

Starent Networks, Corp.  
Form 10-Q  
November 06, 2009  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2009

or

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

For the transition period from            to

Commission File Number: 001-33511

**STARENT NETWORKS, CORP.**

(Exact name of registrant as specified in its charter)

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

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

**30 International Place**  
**Tewksbury, MA 01876**

(Address of principal executive offices) (zip code)

**(978) 851-1100**

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).  Yes  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

As of November 2, 2009, there were 72,120,431 shares of the registrant's \$0.001 par value per share common stock outstanding.

---

**Table of Contents**

**STARENT NETWORKS, CORP.**  
**QUARTERLY REPORT ON FORM 10-Q**  
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009**

**Table of Contents**

| <b>Item</b>  | <b>Page</b> |
|--|-------------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>  |             |
| ITEM 1. <u>Condensed Consolidated Financial Statements (unaudited)</u>   | 3           |
| <u>Condensed Consolidated Balance Sheets as of September 30, 2009 and December 31, 2008</u>                            | 3           |
| <u>Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2009 and 2008</u> | 4           |
| <u>Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2009 and 2008</u>           | 5           |
| <u>Notes to Condensed Consolidated Financial Statements</u>  | 6           |
| ITEM 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                   | 14          |
| ITEM 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 28          |
| ITEM 4. <u>Controls and Procedures</u>   | 28          |
| <b><u>PART II. OTHER INFORMATION</u></b>   |             |
| ITEM 1. <u>Legal Proceedings</u>   | 29          |
| ITEM 1A. <u>Risk Factors</u>   | 29          |
| ITEM 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>   | 43          |
| ITEM 6. <u>Exhibits</u>  | 43          |

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

|   | September 30,<br>2009 | December 31,<br>2008 |
|---|-----------------------|----------------------|
| <b>Assets</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and cash equivalents   | \$ 407,456            | \$ 369,351           |
| Accounts receivable   | 53,836                | 53,689               |
| Inventories   | 56,476                | 48,734               |
| Deferred tax assets, net  | 6,924                 | 3,449                |
| Prepaid expenses and other current assets   | 7,830                 | 4,709                |
| <br>  |                       |                      |
| Total current assets  | 532,522               | 479,932              |
| Property and equipment, net   | 38,541                | 29,632               |
| Deferred tax assets, net  | 15,967                | 9,699                |
| Other assets  | 10,910                | 8,011                |
| Restricted cash   | 821                   | 943                  |
| <br>  |                       |                      |
| Total assets  | \$ 598,761            | \$ 528,217           |
| <br>  |                       |                      |
| <b>Liabilities and stockholders equity</b>  |                       |                      |
| Current liabilities:  |                       |                      |
| Accounts payable  | \$ 13,753             | \$ 9,042             |
| Accrued expenses and other current liabilities  | 12,586                | 8,164                |
| Accrued payroll and related expenses  | 12,216                | 15,195               |
| Accrued income taxes  | 14,180                | 1,945                |
| Current portion of deferred revenue   | 129,505               | 141,726              |
| <br>  |                       |                      |
| Total current liabilities   | 182,240               | 176,072              |
| Deferred revenue, net of current portion  | 7,737                 | 10,959               |
| Other long-term liabilities   | 2,762                 | 2,985                |
| <br>  |                       |                      |
| Commitments and contingencies (Note 8 and 11)   |                       |                      |
| Stockholders equity:  |                       |                      |
| Preferred stock, \$0.001 par value; 5,000,000 shares authorized and no shares outstanding   |                       |                      |
| Common stock, \$0.001 par value; 250,000,000 shares authorized; 71,739,454 and 69,867,985 shares issued and outstanding at September 30, 2009 and December 31, 2008, respectively | 72                    | 70                   |
| Additional paid-in capital  | 396,397               | 371,655              |
| Retained earnings (accumulated deficit)   | 9,553                 | (33,524)             |
| <br>  |                       |                      |
| Total stockholders equity   | 406,022               | 338,201              |

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

|  |            |            |
|--|------------|------------|
| Total liabilities and stockholders' equity | \$ 598,761 | \$ 528,217 |
|--|------------|------------|

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

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

(unaudited and in thousands, except per share data)

|   | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                  |
|---|-------------------------------------|------------------|------------------------------------|------------------|
|   | 2009                                | 2008             | 2009                               | 2008             |
| <b>Revenues:</b>                                  |                                     |                  |                                    |                  |
| Product   | \$ 73,160                           | \$ 55,450        | \$ 202,119                         | \$ 156,497       |
| Service   | 12,810                              | 10,611           | 35,372                             | 26,960           |
| <b>Total revenues</b>                             | <b>85,970</b>                       | <b>66,061</b>    | <b>237,491</b>                     | <b>183,457</b>   |
| <b>Cost of revenues:</b>                          |                                     |                  |                                    |                  |
| Product   | 10,100                              | 10,151           | 29,711                             | 28,697           |
| Service   | 6,405                               | 4,107            | 16,957                             | 11,823           |
| <b>Total cost of revenues</b>                     | <b>16,505</b>                       | <b>14,258</b>    | <b>46,668</b>                      | <b>40,520</b>    |
| <b>Gross profit</b>                               | <b>69,465</b>                       | <b>51,803</b>    | <b>190,823</b>                     | <b>142,937</b>   |
| <b>Operating expenses:</b>                        |                                     |                  |                                    |                  |
| Research and development                          | 16,892                              | 13,750           | 47,478                             | 38,594           |
| Sales and marketing                               | 18,677                              | 17,894           | 52,009                             | 52,918           |
| General and administrative                        | 10,569                              | 6,129            | 23,946                             | 17,215           |
| <b>Total operating expenses</b>                   | <b>46,138</b>                       | <b>37,773</b>    | <b>123,433</b>                     | <b>108,727</b>   |
| <b>Income from operations</b>                     | <b>23,327</b>                       | <b>14,030</b>    | <b>67,390</b>                      | <b>34,210</b>    |
| Interest income                                   | 252                                 | 1,940            | 1,022                              | 6,232            |
| Foreign currency exchange gain (loss)             | 1,299                               | (1,308)          | 2,057                              | (556)            |
| Other income (expense), net                       | 31                                  |                  | (5)                                |                  |
| <b>Income before income tax (expense) benefit</b> | <b>24,909</b>                       | <b>14,662</b>    | <b>70,464</b>                      | <b>39,886</b>    |
| Income tax (expense) benefit                      | (9,787)                             | 4,926            | (27,388)                           | 3,131            |
| <b>Net income</b>                                 | <b>\$ 15,122</b>                    | <b>\$ 19,588</b> | <b>\$ 43,076</b>                   | <b>\$ 43,017</b> |
| <b>Net income per common share (Note 3):</b>      |                                     |                  |                                    |                  |
| Basic   | \$ 0.21                             | \$ 0.28          | \$ 0.61                            | \$ 0.62          |
| Diluted   | \$ 0.20                             | \$ 0.26          | \$ 0.57                            | \$ 0.58          |

Weighted-average shares outstanding used in computing net income per common share (Note 3):

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

|         |        |        |        |        |
|---------|--------|--------|--------|--------|
| Basic   | 71,418 | 69,683 | 70,720 | 69,328 |
| Diluted | 76,356 | 74,192 | 75,752 | 74,343 |

