensation expense for restricted stock awards is measured based on the closing fair market value of the Company's common stock on the date of grant. Stock-based compensation expense for stock options is estimated at the grant date based on each option's fair value as calculated by the Black-Scholes option pricing model ("Black-Scholes model"). Stock-based compensation is expensed ratably on a straight-line basis over the requisite service period, which is generally the vesting term of the share-based payment awards.

*Accumulated Other Comprehensive Income:*

Comprehensive income includes all changes in equity (net assets) during a period from non-owner sources. Other comprehensive income or loss for 2009, 2008 and 2007 is shown in the consolidated statement of stockholders' equity. As of December 31 of each of the years indicated below, the components of accumulated other comprehensive income reported in the consolidated balance sheets were as follows:

| | December 31 | |
|---|---|---|
| | 2009 | 2008 |
| | (in thousands) | |
| Unrealized gain (loss) on available-for-sale securities, net of tax | | $ (3,313) |
| Foreign currency translation, net of tax | $ 70,848 | 72,407 |
| Accumulated other comprehensive income | $ 70,848 | $ 69,094 |

Accumulated other comprehensive income includes no material amounts related to noncontrolling interests.

*Income Taxes:*

The Company is subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating the Company's tax positions and determining its provision for income taxes. During the ordinary course of business, there are many transactions and calculations for which the ultimate tax determination is uncertain. The Company

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

recognizes the tax benefit (expense) from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The Company recognizes interest expense and penalties related to income tax matters as part of the provision for income taxes.

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

The Company provides U.S. taxes on foreign undistributed earnings that are not considered to be permanently reinvested outside the United States.

*Financial Instruments and Derivatives:*

Financial instruments consist of cash and cash equivalents, short and long-term investments, notes receivable, accounts receivable and payable and accrued liabilities. In the first quarter of 2008, the Company adopted new accounting guidance related to fair value measurements. This new accounting guidance did not have a material impact on the financial statements of the Company. The new disclosures required by the accounting guidance are included in Note 4. The carrying amounts of cash and cash equivalents, bank notes, accounts receivable and payable, notes receivable, and accrued liabilities approximate their fair values because of the short-term nature of those instruments. The fair value of long term investments in equity securities is determined based on quoted market prices or available information about investees.

The Company may use derivative financial instruments to manage its exposures to foreign currency exchange rate changes. The objectives for holding derivatives include reducing, eliminating, and efficiently managing the economic impact of these exposures as effectively as possible. Derivative instruments are recognized as either assets or liabilities on the balance sheet. The Company measures those instruments at fair value and recognizes changes in the fair value of derivatives in earnings in the period of change unless the derivative qualifies as an effective hedge that offsets certain exposures. Such contracts are designated at inception to the related foreign currency exposures being hedged. The Company has not hedged any such transactions in 2009, 2008 and 2007.

*Foreign Currency Translation:*

The Company's operations are conducted through international subsidiaries where the local currency is the functional currency and the financial statements of those subsidiaries are translated from their respective functional currencies into U.S. dollars. All foreign currency assets and liabilities are translated at the period-end exchange rate and all revenues and expenses are translated at the average exchange rate for the period. The effects of translating the financial statements of foreign subsidiaries into U.S. dollars are reported as a cumulative translation adjustment, a separate component of comprehensive income in stockholders' equity. The foreign currency translation gain/loss for transactions denominated in other than the functional currency is included in other income, net on

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

### NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

the Company's consolidated statements of operations. In connection with this remeasurement process the Company recorded a gain of $6.3 million in 2009, a loss of $9.9 million in 2008 and a gain of $4.6 million 2007.

*Earnings Per Share:*

Basic earnings per share ("EPS") is computed by dividing net income (loss) available to common stockholders by the weighted average number of shares of the Company's common stock outstanding during the period, which excludes nonvested restricted stock. Diluted EPS presents the amount of net income (loss) available to each share of common stock outstanding during the period plus each share of common stock that would have been outstanding assuming the Company had issued shares of common stock for all dilutive potential common shares outstanding during the period. The Company's potentially dilutive common shares include outstanding stock options, nonvested restricted stock, restricted stock units, convertible subordinated notes prior to their maturity on March 1, 2008, and Employee Stock Purchase Plan ("ESPP") shares prior to termination of the ESPP effective May 15, 2009. For the years ended December 31, 2009, 2008 and 2007, no potential common shares were dilutive because of the net loss in each of these years, therefore basic and dilutive EPS are the same. The following table summarizes the total potential shares of common stock that were excluded from the diluted per share calculation, because to include them would have been anti-dilutive for the period.

| | Years ended December 31, | | |
|---|---|---|---|
| | **2009** | **2008** | **2007** |
| | | **(in thousands)** | |
| Weighted average stock options and awards outstanding | 12,412 | 22,439 | 19,427 |
| Conversion of convertible subordinated notes | | 1,897 | 11,543 |
| Other | 109 | 931 | 765 |
| | 12,521 | 25,267 | 31,735 |

*Variable Interest Entities:*

The accounting guidance requires that if an entity is the primary beneficiary of a variable interest entity, ("VIE"), the assets, liabilities, and results of operations of the VIE should be included in the consolidated financial statements of the entity. The Company evaluates its investments periodically or when "triggering" events occur.

