

UTSTARCOM INC
Form 10-Q
August 06, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2010

OR

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

For the transition period from__ to__

COMMISSION FILE NUMBER 000-29661

UTSTARCOM, INC.

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(Exact name of registrant as specified in its charter)

DELAWARE
(State of Incorporation)

52-1782500
(I.R.S. Employer Identification No.)

1275 HARBOR BAY PARKWAY
ALAMEDA, CALIFORNIA
(Address of principal executive offices)

94502
(zip code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 Accelerated filer
Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

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

As of July 30, 2010 there were 131,905,838 shares of the registrant's common stock outstanding, par value \$0.00125.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****UTSTARCOM, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

| | June 30, 2010 | December 31, 2009 |
|--|---|------------------------------|
| | (In thousands, except par value) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 306,841 | \$ 265,843 |
| Short-term investments | 1,155 | 1,038 |
| Accounts receivable, net of allowances for doubtful accounts of \$30,135 and \$26,065, respectively | 44,274 | 42,346 |
| Notes receivable | 930 | 1,427 |
| Inventories | 59,090 | 72,300 |
| Deferred costs | 102,231 | 130,453 |
| Prepays and other current assets | 56,970 | 47,906 |
| Short-term restricted cash | 22,162 | 26,448 |
| Total current assets | 593,653 | 587,761 |
| Property, plant and equipment, net | 5,186 | 130,612 |
| Long-term investments | 9,062 | 8,402 |
| Long-term deferred costs | 180,777 | 184,978 |
| Long-term deferred tax assets | 5,601 | 4,822 |
| Other long-term assets | 19,016 | 12,536 |
| Total assets | \$ 813,295 | \$ 929,111 |
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 30,159 | \$ 54,115 |
| Income taxes payable | | 1,130 |
| Customer advances | 147,398 | 120,364 |
| Deferred revenue | 162,443 | 170,777 |
| Deferred tax liabilities | 3,890 | 3,890 |
| Other current liabilities | 97,207 | 142,894 |
| Total current liabilities | 441,097 | 493,170 |
| Long-term deferred revenue | 108,232 | 160,932 |
| Other long-term liabilities | 26,927 | 18,858 |
| Total liabilities | 576,256 | 672,960 |
| Commitments and contingencies (Note 10) | | |
| Equity: | | |
| UTStarcom, Inc. stockholders' equity: | | |
| Common stock: \$0.00125 par value; 750,000 authorized shares; 131,905 and 130,095 shares issued and outstanding at June 30, 2010 and December 31, 2009, respectively | 154 | 153 |
| Additional paid-in capital | 1,256,049 | 1,251,532 |
| Accumulated deficit | (1,092,102) | (1,067,174) |

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| | | |
|--|------------|------------|
| Accumulated other comprehensive income | 72,156 | 70,848 |
| Total UTStarcom, Inc. stockholders' equity | 236,257 | 255,359 |
| Noncontrolling interests | 782 | 792 |
| Total equity | 237,039 | 256,151 |
| Total liabilities and equity | \$ 813,295 | \$ 929,111 |

See accompanying notes to the condensed consolidated financial statements.

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UTSTARCOM, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| | Three months ended June 30, | | Six months ended June 30, | |
|--|---------------------------------------|-------------|---------------------------|--------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands, except per share data) | | | |
| Net sales | | | | |
| Products | \$ 62,615 | \$ 65,735 | \$ 131,795 | \$ 171,247 |
| Services | 10,550 | 14,428 | 22,217 | 28,256 |
| | 73,165 | 80,163 | 154,012 | 199,503 |
| Cost of net sales | | | | |
| Products | 43,507 | 87,265 | 89,789 | 174,302 |
| Services | 6,786 | 8,736 | 14,142 | 19,387 |
| Gross profit (loss) | 22,872 | (15,838) | 50,081 | 5,814 |
| <i>See Note 16 for net sales to related party and associated cost of net sales</i> | | | | |
| Operating expenses: | | | | |
| Selling, general and administrative | 21,162 | 26,971 | 51,352 | 81,151 |
| Research and development | 9,078 | 16,229 | 19,101 | 37,737 |
| Restructuring | (216) | 27,757 | 7,291 | 32,576 |
| Net gain on divestitures | (2,056) | (1,357) | (3,808) | (1,357) |
| Total net operating expenses | 27,968 | 69,600 | 73,936 | 150,107 |
| Operating loss | (5,096) | (85,438) | (23,855) | (144,293) |
| Interest income | 450 | 599 | 798 | 1,348 |
| Interest expense | (68) | (230) | (138) | (520) |
| Other income (expense), net | (4,767) | 5,429 | 100 | (1,785) |
| Loss before income taxes | (9,481) | (79,640) | (23,095) | (145,250) |
| Income tax benefit (expense) | 510 | (4,659) | (1,843) | (6,483) |
| Net loss | (8,971) | (84,299) | (24,938) | (151,733) |
| Net loss attributable to noncontrolling interests | 6 | 16 | 10 | 17 |
| Net loss attributable to UTStarcom, Inc. | \$ (8,965) | \$ (84,283) | \$ (24,928) | \$ (151,716) |
| Net loss per share attributable to UTStarcom, Inc.- | | | | |
| Basic and Diluted | \$ (0.07) | \$ (0.66) | \$ (0.19) | \$ (1.20) |
| Weighted average shares used in per-share calculation - Basic and Diluted | 130,311 | 127,160 | 129,866 | 126,450 |

See accompanying notes to the condensed consolidated financial statements.

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UTSTARCOM, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

| | Six months ended June 30, | |
|---|---------------------------|--------------|
| | 2010 | 2009 |
| | (In thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ (24,938) | \$ (151,733) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 3,410 | 6,918 |
| Amortization of deferred gain on sale-leaseback | (107) | |
| Provision for (recovery of) doubtful accounts | 4,161 | (2,129) |
| Deferred income taxes | (712) | 1,752 |
| Stock-based compensation expense | 4,547 | 6,427 |
| Other-than-temporary impairment of equity investment | | 3,798 |
| Net gain on divestitures | (3,808) | (1,357) |
| Gain on settlement of an investment interest | (481) | |
| Other | 42 | (503) |
| Changes in operating assets and liabilities, net of dispositions: | | |
| Accounts receivable | (9,928) | 96,273 |
| Inventories and deferred costs | 44,111 | 30,024 |
| Other assets | (9,468) | 61,086 |
| Accounts payable | (25,341) | (119,405) |
| Income taxes payable | 207 | 2,182 |
| Customer advances | 27,313 | 33,606 |
| Deferred revenue | (53,489) | (21,133) |
| Other liabilities | (40,483) | 17,058 |
| Net cash used in operating activities | (84,964) | (37,136) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Additions to property, plant and equipment | (1,826) | (1,337) |
| Proceeds from divestiture | 1,500 | |
| Proceeds from sale of building (net of tax payments) | 123,955 | |
| Change in restricted cash | 2,998 | 1,404 |
| Proceeds from settlement of an investment interest | 481 | |
| Purchase of an investment interest | (550) | |
| Purchase of short-term investments | (9,252) | (5,613) |
| Proceeds from sale of short-term investments | 5,415 | 6,421 |
| Other | 971 | 392 |
| Net cash provided by investing activities | 123,692 | 1,267 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Repurchase of common stock | (30) | |
| Other | | (389) |
| Net cash used in financing activities | (30) | (389) |
| Effect of exchange rate changes on cash and cash equivalents | 2,300 | (749) |
| Net increase (decrease) in cash and cash equivalents | 40,998 | (37,007) |
| Cash and cash equivalents at beginning of period | 265,843 | 309,603 |
| Cash and cash equivalents at end of period | \$ 306,841 | \$ 272,596 |

See accompanying notes to the condensed consolidated financial statements.

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UTSTARCOM, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 - BASIS OF PRESENTATION AND LIQUIDITY

The accompanying unaudited condensed consolidated financial statements include the accounts of UTStarcom, Inc. (Company) and its wholly and majority owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in the preparation of the condensed consolidated financial statements. The noncontrolling interests in consolidated subsidiaries are shown separately in the condensed consolidated financial statements.

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations. The December 31, 2009 condensed consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. However, the Company believes that the disclosures are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read in conjunction with the Company s December 31, 2009 financial statements, including the notes thereto, and the other information set forth in the Company s Annual Report on Form 10-K for the year ended December 31, 2009. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results may be different. See the Company s 2009 Annual Report for discussion of the Company s critical accounting policies and estimates.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments (consisting of only normal recurring adjustments) considered necessary for a fair statement of the Company s financial condition, the results of its operations and its cash flows for the periods indicated. The results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the operating results for the full year.

In December 2009, the Company entered into a Sales Leaseback Agreement for the sale of its manufacturing, research and development, and administrative offices facility in Hangzhou, China to a third party for approximately \$138.8 million with leaseback of approximately one-third of the facility. On May 31, 2010, the Company and the buyer agreed that all conditions precedent to the closing had been met, the sale was consummated and the leaseback commenced on June 1, 2010. As of May 31, 2010, the Company had received all of the sales proceeds. See Note 7 for additional information on sale-leaseback transaction.

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 investments are expected to close in the third quarter of 2010.

Management believes that both the Company's China and non-China operations have sufficient liquidity to finance working capital and capital expenditure needs during the next 12 months. 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.

NOTE 2 - ACCOUNTING POLICIES AND RECENT ACCOUNTING PRONOUNCEMENTS

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

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outstanding stock options, nonvested restricted stock, restricted stock units and Employee Stock Purchase Plan (ESPP) shares prior to termination of the ESPP effective May 15, 2009, which are reflected in diluted net income per share by application of the treasury stock method. Under the treasury stock method, the amount that the employee must pay for exercising stock options, the amount of stock-based compensation cost for future services that the Company has not yet recognized, and the amount of tax benefit that would be recorded in additional paid-in capital upon exercise are assumed to be used to repurchase shares. For the three and six months ended June 30, 2010 and 2009, no potential common shares were dilutive because of the net loss in the periods. Potential shares of common stock of approximately 8.5 million and 13.6 million were excluded from the diluted per share calculation for the three months ended June 30, 2010 and 2009, respectively, while 8.9 million and 14.4 million were excluded from the diluted per share calculation for the six months ended June 30, 2010 and 2009, respectively, because to include them would have been anti-dilutive for the periods.

Fair Value

Pursuant to the accounting guidance for fair value measurements and its subsequent updates, fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. The accounting guidance also establishes a three-tier fair value hierarchy which requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. The fair value hierarchy prioritizes the inputs into three levels that may be used in measuring fair value as follows:

Level 1 - observable inputs such as quoted prices in active markets for identical assets or liabilities.

Level 2 - inputs other than the quoted prices in active markets for identical assets or liabilities that are observable either directly or indirectly.

Level 3 - unobservable inputs based on the Company's assumptions.

In January 2010, the Financial Accounting Standards Board (FASB) issued amended standards that require additional fair value disclosures. These disclosure requirements are effective in two phases. In the first quarter of 2010, the Company adopted the requirements for disclosures about inputs and valuation techniques used to measure fair value as well as disclosures about significant transfers between hierarchy levels. Beginning in the first quarter of 2011, these amended standards will require presentation of disaggregated activity within the reconciliation for fair value measurements using significant unobservable inputs (Level 3). These amended standards do not significantly impact the Company's consolidated financial statements.

At June 30, 2010, the Company had no assets and liabilities measured at fair value on a recurring basis. The Company's money market funds, which are included in cash and cash equivalents, are recorded at cost which approximates fair value, classified within Level 1 of the fair value hierarchy. The fair value of certain of the Company's financial instruments that are not measured at fair value, including accounts receivable, accounts payable, and other current liabilities, approximates the carrying amount because of their short maturities.

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During the six months ended June 30, 2010, the Company had no assets and liabilities measured at fair value on a non-recurring basis. At December 31, 2009, the Company determined as a result of the sale leaseback transaction entered into in December 2009 (see Note 7) that the net book value of its Hangzhou facility was in excess of its fair value. Due to the apparent decline in value, the Company conducted a recoverability test for this entity-wide asset and determined the carrying value of the net assets of the Company exceeded the undiscounted cash flows expected to result from the use and eventual disposition of the asset group. In the Company's assessment of fair value, management placed primary reliance on the market approach (the third party offer). The result of this analysis reduced the Company's overall assessment of fair value of the property by \$33.3 million. Accordingly, the Company recorded a non-cash impairment charge of \$33.3 million during the fourth quarter of 2009. The Company's overall assessment of fair value of the property at December 31, 2009 was based on Level 2 inputs.

Variable Interest Entities

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 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 Company adopted this new standard in the first quarter of fiscal year 2010. See Note 17 for the impact of the adoption of the guidance on the Company's consolidated financial statements.

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Recent Accounting Pronouncements Not Yet Adopted

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

IP Messaging and US PDSN Assets

In June 2010, the Company completed a sale of its non-core IP Messaging and US PDSN Assets as part of its strategy to focus on core IP-based product offerings. The divested assets were located in North America, Caribbean, and Latin America regions and were part of the Multimedia Communications segment. Consideration for the approximately \$1.7 million of net liabilities transferred included approximately \$0.4 million cash proceeds plus potential additional contingent consideration of up to \$1.6 million. A gain of \$2.1 million, net of taxes, was recognized in June 2010 as a reduction to operating expenses. The Company determined that the sale of these non-core product lines did not meet the criteria for presentation as a discontinued operation as these non-core product lines did not meet the definition of a component of an entity.

Sale of Remote Access Server product line

In January 2010, the Company completed a sale of certain assets and liabilities related to its Remote Access Server (RAS) product line and received total consideration of approximately \$1.5 million. The primary RAS product was the Total Control 1000 Transaction Gateway, which offers the market a proven processing platform for carrier-class transaction network service providers and enterprises for dial-up connectivity. In the first quarter of 2010, the Company transferred net liabilities of approximately \$0.3 million in connection with this transaction and recorded a net gain of \$1.8 million as a reduction of operating expenses. The Company determined that the divestiture of the RAS product line did not meet the criteria for presentation as a discontinued operation as the RAS product line did not meet the definition of component of an entity.

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 (PCD LLC). Concurrent with the closing of the divestiture transaction, the Company entered into a three-year supply agreement with PCD LLC whereby the Company indicated its intent to supply handset products to PCD LLC. In connection with the wind down of our Korea operations, in December 2008, we furnished PCD LLC with 180-day s notice of termination of the supply agreement.