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

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

(unaudited and in thousands)

|   | <b>Nine Months Ended<br/>September 30,</b> |                   |
|---|--|-------------------|
|   | <b>2009</b>                                | <b>2008</b>       |
| <b>Cash flows from operating activities:</b>  |  |                   |
| Net income  | \$ 43,076                                  | \$ 43,017         |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |  |                   |
| Depreciation and amortization   | 12,715                                     | 8,090             |
| Share-based compensation  | 15,941                                     | 12,430            |
| Loss on disposal of property and equipment  | 92   | 36                |
| Benefit from deferred income taxes, net   | (9,746)                                    | (6,622)           |
| Changes in operating assets and liabilities:  |  |                   |
| Accounts receivable   | (85)                                       | (390)             |
| Inventories   | (7,603)                                    | (12,901)          |
| Prepaid expenses and other current assets   | (3,041)                                    | 1,133             |
| Other assets  | 147  | (116)             |
| Accounts payable  | 4,688                                      | 2,399             |
| Accrued expenses and other liabilities  | 477  | 1,448             |
| Accrued income taxes  | 12,181                                     | 1,821             |
| Deferred revenue  | (15,477)                                   | 86,920            |
| <b>Net cash provided by operating activities</b>  | <b>53,365</b>                              | <b>137,265</b>    |
| <b>Cash flows from investing activities:</b>  |  |                   |
| Purchases of property and equipment and other technologies                                  | (22,802)                                   | (16,820)          |
| Proceeds from maturities of short-term investments  |  | 9,610             |
| Investments in and advances to unconsolidated companies                                     | (1,000)                                    |                   |
| Change in restricted cash   | 122  | (43)              |
| <b>Net cash used in investing activities</b>  | <b>(23,680)</b>                            | <b>(7,253)</b>    |
| <b>Cash flows from financing activities:</b>  |  |                   |
| Proceeds from exercises of stock options  | 8,608                                      | 2,683             |
| Additional expenses from public offerings   |  | (87)              |
| <b>Net cash provided by financing activities</b>  | <b>8,608</b>                               | <b>2,596</b>      |
| Effect of exchange rate changes on cash and cash equivalents                                | (188)                                      | (208)             |
| <b>Net increase in cash and cash equivalents</b>  | <b>38,105</b>                              | <b>132,400</b>    |
| Cash and cash equivalents, beginning of year  | 369,351                                    | 223,987           |
| <b>Cash and cash equivalents, end of year</b>   | <b>\$ 407,456</b>                          | <b>\$ 356,387</b> |



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

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

**Table of Contents**

**STARENT NETWORKS, CORP.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Overview**

***Business Description***

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

***Proposed Merger***

As discussed below under Note 11, Subsequent Event , on October 12, 2009, the Company entered into a definitive Agreement and Plan of Merger (the Merger Agreement ) with Cisco Systems, Inc. ( Cisco ) and Barcelona Acquisition Corp. ( Barcelona ), a wholly-owned subsidiary of Cisco. Pursuant to the terms of the Merger Agreement, and subject to the conditions thereof, Barcelona will merge with and into the Company and the Company will become a wholly-owned subsidiary of Cisco (the Merger ). If the Merger is completed, the Company's stockholders will be entitled to receive \$35.00 in cash for each share of the Company's common stock owned by them as of the date of the Merger.

***Basis of Presentation***

The accompanying interim condensed consolidated financial statements have been prepared by the Company, are unaudited and, in the opinion of management, include all adjustments, consisting only of normal, recurring adjustments and accruals necessary for a fair statement of the Company's financial position at September 30, 2009, results of operations for the three and nine months ended September 30, 2009 and 2008, and cash flows for the nine months ended September 30, 2009 and 2008 in accordance with generally accepted accounting principles in the United States ( GAAP ). Interim results are not necessarily indicative of results for any other interim period or a full year. The condensed consolidated balance sheet presented as of December 31, 2008 has been derived from the audited consolidated financial statements as of that date.

The condensed consolidated financial statements and notes are presented as permitted by Form 10-Q and do not contain all of the information that is included in the annual financial statements and notes of the Company. The condensed consolidated financial statements and notes presented herein should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2008.

The Company has evaluated subsequent events through November 6, 2009, the date it filed its report on Form 10-Q for the quarter ended September 30, 2009 with the Securities and Exchange Commission ( SEC ), and has disclosed all material subsequent events in Note 11.

***Significant Estimates and Assumptions***

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenue and expenses during the reporting periods. On an ongoing basis, the Company evaluates its estimates and judgments, including those related to revenue recognition, the realizable value of accounts receivable and inventories, valuation of share-based compensation instruments, loss contingencies and valuation allowances for deferred tax assets. Actual amounts could differ from these estimates. Changes in estimates are recorded in the period in which they become known.

***Reclassification***

Certain prior year amounts related to the classification of foreign currency gains or losses within the operating cash flows section of the condensed consolidated statements of cash flows have been reclassified to conform to the current year presentation. These reclassifications had no impact on previously reported net cash provided by operating activities, results of operations, or any balance sheet captions.



**Table of Contents****STARENT NETWORKS, CORP.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)*****Concentrations of Risk and Off-Balance-Sheet Risk***

The Company has no significant off-balance-sheet risk such as foreign exchange contracts, option contracts or other foreign hedging arrangements. Financial instruments that potentially subject the Company to concentrations of credit risk are principally cash equivalents and accounts receivable. The Company's cash equivalents are principally maintained in a limited number of highly rated financial institutions and consisted primarily of money market funds.

The Company had two customers for the three months ended September 30, 2009 that each accounted for more than 10% of revenues and in the aggregate accounted for 85% of revenues. The Company had one customer for the nine months ended September 30, 2009 that accounted for 70% of revenues. The Company had two customers for the three and nine months ended September 30, 2008, that each accounted for more than 10% of revenues and in the aggregate accounted for 79% and 80% of revenues for each of the respective periods. At September 30, 2009, the Company had two customers that in the aggregate accounted for 52% of accounts receivable. At December 31, 2008, the Company had two customers that in the aggregate accounted for 76% of accounts receivable.

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

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

**2. Share-Based Compensation**

The fair value of share-based option awards was estimated at the date of grant using the Black-Scholes stock option pricing model. The following assumptions were used in determining the fair value:

|                          | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |              |
|--------------------------|-------------------------------------|------------|------------------------------------|--------------|
|                          | 2009                                | 2008       | 2009                               | 2008         |
| Risk-free interest rates | 2.47%                               | 3.30%      | 2.14% - 2.71%                      | 3.01 - 3.30% |
| Expected dividend yield  | 0%                                  | 0%         | 0%                                 | 0%           |
| Expected life            | 6.25 years                          | 6.25 years | 6.25 years                         | 6.25 years   |
| Expected volatility      | 58%                                 | 56%        | 58% - 59%                          | 54 - 56%     |

The Company uses the simplified method to estimate the expected term for share option grants as it does not have enough historical experience to provide a reasonable estimate due to the limited period that the Company's common stock has been publicly traded. In 2008, the Company modified its computation of expected volatility to base it on the combination of historical trading activity of the Company's common stock, the Company's implied volatility, and an analysis of comparable companies from a representative peer group selected based on industry and market capitalization in order to derive an expected volatility. Prior to the modification, the computation of expected volatility was based on the historical volatility of comparable companies from a representative peer group selected based on industry and market capitalization. The risk-free interest rate is based on a U.S. Treasury instrument whose term is consistent with the expected life of the stock options. In addition to the assumptions above, management makes an estimate of expected forfeitures and is recognizing compensation costs only for those equity awards expected to vest.

For restricted stock and restricted stock units, the quoted market price of our common stock at the time of grant is used to estimate fair value.

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

The Company recognizes the compensation cost of share-based awards on a graded-vesting basis over the requisite service period of each award, which is generally the vesting period.