*Recent Accounting Pronouncements:*

In June 2009, the Financial Accounting Standards Board ("FASB") issued the FASB Accounting Standards Codification (the "Codification") for financial statements issued for interim and annual periods ending after September 15, 2009. The Codification became the single authoritative source for GAAP. Accordingly, previous references to GAAP accounting standards are no longer used in the Company's disclosures, including these Notes to the Consolidated Financial Statements. The adoption of the Codification in the third quarter of 2009 did not have any substantive impact on the Company's consolidated financial statements.

In June 2009, the FASB issued authoritative guidance requiring an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

entity as one with the power to direct the activities of a variable interest entity that most significantly impact the entity's economic performance and the obligation to absorb losses of the entity that could potentially be significant to the variable interest. The guidance will be effective as of the beginning of the annual reporting period commencing after November 15, 2009 and will be adopted by the Company in the first quarter of fiscal year 2010. The Company is assessing the potential impact, if any, of the adoption of the guidance on its consolidated financial statements.

In September 2009, the FASB issued new standards for revenue recognition with multiple deliverables. These new standards impact the determination of when the individual deliverables included in a multiple-element arrangement may be treated as separate units of accounting. Additionally, these new standards modify the manner in which the transaction consideration is allocated across the separately identified deliverables by no longer permitting the residual method of allocating arrangement consideration. These new standards are effective for the Company beginning in the first quarter of fiscal year 2011, however early adoption is permitted. The Company is currently assessing the potential impact, if any, of the guidance on its consolidated financial statements.

In September 2009, the FASB issued new standards for the accounting for certain revenue arrangements that include software elements. These new standards amend the scope of pre-existing software revenue guidance by removing from the guidance non-software components of tangible products and certain software components of tangible products. These new standards are effective for the Company beginning in the first quarter of fiscal year 2011, however early adoption is permitted. The Company is currently assessing the potential impact, if any, of the guidance on its consolidated financial statements.

**NOTE 3 DIVESTITURES**

Beginning in the fourth quarter of 2007, the Company launched a number of initiatives, including potential divestitures of non-core assets, to focus on its core growth technologies, including IPTV, IP-based softswitch and broadband devices. During the third quarter of 2009, the Company completed a sale of its Korea operations. During the third quarter of 2008, the Company completed its divestitures of UTStarcom Personal Communications LLC and Mobile Solutions Business Unit.

***2009***

*Korea operations*

On July 31, 2009, the Company completed a sale of its Korea operations to an entity founded by a former employee and received total consideration of approximately $2.0 million. In connection with this transaction, the Company recorded a net loss of $1.3 million during 2009. Included in this amount was $2.2 million of foreign currency losses previously carried in accumulated other comprehensive income that were realized upon completion of sale and liquidation of the subsidiary. The Company determined that the divestiture of Korea operations did not meet the criteria for presentation as a discontinued operation as the Korea operations did not meet the definition of component of an entity.

***2008***

*UTStarcom Personal Communications LLC (PCD)*

On July 1, 2008, the Company completed the sale of UTStarcom Personal Communications LLC, a wholly-owned subsidiary of the Company ("PCD"), to Personal Communications Devices, LLC

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**NOTE 3 DIVESTITURES (Continued)**

("PCD LLC"), an entity controlled by AIG Global Investment Group and certain other investors. The total sale consideration to the Company was based primarily on the working capital of PCD as of the closing of the transaction, subject to certain adjustments. Upon final settlement of the working capital adjustments in the fourth quarter of 2008, the total sale consideration to the Company was $237.7 million. During 2008, the Company recorded net cash proceeds of $219.1 million from the sale of PCD, which was represented by the total sale consideration of $237.7 million, less $8.6 million of transaction costs and $10.0 million held in escrow. At December 31, 2008, the Company recorded an additional $1.3 million of transaction costs which had been incurred but not yet paid. The Company also invested $1.6 million in equity securities of PCD LLC representing approximately a 2.6% interest in PCD LLC. The Company recorded a $3.8 million gain on sale of PCD net assets during 2008. The following table summarizes the components of the gain on sale (in thousands):

| | | |
|---|---|---|
| Purchase price | $ | 237,669 |
| Less: | | |
| Accounts receivable, net | | (121,979) |
| Inventories | | (205,367) |
| Prepaids and other assets | | (8,885) |
| Property, plant and equipment, net | | (1,539) |
| Intangible assets, net | | (15,783) |
| Accounts payable | | 89,628 |
| Other liabilities | | 39,999 |
| Estimated transaction related costs | | (9,980) |
| Gain on sale, net of tax | $ | 3,763 |