On June 30, 2009, the Company entered into a Settlement Agreement and Release (the Settlement Agreement) with PCD LLC. Under the Settlement Agreement, the Company waived its right to any earnout payments and granted a call option to PCD LLC for the Company s \$1.6 million investment in the equity securities of PCD LLC. The Company also agreed to pay PCD LLC a total of \$11.1 million which included warranty costs of approximately \$8.4 million (see Note 8) and a reduction of revenue of approximately \$2.7 million. In addition to the \$11.1 million claim settlement, the Company recorded an additional \$17.6 million of costs for inventory write-downs to net realizable value, write-downs of excess inventory and warranty reserves related to transactions with PCD LLC. The Company recorded these transactions in the second quarter of 2009, resulting in a decrease in revenue of approximately \$2.7 million and an increase in cost of net sales of \$26.0 million.

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

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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.

Sale of Assets to Marvell Technology Group Ltd

In February 2006, the Company sold substantially all of the assets and selected liabilities of its semiconductor design business division to Marvell Technology Group Ltd. (Marvell). In connection with the sale of assets, the Company entered into a supply agreement with Marvell to purchase chipsets for the Company's handset products over the next five years. The value allocated to the supply agreement of \$20.2 million has been amortized in proportion to the quantities of chipsets purchased under the supply agreement. During the first quarter of 2009, the Company revised its estimates of customer demand for certain handset products and determined that future chipset purchases from Marvell would be negligible. As a result, the Company fully amortized against cost of goods sold the remaining value of the supply agreement of \$8.5 million in the three months ended March 31, 2009.

NOTE 4 - COMPREHENSIVE LOSS

Total comprehensive loss for the three and six months ended June 30, 2010 and 2009 consisted of the following:

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|-------------|---------------------------|--------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Net loss | \$ (8,971) | \$ (84,299) | \$ (24,938) | \$ (151,733) |
| Other Comprehensive income | | | | |
| Reclassification for realization of previously unrealized (gains) losses, net of tax | | 4,011 | | 3,313 |
| Foreign currency translation | 3,609 | (2,657) | 1,308 | (2,084) |
| Comprehensive loss | (5,362) | (82,945) | (23,630) | (150,504) |
| Comprehensive loss attributable to noncontrolling interests (1) | (6) | (16) | (10) | (17) |
| Comprehensive loss attributable to UTStarcom, Inc. | \$ (5,356) | \$ (82,929) | \$ (23,620) | \$ (150,487) |

(1) Comprehensive loss attributable to noncontrolling interests consisted solely of net loss.

The changes in noncontrolling interests during the six months ended June 30, 2010 and 2009 were as follows:

Six months ended June 30,

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| | 2010 | | 2009 | |
|---|------|----------------|------|------|
| | | (in thousands) | | |
| Balance at beginning of period | \$ | 792 | \$ | 808 |
| Comprehensive loss attributable to noncontrolling interests | | (10) | | (17) |
| Balance at end of period | \$ | 782 | \$ | 791 |

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The following tables provide details of selected balance sheet items:

| | June 30, 2010 | | December 31, 2009 |
|---------------------|--------------------------|----|------------------------------|
| | (in thousands) | | |
| Inventories: | | | |
| Raw materials | \$ 8,861 | \$ | 18,863 |
| Work in process | 21,715 | | 12,881 |
| Finished goods (1) | 28,514 | | 40,556 |
| Total | \$ 59,090 | \$ | 72,300 |

(1) Includes finished goods at customer sites of approximately \$21.8 million and \$33.8 million at June 30, 2010 and December 31, 2009, respectively, for which the customer has taken possession, but based on specific contractual terms, title has not yet passed to the customer.

Inventories of approximately \$2.9 million held by the Company's manufacturing outsource partner are recorded in prepaids and other current assets in the condensed consolidated balance sheet at June 30, 2010.

| | June 30, 2010 | | December 31, 2009 |
|---|--------------------------|----|------------------------------|
| | (in thousands) | | |
| Property, plant and equipment, net: | | | |
| Buildings | \$ 234 | \$ | 184,436 |
| Leasehold improvements | 14,272 | | 15,422 |
| Automobiles | 4,126 | | 4,243 |
| Software | 36,936 | | 37,240 |
| Equipment and Furniture | 145,914 | | 172,214 |
| Others | 2,716 | | 1,690 |
| Total | 204,198 | | 415,245 |
| Less: accumulated depreciation and impairment | (199,012) | | (284,633) |
| Total (see Note 7) | \$ 5,186 | \$ | 130,612 |

| | June 30, 2010 | | December 31, 2009 |
|---------------------------------------|--------------------------|----|------------------------------|
| | (in thousands) | | |
| Other current liabilities: | | | |
| Accrued contract costs | \$ 18,843 | \$ | 27,657 |
| Accrued payroll and compensation | 26,634 | | 35,871 |
| Warranty costs | 9,592 | | 16,150 |
| Accrued other taxes | 15,298 | | 15,863 |
| Restructuring costs | 9,903 | | 21,707 |
| Deposit received for sale of building | | | 7,323 |

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| | | | | |
|--------|----|--------|----|---------|
| Others | | 16,937 | | 18,323 |
| Total | \$ | 97,207 | \$ | 142,894 |

Table of Contents**NOTE 6 - CASH, CASH EQUIVALENTS, INVESTMENTS AND FAIR VALUE MEASUREMENTS**

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 June 30, 2010 and December 31, 2009, there were no available-for-sale securities investments subject to fair value accounting included in cash and cash equivalents or long-term investments.

Short-term investments, consisting of bank notes, were \$1.2 million and \$1.0 million at June 30, 2010 and December 31, 2009, respectively. The Company accepts bank notes receivable with maturity dates of between three and six months from its customers in China in the normal course of business. The Company may discount these bank notes with banking institutions in China. During the six months ended June 30, 2010, no bank notes were sold. During the three months ended June 30, 2009, there were no bank notes sold. During the six months ended June 30, 2009, the Company sold \$9.9 million of bank notes and recorded immaterial costs as a result of discounting the notes. All long-term investments are in privately-held companies and are accounted for under the cost method. 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 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.

The following table shows the break-down of the Company's equity securities classified as long-term investments at June 30, 2010 and December 31, 2009:

| | June 30, 2010 | December 31, 2009 |
|-------------------------|------------------|----------------------|
| | (in thousands) | |
| Cortina | \$ 3,348 | \$ 3,348 |
| GCT SemiConductor, Inc. | 3,000 | 3,000 |
| Xalted Networks | 1,583 | 1,583 |
| SBI | 1,131 | 471 |
| Total equity securities | \$ 9,062 | \$ 8,402 |

SBI NEO Technology A Investment LPS (SBI)

In 2008, the Company invested \$0.5 million into SBI in exchange for approximately 2% of the Partnership interest. The Partnership's investment objective is to invest in unlisted or listed companies in Japan and overseas that are engaged in high growth businesses, including businesses focused on information technology and the environment. In the first quarter of 2010, the Company contributed an additional \$0.6 million into SBI, and at June 30, 2010 maintains an approximately 2% Partnership interest. The Company has concluded that it does not have a controlling interest in SBI as it does not have the power to direct the activities of SBI that most significantly impact the entity's economic performance. Affiliates of a related party have a controlling interest in SBI, see Note 16. The Company accounts for the investment in SBI using the cost method.

NOTE 7 SALE-LEASEBACK TRANSACTION

In December 2009, the Company entered into a Property Transfer and Leaseback Agreement (the Sale Leaseback Agreement) for the sale of its manufacturing, research and development and administrative office facility in Hangzhou, China (the Hangzhou facility) to a third party for proceeds of approximately \$138.8 million and the leaseback of approximately one-third of the property through 2016. As of May 31, 2010, the Company had received all of the sales proceeds and met all criteria for consummation of sale of the Hangzhou facility. On May 31, 2010, the Company and the buyer agreed that all conditions precedent to the closing had been met and the leaseback commenced on June 1, 2010.

Management determined that the transaction qualified for sale-leaseback accounting as all of the risks and rewards of ownership were transferred to the buyer upon closing of the transaction and the leaseback arrangement did not include any form of continuing involvement, other than a normal leaseback. In the second quarter of 2010, the Company recorded the sale of the Hangzhou facility and recorded a deferred gain of \$7.7 million at the time of sale. The deferred gain was represented by the gross sales proceeds of \$138.8 million, less \$7.5 million of transaction related taxes and other fees, and less the net book value of the Hangzhou facility of \$123.6 million. The gain on sale was deferred in accordance with the accounting guidance for sale-leaseback transactions, as the Company has retained more than a minor portion of the use of the property through the six-year leaseback. The deferred gain on the sale-leaseback is being amortized in proportion to the related gross rental charged to expense over the leaseback term. At June 30, 2010, \$1.2 million of deferred gain is included in other current liabilities and \$6.5 million of deferred gain is included in other long-term liabilities in the condensed consolidated balance sheet.

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In connection with the Sale Leaseback Agreement, on February 1, 2010, the Company entered into a Lease Contract (the "Lease") with respect to the leaseback of a portion of the Hangzhou facility. Under the terms of the Lease, the Company will lease back 71,027 sqm gross floor area (GFA) aboveground and 12,000 sqm GFA underground of the building for a period of 6 years at a rate of approximately \$0.37, \$0.44 and \$0.47, respectively, per sqm per day for years 1-2, 3-4 and 5-6, respectively, of the lease period for the aboveground space; and approximately \$3.66 per sqm per month for the underground space for the full lease period. The Company was also required to pay a security deposit in the amount of approximately \$1.8 million and prepay part of the rent and fees for the last six months of the lease term in the amount of approximately \$3.4 million upon lease inception on June 1, 2010. The Company may terminate all or part of the Lease by giving six months advance notice; however, the Company would be required to pay penalties and additional compensation in the event of early termination. The Company has determined that the Lease qualifies as an operating lease. See Note 10 for future minimum lease payments under all noncancelable operating leases.

NOTE 8 - WARRANTY OBLIGATIONS AND OTHER GUARANTEES

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. Specific warranty accruals are reversed upon the expiration of the warranty period and are recorded as a reduction of cost of net sales. 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.

Expirations recorded as a reduction of cost of net sales approximated \$1.2 million and \$1.8 million for the three months ended June 30, 2010 and 2009, respectively, and \$2.6 million and \$2.3 million for the six months ended June 30, 2010 and 2009, respectively and are included in the table below as benefit from expirations. The following table summarizes the activity related to warranty obligations during the three and six months ended June 30, 2010 and 2009:

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|-----------|---------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Balance at beginning of period | \$ 12,011 | \$ 29,814 | \$ 16,150 | \$ 29,840 |
| Accruals for warranties issued during the period (benefit from expirations), net | (1,324) | 7,251 | (3,084) | 10,833 |
| Settlements made during the period | (1,095) | (3,241) | (3,474) | (6,849) |
| Balance at end of period | \$ 9,592 | \$ 33,824 | \$ 9,592 | \$ 33,824 |

During the second quarter of 2009, the Company recorded a special warranty charge related to certain handsets sold to PCD LLC. Under the Settlement Agreement with PCD LLC (see Note 3), the Company agreed to pay PCD LLC \$8.4 million to settle certain PCD LLC customers warranty claims arising from the handsets sold to PCD LLC. The \$8.4 million claim settlement is included in the accruals for warranties issued during the three and six months ended June 30, 2009 in the table above.

Certain of the Company's sales contracts include provisions under which customers would be indemnified by the Company in the event of, among other things, a third-party claim against the customer for intellectual property rights infringement related to the Company's products. There are no limitations on the maximum potential future payments under these guarantees. The Company has not accrued any amount in relation to these provisions as no such claims have developed into assertable claims and the Company believes it has defensible rights to the intellectual property embedded in its products.

NOTE 9 - RESTRUCTURING COSTS

Restructuring Costs

During the three months ended June 30, 2010, the Company recorded approximately \$0.2 million net reversal of restructuring charges recorded in previous periods. During the six months ended June 30, 2010, the Company recorded approximately \$7.3 million in restructuring charges. For the three and six months ended June 30, 2009, the Company recorded restructuring charges of \$27.8 million and \$32.6 million, respectively. The following describes the Company's restructuring initiatives.

Table of Contents*2009 Restructuring Plan*

On June 9, 2009, the Board of Directors of the Company approved a restructuring plan (the 2009 Restructuring Plan) designed to reduce the Company's operating costs. The 2009 Restructuring Plan includes a worldwide reduction in force of approximately 50% of the Company's headcount, or approximately 2,300 employees located primarily in China and the United States and, to a lesser degree, other international locations. During the three months ended June 30, 2010, the Company recorded \$1.4 million reversal of restructuring charges recorded in prior periods resulting from change in estimate. This change in estimate resulted from voluntary resignation of employees originally included in the restructuring plan as well as retention of employees originally identified in the plan to replace employees who voluntarily resigned. Partially offsetting this reversal was approximately \$0.9 million additional charges related to employees located in the United States and other international locations as the Company continues to phase-out non-core international operations. During the three months ended June 30, 2010, the Company also recorded an additional \$0.3 million of lease costs on exited facilities. During the six months ended June 30, 2010, the Company recorded restructuring costs of approximately \$6.9 million related to the 2009 Restructuring Plan, net of approximately \$1.7 million of reversal of charges recorded in prior periods. The restructuring costs for the six months ended June 30, 2010 consist primarily of severance and benefits related to additional employees included in the Restructuring Plan in the first quarter of 2010, adjusted for change in estimate in the second quarter of 2010. During the second quarter of 2009, the Company recorded restructuring charges of approximately \$25.9 million related to the 2009 Restructuring Plan, including \$24.7 million for severance and benefits and \$1.2 million related to the estimated loss on a lease obligation that expires in 2013. Total restructuring costs recorded through June 30, 2010 related to the 2009 Restructuring Plan approximated \$46.8 million.

2008 Restructuring Plan

During fiscal 2008, the Company implemented a restructuring plan (the 2008 Restructuring Plan) primarily related to a global reduction in force across all functions and employee terminations at certain non-core operations which the Company was in the process of winding down. The total number of employees affected totaled approximately 750, including 350 in China, 200 in Korea and 200 in other locations including the United States. During the three and six months ended June 30, 2010, the Company recorded additional restructuring costs related to the 2008 Restructuring Plan of approximately \$0.1 million and \$0.4 million, respectively, for severance and benefit costs being recognized over the remaining service period for employees included in the 2008 Restructuring Plan. During the three and six months ended June 30, 2009, the Company recorded \$1.8 million and \$6.4 million, respectively, in restructuring charges related to the 2008 Restructuring Plan. Total restructuring costs recorded through June 30, 2010 related to the 2008 Restructuring Plan approximated \$19.8 million.