**Table of Contents****STARENT NETWORKS, CORP.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)**

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

|  | <b>Three Months Ended<br/>September 30,<br/>2009</b> |                 | <b>Nine Months Ended<br/>September 30,<br/>2008</b> |                  |
|--|--|-----------------|---|------------------|
| Share-based compensation included in:                                |  |                 |   |                  |
| Cost of revenues   | \$ 596   | \$ 376          | \$ 1,488  | \$ 1,070         |
| <b>Total share-based compensation included in cost of revenues</b>   | <b>596</b>   | <b>376</b>      | <b>1,488</b>  | <b>1,070</b>     |
| Research and development   | 2,379  | 1,594           | 5,766   | 4,701            |
| Sales and marketing  | 1,927  | 1,457           | 4,923   | 3,750            |
| General and administrative   | 1,404  | 1,115           | 3,764   | 2,909            |
| <b>Total share-based compensation included in operating expenses</b> | <b>5,710</b>   | <b>4,166</b>    | <b>14,453</b>                                       | <b>11,360</b>    |
| <b>Total share-based compensation</b>                                | <b>\$ 6,306</b>                                      | <b>\$ 4,542</b> | <b>\$ 15,941</b>                                    | <b>\$ 12,430</b> |

**3. Net Income per Common Share**

The following table presents the calculation of basic and diluted net income per common share (in thousands, except per share data):

|  | <b>Three Months Ended<br/>September 30,<br/>2009</b> |           | <b>Nine Months Ended<br/>September 30,<br/>2008</b> |           |
|--|--|-----------|---|-----------|
| Net income   | \$ 15,122  | \$ 19,588 | \$ 43,076   | \$ 43,017 |
| Weighted-average common shares outstanding - basic             | 71,418   | 69,683    | 70,720  | 69,328    |
| Dilutive effect of stock options and unvested restricted stock | 4,938  | 4,509     | 5,032   | 5,015     |
| Weighted-average common shares outstanding - diluted           | 76,356   | 74,192    | 75,752  | 74,343    |
| Net income per common share:                                   |  |           |   |           |
| Basic  | \$ 0.21  | \$ 0.28   | \$ 0.61   | \$ 0.62   |
| Diluted  | \$ 0.20  | \$ 0.26   | \$ 0.57   | \$ 0.58   |

Basic net income per common share is computed by dividing net income by the weighted-average number of common shares outstanding during the period, excluding the dilutive effects of common stock equivalents. Common stock equivalents include stock options and restricted stock. Diluted net income per common share includes the dilutive effect of stock options and unvested restricted stock under the treasury stock method.

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

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

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2009</b>               | <b>2008</b> | <b>2009</b>              | <b>2008</b> |
| Options to purchase common stock and unvested restricted common stock subject to repurchase | 525                       | 3,361       | 996                      | 2,544       |

#### **4. Fair Value Measurements**

On January 1, 2009, the Company adopted a newly issued accounting standard for fair value measurements of all nonfinancial assets and nonfinancial liabilities not recognized or disclosed at fair value in the financial statements on a recurring basis. The accounting standard for those assets and liabilities did not have a material impact on its financial position, results of operations or liquidity. The Company did not have any significant nonfinancial assets or nonfinancial liabilities that would be recognized or disclosed at fair value on a recurring basis as of September 30, 2009.

**Table of Contents****STARENT NETWORKS, CORP.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)**

The accounting standard for fair value measurements provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The accounting standard established a fair value hierarchy which requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs required as well as the assets and liabilities that we value using those levels of inputs.

The three levels of inputs that may be used to measure fair value are described below:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table summarizes the Company's assets that were measured at fair value on a recurring basis (in thousands):

|   | Fair Value Measurements at September 30, 2009 |         |         |            |
|---|---|---------|---------|------------|
|   | Level 1                                       | Level 2 | Level 3 | Total      |
| (in thousands)                                      |   |         |         |            |
| <b>Cash equivalents:</b>                            |   |         |         |            |
| Money market funds <sup>(1)</sup>                   | \$ 349,704                                    | \$      | \$      | \$ 349,704 |
| <b>Fair Value Measurements at December 31, 2008</b> |   |         |         |            |
| (in thousands)                                      |   |         |         |            |
| <b>Cash equivalents:</b>                            |   |         |         |            |
| Money market funds <sup>(1)</sup>                   | \$ 348,204                                    | \$      | \$      | \$ 348,204 |

<sup>(1)</sup> Included in Cash and cash equivalents in the accompanying Condensed Consolidated Balance Sheets.

The carrying amounts reflected in the condensed consolidated balance sheets for accounts receivable, other current assets, accounts payable and accrued expenses and other current liabilities approximate fair values due to their short-term maturities.

**5. Inventories**

Inventories principally include the cost of raw materials and subassemblies, the cost of third-party contract manufacturers and cost of sales deferred until such time as related revenue is recognized. Deferred costs of sales are included as a component of finished goods. Inventories consisted of the following (in thousands):



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

|                 | September 30,<br>2009 | December 31,<br>2008 |
|-----------------|-----------------------|----------------------|
| Raw materials   | \$ 2,218              | \$ 2,656             |
| Work in process | 7,725                 | 7,545                |
| Finished goods  | 46,533                | 38,533               |
|                 | \$ 56,476             | \$ 48,734            |

**Table of Contents****STARENT NETWORKS, CORP.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)****6. Purchased Technologies**

The Company may purchase software licenses for use in its products. The cost of purchased software to be sold, leased or otherwise marketed that has no alternative future use are accounted in the same manner as if the costs were incurred to develop the software internally. Purchased software is required to be capitalized if technological feasibility has been established and all research and development activities for the other components of the product have been completed. The Company has established technological feasibility by the current use of the software licenses in its products, for which all research and development activities for the other components of the product have been completed. Purchased software licenses are classified as other non-current assets in the condensed consolidated balance sheets.

The following table summarizes the Company's purchased software licenses and related amortization (in thousands):

|                               | September 30,<br>2009 | December 31,<br>2008 |
|-------------------------------|-----------------------|----------------------|
| Software licenses             | \$ 2,100              | \$ 100               |
| Accumulated amortization      | (181)                 | (56)                 |
| <b>Software licenses, net</b> | <b>\$ 1,919</b>       | <b>\$ 44</b>         |

Amortization expense is recorded to product cost of sales on a straight-line basis, which approximates the pattern of economic benefit of the software licenses over the economic life of the software licenses, which is generally 3 to 5 years. For the three and nine months ended September 30, 2009, amortization expense was \$0.1 million for each of the respective periods. For the three and nine months ended September 30, 2008, amortization expense was approximately \$8,000 and \$25,000, respectively.

**7. Income Taxes**

The Company's effective income tax rate was 39.3% and 38.9% for the three and nine months ended September 30, 2009, respectively. The Company's effective income tax rate was (33.6)% and (7.8)% for the three and nine months ended September 30, 2008, respectively. The effective income tax rate was based upon the estimated income for the year, the estimated composition of the income in different jurisdictions and adjustments, if any, in the applicable quarterly periods for potential tax consequences, benefits, resolution of tax audits or other tax contingencies. For the three and nine months ended September 30, 2009, the effective income tax rate varied from the U.S. federal statutory tax rate of 35% primarily due to the effects of nondeductible share-based compensation and state income taxes, both partially offset by federal and state research and development tax credits. The tax rate in the first nine months of 2009 was nearer the statutory tax rate than in the same period of 2008, due to the Company reversing the valuation allowance recorded against its deferred tax assets in the third quarter of 2008. The Company's income tax provision for the three and nine months ended September 30, 2008 included (i) a tax benefit of \$6.6 million recorded upon the Company's decision to release a substantial portion of the valuation allowance recorded against net deferred tax assets and (ii) a provision of \$0.2 million to reserve an uncertain tax position in a foreign jurisdiction. Excluding the effect of this one-time tax benefit and tax reserve, the Company's remaining income tax provisions for the three and nine months ended September 30, 2008 were primarily attributable to federal and state income taxes in the U.S. and taxes related to foreign jurisdictions. The federal and state tax provisions for those periods included amounts in relation to the Company's income generated in the U.S., partially reduced by the utilization of available net operating loss carryforwards and tax credits that were recorded on its balance sheet with a full valuation allowance prior to their utilization.