2007 Restructuring Plan

At June 30, 2010, the 2007 Restructuring Plan was complete.

The activity in the accrued restructuring balances related to the plans described above was as follows for the six months ended June 30, 2010 and 2009:

| Balance at December 31, 2009 | Restructuring Charges | Cash Payments | Non-cash Settlement | Balance at June 30, 2010 |
|------------------------------------|--------------------------|---------------|------------------------|--------------------------------|
|------------------------------------|--------------------------|---------------|------------------------|--------------------------------|

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(in thousands)

| | | | | | | | | | | |
|---------------------------------------|----|--------|----|-------|----|----------|----|---------|----|-------|
| 2009 Restructuring Plan | | | | | | | | | | |
| Workforce Reduction | \$ | 16,939 | \$ | 6,480 | \$ | (14,710) | \$ | (1,613) | \$ | 7,096 |
| Lease Costs | | 1,516 | | 375 | | (267) | | | | 1,624 |
| Other Costs | | 6 | | | | | | | | 6 |
| Total 2009 Restructuring Plan | | 18,461 | | 6,855 | | (14,977) | | (1,613) | | 8,726 |
| 2008 Restructuring Plan | | | | | | | | | | |
| Workforce Reduction | | 2,526 | | 466 | | (1,815) | | | | 1,177 |
| Lease Costs | | 385 | | | | (385) | | | | |
| Other Costs | | 30 | | (30) | | | | | | |
| Total 2008 Restructuring Plan | | 2,941 | | 436 | | (2,200) | | | | 1,177 |
| 2007 Restructuring Plan - Lease Costs | | | | | | | | | | |
| | | 305 | | | | (305) | | | | |
| Total | \$ | 21,707 | \$ | 7,291 | \$ | (17,482) | \$ | (1,613) | \$ | 9,903 |

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| | Balance at December 31, 2008 | Restructuring Charges | Cash Payments (in thousands) | Non-cash Settlement | Balance at June 30, 2009 |
|--|------------------------------------|--------------------------|---------------------------------|------------------------|--------------------------------|
| 2009 Restructuring Plan | | | | | |
| Workforce Reduction | \$ | \$ 24,715 | \$ (1,070) | \$ (417) | \$ 23,228 |
| Lease Costs | | 1,223 | | | 1,223 |
| Other Costs | | 7 | (7) | | |
| Total 2009 Restructuring Plan | | 25,945 | (1,077) | (417) | 24,451 |
| 2008 Restructuring Plan | | | | | |
| Workforce Reduction | 7,976 | 5,377 | (7,569) | (380) | 5,404 |
| Lease Costs | 249 | 1,114 | (467) | | 896 |
| Other Costs | 498 | (64) | (247) | | 187 |
| Total 2008 Restructuring Plan | 8,723 | 6,427 | (8,283) | (380) | 6,487 |
| 2007 Restructuring Plan - Lease | | | | | |
| Costs | 788 | 204 | (321) | | 671 |
| Total | \$ 9,511 | \$ 32,576 | \$ (9,681) | \$ (797) | \$ 31,609 |

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. The Company expects to incur additional restructuring charges in 2010 as it continues to execute the 2009 and 2008 Restructuring Plans.

NOTE 10 - COMMITMENTS AND CONTINGENCIES*Leases*

The Company leases certain facilities under noncancelable operating leases that expire at various dates through 2016. In connection with the Sale Leaseback Agreement, the Company entered into a lease with respect to the leaseback of a portion of the Hangzhou facility, see Note 7. The leaseback commenced on June 1, 2010 and the contractual obligations related to the Hangzhou facility lease are included in the table below. Future minimum lease payments under all noncancelable operating leases with an initial term in excess of one year as of June 30, 2010 are as follows:

| Twelve months ending June 30: | Amount (in thousands) |
|-------------------------------|--------------------------|
| 2011 | \$ 16,666 |
| 2012 | 14,246 |
| 2013 | 14,669 |
| 2014 | 13,861 |
| 2015 | 14,273 |
| Thereafter | 7,262 |
| Total | \$ 80,977 |

Litigation

Securities Class Action Litigation

Beginning in October 2004, several shareholder class action lawsuits alleging federal securities violations were filed against the Company and various officers and directors of the Company. The actions have been consolidated in United States District Court for the Northern District of California under the caption *In re UTStarcom, Inc. Securities Litigation*, Master File No. C-04-4908-JW (PVT). The lead plaintiffs in the case filed a First Amended Consolidated Complaint on July 26, 2005. The First Amended Complaint

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alleged violations of the Securities Exchange Act of 1934, and was brought on behalf of a putative class of shareholders who purchased the Company's stock after April 16, 2003 and before September 20, 2004. On April 13, 2006, the lead plaintiffs filed a Second Amended Complaint adding new allegations and extending the end of the class period to October 6, 2005. In addition to the Company defendants, the plaintiffs are also suing Softbank. Plaintiffs' complaint seeks recovery of damages in an unspecified amount.

On June 2, 2006, the Company and the individual defendants filed a motion to dismiss the Second Amended Complaint. On March 21, 2007, the Court granted defendants' motion and dismissed plaintiffs' Second Amended Complaint. The Court granted plaintiffs leave to file a Third Amended Complaint, which plaintiffs filed on May 25, 2007. On July 13, 2007, the Company and the individual defendants filed a motion to dismiss and a motion to strike the Third Amended Complaint. On 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, the Company 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, the Company and the individual defendants filed a motion to dismiss and a motion to strike certain allegations from the Fourth Amended Complaint. On March 27, 2009, the Court denied defendants' motion to dismiss and granted defendants' motion to strike.

Plaintiffs, the Company and the individual defendants have signed and filed 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 Company's and individual defendants' insurers would pay the full amount of the settlement. On May 13, 2010, the Court granted preliminary approval of the settlement and scheduled a final approval hearing for August 30, 2010. There is no assurance that the settlement will receive final approval. Moreover, because Defendant Softbank is not a party to this settlement, discovery and motion practice are continuing. No trial date has been set. We have continued to incur costs with regard to discovery in connection with the ongoing litigation between the non-settling parties. Accordingly, the Company is unable at this time to estimate the effects of this lawsuit on the Company's financial position, results of operations, or cash flows.

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 the Company's current and former officers and directors in the Superior Court of the County of Alameda, California. The complaint alleges that the individual defendants, among other things, breached their duties, were unjustly enriched, and violated the California Corporations Code in connection with the timing of stock option grants. The complaint names the Company as a nominal defendant and seeks unspecified monetary damages against the individual defendants and various forms of injunctive relief. On February 2, 2007, the Company and the individual defendants filed demurrers against the complaint. On April 11, 2007, the Court sustained the individual defendants' demurrer, overruled the Company's demurrer, ordered the plaintiff to file an amended complaint, and ordered the Company to answer the original complaint. The plaintiff filed an amended complaint and the Company has filed an answer to the amended complaint. On August 21, 2007, the individual defendants filed demurrers against the amended complaint. The Court sustained the individual defendants' demurrers and ordered the plaintiff to file a second amended complaint. On September 26, 2008, plaintiff filed his second amended complaint. On November 21, 2008, the Company and the individual defendants filed demurrers against the second amended complaint. On February 27, 2009, the Court sustained the Company's demurrer and ordered the plaintiff to file a third amended complaint. On March 20, 2009, plaintiff filed his third amended complaint. On May 5, 2009, the Company and the individual defendants filed demurrers against the third amended complaint. On August 11, 2009, the Court sustained the Company's 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. On April 15, 2010, plaintiff filed a Request for

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Dismissal without prejudice with the Court of Appeals. Pursuant to the Request, the appeal may be reinstated if the Superior Court does not grant preliminary or final approval of the settlement. There is no assurance that the settlement will receive court approval. Accordingly, the Company is unable at this time to estimate the effects of this lawsuit on the Company's financial position, results of operations, or cash flows.

IPO Allocation

On October 31, 2001, a complaint was filed in United States District Court for the Southern District of New York against the Company, some of the Company's directors and officers and various underwriters for the Company's initial public offering. Substantially similar actions were filed concerning the initial public offerings for more than 300 different issuers, and the cases were coordinated as *In re Initial Public 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

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allocation of IPO shares in exchange for excessive brokerage commissions, agreements to purchase shares at higher prices in the aftermarket and misleading analyst reports. Plaintiffs seek unspecified damages on behalf of a purported class of purchasers of the Company's common stock between March 2, 2000 and December 6, 2000. The Company's directors and officers have been dismissed without prejudice pursuant to a stipulation. On February 19, 2003, the Court granted in part and denied in part a motion to dismiss the claims brought by defendants, including the Company. The order dismissed all claims against the Company except for a claim brought under Section 11 of the Securities Act of 1933, which alleges that the registration statement filed in accordance with the IPO was misleading.

The parties have reached a global settlement of the litigation. Under the settlement the insurers will pay the full amount of the settlement share allocated to the Company, and the Company will bear no financial liability. The Company, 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. On October 5, 2009, the Court entered an Opinion and Order granting final approval of the settlement. Certain objectors have filed appeals. If for any reason the settlement does not become effective, the Company believes it has meritorious defenses to the claims and intends to defend the action vigorously.

Other Litigation

The Company is a party to other litigation matters and claims that are normal in the course of operations, and while the results of such litigation matters and claims cannot be predicted with certainty, management of the Company believes that the final outcome of such matters will not have a material adverse impact on the Company's financial position, results of operations or cash flows.

Letters of credit

The Company issues standby letters of credit primarily to support international sales activities outside of China and in support of purchase commitments. When the Company submits a bid for a sale, often the potential customer will require that the Company issue a bid bond or a standby letter of credit to demonstrate its commitment through the bid process. In addition, the Company may be required to issue standby letters of credit as guarantees for advance customer payments upon contract signing or performance guarantees. The standby letters of credit usually expire without being drawn by the beneficiary thereof. Finally, the Company may issue commercial letters of credit in support of purchase commitments. At June 30, 2010, the Company had short-term restricted cash of \$22.2 million, and had long-term restricted cash of \$12.1 million included in other long-term assets. The restricted cash amounts primarily collateralize the Company's outstanding letters of credit approximating \$25.4 million at June 30, 2010.

NOTE 11 STOCK INCENTIVE PLAN

During the six months ended June 30, 2010, the Company granted equity awards primarily consisting of restricted stock and restricted stock units (RSUs), and to a much lesser extent, option awards. Such awards generally vest over a period of one to four years from the date of grant. Restricted stock has the voting rights of common stock and the shares underlying restricted stock are issued and outstanding. There were no option awards during the three months ended June 30, 2010.

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In February 2008, the Compensation Committee granted 1,073,333 performance-based awards to certain senior executive officers. During the third quarter of 2008, 233,333 of these contingently issuable shares were forfeited as a result of employee terminations. On October 6, 2008, the performance requirements with respect to 60,000 of these contingently issuable shares were eliminated, these restricted stock units have a fair value of \$2.69 per share, which equals the closing price of the Company's common stock on the NASDAQ Stock Market on the measurement date of October 6, 2008. On February 18, 2009, the Committee determined, based on the Company's and each executive officer's level of performance during the Company's 2008 fiscal year, that an additional 367,500 shares underlying the previously granted performance-based restricted stock units had been earned, each of these performance-based restricted stock units has a fair value of \$1.27 per share, which equals the closing price of the Company's common stock on the NASDAQ Stock Market on the measurement date of February 18, 2009. These restricted stock units vested 50% on February 27, 2009 and 50% vested on February 26, 2010.

In February 2009, the Compensation Committee also granted to senior executive officers 313,293 restricted stock units with a four-year vesting and an additional 626,586 performance-based awards, subject to the attainment of goals determined by the Compensation Committee. The Company may be subject to variable levels of expense related primarily to the varying levels of performance, as well as for fluctuations in the Company's stock price as these awards are marked to market periodically until the earlier of i) the date of the Compensation Committee's determination on performance or ii) the date they were deemed fully vested as a result of involuntary termination. Of the 626,586 performance-based awards granted in February 2009, 401,859 awards were deemed fully vested during fiscal 2009 as a result of involuntary terminations, prior to the annual Compensation Committee's evaluation of performance. At its meeting on February 18, 2010, the Compensation Committee evaluated the performance against established objectives of the remaining 224,727 performance-based awards and determined 148,769 RSUs were earned.

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In February 2010, the Compensation Committee decided no annual grants of stock-based awards would be made to existing senior executives for the 2010 year in light of the Company's previously announced planned changes in management.

To reduce the Company's long term cost structure and manage shareholder dilution, the Company has elected to terminate the ESPP program effective May 15, 2009. The cancellation has been accounted for as a settlement of shares for no consideration. This resulted in an immediate expense recognition in the first quarter of 2009 of \$1.2 million associated with the unrecognized compensation for canceled purchase periods of the 24-month offering.

During the quarter ended June 30, 2009, an adjustment was made to increase the estimated forfeiture rate for equity awards of employees that are being included in the 2009 Restructuring Plan as the awards are not expected to ultimately vest. The resulting net effect of the forfeiture rate adjustment was a decrease to the Company's stock-based compensation expense for the three months ended June 30, 2009 by approximately \$0.4 million.

The total stock-based compensation expense, including the ESPP expense described above, recognized in the condensed consolidated statement of operations for the three months and six months ended June 30, 2010 and 2009 was as follows:

| | Three months ended June 30, | | Six months ended June 30, | |
|-------------------------------------|--------------------------------|----------|------------------------------|----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Cost of net sales | \$ 36 | \$ 60 | \$ 93 | \$ 491 |
| Selling, general and administrative | 1,079 | 1,617 | 2,480 | 4,056 |
| Research and development | 153 | 186 | 361 | 1,083 |
| Restructuring | 419 | 417 | 1,613 | 797 |
| Total | \$ 1,687 | \$ 2,280 | \$ 4,547 | \$ 6,427 |

Option activity as of June 30, 2010 and changes during the six months ended June 30, 2010 were as follows:

| | Number of shares outstanding (in thousands) | Weighted average exercise price |
|--|--|--|
| Options outstanding, December 31, 2009 | 5,750 | \$ 8.98 |
| Options granted | 100 | \$ 2.18 |
| Options exercised | (2) | \$ 2.82 |
| Options forfeited or expired | (699) | \$ 11.05 |
| Options outstanding, June 30, 2010 | 5,149 | \$ 8.57 |

Nonvested restricted stock and restricted stock units as of June 30, 2010, and changes during the six months ended June 30, 2010, were as follows:

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| | Shares (in thousands) | | Weighted average grant date fair value |
|----------------------------------|--------------------------|----|--|
| Nonvested at December 31, 2009 | 4,030 | \$ | 2.38 |
| Granted | 1,230 | \$ | 2.28 |
| Vested | (1,593) | \$ | 2.35 |
| Forfeited | (430) | \$ | 2.16 |
| Total nonvested at June 30, 2010 | 3,237 | \$ | 2.39 |

At June 30, 2010, there was approximately \$5.8 million of total unrecognized compensation cost not including forfeitures, related to non-vested stock options, restricted stock and restricted stock units, as measured, which the Company expects to recognize over a weighted-average period of 2.4 years. For additional information regarding the Company's stock-based compensation plans, see the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

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NOTE 12 - INCOME TAXES

As of December 31, 2009, the Company had gross unrecognized tax benefits of approximately \$90.6 million and had certain deferred tax assets and the federal tax benefit of state income tax items totaling \$77.8 million. If recognized, the portion of gross unrecognized tax benefits that would decrease the provision for income taxes and decrease the Company's net loss is approximately \$12.8 million.

As of June 30, 2010, the Company had gross unrecognized tax benefits of approximately \$92.4 million and had certain deferred tax assets and the federal tax benefit of state income tax items totaling \$78.4 million. If recognized, the portion of gross unrecognized tax benefits that would decrease the provision for income taxes and decrease the Company's net loss is approximately \$14.0 million.

The Company recognizes interest expense and penalties related to the above unrecognized tax benefits within income tax expense. The Company had accrued interest and penalties of approximately \$3.1 million as of December 31, 2009 and approximately \$3.3 million as of June 30, 2010.

The Company is subject to taxation in the U.S. federal jurisdiction and various U.S. state and foreign jurisdictions. The Company is under audit by the taxing authorities in China on a recurring basis. The material jurisdictions that the Company is subject to examination are in the United States and China. The Company's tax years for 1999 through 2009 are still open for examination in China. The Company's tax years for 2006 through 2009 are still open for examination in the United States. The Company believes that it is reasonably possible that the amount of gross unrecognized tax benefits related to the resolution of income tax matters could be reduced by approximately \$1.0 million during the next 12 months as income tax audits are settled and statute of limitations expire. The portion of the \$1.0 million of gross unrecognized tax benefits that would decrease the provision for income taxes and increase the Company's net income is approximately \$0.7 million.

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 the Company believes that it has adequately provided for all tax positions, amounts asserted by taxing authorities could be greater than the Company's 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.

In establishing its deferred income tax assets and liabilities, the Company makes judgments and interpretations based on the enacted tax laws and published tax guidance applicable to its operations. The Company records deferred tax assets and liabilities and evaluates the need for valuation allowances to reduce the deferred tax assets to realizable amounts. The likelihood of a material change in the Company's expected realization of these assets is dependent on future taxable income and its ability to use foreign tax credit carryforwards and carrybacks.

Income tax benefit was \$0.5 million for the three months ended June 30, 2010 compared to income tax expense of \$4.7 million for the three months ended June 30, 2009. In the second quarter of 2010, a one-time tax benefit of \$0.9 million was recorded mainly related to the release of previously established valuation allowance on deferred tax assets in Taiwan which was offset by foreign tax expenses. Income tax expense was \$1.8 million for the six months ended June 30, 2010 compared to \$6.5 million for the six months ended June 30, 2009. The decrease in income tax expense in the six month ended June 30, 2010 compared with six month ended June 30, 2009 was primarily due to the decreased ordinary income in jurisdictions where the Company has been profitable and a one-time tax expense of \$1.4 million in the three month ended June 30, 2009 related to establishing of valuation allowance on net deferred tax assets in Korea.

For 2010 and 2009, the Company has not provided any tax benefit on any forecasted losses incurred and tax credits generated in the United States and other countries, because management believes that it is more likely than not that the tax benefit associated with these losses will not be realized. Also, for 2010 and 2009, the Company continues to accrue tax expense in jurisdictions where the Company has been historically profitable. Estimates of the annual effective tax rate at the end of the interim periods are based on evaluations of possible future events and transactions and may be subject to subsequent refinement or revision.

Table of Contents**NOTE 13 - OTHER INCOME (EXPENSE), NET**

Other income (expense), net for the three and six months ended June 30, 2010 and 2009, respectively were comprised of the following:

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|---------|---------------------------|------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Other-than-temporary impairment of equity investment | \$ | \$ | (3,798) | \$ (3,798) |
| Foreign exchange gains (losses) | | (4,938) | 9,003 | (851) |
| Settlement with MRV Communications (1) | | 58 | | 481 |
| Other | | 113 | 224 | 470 |
| Total | \$ | (4,767) | \$ 5,429 | \$ 100 |
| | | | | \$ (1,785) |

(1) Previously, the Company held an 8% ownership interest in Fiberson, which was acquired by MRV Communications (MRV) in 2007. In connection with the acquisition, Fiberson shareholders received cash and stock as well as the right to potential deferred consideration. In December 2009, MRV entered into a settlement agreement for dismissal of legal proceedings between MRV and the former shareholders of Fiberson regarding the amount of contingent consideration owed related to its acquisition. Proceeds received in the first quarter of 2010 represented the Company's proportionate share of the settlement amounts.

NOTE 14 - SEGMENT REPORTING

In the fourth quarter of 2009, the Company substantially completed the wind-down of its handset business. Except for sales relating to inventory clearing, the Company does not expect any significant handset revenue in 2010. Beginning on January 1, 2010, the Company integrated its Services Segment into its Multimedia Communications and Broadband Infrastructure segments based on products for which services are performed. Effective January 1, 2010, the new reporting segments are as follows:

- **Multimedia Communications** Focused on development and market opportunities in IPTV solutions and Wireless infrastructure technologies, including related services revenue.
- **Broadband Infrastructure** Focused on our world class portfolio of broadband products, including related services revenue.
- **Handsets** Focused on mobile phone business including 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.

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The Company's chief operating decision makers make financial decisions based on information it receives from its internal management system and currently evaluates the operating performance of and allocates resources to the reporting segments based on segment revenue and gross profit. Cost of sales and direct expenses in relation to production are assigned to the reporting segments. The accounting policies used in measuring segment assets and operating performance are the same as those used at the consolidated level.

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Summarized below are the Company's segment net sales, gross (loss) profit and segment margin for the three and six months ended June 30, 2010 and 2009 based on the current reporting segment structure. The Company has reclassified its previously reported segment information for the three and six months ended June 30, 2009 to conform to the current segment presentation.

| | Three months ended June 30, | | | | Six months ended June 30, | | | |
|------------------------------------|-----------------------------|----------------|-----------|----------------|---------------------------|----------------|------------|----------------|
| | 2010 | % of net sales | 2009 | % of net sales | 2010 | % of net sales | 2009 | % of net sales |
| (in thousands, except percentages) | | | | | | | | |
| Net Sales by Segment | | | | | | | | |
| Multimedia Communications | \$ 46,986 | 64% | \$ 47,993 | 60% | \$ 89,311 | 58% | \$ 90,476 | 45% |
| Broadband Infrastructure | 24,681 | 34% | 18,986 | 24% | 59,235 | 38% | 39,782 | 20% |
| Handsets | 1,498 | 2% | 13,184 | 16% | 5,466 | 4% | 69,245 | 35% |
| | \$ 73,165 | 100% | \$ 80,163 | 100% | \$ 154,012 | 100% | \$ 199,503 | 100% |

| | Three months ended June 30, | | | | Six months ended June 30, | | | |
|---------------------------------------|-----------------------------|----------------|-------------|----------------|---------------------------|----------------|-----------|----------------|
| | 2010 | Gross Profit % | 2009 | Gross Profit % | 2010 | Gross Profit % | 2009 | Gross Profit % |
| (in thousands, except percentages) | | | | | | | | |
| Gross (loss) profit by Segment | | | | | | | | |
| Multimedia Communications | \$ 12,551 | 27% | \$ 15,835 | 33% | \$ 28,571 | 32% | \$ 28,703 | 32% |
| Broadband Infrastructure | 8,222 | 33% | 2,548 | 13% | 17,845 | 30% | 5,030 | 13% |
| Handsets | 2,099 | 140% | (34,221) | (260)% | 3,665 | 67% | (27,919) | (40)% |
| | \$ 22,872 | 31% | \$ (15,838) | (20)% | \$ 50,081 | 33% | \$ 5,814 | 3% |

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|-------------|---------------------------|--------------|
| | 2010 | 2009 | 2010 | 2009 |
| (in thousands) | | | | |
| Segment Margin and Operating Loss | | | | |
| Multimedia Communications | \$ 6,052 | \$ 5,430 | \$ 14,253 | \$ 6,063 |
| Broadband Infrastructure | 4,964 | (1,652) | 11,508 | (4,017) |
| Handsets | 1,808 | (38,702) | 2,999 | (38,466) |
| Total segment margin | 12,824 | (34,924) | 28,760 | (36,420) |
| General and Corporate | (17,920) | (50,514) | (52,615) | (107,873) |
| Operating Loss | \$ (5,096) | \$ (85,438) | \$ (23,855) | \$ (144,293) |

Sales are attributed to a geographical area based upon the location of the customer. Sales data by geographical area are as follows:

| | Three months ended June 30, | | | | Six months ended June 30, | | | |
|------------------------------------|-----------------------------|----------------|-----------|----------------|---------------------------|----------------|------------|----------------|
| | 2010 | % of net sales | 2009 | % of net sales | 2010 | % of net sales | 2009 | % of net sales |
| (in thousands, except percentages) | | | | | | | | |
| Net Sales by region | | | | | | | | |
| United States | \$ 2,450 | 3% | \$ 1,731 | 2% | \$ 5,903 | 4% | \$ 42,990 | 22% |
| China | 43,211 | 59% | 52,531 | 66% | 83,186 | 54% | 103,749 | 52% |
| Japan | 11,137 | 15% | 6,505 | 8% | 22,233 | 14% | 13,042 | 7% |
| India | 6,555 | 9% | 9,536 | 12% | 12,353 | 8% | 19,120 | 10% |
| Philippines | 2,990 | 4% | 2,091 | 3% | 15,674 | 10% | 2,896 | 1% |
| Other | 6,822 | 10% | 7,769 | 9% | 14,663 | 10% | 17,706 | 8% |
| Total net sales | \$ 73,165 | 100% | \$ 80,163 | 100% | \$ 154,012 | 100% | \$ 199,503 | 100% |

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Long-lived assets, consisting of property, plant and equipment, by geographical area are as follows:

| | June 30, 2010 | (in thousands) | December 31, 2009 |
|-------------------------|------------------|----------------|----------------------|
| United States | \$ 123 | | \$ 170 |
| China | 4,434 | | 129,746 |
| Other | 629 | | 696 |
| Total long-lived assets | \$ 5,186 | | \$ 130,612 |

Table of Contents**NOTE 15 - CREDIT RISK AND CONCENTRATION**

At June 30, 2010, the Company's accounts receivable balance included amounts due from Philippine Long Distance Telephone Company representing approximately 21%, of the Company's total accounts receivable, net of allowances for doubtful accounts. At December 31, 2009, the Company's accounts receivable balance included amounts due from China Telecom, JiangSu Branch representing approximately 11% of the Company's total accounts receivable, net of allowances for doubtful accounts.

The following customers accounted for 10% or more of the Company's net sales:

| | For the three months ended June 30, (% of net sales) | For the six months ended June 30, |
|---|---|---|
| 2010 | | |
| Softbank and affiliates | 10% | 12% |
| Philippines Long Distance Telephone Company | 4% | 10% |
| 2009 | | |
| PCD LLC | | 17% |

Approximately 55% and 37% of the Company's net sales during the three months ended June 30, 2010 and 2009, respectively, and approximately 49% and 29% of the Company's net sales during the six months ended June 30, 2010 and 2009, respectively, were to entities affiliated with the government of China. Accounts receivable balances from these China government affiliated entities or state owned enterprises were \$40.4 million and \$45.7 million as of June 30, 2010 and December 31, 2009, respectively. The Company extends credit to its customers in China generally without requiring collateral. With respect to global sales outside of China, the Company may require letters of credit from its customers. The Company monitors its exposure for credit losses and maintains allowances for doubtful accounts.

Approximately 59% and 66% of the Company's sales for the three months ended June 30, 2010 and 2009, respectively, and approximately 54% and 52% of the Company's net sales during the six months ended June 30, 2010 and 2009, respectively were made in China. Accordingly, the political, economic and legal environment, as well as the general state of China's economy may influence the Company's business, financial condition and results of operations. The Company's operations in China are subject to special considerations and significant risks not typically associated with companies in the United States. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected by, among other things, changes in the political, economic and social conditions in China, and by changes in governmental policies with respect to laws and regulations, changes in China's telecommunications industry and regulatory rules and policies, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation.

NOTE 16 - RELATED PARTY TRANSACTIONS

Softbank and affiliates

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The Company recognizes revenue with respect to sales of telecommunications equipment to affiliates of Softbank, a significant stockholder of the Company. Softbank offers ADSL coverage throughout Japan, which is marketed under the name YAHOO! BB. The Company supports Softbank's fiber-to-the-home service through sales of its carrier class GEAPON product as well as its NetRing™ product. In addition, the Company supports Softbank's new internet protocol television (IPTV), through sales of its RollingStream™ product. During the three and six months ended June 30, 2010 and 2009, the Company recognized revenue and related cost of net sales for sales of telecommunications equipment and services to affiliates of Softbank as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------|-----------------------------|----------|---------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Net sales | \$ 10,838 | \$ 5,033 | \$ 21,512 | \$ 11,198 |
| Cost of net sales | 3,874 | 2,841 | 8,968 | 6,758 |
| Gross profit | \$ 6,964 | \$ 2,192 | \$ 12,544 | \$ 4,440 |

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Gross profit as a percentage of net sales fluctuations are expected and generally result from changes in product mix. In the three and six months ended June 30, 2010, gross profit as a percentage of net sales also benefited approximately \$2.4 million from the release of previously deferred revenue carve-out for potential penalty and cancellation penalties. Included in accounts receivable at June 30, 2010 and December 31, 2009 were \$7.6 million and \$5.5 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 June 30, 2010 and December 31, 2009, the Company's customer advance balance related to Softbank agreements was \$0.2 million and \$0.2 million, respectively. The current deferred revenue balance related to Softbank was \$1.2 million and \$1.4 million as of June 30, 2010 and December 31, 2009, respectively. As of June 30, 2010, the Company's noncurrent deferred revenue balance related to Softbank was \$7.8 million compared to \$8.8 million as of December 31, 2009.

As discussed in Note 6, the Company has a \$1.1 million investment in SBI. Affiliates of Softbank have a controlling interest in SBI.