**8. Litigation**

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

On October 15, 2009, the Company and UTStarcom, Inc. agreed to settle all legal disputes between the two companies. Under the settlement, Starent made a one-time payment to UTStarcom in the amount of \$3.5 million and received a perpetual royalty-free license to UTStarcom patents. Included in the settlement was the dismissal of two previously pending actions in the United States District Courts for the Northern District of Illinois (filed on May 8, 2007) and the Northern District of California (filed on February 16, 2005). During the three months ended September 30, 2009, the Company recognized the \$3.5 million settlement payment as a general and administrative expense.

On October 14, 2009, The Company, its directors and Cisco were named as defendants in a putative class action complaint, captioned *Whitmeyer v. Starent Networks Corp., et al.*, C.A. No. 09-4378-BLS, filed in the Superior Court, Business Litigation Session, of Suffolk County of the Commonwealth of Massachusetts. That action, purportedly brought on behalf of a class of stockholders, alleges that the Company's directors breached their fiduciary duties in connection with the proposed merger by, among other things, failing to maximize stockholder value, fully inform themselves of the Company's market value, obtain the best financial and other terms, and act in the best interests of public stockholders, and seeking to benefit themselves improperly. The suit further alleges that the Company and Cisco aided and abetted the directors' purported breaches. Plaintiff seeks declaratory, injunctive and other equitable relief, including to enjoin the Company and Cisco from consummating the merger, in addition to fees and costs. On October 28, 2009, the defendants filed an answer to the complaint.

On October 20, 2009, the Company, our directors and Cisco were named as defendants in a second putative class action complaint, captioned *Laborers Local 235 Benefit Funds v. Starent Networks Corp., et al.*, C.A. No. 5002, filed in the Court of Chancery of the State of Delaware. On November 3, 2009, the Plaintiff filed a Verified Amended Complaint. In the amended complaint, the Plaintiff purports to represent a class of stockholders and seeks equitable relief, including to enjoin the Company and Cisco from consummating the merger, in addition to fees and costs. Plaintiff alleges in the amended complaint that our directors breached their fiduciary duties by, among other things, agreeing to a proposed merger in which the consideration is unfair and inadequate, failing to take steps to maximize stockholder value, and putting their own interests above those of stockholders, and that the preliminary proxy statement the Company filed with the SEC on October 30, 2009 included materially misleading information concerning the merger. The amended complaint further alleges that Cisco aided and abetted the directors' purported breaches. Also on November 3, 2009, the Plaintiff filed a Motion for Preliminary Injunction seeking to enjoin the merger, and a Motion for Expedited Proceedings. The defendants have yet to file a response to these motions.

The Company believes that the claims asserted in both these suits are without merit.

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

**Table of Contents****STARENT NETWORKS, CORP.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(unaudited)****9. Business Segments**

The Company views its operations and manages its business as one operating segment. Revenue by geography is based on the billing address of the customer. The following tables set forth revenue and long-lived assets by geographic area (in thousands):

**Revenues**

|                          | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                          | 2009                                | 2008      | 2009                               | 2008       |
| United States and Canada | \$ 59,541                           | \$ 54,977 | \$ 195,819                         | \$ 164,619 |
| Japan                    | 20,670                              | 6,788     | 31,208                             | 11,927     |
| Korea                    | 842                                 | 3,427     | 2,558                              | 5,501      |
| Rest of world            | 4,917                               | 869       | 7,906                              | 1,410      |
| Total                    | \$ 85,970                           | \$ 66,061 | \$ 237,491                         | \$ 183,457 |

**Long-lived Assets**

|               | September 30,<br>2009 | December 31,<br>2008 |
|---------------|-----------------------|----------------------|
| United States | \$ 29,987             | \$ 21,059            |
| India         | 7,983                 | 7,857                |
| Rest of world | 571                   | 716                  |
| Total         | \$ 38,541             | \$ 29,632            |

**10. Recent Accounting Standards**

In January 2009, the Company adopted the accounting standard for fair value measurement for all non-financial assets and non-financial liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In January 2009, the Company adopted the accounting standard for determining whether instruments granted in share-based payment transactions are participating securities. This standard provides that vested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform to these provisions. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

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

In January 2009, the accounting standard relating to business combinations became effective for the Company. This standard significantly changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in process research and development and restructuring costs. In addition, under this statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. This standard may have a material impact on the Company's consolidated financial statements if or when it enters into a business combination.

In January 2009, the accounting standard for noncontrolling interests in consolidated financial statements became effective for the Company. This standard changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method significantly changes the accounting for transactions with minority interest holders. The adoption of this standard did not have an impact on the Company's consolidated financial statements.

---

**Table of Contents**

**STARENT NETWORKS, CORP.**

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

**(unaudited)**

In June 2009, the Company adopted the accounting standard that amends the requirements for disclosures about fair value of financial instruments for annual, as well as in interim financial statements. This standard requires those disclosures in all interim financial statements. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In June 2009, the accounting standard for determining whether a market is not active and a transaction is not distressed, became effective for the Company. This standard provides additional authoritative guidance in determining whether a market is active or inactive and whether a transaction is distressed, is applicable to all assets and liabilities (i.e., financial and nonfinancial) and will require enhanced disclosures. This standard did not have an impact on the Company's consolidated financial statements.

In June 2009, the accounting standard for recognition and presentation of other-than-temporary impairments, became effective for the Company. This standard amends the other-than-temporary impairment guidance for debt and equity securities. The adoption of this standard did not have an impact on the Company's consolidated financial statements.

In June 2009, the Company adopted the accounting standard regarding the general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The disclosures required by this standard are reflected in Note 1 of the Company's consolidated financial statements.

In June 2009, the FASB issued a new standard pertaining to the consolidation of variable interest entities that requires an analysis to determine whether a variable interest gives the entity a controlling financial interest in a variable interest entity. This standard also requires an ongoing reassessment of the primary beneficiary of the variable interest entity and eliminates the quantitative approach previously required for determining whether an entity is the primary beneficiary. This standard is effective for fiscal years beginning after November 15, 2009. The company is currently evaluating the impact of adopting the provisions of this standard.

In August 2009, the company adopted the accounting standard pertaining to measuring liabilities at fair value. This standard provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following methods: 1) a valuation technique that uses a) the quoted price of the identical liability when traded as an asset or b) quoted prices for similar liabilities or similar liabilities when traded as assets and/or 2) a valuation technique that is consistent with the fair value measurements accounting standard. This standard also clarifies that when estimating the fair value of a liability, a reporting entity is not required to adjust to include inputs relating to the existence of transfer restrictions on that liability. The adoption of this standard did not have an impact on the Company's consolidated financial statements.