As of June 30, 2010, Softbank beneficially owned approximately 11% of the Company's outstanding stock.

NOTE 17 VARIABLE INTEREST ENTITIES

In October 2008, the Company made an investment in Turnstone Environment Technologies LLC (TET), a Delaware limited liability company formed for the purpose of licensing and developing energy efficient renewable cooling solutions for cell towers in the telecommunications industry. In exchange for 5,180,788 Series A Preferred units representing approximately 22% of voting interest in TET and 500,000 Series A Preferred warrants at an exercise price of \$0.9265 per unit and with an expiration term of 5 years, the Company contributed \$4.8 million in cash. The Company currently does not have any representation on TET's board of directors nor the ability to control the management and operation decisions of TET. The operations of TET are in the development stage and the entity is actively seeking additional investors. The Company does not intend to and has no obligation to fund future losses or make additional contributions other than its initial investment. As of December 31, 2009 and 2008, TET was in effect entirely funded by the Company's initial investment as the capital contributions of the other current investors were not substantive. The Company determined that the venture was a variable interest entity and the Company was the primary beneficiary because it was exposed to the majority of the variable interest entity's expected losses. Therefore, the Company was required to consolidate TET's financial statements under ASC 810-10-15, Variable Interest Entities Subsections. Beginning January 1, 2009, the assets, liabilities and operating results of TET were consolidated into the Company's balance sheet and statement of operations. TET had no revenues and \$3.9 million in expenses for the year ended December 31, 2009, of which \$3.1 million relates to amortization of an acquired exclusive license to utilize solar cooling technology. The Company initially determined the appropriate amortization period for the exclusive license was to match the estimated revenue generation period from sale of products utilizing the licensed technology. In the third quarter of 2009, as a result of the delay in revenue generation, the Company changed its estimate to a systematic and rational allocation of straight-line amortization expense based on the term of the technology license. TET's operations are not considered to be integral to the Company's major operating activities. As such, all income and expenses from TET's operations, which are includable in the Company's income statement as a result of the application of ASC 810-10-15, Variable Interest Entities Subsections, have been classified within operating expense.

In the fourth quarter of 2009, the Company evaluated several fourth quarter events, including the continued unsuccessful efforts of TET to secure additional funding; the continued unsuccessful efforts of TET to locate a suitable local manufacturing partner, TET's continued need to amend and extend payment due dates of the acquired exclusive license to utilize solar cooling technology and the departure of a key employee of TET. The Company determined that the combined effect of these events, as well as others, was a triggering event for an impairment analysis of TET's long-lived assets. The Company further determined that the estimated cash flows from TET were not sufficient to recover the carrying

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value of TET's net assets. As a result, the Company recorded a \$0.9 million impairment charge, included within operating expense, equal to its initial cost of investment of \$4.8 million less the cumulative absorbed losses to date. As of December 31, 2009, the effect of consolidating TET resulted in an immaterial impact on the consolidated balance sheet.

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In June 2009, the FASB issued authoritative guidance which revised the approach to identifying primary beneficiaries from a quantitative-based risks-and rewards calculation to a qualitative approach when assessing whether an entity has a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest 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 Company adopted this new guidance in the first quarter of fiscal year 2010. Under the new guidance, the Company concluded that it does not have the power to direct the activities of TET that most significantly impact the entity's economic performance, and therefore, is not TET's primary beneficiary which would require consolidation. The Company further concluded that under the new guidance it would have accounted for its initial investment under the cost method. The new guidance also requires an enterprise upon initial adoption to determine the carrying amount of an investment in an entity that is no longer consolidated, as if it always had applied the provisions of the new guidance. Because under either the consolidation model or the cost method, the balance(s) of the assets/liabilities (investment) would be zero in the financial statements of the Company at December 31, 2009 or January 1, 2010, respectively, the adoption of the new guidance in the first quarter of 2010 has no financial statement impact to the Company.

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

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q 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. Statements that contain words like expects, anticipates, may, will, targets, projects, intends, believes, seeks, estimates, or variations of such words and similar expressions are forward-looking statements. In addition, any statements that refer to trends in our businesses, future financial results, and our liquidity and business plans are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks and uncertainties, including those discussed in Part II, Item 1A-Risk Factors of this Form 10-Q. 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 those 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-Q.

EXECUTIVE SUMMARY

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 business is based in China, India and other Asia markets. We also continue to maintain a presence in selective markets in 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 devices can be changed or upgraded in modules, saving our customers the expense of replacing their entire system installation.

Overview of Our Second Quarter 2010

- In the second quarter of 2010, we completed the sale of our manufacturing, research and development and administrative office facility in Hangzhou, China (the Hangzhou facility) to a third party for proceeds of approximately \$138.8 million and the leaseback of approximately one-third of the property through 2016. We derecognized the building from our balance sheet and recorded a deferred gain of \$7.7 million at the time of sale. The deferred gain was represented by the gross sales

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proceeds of \$138.8 million, less \$7.5 million of transaction related taxes and other fees, and less the net book value of the Hangzhou facility of \$123.6 million. The deferred gain on the sale-leaseback is being amortized in proportion to the related gross rental charged to expense over the leaseback term.

- In June 2010, we completed a sale of our non-core IP Messaging and US PDSN Assets as part of our strategy to focus on core IP-based product offerings. The divested assets were located in North America, Caribbean, and Latin America regions and were part of the Multimedia Communications segment. Consideration for the approximately \$1.7 million of net liabilities transferred included approximately \$0.4 million cash proceeds plus potential additional contingent consideration of up to \$1.6 million. A gain of \$2.1 million, net of taxes, was recognized in June 2010 as a reduction to operating expenses. The disposal of these product lines is not expected to have a material impact on future operating results of the Multimedia Communications segment.
- Net sales decreased by \$7.0 million to \$73.2 million during the three months ended June 30, 2010 compared to the same period in 2009. The decrease was primarily due to the wind-down of our handset business which resulted in a decrease of \$11.7 million in revenue. This decrease was partially offset by the \$5.7 million increase in sales of Broadband Infrastructure segment. Accelerated amortization of \$23.1 million of PAS deferred product revenue offset the decrease in revenue of all other major product lines of the Multimedia Communications segment.
- Gross profit was \$22.9 million, or 31% of net sales in the second quarter of 2010 compared to negative \$15.8 million, or negative 20% of net sales in the corresponding period of 2009. The overall gross profit increase both in absolute dollars and percentage of net sales was primarily due to additional inventory reserves and claim settlement recorded in the second quarter of 2009 related to certain handsets sold to PCD LLC for the Handsets segment.
- Selling, general and administrative and research and development operating expenses decreased \$13.0 million primarily as a result of lower costs as a result of restructuring and other cost reduction initiatives, partially offset by a \$0.3 million provision for doubtful accounts during the three months ended June 30, 2010 compared to \$10.5 million recovery of doubtful accounts in the same period of 2009.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon our Consolidated Condensed Financial Statements, which we have prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. 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.

On a regular basis we evaluate our estimates, assumptions and judgments and make changes accordingly. An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, if different estimates reasonably could have been used, or if changes in the estimate that are reasonably likely to occur could materially impact the financial statements. We believe that the estimates, assumptions and judgments involved in revenue recognition, receivables and

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allowances for doubtful accounts, accruals including third party commissions payable, restructuring liabilities, litigation and other contingencies, stock-based compensation, product warranty, variable interest entities, inventories, deferred costs, research and development and capitalized software development costs, income taxes, impairment of intangible assets and long-lived assets, and valuation and impairment of investments have the greatest potential impact on our condensed consolidated financial statements, so we consider these to be our critical accounting policies. Management believes that there have been no significant changes during the six months ended June 30, 2010 to the items that we disclosed as our critical accounting policies and estimates in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2009.

RECENT ACCOUNTING PRONOUNCEMENTS

For a description of the new accounting standards that affect us, see Note 2 of Notes to our Condensed Consolidated Financial Statements included under Part I, Item 1 of this Quarterly Report on Form 10-Q.

RESULTS OF OPERATIONS

In the fourth quarter of 2009, we substantially completed the wind-down of our handset business. Except for sales relating to inventory clearing, we do not expect any significant revenue from our handset segment in the remainder of 2010. In addition, in order to optimize our resources and improve efficiency, beginning on January 1, 2010 we integrated our Services Segment into our

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Multimedia Communications and Broadband Infrastructure segments based on products for which services are performed. Effective January 1, 2010, the new reporting segments are as follows:

- **Multimedia Communications** Focused on development and market opportunities in IPTV solutions and Wireless infrastructure technologies, including related services revenue.
- **Broadband Infrastructure** Focused on our world class portfolio of broadband products, including related services revenue.
- **Handsets** Focused on mobile phone business including 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.

We have reclassified our previously reported segment information for the three and six months ended June 30, 2009 to conform to the current segment presentation.

NET SALES

| | Three months ended June 30, | | | | Six months ended June 30, | | | |
|------------------------------------|-----------------------------|----------------|-----------|----------------|---------------------------|----------------|------------|----------------|
| | 2010 | % of net sales | 2009 | % of net sales | 2010 | % of net sales | 2009 | % of net sales |
| (in thousands, except percentages) | | | | | | | | |
| Net Sales by Segment | | | | | | | | |
| Multimedia Communications | \$ 46,986 | 64% | \$ 47,993 | 60% | \$ 89,311 | 58% | \$ 90,476 | 45% |
| Broadband Infrastructure | 24,681 | 34% | 18,986 | 24% | 59,235 | 38% | 39,782 | 20% |
| Handsets | 1,498 | 2% | 13,184 | 16% | 5,466 | 4% | 69,245 | 35% |
| | \$ 73,165 | 100% | \$ 80,163 | 100% | \$ 154,012 | 100% | \$ 199,503 | 100% |

| | Three months ended June 30, | | | | Six months ended June 30, | | | |
|------------------------------------|-----------------------------|----------------|-----------|----------------|---------------------------|----------------|------------|----------------|
| | 2010 | % of net sales | 2009 | % of net sales | 2010 | % of net sales | 2009 | % of net sales |
| (in thousands, except percentages) | | | | | | | | |
| Net Sales by region | | | | | | | | |
| United States | \$ 2,450 | 3% | \$ 1,731 | 2% | \$ 5,903 | 4% | \$ 42,990 | 22% |
| China | 43,211 | 59% | 52,531 | 66% | 83,186 | 54% | 103,749 | 52% |
| Japan | 11,137 | 15% | 6,505 | 8% | 22,233 | 14% | 13,042 | 7% |
| India | 6,555 | 9% | 9,536 | 12% | 12,353 | 8% | 19,120 | 10% |
| Philippines | 2,990 | 4% | 2,091 | 3% | 15,674 | 10% | 2,896 | 1% |
| Other | 6,822 | 10% | 7,769 | 9% | 14,663 | 10% | 17,706 | 8% |
| Total net sales | \$ 73,165 | 100% | \$ 80,163 | 100% | \$ 154,012 | 100% | \$ 199,503 | 100% |

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Three months ended June 30, 2010 and 2009

Net sales decreased by 9% to \$73.2 million during the three months ended June 30, 2010 compared to the same period in 2009. The decrease was primarily due to the wind-down of our handset business which resulted in a decrease of \$11.7 million in revenue. This decrease was partially offset by the \$5.7 million increase in sales of Broadband Infrastructure segment. Multimedia Communications net sales was at \$47.0 million for the three months ended June 30, 2010 as compared to \$48.0 million for the same period of 2009 mainly due to the accelerated amortization of PAS deferred product revenue offsetting the decrease in revenue of all other major product lines of the segment.

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Six months ended June 30, 2010 and 2009

Net sales decreased by 23% to \$154.0 million during the six months ended June 30, 2010 compared to the same period in 2009. The decrease was primarily due to the wind-down of our handset business which resulted in a decrease of \$63.8 million in revenue. This decrease was partially offset by the \$19.5 million increase in sales of Broadband Infrastructure segment mainly due to \$11.9 million MSAN product revenue recognized from an international customer in the first quarter of 2010. Multimedia Communications net sales was at \$89.3 million for the six months ended June 30, 2010 as compared to \$90.5 million for the same period of 2009, mainly due to the accelerated amortization of PAS deferred product revenue offsetting the decrease in revenue of all other major product lines of the segment.

For additional discussion, see the Segment Reporting section of this Item 2.

In 2010 and beyond, we do not expect significant new contracts for our PAS handsets and infrastructure equipment. As of June 30, 2010, we have approximately \$141.7 million of deferred revenue associated with PAS infrastructure sales to be recognized ratably over the expected period of support. We review assumptions regarding the estimated post contract support periods on a regular basis. Due to the China telecommunication industry restructuring and launching 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 fourth quarter of 2009, we 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 first 2 quarters of 2010 were increased by approximately \$25.3 million and \$8.9 million, respectively compared to the same periods in 2009. In both 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.

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. Our growth in India, however, may be adversely impacted by recent changes in India requiring all manufacturers to satisfy certain security and supply chain standards to the satisfaction of Indian authorities. We are pursuing alternative long-term solutions and working with the carriers who use our products to make sure we can satisfy these new requirements.

GROSS (LOSS) PROFIT

| | Three months ended June 30, | | | | Six months ended June 30, | | | |
|---------------------------------------|------------------------------------|----------------|-------------|----------------|---------------------------|----------------|-----------|----------------|
| | 2010 | Gross Profit % | 2009 | Gross Profit % | 2010 | Gross Profit % | 2009 | Gross Profit % |
| | (in thousands, except percentages) | | | | | | | |
| Gross (loss) profit by Segment | | | | | | | | |
| Multimedia | | | | | | | | |
| Communications | \$ 12,551 | 27% | \$ 15,835 | 33% | \$ 28,571 | 32% | \$ 28,703 | 32% |
| Broadband Infrastructure | 8,222 | 33% | 2,548 | 13% | 17,845 | 30% | 5,030 | 13% |
| Handsets | 2,099 | 140% | (34,221) | (260)% | 3,665 | 67% | (27,919) | (40)% |
| | \$ 22,872 | 31% | \$ (15,838) | (20)% | \$ 50,081 | 33% | \$ 5,814 | 3% |

Cost of sales consists primarily of material and labor costs, including stock-based compensation, associated with manufacturing, assembly and testing of products, costs associated with installation and customer training, warranty costs, fees to agents, inventory write-downs 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 obtaining Chinese import permits and approvals. Our global program to outsource our manufacturing operations is still in progress.