In September 2009, the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles became effective for the Company for interim and annual periods. The Codification does not change U.S. GAAP, but combines all authoritative standards, such as those issued by the FASB, the American Institute of Certified Public Accountants and the Emerging Issues Task Force, into a comprehensive, topically organized online database. The Codification is the single source of authoritative U.S. GAAP applicable for all non-governmental entities, except for rules and interpretive releases of the SEC. The codification did not have a material impact on the Company's consolidated financial statements.

In October 2009, the FASB issued an accounting standard for multiple-deliverable revenue arrangements, which amends previously issued guidance to require an entity to use an estimated selling price when vendor specific objective evidence or acceptable third party evidence does not exist for any products or services included in a multiple element arrangement. The arrangement consideration should be allocated among the products and services based upon their relative selling prices, thus eliminating the use of the residual method of allocation. This standard also requires expanded qualitative and quantitative disclosures regarding significant judgments made and changes in applying this guidance. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. The company is currently evaluating the impact of adopting the provisions of this standard.

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

In October 2009, the FASB issued an accounting standard for certain revenue arrangements that include software elements. This standard amends previously issued guidance to exclude tangible products containing software components and non-software components that function together to deliver the product's essential functionality. Entities that sell joint hardware and software products that meet this scope exception will be required to follow the guidance for multiple-deliverable revenue arrangements. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. The company is currently evaluating the impact of adopting the provisions of this standard.

**Table of Contents**

**STARENT NETWORKS, CORP.**

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

**(unaudited)**

**11. Subsequent Event**

On October 12, 2009, the Company entered into the Merger Agreement with Cisco and Barcelona. Pursuant to the terms of the Merger Agreement, and subject to the conditions thereof, Barcelona will merge with and into the Company and the Company will become a wholly-owned subsidiary of Cisco (the Merger). If the Merger is completed, the Company's stockholders will be entitled to receive \$35.00 in cash for each share of the Company's common stock owned by them as of the date of the Merger. Holders of shares of the Company's common stock that are subject to vesting will only be entitled to receive merger consideration for such shares if and to the extent vesting conditions are met following the Merger. The consummation of the Merger is subject to customary conditions, including adoption of the Merger Agreement by the Company's stockholders and expiration or termination of any waiting period (and any extension thereof) under the Hart-Scott Rodino Antitrust Improvement Act of 1976, as amended. Dates for closing the Merger and for the Company's stockholders meeting have not yet been determined. The Company has made various representations and warranties and agreed to specified covenants in the Merger Agreement, including covenants relating to the conduct of the Company's business between the date of the Merger Agreement and the closing of the Merger, restrictions on solicitation of proposals with respect to alternative transactions, governmental filings and approvals, public disclosures and other matters. The Merger Agreement contains certain termination rights of Cisco and the Company and provides that, upon the termination of the Merger Agreement under specified circumstances, the Company will be required to pay Cisco a termination fee of \$63.5 million.



**Table of Contents**

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

***Cautionary Statement***

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

*our ability to attract and retain customers;*

*our financial performance;*

*our development activities;*

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

*our ability to establish and maintain intellectual property rights;*

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

*our ability to manage growth, both in the United States and internationally;*

*the spending of our proceeds from public offerings of our common stock;*

*our cash needs; and*

*our proposed merger with Cisco Systems, Inc.*

*The outcome of the events described in these forward-looking statements is subject to known and unknown risks, uncertainties and other factors, including the factors set forth in Part II Item 1A Risk Factors in this Quarterly Report on Form 10-Q, that could cause actual results to differ materially from the results anticipated by these forward-looking statements. You should read these factors and the risks described in other documents that we file from time to time with the Securities and Exchange Commission, or SEC, in conjunction with the unaudited condensed consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q and in the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2008.*

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



---

## **Table of Contents**

### *Overview*

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

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

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

We sell our products and services to mobile operators around the world both directly and indirectly through our relationships with original equipment manufacturers, or OEMs, system integrators and distributors. We were founded in 2000 and our products were first used commercially by a mobile operator in the first quarter of 2003. Since 2003, our products have been deployed by over 100 mobile operators in over 45 countries.

We maintain our corporate headquarters in Tewksbury, Massachusetts, and have sales and development offices in various locations worldwide. We conduct our research and development activities at two locations in India and two locations in the United States. As of September 30, 2009, we had 1,009 employees worldwide. Our revenues for the year ended December 31, 2008, were \$254.1 million and for the three and nine months ended September 30, 2009 were \$86.0 million and \$237.5 million, respectively. Our net income for the year ended December 31, 2008 was \$60.5 million and for the three and nine months ended September 30, 2009 was \$15.1 million and \$43.1 million, respectively.

### *Recent Developments*

#### ***Merger Agreement***

On October 12, 2009, we entered into a definitive Agreement and Plan of Merger, which we refer to as the Merger Agreement with Cisco Systems, Inc., or Cisco, and Barcelona Acquisition Corp., or Barcelona, a wholly-owned subsidiary of Cisco. Pursuant to the terms of the Merger Agreement, and subject to the conditions thereof, Barcelona will merge with and into us and we will become a wholly-owned subsidiary of Cisco, which we refer to as the Merger. If the Merger is completed, our stockholders will be entitled to receive \$35.00 in cash for each share of our common stock owned by them as of the date of the Merger. The consummation of the Merger is subject to customary conditions, including adoption of the Merger Agreement by our stockholders and expiration or termination of any waiting period (and any extension thereof) under the Hart-Scott Rodino Antitrust Improvement Act of 1976, as amended. Dates for closing the Merger and for our stockholders meeting have not yet been determined. We have made various representations and warranties and agreed to specified covenants in the Merger Agreement, including covenants relating to the conduct of our business between the date of the Merger Agreement and the closing of the Merger, restrictions on solicitation of proposals with respect to alternative transactions, governmental filings and approvals, public disclosures and other matters. Holders of shares of our common stock that are subject to vesting will only be entitled to receive merger consideration for such shares if and to the extent vesting conditions are met following the Merger. The Merger Agreement contains certain termination rights of Cisco and us and provides that, upon the termination of the Merger Agreement under specified circumstances, we will be required to pay Cisco a termination fee of \$63.5 million.



## **Table of Contents**

### ***Settlement of UTStarcom Litigation***

On October 15, 2009, we agreed with UTStarcom, Inc. to settle all legal disputes between us. Under the settlement, we made a one-time payment to UTStarcom in the amount of \$3.5 million and receive a perpetual royalty-free license to UTStarcom patents. Included in the settlement was the dismissal of two pending actions in the United States District Courts for the Northern District of Illinois (filed on May 8, 2007) and the Northern District of California (filed on February 16, 2005). During the three months ended September 30, 2009, we recognized the \$3.5 million settlement payment as a charge to general and administrative expense.

### ***Statement of Operations Components***

#### ***Revenues***

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

maintenance and technical support associated with our software;

hardware repair and maintenance services; and

implementation, training and professional services.

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collection is probable.

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

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

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

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

*The timing of revenue recognition in relation to the shipment of products.* Our products contain software which is not incidental to our products. We are often required to defer recognition of revenue for a significant period of time after shipment, as a consequence of certain features of our customer arrangements (such as customer acceptance provisions), as well as the requirement that we establish company-specific evidence of the fair values of our products and services.

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

recorded revenues.

*Cost of Revenues*

Cost of revenues consists of costs of products sold and services provided. Cost of products consists primarily of payments to a third party manufacturer for purchased materials and services as well as internal costs, such as salaries and benefits related to personnel, provisions for inventory obsolescence, related overhead and share-based compensation. The use of an outsourced

## **Table of Contents**

manufacturer enables us to conserve working capital, adjust to fluctuations in demand and provide for timely delivery to our customers. Cost of services consists primarily of salaries, benefits and share-based compensation related to professional services and technical support personnel, product repair costs, depreciation and related overhead.