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

Table of Contents*Three months ended June 30, 2010 and 2009*

Gross profit was \$22.9 million, or 31% of net sales, in the three months ended June 30, 2010 compared to negative \$15.8 million, or negative 20% of net sales, in the corresponding period of 2009. The overall gross profit increase both in absolute dollars and percentage of net sales was primarily due to additional inventory reserves and claim settlement recorded in the second quarter of 2009 related to certain handsets sold to PCD LLC for the Handsets segment. The increased sales of Broadband product with high margin contributed \$5.7 million gross margin in the second quarter of 2010, compared to the same period in 2009. In addition, the decrease in sales of higher margin Multimedia Communications products was partially offset by the acceleration of PAS deferred product revenue amortization.

Six months ended June 30, 2010 and 2009

Gross profit was \$50.1 million, or 33% of net sales, in the six months ended June 30, 2010 compared to \$5.8 million, or 3% of net sales, in the corresponding period of 2009. The overall gross profit increase both in absolute dollars and percentage of net sales was primarily due to the acceleration of PAS deferred product revenue amortization of Multimedia Communications segment, increased sales of higher margin TN products in the Broadband Infrastructure segment and less reserve in Handset segment, which was partially offset by the loss in sales of other Multimedia Communications products. Compared to the six months ended June 30, 2009, Broadband Infrastructure segment contributed \$12.8 million increase in gross profit in the same period of 2010. There was \$31.6 million gross profit increase in Handset segment for the six months ended June 30, 2010 compared to the same period in 2009 primarily due to additional inventory reserves and claim settlement recorded in the second quarter of 2009 related to certain handsets sold to PCD LLC, as well as additional inventory reserves in the first quarter of 2009, partially offset by an \$8.5 million decrease to cost of sales in the Handsets segment resulting from the amortization of the Marvell supply agreement during the first quarter of 2009 (See Note 3 of notes to our condensed consolidated financial statements included under Part I, Item 1 of this Quarterly Report on Form 10-Q.)

For additional discussion, see the Segment Reporting section of this Item 2.

OPERATING EXPENSES

The following table summarizes our operating expenses:

| | Three months ended June 30, | | | | Six months ended June 30, | | | |
|-------------------------------------|------------------------------------|----------------------|-----------|----------------------|---------------------------|----------------------|-----------|----------------------|
| | 2010 | % of net sales | 2009 | % of net sales | 2010 | % of net sales | 2009 | % of net sales |
| | (in thousands, except percentages) | | | | | | | |
| Selling, general and administrative | \$ 21,162 | 29% | \$ 26,971 | 34% | \$ 51,352 | 33% | \$ 81,151 | 41% |
| Research and development | 9,078 | 12% | 16,229 | 20% | 19,101 | 12% | 37,737 | 19% |
| Restructuring | (216) | 0% | 27,757 | 35% | 7,291 | 5% | 32,576 | 16% |

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| | | | | | | | | |
|------------------------------|-----------|------|-----------|------|-----------|------|------------|------|
| Net gain on divestitures | (2,056) | (3)% | (1,357) | (2)% | (3,808) | (2)% | (1,357) | (1)% |
| Total net operating expenses | \$ 27,968 | 38% | \$ 69,600 | 87% | \$ 73,936 | 48% | \$ 150,107 | 75% |

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 (R&D) 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

Three months ended June 30, 2010 and 2009

SG&A expenses were \$21.2 million for the three months ended June 30, 2010, a decrease of \$5.8 million as compared to \$27.0 million for the same period in 2009. The decrease in SG&A expense was primarily due to a \$9.4 million decrease in personnel related expenses as a result of our restructuring plans and recent cost reduction measures, a \$2.6 million reduction in legal and accounting fees as a result of reduced activity in investigations and litigation, a \$0.8 million reduction in advertising and marketing, sales promotions, as well as shows and exhibits expenses due to reduced sales activities, and a \$0.4 million decrease in travel related expenses due to reduced travel activity and cost containment efforts, and a \$1.0 million decrease in facility related expenses, a \$0.7

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million reduction in other taxes, fees, licenses, and a \$0.3 million reduction in insurance as a result of the reduced cost structure. These cost savings were partially offset by a \$0.3 million provision for doubtful accounts during the three months ended June 30, 2010 compared to \$10.5 million recovery of doubtful accounts in the same period of 2009.

Six months ended June 30, 2010 and 2009

SG&A expenses were \$51.4 million for the six months ended June 30, 2010, a decrease of \$29.8 million as compared to \$81.2 million for the same period in 2009. The decrease in SG&A expense was primarily due to a \$21.1 million decrease in personnel related expenses as a result of our restructuring plans and recent cost reduction measures, a \$5.5 million reduction in legal and accounting fees as a result of reduced activity in investigations and litigation, a \$2.1 million reduction in advertising and marketing, sales promotions, as well as shows and exhibits expenses due to reduced sales activities, a \$0.8 million savings from reduction in the use of outside services, and a \$1.2 million decrease in travel related expenses due to reduced travel activity and cost containment efforts and a \$2.6 million decrease in facility related expenses, a \$0.8 million reduction in other taxes, fees, licenses and a \$0.7 million reduction in insurance as a result of the reduced cost structure. These cost savings were partially offset by a \$4.3 million provision for doubtful accounts compared to \$2.1 million recovery of doubtful accounts in the same period of 2009.

RESEARCH AND DEVELOPMENT

Three months ended June 30, 2010 and 2009

R&D expenses decreased by \$7.2 million during the three months ended June 30, 2010 compared to the same period in 2009. The decrease was mainly due to a \$5.6 million decrease as a result of our restructuring plans, \$0.2 million savings from reduction in use of outside services, and a total of \$1.5 million decrease in depreciation, software license, parts and facilities related expenses as we continued to streamline our operations and wind down our handset business unit.

Six months ended June 30, 2010 and 2009

R&D expenses decreased by \$18.6 million during the six months ended June 30, 2010 compared to the same period in 2009. The decrease was mainly due to a \$13.4 million decrease as a result of our restructuring plans, \$1.7 million savings from reduction in use of outside services, and a total of \$3.4 million decrease in depreciation, software license, parts and facilities related expenses as we continued to streamline our operations and wind down our handset business unit.

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RESTRUCTURING

Three and six months ended June 30, 2010

During the three months ended June 30, 2010, we recorded approximately \$0.2 million net reversal of restructuring charges recorded in previous periods. During the six months ended June 30, 2010, we recorded approximately \$7.3 million in restructuring charges.

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 three months ended June 30, 2010, we recorded \$1.4 million reversal of restructuring charges recorded in prior periods resulting from change in estimate. This change in estimate resulted from voluntary resignation of employees originally included in the restructuring plan as well as retention of employees originally identified in the plan and to replace employees who voluntarily resigned. Partially offsetting this reversal was approximately \$0.9 million additional charges related to employees located in the United States and other international locations as we continue to phase-out non-core international operations. During the three months ended June 30, 2010, we also recorded an additional \$0.3 million of lease costs on exited facilities. During the six months ended June 30, 2010, we recorded restructuring costs of approximately \$6.9 million related to the 2009 Restructuring Plan, net of approximately \$1.7 million of reversal of charges recorded in prior periods. The restructuring costs for the six months ended June 30, 2010 consist primarily of severance and benefits related to additional employees included in the Restructuring Plan in the first quarter of 2010, adjusted for change in estimate in the second quarter of 2010. Total restructuring costs recorded through June 30, 2010 related to the 2009 Restructuring Plan approximated \$46.8 million.

During fiscal 2008, we implemented a restructuring plan (the 2008 Restructuring Plan) primarily related to a global reduction in force across all functions and employee terminations at certain non-core operations which we were in the process of winding down. The number of employees affected totaled approximately 750, including 350 in China, 200 in Korea and 200 in other locations including the United States. During the three and six months ended June 30, 2010, we recorded additional restructuring costs related to the 2008 Restructuring Plan of approximately \$0.1 million and \$0.4 million, respectively, for severance and benefit costs being recognized over the remaining service period for employees included in the 2008 Restructuring Plan. Total restructuring costs recorded through June 30, 2010 related to the 2008 Restructuring Plan approximated \$19.8 million.

Three and six months ended June 30, 2009

During the three and six months ended June 30, 2009, we recorded approximately \$27.8 million and \$32.6 million, respectively, in restructuring charges. During the second quarter of 2009, we recorded restructuring charges of approximately \$25.9 million related to the 2009 Restructuring Plan, including \$24.7 million for severance and benefits and \$1.2 million related to the estimated loss on a lease obligation that expires in 2013. During the three and six months ended June 30, 2009, the Company also recorded \$1.8 million and \$6.4 million, respectively, in restructuring charges related to the 2008 Restructuring Plan. The \$6.4 million restructuring charge for the six months ended June 30, 2009 related to the 2008 Restructuring Plan included \$5.3 million for severance and benefits primarily related to the transition of key functions to China and \$1.1 million for lease termination costs. Approximately 60 employees are affected by the transition of these key functions to China.

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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.

GAIN ON DIVESTITURES

Three and six months ended June 30, 2010

Gain on divestiture for the three months ended June 30, 2010 of \$2.1 million was related to the sale of our non-core IP Messaging and US PDSN Assets in June 2010. The divested assets were located in North America, Caribbean, and Latin America regions and were part of the Multimedia Communications segment. Consideration for the approximately \$1.7 million of net liabilities transferred included approximately \$0.4 million cash proceeds plus potential additional contingent consideration of up to \$1.6 million. Due to the uncertainty surrounding receipt of the contingent consideration, we have not included this amount in the gain calculation. If and when additional consideration is received, it will be recognized as additional gain on divestiture. Gain on divestitures for the six months ended June 30, 2010 of approximately \$3.8 million was comprised of the \$2.1 million gain on sale of IP Messaging and US PDSN Assets and \$1.8 million gain on sale of the RAS product line in the first quarter of 2010.

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Three and six months ended June 30, 2009

Gain on divestiture for the three and six months ended June 30, 2009 was comprised of an additional \$1.4 million gain on sale of PCD assets resulting from and adjustment to reflect actual transaction-related costs.

STOCK-BASED COMPENSATION EXPENSE

At June 30, 2010, there was approximately \$5.8 million of total unrecognized compensation cost not including forfeitures, 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 2.4 years. The following table summarizes the stock-based compensation expense in our consolidated statement of operations:

| | Three months ended June 30, | | Six months ended June 30, | |
|-------------------------------------|------------------------------------|-------------|----------------------------------|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Cost of net Sales | \$ 36 | \$ 60 | \$ 93 | \$ 491 |
| Selling, general and administrative | 1,079 | 1,617 | 2,480 | 4,056 |
| Research and development | 153 | 186 | 361 | 1,083 |
| Restructuring | 419 | 417 | 1,613 | 797 |
| Total | \$ 1,687 | \$ 2,280 | \$ 4,547 | \$ 6,427 |

OTHER INCOME (EXPENSE)*INTEREST INCOME*

Three and six months ended June 30, 2010 and 2009

Interest income was \$0.5 million and \$0.6 million for the three months ended June 30, 2010 and 2009, respectively. Interest income was \$0.8 million and \$1.3 million for the six months ended June 30, 2010 and 2009, respectively. Interest income decreased for the six months ended June 30, 2010 compared to the same period in 2009, primarily due to a decline in the average interest rate.

INTEREST EXPENSE

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Three and six months ended June 30, 2010 and 2009

Interest expense was \$0.1 million and \$0.2 million for the three months ended June 30, 2010 and 2009, respectively. Interest expense was \$0.1 million and \$0.5 million for the six months ended June 30, 2010 and 2009, respectively. The decrease in interest expense for the three and six months ended June 30, 2010 compared to the same period in 2009 was primarily attributable to the decreased use of credit facilities in 2010.

OTHER INCOME (EXPENSE), NET

Three months ended June 30, 2010 and 2009

Other expense, net was \$4.8 million for the three months ended June 30, 2010 as compared to other income, net of \$5.4 million for the three months ended June 30, 2009. Other expense, net of \$4.8 million for the three months ended June 30, 2010 consisted primarily of \$4.9 million of foreign currency losses. Other income, net of \$5.4 million for the three months ended June 30, 2009 consisted primarily of foreign currency gains of \$9.0 million, offset partially by a \$3.8 million other-than-temporary impairment of an equity investment.

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Six months ended June 30, 2010 and 2009

Other income, net for the six months ended June 30, 2010 was \$0.1 million as compared to expense of \$1.8 million for the six months ended June 30, 2009. Other income, net for the six months ended June 30, 2010 consisted primarily of \$0.9 million of foreign currency losses, offset partially by \$0.4 million settlement proceeds with MRV Communications (MRV) related to our investment in MRV which was sold in 2009, and \$0.4 million of other immaterial items. Other expense, net for the six months ended June 30, 2009 consisted primarily of a \$3.8 million other-than-temporary impairment of an equity investment, offset partially by foreign currency gains of \$1.7 million.

INCOME TAX EXPENSE

Income tax expense is based upon a blended effective tax rate based upon our expectation of the amount of income to be earned in each tax jurisdiction and is accounted under the liability method. Deferred income taxes are recognized for the differences between the tax bases of assets and liabilities and their financial statement amounts based on enacted tax rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. We expect to maintain a full valuation allowance on our remaining net deferred tax assets until an appropriate level of profitability that generates taxable income is sustained or until we are able to develop tax strategies that would enable us to conclude that it is more likely than not that a portion of our deferred tax assets will be realizable. Any reversal of valuation allowances will favorably impact our results of operations in the period of the reversal.

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.

Three months ended June 30, 2010 and 2009

Income tax benefit was \$0.5 million for the three months ended June 30, 2010 compared to income tax expense of \$4.7 million for the three months ended June 30, 2009. In the second quarter of 2010, a one-time tax benefit of \$0.9 million was recorded mainly related to the release of previously established valuation allowance on deferred tax assets in Taiwan which was offset by foreign tax expenses. The decrease in income tax expense in the three month ended June 30, 2010 compared with three month ended June 30, 2009 was primarily due to the decreased ordinary income in jurisdictions where the Company has been profitable and a one-time tax expense of \$1.4 million in the three month ended June 30, 2009 related to establishing of valuation allowance on net deferred tax assets in Korea.

Six months ended June 30, 2010 and 2009

Income tax expense was \$1.8 million for the six months ended June 30, 2010 compared to \$6.5 million for the six months ended June 30, 2009. The decrease in income tax expense in the six month ended June 30, 2010 compared with six month ended June 30, 2009 was primarily due to the decreased ordinary income in jurisdictions where the Company has been profitable and a one-time tax expense of \$1.4 million in the three

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month ended June 30, 2009 related to establishing of valuation allowance on net deferred tax assets in Korea.