### *Gross Profit*

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

### *Operating Expenses*

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

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

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

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

### *Other Income and Expense Items*

#### ***Interest Income***

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

#### ***Foreign Currency Exchange Gain (Loss)***

Foreign currency gain (loss) primarily consists of foreign currency transactions with international customers and our foreign subsidiaries. The functional currency of our foreign operations is the U.S. dollar. Accordingly, all assets and liabilities of these foreign subsidiaries are remeasured into U.S. dollars using the exchange rates in effect at the balance sheet date, with the exception of certain non-monetary items which are remeasured at historical rates. Revenues and expenses of these foreign subsidiaries are remeasured into U.S. dollars at the average rates in effect during the year.

#### ***Income Tax (Expense) Benefit***

Our income tax expense consists of provisions for income taxes in both the United States and foreign jurisdictions. We provide for income taxes during interim periods based on the estimated effective tax rate for the full fiscal year and record certain discrete items in the period in which they occur, such as incremental tax deductions related to employee stock options as well as changes in tax position uncertainties. Our income tax benefit consisted primarily of a one-time tax benefit due to the release of a substantial portion of the valuation allowance recorded against net deferred tax assets in the United States,

*Application of Critical Accounting Policies and Use of Estimates*

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



**Table of Contents**

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

**Results of Operations****Revenues**

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

|                                   | Three Months Ended     |                    | Period-to-Period Change |            | Nine Months Ended      |                    | Period-to-Period Change |            |
|-----------------------------------|------------------------|--------------------|-------------------------|------------|------------------------|--------------------|-------------------------|------------|
|                                   | September 30, 2009     | September 30, 2008 | \$                      | %          | September 30, 2009     | September 30, 2008 | \$                      | %          |
|                                   | (dollars in thousands) |                    |                         |            | (dollars in thousands) |                    |                         |            |
| <b>Revenues:</b>                  |                        |                    |                         |            |                        |                    |                         |            |
| Product                           | \$ 73,160              | \$ 55,450          | \$ 17,710               | 32%        | \$ 202,119             | \$ 156,497         | \$ 45,622               | 29%        |
| <i>Percentage of revenues</i>     | 85%                    | 84%                |                         |            | 85%                    | 85%                |                         |            |
| Service                           | 12,810                 | 10,611             | 2,199                   | 21         | 35,372                 | 26,960             | 8,412                   | 31         |
| <i>Percentage of revenues</i>     | 15%                    | 16%                |                         |            | 15%                    | 15%                |                         |            |
| <b>Total revenues</b>             | <b>\$ 85,970</b>       | <b>\$ 66,061</b>   | <b>\$ 19,909</b>        | <b>30%</b> | <b>\$ 237,491</b>      | <b>\$ 183,457</b>  | <b>\$ 54,034</b>        | <b>29%</b> |
| <b>Revenues by Customer Type:</b> |                        |                    |                         |            |                        |                    |                         |            |
| Direct                            | \$ 59,157              | \$ 54,070          | \$ 5,087                | 9%         | \$ 194,624             | \$ 163,391         | \$ 31,233               | 19%        |
| <i>Percentage of revenues</i>     | 69%                    | 82%                |                         |            | 82%                    | 89%                |                         |            |
| Indirect                          | 26,813                 | 11,991             | 14,822                  | 124        | 42,867                 | 20,066             | 22,801                  | 114        |
| <i>Percentage of revenues</i>     | 31%                    | 18%                |                         |            | 18%                    | 11%                |                         |            |
| <b>Total revenues</b>             | <b>\$ 85,970</b>       | <b>\$ 66,061</b>   | <b>\$ 19,909</b>        | <b>30%</b> | <b>\$ 237,491</b>      | <b>\$ 183,457</b>  | <b>\$ 54,034</b>        | <b>29%</b> |
| <b>Revenues by Geography:</b>     |                        |                    |                         |            |                        |                    |                         |            |
| United States and Canada          | \$ 59,541              | \$ 54,977          | \$ 4,564                | 8%         | \$ 195,819             | \$ 164,619         | \$ 31,200               | 19%        |
| <i>Percentage of revenues</i>     | 69%                    | 83%                |                         |            | 82%                    | 90%                |                         |            |
| Japan                             | 20,670                 | 6,788              | 13,882                  | 205        | 31,208                 | 11,927             | 19,281                  | 162        |
| <i>Percentage of revenues</i>     | 24%                    | 10%                |                         |            | 13%                    | 7%                 |                         |            |
| Korea                             | 842                    | 3,427              | (2,585)                 | (75)       | 2,558                  | 5,501              | (2,943)                 | (53)       |
| <i>Percentage of revenues</i>     | 1%                     | 5%                 |                         |            | 1%                     | 3%                 |                         |            |
| Rest of world                     | 4,917                  | 869                | 4,048                   | 466        | 7,906                  | 1,410              | 6,496                   | 461        |
| <i>Percentage of revenues</i>     | 6%                     | 1%                 |                         |            | 3%                     | 1%                 |                         |            |
| <b>Total revenues</b>             | <b>\$ 85,970</b>       | <b>\$ 66,061</b>   | <b>\$ 19,909</b>        | <b>30%</b> | <b>\$ 237,491</b>      | <b>\$ 183,457</b>  | <b>\$ 54,034</b>        | <b>29%</b> |

Revenues increased \$19.9 million, or 30%, during the three months ended September 30, 2009 compared to the same period in 2008, due to an increase in product revenues of \$17.7 million and an increase in service revenues of \$2.2 million. Product revenues, which include hardware and software, increased primarily due to product shipments in the United States, Canada and Japan for which we received customer acceptances and recognized revenue during the three months ended September 30, 2009 as compared to the same period in 2008. The \$2.2 million increase in service revenues for the three months ended September 30, 2009 compared to the same period in 2008 was due to an increase in the amount of our products installed at mobile operators, which is generally the basis of maintenance and service fees. Direct revenues increased \$5.1 million, or 9%, primarily due to increased sales to existing customers. Indirect revenues increased \$14.8 million, or 124%, primarily due to the initial

recognition of revenue related to a new customer in Japan.

**Table of Contents**

Revenues increased \$54.0 million, or 29%, during the nine months ended September 30, 2009 compared to the same period in 2008, due to an increase in product revenues of \$45.6 million and an increase in service revenues of \$8.4 million. Product revenues, which include hardware and software, increased primarily due to product shipments in the United States, Canada and Japan for which we received customer acceptances and recognized revenue during the nine months ended September 30, 2009 as compared to the same period in 2008. The \$8.4 million increase in service revenues for the nine months ended September 30, 2009 compared to the same period in 2008 was due to an increase in the amount of our products installed at mobile operators. Direct revenues increased \$31.2 million, or 19%, primarily due to increased sales to existing customers. Indirect revenues increased \$22.8 million, or 114%, as described above.