SEGMENT REPORTING

Summarized below are our segment net sales and gross profit for the three and six months ended June 30, 2010 and 2009, respectively.

Multimedia Communications

| | Three months ended June 30, | | Six months ended June 30, | |
|---|------------------------------------|-----------|---------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands, except percentages) | | | |
| Net sales | \$ 46,986 | \$ 47,993 | \$ 89,311 | \$ 90,476 |
| Gross profit | \$ 12,551 | \$ 15,835 | \$ 28,571 | \$ 28,703 |
| Gross profit as a percentage of net sales | 27% | 33% | 32% | 32% |

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During the three months ended June 30, 2010, Multimedia Communications segment's sales were \$47.0 million as compared to \$48.0 million for the same period in 2009 as the accelerated PAS deferred product revenue amortization offset the decrease in revenue of all other major product lines. Amortization of PAS deferred product revenue accounted for \$23.2 million or 49% of Multimedia Communication sales for the three months ended June 30, 2010, compared to \$10.5 million or 22% for the same period in 2009. Revenue from Set Top Box (STB) product accounted for 20% and 9% of Multimedia Communications segments in the second quarter of 2010 and 2009, respectively.

During the six months ended June 30, 2010, sales of Multimedia Communications segment were \$89.3 million as compared to \$90.5 million for the same period in 2009 as accelerated PAS deferred product revenue amortization offset the decrease in revenue of all other major product lines. Amortization of PAS deferred product revenue accounted for \$46.3 million or 52% of Multimedia Communications sales for the six months ended June 30, 2010, compared to \$21.0 million or 23% for the same period in 2009.

The gross profit as a percentage of net sales decreased to 27% for the three months ended June 30, 2010 from 33% for the corresponding period in 2009. The decrease in gross profit percentage was mainly due to loss order provision and inventory provision for STB and NGN products in the second quarter of 2010 as well as an approximately \$1.0 million benefit to gross profit in the second quarter of 2009 from sales of product inventory which was previously fully reserved. The gross profit as a percentage of net sales remained stable at 32% for the six months ended June 30, 2010 and 2009.

In 2010 and beyond, we do not expect significant new contracts for our PAS handsets and infrastructure equipment. We plan to aggressively pursue opportunities for our IPTV product portfolios in multiple markets. 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.

Broadband Infrastructure

| | Three months ended June 30, | | Six months ended June 30, | |
|---|------------------------------------|-----------|---------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands, except percentages) | | | |
| Net sales | \$ 24,681 | \$ 18,986 | \$ 59,235 | \$ 39,782 |
| Gross profit | \$ 8,222 | \$ 2,548 | \$ 17,845 | \$ 5,030 |
| Gross profit as a percentage of net sales | 33% | 13% | 30% | 13% |

Broadband Infrastructure sales increased by 30% and 49%, respectively, during the three and six months ended June 30, 2010 as compared to the same periods in 2009. The increase in sales for the three months ended June 30, 2010 was due to the increase in sales of all major product lines. The increase in sales for the six months ended June 30, 2010 was mainly due to the increase in sales of MSAN products, including \$11.9 million revenue from an international customer. Also contributing to the increase in sales for the six months ended June 30, 2010 was the increase in sales of most major product lines, offset partially by a decrease of MSTP sales. TN product revenue comprised approximately 9% and 1% of Broadband Infrastructure sales for the six months ended June 30, 2010 and 2009, respectively. Softbank in Japan, one of our largest infrastructure customers, represented approximately 44% and 27% of total Broadband sales during the three months ended June 30, 2010 and 2009, respectively, and 36% and 28% during the six months ended June 30, 2010 and 2009, respectively.

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During the fourth quarter of 2009, we began recognizing revenue ratably on a significant customer contract over the seven year warranty period; for the three and six months ended June 30, 2010, we recognized revenue of \$3.2 million and \$6.1 million, respectively, and immaterial gross profit on this contract.

Gross profit percentage increased to 33% for the three months ended June 30, 2010 from 13% for the corresponding period of 2009. The increase in gross profit percentage was primarily due to the increase in high margin product sales to Softbank, including approximately \$2.4 million from the release of previously deferred revenue carve-out for potential penalty and cancellation penalties, and also due to lower provision for inventory and loss order in 2010 compared to 2009. Gross profit percentage increased to 30% for the six months ended June 30, 2010 from 13% for the corresponding period of 2009. The increase in gross profit percentage was primarily due to the increase in high margin product sales to Softbank, including approximately \$2.4 million from the release of previously deferred revenue carve-out for potential penalty and cancellation penalties, and also due to lower provision for inventory in 2010 compared to 2009, as well as the increase in sales of TN product with higher gross margin.

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

Table of Contents**Handsets**

| | Three months ended June 30, | | Six months ended June 30, | |
|---|------------------------------------|-------------|---------------------------|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands, except percentages) | | | |
| Net sales | \$ 1,498 | \$ 13,184 | \$ 5,466 | \$ 69,245 |
| Gross profit | \$ 2,099 | \$ (34,221) | \$ 3,665 | \$ (27,919) |
| Gross profit as a percentage of net sales | 140% | (260)% | 67% | (40)% |

Net sales decreased by 89% and 92% for the three and six months ended June 30, 2010, respectively, compared to the same period in 2009. The decrease was primarily due to the substantial wind-down of our worldwide handset business. Except for sales related to inventory clearing, we do not expect any significant handset revenue in 2010.

Gross profit as a percentage of net sales increased from negative 260% for the three months ended June 30, 2009 to 140% for the corresponding period in 2010. The increase was due to approximately \$1.5 million inventory clearing sales of PAS and CDMA handset which was previously fully reserved and also due to approximately \$0.5 million royalty reversal. In addition, gross loss in the second quarter of 2009 included approximately \$28.7 million as a result of transactions with PCD LLC consisting of a claim settlement of \$11.1 million for product-related liability disputes and product returns and \$17.6 million of costs for inventory write-downs to net realizable value, write-downs of excess inventory and warranty reserves.

Gross profit as a percentage of net sales increased from negative 40% for the six months ended June 30, 2009 to 67% for the corresponding period in 2010. The increase was mainly due to inventory clearing sales of PAS and CDMA handset which was previously fully reserved. We incurred additional warranty reserve recorded during the first quarter of 2009 due to additional repairs for one of our handset products, and additional inventory reserve for our PAS handsets as we anticipated decrease in demand after China launched its 3G networks. The additional PAS handset inventory reserve was partially offset by a decrease to cost of sales from the amortization of the Marvell supply agreement. In addition, gross profit for the six months ended June 30, 2009 was also reduced by approximately \$30.0 million as a result of transactions with PCD LLC consisting of a claim settlement of \$11.1 million for product-related liability disputes and product returns and \$18.9 million of costs for inventory write-downs to net realizable value, write-downs of excess inventory and warranty reserves.

RELATED PARTY TRANSACTIONS*Softbank and affiliates*

We recognize revenue with respect to sales of telecommunications equipment to affiliates of Softbank, a significant stockholder of the 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 its carrier class GEAPON product as well as its NetRing™ product. In addition, we support Softbank's new internet protocol television (IPTV), through sales of its RollingStream™ product. During the three and six months ended June 30, 2010 and 2009, we recognized revenue and related cost of net sales for sales of telecommunications equipment and services to affiliates of Softbank as follows.

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|-------------------|-----------------------------|----------|---------------------------|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| | (in thousands) | | | |
| Net sales | \$ 10,838 | \$ 5,033 | \$ 21,512 | \$ 11,198 |
| Cost of net sales | 3,874 | 2,841 | 8,968 | 6,758 |
| Gross profit | \$ 6,964 | \$ 2,192 | \$ 12,544 | \$ 4,440 |

Gross profit as a percentage of net sales fluctuations are expected and generally result from changes in product mix. In the three and six months ended June 30, 2010, gross profit as a percentage of net sales also benefited approximately \$2.4 million from the release of previously deferred revenue carve-out for potential penalty and cancellation penalties. Included in accounts receivable at June 30, 2010 and December 31, 2009 were \$7.6 million and \$5.5 million, respectively, related to these transactions.

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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 June 30, 2010 and December 31, 2009, our customer advance balance related to Softbank agreements was \$0.2 million and \$0.2 million, respectively. The current deferred revenue balance related to Softbank was \$1.2 million and \$1.4 million as of June 30, 2010 and December 31, 2009, respectively. As of June 30, 2010, our noncurrent deferred revenue balance related to Softbank was \$7.8 million compared to \$8.8 million as of December 31, 2009.

As discussed in Note 6 to our condensed consolidated financial statements included under Part 1, Item 1 of this Quarterly Report on Form 10-Q, we have a \$1.1 million investment in SBI. Affiliates of Softbank have a controlling interest in SBI.

As of June 30, 2010, Softbank beneficially owned approximately 11% of our outstanding stock.

LIQUIDITY AND CAPITAL RESOURCES

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

| | June 30, 2010 | December 31, 2009 (in thousands) | Change |
|-------------------------------------|------------------|--|-----------|
| Cash and cash equivalents | \$ 306,841 | \$ 265,843 | \$ 40,998 |
| Short-term investments - Bank notes | 1,155 | 1,038 | 117 |
| Total | \$ 307,996 | \$ 266,881 | \$ 41,115 |

| | 2010 | Six months ended June 30, 2009 (in thousands) | Change |
|---------------------------------------|-------------|---|-------------|
| Cash used in operating activities | \$ (84,964) | \$ (37,136) | \$ (47,828) |
| Cash provided by investing activities | 123,692 | 1,267 | 122,425 |
| Cash used in financing activities | (30) | (389) | 359 |

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| | | | | | | |
|--|----|--------|----|----------|----|--------|
| Effect of exchange rate changes on cash and cash equivalents | | 2,300 | | (749) | | 3,049 |
| Net increase (decrease) in cash and cash equivalents | \$ | 40,998 | \$ | (37,007) | \$ | 78,005 |

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 June 30, 2010, cash and cash equivalents approximating \$213 million was held by our subsidiaries in China.

Cash used in operating activities during the six months ended June 30, 2010 of \$85.0 million resulted primarily from the net loss of \$24.9 million, adjusted for \$3.8 million gains from investing activities, and by changes in net operating assets and liabilities using net cash of \$67.1 million, partially offset by non-cash charges including \$3.4 million of depreciation and amortization, \$4.5 million stock-based compensation and \$4.2 million provision for doubtful accounts. Changes in net operating assets and liabilities using net cash during the six months ended June 30, 2010 included \$25.3 million for settlement of accounts payable and \$40.5 million for settlement of other liabilities as the Company continues to streamline operations. Changes in deferred revenue of \$53.5 million during the six months ended June 30, 2010 resulted primarily from amortization of PAS deferred product revenue. Cash used in operating activities during the six months ended June 30, 2009 of \$37.1 million resulted primarily from the net loss of \$151.7 million offset by non-cash charges including \$6.9 million of depreciation and amortization, \$6.4 million stock-based compensation and also offset by changes in operating assets and liabilities providing net cash of \$99.7 million. The decrease in sales activity in the first six months of 2009 was the primary driver of the changes in operating assets and liabilities.

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Cash provided by investing activities during the six months ended June 30, 2010 of \$123.7 million included net proceeds from divestiture of \$1.5 million, proceeds from sale of building of \$124.0 million, and changes in restricted cash of \$3.0 million, offset partially by cash outflows including \$3.8 million for net purchases of short-term investments, \$1.8 million for purchases of property, plant and equipment and \$0.6 million for purchase of an investment interest. Cash outflows of approximately \$3.8 million for net purchases of short-term investments related primarily to a non-qualified deferred compensation plan established in fiscal 2010 which allows a six-month deferral of compensation for certain employees. Cash provided by investing activities during the six months ended June 30, 2009 was \$1.3 million. No significant investing activities occurred in the six months ended June 30, 2009.

Cash used in financing was immaterial during the six months ended June 30, 2010 and 2009.

Accounts Receivable, Net

Accounts receivable increased \$2.0 million from \$42.3 million at December 31, 2009 to \$44.3 million at June 30, 2010. At June 30, 2010, our allowance for doubtful accounts was \$30.1 million on gross receivables of \$74.4 million. We recorded provision for doubtful accounts of \$0.3 million and \$4.3 million for the three and six months ended June 30, 2010, respectively. We recorded net recoveries of doubtful accounts of approximately \$10.5 million and \$2.1 million for the three and six months ended June 30, 2009, respectively, primarily due to significant collection of long-aged receivables during the second quarter of 2009, partially offset by provision for doubtful accounts. 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:

| | June 30 2010 | | December 31, 2009 (in thousands) | | Increase (Decrease) |
|----------------------------------|-----------------|----|--|----|------------------------|
| Inventories: | | | | | |
| Raw materials | \$ 8,861 | \$ | 18,863 | \$ | (10,002) |
| Work in-process | 21,715 | | 12,881 | | 8,834 |
| Finished goods | 28,514 | | 40,556 | | (12,042) |
| Total inventories | \$ 59,090 | \$ | 72,300 | \$ | (13,210) |
| Short-term deferred costs | | | | | |
| Short-term deferred costs | \$ 102,231 | \$ | 130,453 | \$ | (28,222) |
| Long-term deferred costs | | | | | |
| Long-term deferred costs | \$ 180,777 | \$ | 184,978 | \$ | (4,201) |

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

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were approximately \$21.8 million and \$33.8 million at June 30, 2010 and December 31, 2009, respectively.

Inventories of approximately \$2.9 million held by the Company's manufacturing outsource partner are recorded in prepaids and other current assets in the condensed consolidated balance sheet at June 30, 2010.

Liquidity

We have incurred net losses of \$225.7 million, \$150.3 million and \$195.6 million during the years ended December 31, 2009, 2008 and 2007, respectively. During the six months ended June 30, 2010, we incurred a net loss of \$24.9 million. We have recorded operating losses in 21 of the 22 consecutive quarters in the period ended June 30, 2010. At June 30, 2010, we have an accumulated deficit of \$1,092.1million. We incurred net cash outflows from operations of \$67.4 million, \$55.2 million and \$225.1 million in 2009, 2008 and 2007 respectively. Cash used in operations was \$85.0 million during the six months ended June 30, 2010. While operating results are expected to improve in 2010 compared with prior years, we expect to continue to incur losses for fiscal 2010.

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At June 30, 2010, we had cash and cash equivalents of \$306.8 million, of which \$213 million was held by our subsidiaries in China. 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.

At June 30, 2010, we had approximately \$28.6 million of available credit facilities. In the second quarter of 2010, we entered into two credit facilities totaling \$29.4 million. Both credit facilities can be used for the issuance of certain letters of credit and guarantees and both facilities expire in the second quarter of 2011.

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 the past two years, 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 Custom 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.

In December 2009, we entered into a Sales Leaseback Agreement for the sale of our manufacturing, research and development, and administrative offices facility in Hangzhou, China to another third party for approximately \$138.8 million with leaseback of a portion of the facility. On May 31, 2010, the buyer and we agreed that all conditions precedent to the closing had been met and the leaseback commenced on June 1, 2010. As of May 31, 2010, we had received all of the sales proceeds and met all criteria for consummation of sale of the Hangzhou facility.

On February 1, 2010, we 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 our common stock by BEIID, and two unrelated investment funds, Elite Noble Limited and Shah Capital Opportunity Fund LP. These investments are expected to close in the third quarter of 2010 and will provide additional cash for working capital and general purposes.

Management believes that both our China and non-China operations have sufficient liquidity to finance working capital and capital expenditure needs during the next 12 months. 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.

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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 June 30, 2010, we do not have any off-balance sheet arrangements.

Contractual obligations and other commitments

Our obligations under contractual obligations and commercial commitments at June 30, 2010 were as follows:

| | Total | Less than 1 year | Payments Due by Period | | 3-5 years | More than 5 years |
|----------------------|------------|---------------------|------------------------|----------------|--------------|----------------------|
| | | | 1-3 years | (in thousands) | | |
| Operating leases | \$ 80,977 | \$ 16,666 | \$ 28,915 | | \$ 28,134 | \$ 7,262 |
| Letters of credit | 25,419 | 13,745 | 9,114 | | 58 | 2,502 |
| Purchase commitments | 33,861 | 33,433 | 428 | | | |
| Total | \$ 140,257 | \$ 63,844 | \$ 38,457 | | \$ 28,192 | \$ 9,764 |

Operating leases

We lease certain facilities under non-cancelable operating leases that expire at various dates through 2013 to 2016. 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 became effective on June 1, 2010 and the contractual obligations related to the Hangzhou facility Lease are included in the table above.

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 of June 30, 2010, we had \$92.4 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 \$14.0 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 \$78.4 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.

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Third Party Commissions

The Company records 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 the Company 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 June 30, 2010, approximately \$6.2 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, the Company will reverse such accruals. Such reversals will be recorded in the Statement of Operations during the period management determines that such accruals are no longer necessary. During the six months ended June 30, 2010 approximately \$0.2 million was released to cost of net sales as a result of expiration of statute of limitations. During the six months ended June 30, 2009, no accruals were released to cost of net sales as a result of expiration of statute of limitations.

ITEM 3 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 June 30, 2010 the carrying value of our cash and cash equivalents approximated fair value.

The table below represents carrying amounts and related weighted-average interest rates of our investment portfolio at June 30, 2010:

(in thousands, except
interest rates)

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| | | |
|------------------------------|----|---------|
| Cash and cash equivalents | \$ | 306,841 |
| Average interest rate | | 0.84% |
| Restricted cash - short-term | \$ | 22,162 |
| Average interest rate | | 0.09% |
| Short-term investments | \$ | 1,155 |
| Average interest rate | | 0.00% |
| Restricted cash - long-term | \$ | 12,090 |
| Average interest rate | | 0.01% |
| Total investment securities | \$ | 342,248 |
| Average interest rate | | 0.76% |

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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 are 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, since 2006, 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 held in China was \$213 million at June 30, 2010. Since China un-pegged the Renminbi from the U.S. Dollar in July, 2005, through June 30, 2010, 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 June 30, 2010. 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 \$14.2 million at June 30, 2010.

ITEM 4 CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

UTStarcom, Inc. (UTStarcom or the Company) maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports the Company files or submits pursuant to the Securities Exchange Act of 1934, as amended (Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's (SEC) rules and forms, and that such information is accumulated and communicated to the Company's management, including its chief executive officer (CEO) and chief financial officer (CFO), as appropriate, to allow timely decisions regarding required financial disclosure.

In connection with the preparation of this Quarterly Report on Form 10-Q (Form 10-Q), the Company carried out an evaluation as of June 30, 2010 under the supervision and with the participation of the Company's management, including the CEO and CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon this evaluation, management concluded that as of June 30, 2010 the Company's disclosure controls and procedures were not effective because of the material weaknesses described in Management's Annual Report on Internal Control over Financial Reporting, included in Part II, Item 9A - Controls and Procedures (Item 9A) in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2009 (the 2009 Annual Report), which have not yet been remediated. Investors are directed to Item 9A in the 2009 Annual Report for the description of these weaknesses.

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 Company's annual or interim financial statements will not be prevented or detected on a timely basis. To address the material weaknesses in internal control over financial reporting noted above, the Company performed additional analyses and other procedures (as further described below under Management's Planned Remediation Initiatives and Interim Measures) to ensure that the Company's consolidated financial statements were prepared in accordance with generally accepted accounting principles in the United States (GAAP). Accordingly, the Company's management believes that the consolidated financial statements included in this Form 10-Q fairly present in all material respects the Company's

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financial condition, results of operations and cash flows for the periods presented and that this Form 10-Q does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this report.

Management's Planned Remediation Initiatives and Interim Measures

The Company plans to make necessary changes and improvements to the overall design of its control environment to address the material weaknesses in internal control over financial reporting noted above. In particular, the Company implemented during 2009 and the first and second quarters of 2010, and plans to continue to implement during the remainder of 2010, the specific measures described below. In addition, in connection with the June 30, 2010 quarter-end reporting process, the Company has undertaken additional measures described under the subheading *Interim Measures* below to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's consolidated financial statements included in this Form 10-Q and to ensure that material information relating to the Company and its consolidated subsidiaries was made known to management in connection with the preparation of this Form 10-Q.

Remediation Initiatives

1. To remediate the material weakness described in Item 9A in the 2009 Annual Report over *The recording of reserves for losses on customer contracts*, the Company transitioned the responsibility for calculating the loss contract reserves to its local project office in India in the third and further quarters of 2008, which facilitated enhanced coordination between the local business units, operations, sales and the finance teams resulting in more timely and complete information available for the finance team to analyze. During the third quarter of 2009, the Company finalized its assessment of additional implemented modules of its ERP system in the operation in India, which enhanced the overall monitoring and analysis of the various accounts and balances in India. Although we believe that these enhanced procedures improved the accuracy of the loss reserve calculation, they did not operate for an adequate period of time to ensure effective remediation as of June 30, 2010. In the remainder of 2010, the Company will continue performing the current procedures and make further enhancements, if needed, to confirm full and effective remediation.
2. To remediate the material weakness described in Item 9A in the 2009 Annual Report over *Period-end financial reporting process* the Company added technical resources to the finance team in China in the third and fourth quarters of 2009 as well as the first and second quarters of 2010. In the remainder of 2010, the Company will continue its effort to consolidate and streamline its global close process in China, to standardize the processes for such financial reviews and to ensure the reviewers analyze and monitor financial information in a consistent and thorough manner. Additional technical resources will enable the Company to broaden the scope and quality of the independent reviews of underlying information related to the Company's period-end financial reporting process.
3. To remediate the material weakness described in Item 9A in the 2009 Annual Report over *internal control over financial reporting related to revenue recognition*, the Company will continue to enhance its contracts review process in order to ensure that appropriate members of management have reviewed and confirmed critical information necessary to assess the proper revenue recognition accounting. The Company will continue to assess and enhance its technical resources to broaden the scope and quality of the independent reviews of underlying information related to the revenue contracts.

Interim Measures

Management has not yet implemented all of the measures described above under the heading Remediation Initiatives and/or tested them. Nevertheless, management believes the measures identified above to the extent they have been implemented, together with other measures undertaken by the Company in connection with the preparation of the condensed consolidated financial statements included in this Form 10-Q and described below, address the material weaknesses in internal control over financial reporting described above. These other measures include the following:

1. Extensive reviews of the reserves for losses on customer contracts including, in India, reviews of the inventory cost against the current cost backlog report and reconciliation between the local cost records to the cost records at the Company's headquarters.

2. A variety of manual review procedures, such as an extensive review of journal entry postings into the ERP system, a thorough review of account reconciliations, including revenue and deferred revenue accounts, and a detailed review at its headquarters of trial balances including those issued from decentralized locations, to ensure the completeness and accuracy of the underlying financial information used to generate the consolidated financial statements.

3. Various reviews of the revenue contracts and associated accounting memos as well as the consolidated revenue schedules and fulfillment status reports to ensure that revenue is accurately and completely recorded.

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Management's Conclusion

Management believes the remediation measures described under Management's Planned Remediation Initiatives and Interim Measures above will strengthen the Company's internal control over financial reporting and remediate the material weaknesses identified above. However, management has not yet implemented all of these measures and/or tested them. Management believes that the interim measures described under Management's Planned Remediation Initiatives and Interim Measures above ensure the reliability of financial reporting and the preparation of the Company's financial statements included in this Form 10-Q and has discussed this with the Company's Audit Committee.

The Company is committed to continue improving its internal control processes and will continue to diligently and vigorously review its disclosure controls and procedures and its internal control over financial reporting in order to ensure compliance with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. However, any control system, regardless of how well designed, operated and evaluated, can provide only reasonable, not absolute, assurance that its objectives will be met. As management continues to evaluate and work to improve the Company's internal control over financial reporting, it may determine to take additional or alternate measures to address control deficiencies, and it may determine not to complete certain of the measures described under Management's Planned Remediation Initiatives and Interim Measures above.

Changes in Internal Control over Financial Reporting

No changes other than those described above occurred during the three months ended June 30, 2010 in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

For a description of litigation and governmental investigations, see Note 10 to our Condensed Consolidated Financial Statements included under Part 1, Item 1 of this Quarterly Report on Form 10-Q.

ITEM 1A RISK FACTORS

For a description of risk factors that could materially affect our business, financial condition and future operating results, please consider the risk factors set forth in Part I, Item 1A Risk Factors of Annual Report on Form 10-K for the fiscal year ended December 31, 2009. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or future operating results.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no unregistered sales of equity securities during the period covered by this report.

Issuer Purchases of Equity Securities

The following table summarizes the Company's stock repurchase activity for the three months ended June 30, 2010:

| Period | Total number of shares Purchased (1) | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Approximate dollar value of shares that may yet be purchased under the plans or programs |
|---------------|---|---|---|---|
| April 2010 | | \$ | | \$ |
| May 2010 | 5,038 | \$ 2.11 | | \$ |
| June 2010 | | \$ | | \$ |
| Total | 5,038 | | | \$ |

(1) During the second quarter of 2010, the Company acquired 5,038 shares of common stock that employees presented to the Company to satisfy withholding taxes in connection with the vesting of restricted stock awards.

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None

ITEM 4 REMOVED AND RESERVED**ITEM 5 OTHER INFORMATION**

None

ITEM 6 EXHIBITS

| Exhibit Number | Description | Form | Incorporated by Reference From Exhibit Number | Date Filed |
|-----------------------|---|-------------|--|-------------------|
| 3.1 | Thirteenth Amended and Restated Certificate of Incorporation of UTStarcom, Inc., as amended. | 8-K | 3.1 | 12/12/2003 |
| 3.2 | Second Amended and Restated Bylaws of UTStarcom, Inc., as effective June 28, 2008. | 8-K | 3.1 | 4/14/2008 |
| 4.1 | See exhibits 3.1 and 3.2 for provisions of the Certificate of Incorporation and Bylaws defining the rights of holders of Common Stock. | | | |
| 4.2 | Specimen Common Stock Certificate. | S-1/A | 4.1 | 2/7/2000 |
| 4.3 | Third Amended and Restated Registration Rights Agreement dated December 14, 1999. | S-1 | 4.2 | 12/20/1999 |
| 4.4 | Stockholder Rights Agreement, made as of February 1, 2010, by and between UTStarcom, Inc. and Beijing E-town International Investment and Development Co., Ltd. | 8-K | 4.1 | 2/4/2010 |
| 4.5 | Stockholder Rights Agreement, made as of February 1, 2010, by and among UTStarcom, Inc., Elite Noble Limited and Shah Capital Opportunity Fund LP. | 8-K | 4.2 | 2/4/2010 |
| 10.1 | Amendment to Common Stock Purchase Agreement dated February 1, 2010 by and between the Company and Beijing E-town | 8-K | 10.1 | 5/4/2010 |

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International Investment and Development Co., Ltd.

| | | | | |
|-------|---|-----|------|----------|
| 10.2 | Amendment to Common Stock Purchase Agreement dated February 1, 2010 by and among the Company, Elite Noble Limited and Shah Capital Opportunity Fund LP. | 8-K | 10.2 | 5/4/2010 |
| 10.3* | Offer Letter to Edmond Cheng dated April 26, 2010. | 8-K | 10.1 | 5/4/2010 |
| 10.4* | Agreement between Kenneth Luk and UTStarcom, Inc. dated May 3, 2010. | 8-K | 10.2 | 5/4/2010 |

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| Exhibit Number | Description | Form | Incorporated by Reference From Exhibit Number | Date Filed |
|-----------------------|--|----------------|--|-------------------|
| 10.5 | Supplementary Agreement on Payment (translation from Chinese). | 10-Q | 10.11 | 5/10/2010 |
| 10.6 | Second Amendment to Common Stock Purchase Agreement dated February 1, 2010, as amended on April 30, 2010, by and between the Company and Beijing E-town International. Investment and Development Co., Ltd. | 8-K | 10.1 | 6/10/2010 |
| 10.7 | Second Amendment to Common Stock Purchase Agreement dated February 1, 2010, as amended on April 30, 2010, by and among the Company, Elite Noble Limited and Shah Capital Opportunity Fund LP. | 8-K | 10.2 | 6/10/2010 |
| 10.8 | Third Amendment to Common Stock Purchase Agreement dated February 1, 2010, as amended on April 30, 2010 and June 4, 2010, by and between the Company and Beijing E-town International Investment and Development Co., Ltd. | 8-K | 10.1 | 7/13/2010 |
| 10.9 | Third Amendment to Common Stock Purchase Agreement dated February 1, 2010, as amended on April 30, 2010 and June 4, 2010, by and among the Company, Elite Noble Limited and Shah Capital Opportunity Fund LP. | 8-K | 10.2 | 7/13/2010 |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | Filed herewith | | |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | Filed herewith | | |
| 32.1 | Certifications Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of the Sarbanes-Oxley Act of 2002. | Filed herewith | | |

* Management contract, plan or arrangement

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

UTSTARCOM, INC.

Date: August 6, 2010

By:

/s/ EDMOND CHENG
Edmond Cheng
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)