*Cost of Revenues and Gross Profit*

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

|                                       | Three Months Ended<br>September 30, |           | Period-to-Period Change |     | Nine Months Ended<br>September 30, |            | Period-to-Period Change |     |
|---------------------------------------|-------------------------------------|-----------|-------------------------|-----|------------------------------------|------------|-------------------------|-----|
|                                       | 2009                                | 2008      | \$                      | %   | 2009                               | 2008       | \$                      | %   |
| (dollars in thousands)                |                                     |           |                         |     |                                    |            |                         |     |
| <b>Cost of revenues:</b>              |                                     |           |                         |     |                                    |            |                         |     |
| Product                               | \$ 10,100                           | \$ 10,151 | \$ (51)                 | -1% | \$ 29,711                          | \$ 28,697  | \$ 1,014                | 4%  |
| <i>Percentage of related revenues</i> | 14%                                 | 18%       |                         |     | 15%                                | 18%        |                         |     |
| Service                               | 6,405                               | 4,107     | 2,298                   | 56  | 16,957                             | 11,823     | 5,134                   | 43  |
| <i>Percentage of related revenues</i> | 50%                                 | 39%       |                         |     | 48%                                | 44%        |                         |     |
| Total cost of revenues                | \$ 16,505                           | \$ 14,258 | \$ 2,247                | 16% | \$ 46,668                          | \$ 40,520  | \$ 6,148                | 15% |
| <i>Percentage of revenues</i>         | 19%                                 | 22%       |                         |     | 20%                                | 22%        |                         |     |
| <b>Gross profit:</b>                  |                                     |           |                         |     |                                    |            |                         |     |
| Product                               | \$ 63,060                           | \$ 45,299 | \$ 17,761               | 39% | \$ 172,408                         | \$ 127,800 | \$ 44,608               | 35% |
| <i>Product gross margin</i>           | 86%                                 | 82%       |                         |     | 85%                                | 82%        |                         |     |
| Service                               | 6,405                               | 6,504     | (99)                    | (2) | 18,415                             | 15,137     | 3,278                   | 22  |
| <i>Service gross margin</i>           | 50%                                 | 61%       |                         |     | 52%                                | 56%        |                         |     |
| Total gross profit                    | \$ 69,465                           | \$ 51,803 | \$ 17,662               | 34% | \$ 190,823                         | \$ 142,937 | \$ 47,886               | 34% |
| <i>Gross margin</i>                   | 81%                                 | 78%       |                         |     | 80%                                | 78%        |                         |     |

Product gross margin increased four percentage points to 86% during the three months ended September 30, 2009 as compared to the same period in 2008 due primarily to a higher proportion of software revenue relative to the mix of hardware and software sales in the quarter compared to the prior year. We expect product gross margin to decrease somewhat during the remainder of 2009 due to the expansion of our customer base in certain geographies.

The \$2.3 million increase in cost of services for the three months ended September 30, 2009 as compared to the same period in 2008 was primarily due to higher personnel and overhead costs primarily related to the addition of 50 customer support personnel. Service gross margin decreased eleven percentage points to 50% during the three months ended September 30, 2009 as compared to the same period in 2008. The decrease in margin was due to the increase in expenses described above. We anticipate cost of services will increase during the remainder of 2009 as we continue to expand our customer support organization geographically in future periods; however, we believe service gross margins will increase modestly as we add costs at a slower rate.

Product gross margin increased three percentage points to 85% during the nine months ended September 30, 2009 as compared to the same period in 2008 due primarily to a higher proportion of software revenue relative to the mix of hardware and software sales during the period compared to the prior year.



**Table of Contents**

The \$5.1 million increase in cost of services for the nine months ended September 30, 2009 as compared to the same period in 2008 was primarily due to higher personnel costs and overhead costs primarily related to an increased number of customer support employees. Service gross margin decreased four percentage points to 52% during the nine months ended September 30, 2009 as compared to the same period in 2008 due primarily to the items discussed above.

*Operating Expenses*

The following table sets forth our operating expenses.

|                                 | Three Months Ended     |                  | Period-to-Period Change |            | Nine Months Ended  |                   | Period-to-Period Change |            |
|---------------------------------|------------------------|------------------|-------------------------|------------|--------------------|-------------------|-------------------------|------------|
|                                 | September 30, 2009     | 2008             | \$                      | %          | September 30, 2009 | 2008              | \$                      | %          |
|                                 | (dollars in thousands) |                  |                         |            |                    |                   |                         |            |
| Research and development        | \$ 16,892              | \$ 13,750        | \$ 3,142                | 23%        | \$ 47,478          | \$ 38,594         | \$ 8,884                | 23%        |
| <i>Percentage of revenues</i>   | 20%                    | 21%              |                         |            | 20%                | 21%               |                         |            |
| Sales and marketing             | \$ 18,677              | \$ 17,894        | \$ 783                  | 4%         | \$ 52,009          | \$ 52,918         | \$ (909)                | (2)%       |
| <i>Percentage of revenues</i>   | 22%                    | 27%              |                         |            | 22%                | 29%               |                         |            |
| General and administrative      | \$ 10,569              | \$ 6,129         | \$ 4,440                | 72%        | \$ 23,946          | \$ 17,215         | \$ 6,731                | 39%        |
| <i>Percentage of revenues</i>   | 12%                    | 9%               |                         |            | 10%                | 9%                |                         |            |
| <b>Total operating expenses</b> | <b>\$ 46,138</b>       | <b>\$ 37,773</b> | <b>\$ 8,365</b>         | <b>22%</b> | <b>\$ 123,433</b>  | <b>\$ 108,727</b> | <b>\$ 14,706</b>        | <b>14%</b> |
|                                 | 54%                    | 57%              |                         |            | 52%                | 59%               |                         |            |

Our operating expenses consist primarily of personnel costs, including salaries, commissions, bonuses, share-based compensation and related benefits and taxes; prototype costs related to the design and development of new products and enhancement of existing products; and professional fees, consulting, travel and depreciation expenses. Personnel costs are our largest expense, representing \$25.5 million and \$71.6 million, or 55% and 58%, of our total operating expenses for the three and nine months ended September 30, 2009, respectively. For the three and nine months ended September 30, 2008, personnel costs were \$23.6 million and \$69.1 million, or 63% and 64%, of our total operating expenses for each of the respective periods. The changes in personnel costs are described below.

*Research and development*

The following table sets forth our research and development expenses.

|                               | Three Months Ended     |           | Period-to-Period Change |     | Nine Months Ended  |           | Period-to-Period Change |     |
|-------------------------------|------------------------|-----------|-------------------------|-----|--------------------|-----------|-------------------------|-----|
|                               | September 30, 2009     | 2008      | \$                      | %   | September 30, 2009 | 2008      | \$                      | %   |
|                               | (dollars in thousands) |           |                         |     |                    |           |                         |     |
| Research and development      | \$ 16,892              | \$ 13,750 | \$ 3,142                | 23% | \$ 47,478          | \$ 38,594 | \$ 8,884                | 23% |
| <i>Percentage of revenues</i> | 20%                    | 21%       |                         |     | 20%                | 21%       |                         |     |

Research and development expenses increased \$3.1 million, or 23%, during the three months ended September 30, 2009 as compared to the same period in 2008. The increase was primarily due to increases in cash compensation of \$1.6 million, primarily related to the addition of 138 employees, of which 118 were located in India; and higher depreciation expense of \$1.3 million related to our capital expenditures primarily utilized in our quality assurance and customer lab testing facilities.

Research and development expenses increased \$8.9 million, or 23%, during the nine months ended September 30, 2009 as compared to the same period in 2008. The increase was primarily due to increases in cash compensation of \$3.8 million and higher depreciation expense of \$3.7 million, as described above, and higher share-based compensation expense of \$1.1 million, primarily due to the increase in the fair value of our common stock at the time the share-based awards were granted and our higher number of employees.

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

We intend to continue to invest significantly in our research and development efforts, which we believe are essential to maintaining our competitive position. Accordingly, we anticipate that the amount of personnel costs and depreciation expense will increase during the remainder of 2009 as we continue to add engineering and quality assurance personnel and increase our test lab facilities in a manner consistent with the provisions of our merger agreement with Cisco.

**Table of Contents***Sales and marketing*

The following table sets forth our sales and marketing expenses.

|                               | Three Months Ended     |           | Period-to-Period Change |    | Nine Months Ended  |           | Period-to-Period Change |      |
|-------------------------------|------------------------|-----------|-------------------------|----|--------------------|-----------|-------------------------|------|
|                               | September 30, 2009     | 2008      | \$                      | %  | September 30, 2009 | 2008      | \$                      | %    |
|                               | (dollars in thousands) |           |                         |    |                    |           |                         |      |
| Sales and marketing           | \$ 18,677              | \$ 17,894 | \$ 783                  | 4% | \$ 52,009          | \$ 52,918 | \$ (909)                | (2)% |
| <i>Percentage of revenues</i> | 22%                    | 27%       |                         |    | 22%                | 29%       |                         |      |

Sales and marketing expenses increased \$0.8 million, or 4%, for the three months ended September 30, 2009 as compared to the same period in 2008. This increase was primarily due to higher product demonstration expenses of \$1.4 million, higher share-based compensation expense of \$0.5 million and higher consulting expenses of \$0.4 million. The increases in product demonstration expenses were primarily due to expansion of our sales activities geographically. The increase in share-based compensation was primarily due to the increase in the fair value of our common stock at the time the share-based awards were granted and our higher number of employees. The increase in consulting expenses were primarily due to arrangements we have with third party consultants whose fees are earned as we receive orders from specific customers. The increases in product demonstration, share-based compensation and consulting expenses were partially offset by decreases in cash compensation expense of \$2.0 million. The decrease in cash compensation expense was due to changes in employee compensation plans and the relative achievement against the plans as compared to the same period of 2008, which led to lower commissions being earned during the three months ended September 30, 2009, offset by higher cash compensation primarily related to the addition of 54 employees.

Sales and marketing expenses decreased \$0.9 million, or 2%, for the nine months ended September 30, 2009 as compared to the same period in 2008. This decrease was primarily due to decreases in cash compensation expense of \$6.8 million and consulting expense of \$1.1 million. The decrease in cash compensation was related primarily to lower commission expenses for the same reasons noted above. The decreases in compensation and consulting expenses were offset by higher travel expenses of \$0.7 million due primarily to our employee additions; higher product demonstration expenses of \$3.8 million; higher share-based compensation expense of \$1.2 million and higher other operating expenses, which were primarily due to expansion of our sales activities geographically.

We anticipate continuing to increase the number of sales and marketing personnel we employ in future periods to expand our geographic presence, to address specific customer opportunities and to increase our revenues. The sales commission portion of sales and marketing personnel costs may vary significantly if our customer orders differ materially from the quotas established for our sales personnel.

*General and administrative*

The following table sets forth our general and administrative expenses.

|                               | Three Months Ended     |          | Period-to-Period Change |     | Nine Months Ended  |           | Period-to-Period Change |     |
|-------------------------------|------------------------|----------|-------------------------|-----|--------------------|-----------|-------------------------|-----|
|                               | September 30, 2009     | 2008     | \$                      | %   | September 30, 2009 | 2008      | \$                      | %   |
|                               | (dollars in thousands) |          |                         |     |                    |           |                         |     |
| General and administrative    | \$ 10,569              | \$ 6,129 | \$ 4,440                | 72% | \$ 23,946          | \$ 17,215 | \$ 6,731                | 39% |
| <i>Percentage of revenues</i> | 12%                    | 9%       |                         |     | 10%                | 9%        |                         |     |

General and administrative expenses increased \$4.4 million, or 72%, for the three months ended September 30 2009, as compared to the same period in 2008. The increase was primarily due to the final UTStarcom litigation settlement expense of \$3.5 million, higher cash compensation of \$0.8 million, and higher consulting expenses of \$0.3 million. The increase in cash compensation was primarily related to the addition of 27 employees. The increase in consulting expenses was primarily due to information technology projects. The increases in compensation expense, consulting expense and settlement expenses were partially offset by a decrease in professional fees of \$0.3 million. The decrease in professional fees was primarily due to the receipt of a partial insurance reimbursement of \$1.0 million for legal fees associated with our litigation.





**Table of Contents**

General and administrative expenses increased \$6.7 million, or 39%, for the nine months ended September 30, 2009 as compared to the same period in 2008. The increase was primarily due to the UTStarcom litigation settlement expense of \$3.5 million, higher cash compensation of \$2.4 million, and an increase in consulting expenses of \$1.2 million, as described above. The increases in compensation expense, consulting expense and settlement expenses were partially offset by a decrease in professional fees of \$0.8 million. The decrease in professional fees was primarily due to the receipt of a partial insurance reimbursement of \$1.9 million for legal fees associated with our litigation.

We expect general and administrative expense to decrease in future periods due to the settlement fee being one-time in nature.

*Interest income*

The following table sets forth our interest income.

|                 | Three Months Ended     |          |                         |       | Nine Months Ended      |          |                         |       |
|-----------------|------------------------|----------|-------------------------|-------|------------------------|----------|-------------------------|-------|
|                 | September 30,          |          | Period-to-Period Change |       | September 30,          |          | Period-to-Period Change |       |
|                 | 2009                   | 2008     | \$                      | %     | 2009                   | 2008     | \$                      | %     |
|                 | (dollars in thousands) |          |                         |       | (dollars in thousands) |          |                         |       |
| Interest income | \$ 252                 | \$ 1,940 | \$ (1,688)              | (87)% | \$ 1,022               | \$ 6,232 | \$ (5,210)              | (84)% |

Interest income consists of income generated from the investment of our cash balances. Interest income decreased \$1.7 million and \$5.2 million for the three and nine months ended September 30, 2009 as compared to the same periods in 2008, due primarily to lower rates of return earned on our money market investments.

*Foreign Currency Exchange Gains (Losses)*

The following table sets forth our foreign currency exchange gains (losses).

|                                 | Three Months Ended     |            |                         |        | Nine Months Ended      |          |                         |        |
|---------------------------------|------------------------|------------|-------------------------|--------|------------------------|----------|-------------------------|--------|
|                                 | September 30,          |            | Period-to-Period Change |        | September 30,          |          | Period-to-Period Change |        |
|                                 | 2009                   | 2008       | \$                      | %      | 2009                   | 2008     | \$                      | %      |
|                                 | (dollars in thousands) |            |                         |        | (dollars in thousands) |          |                         |        |
| Foreign currency gains (losses) | \$ 1,299               | \$ (1,308) | \$ 2,607                | (199)% | \$ 2,057               | \$ (556) | \$ 2,613                | (470)% |

For the three months ended September 30, 2009, we recorded foreign currency gains of \$1.3 million as compared to foreign currency losses of \$1.3 million in the same period of 2008. The difference was primarily due to the weakening of the U.S. dollar that occurred during the third quarter of 2009 against foreign currencies in geographic locations in which we operate.

For the nine months ended September 30, 2009, we recorded foreign currency gains of \$2.1 million as compared to foreign currency losses of \$0.6 million in the same period of 2008, as described above.

*Income tax (expense) benefit*

The following table sets forth our income tax (expense) benefit.

|                              | Three Months Ended     |          |                         |        | Six Months Ended       |          |                         |        |
|------------------------------|------------------------|----------|-------------------------|--------|------------------------|----------|-------------------------|--------|
|                              | September 30,          |          | Period-to-Period Change |        | September 30,          |          | Period-to-Period Change |        |
|                              | 2009                   | 2008     | \$                      | %      | 2009                   | 2008     | \$                      | %      |
|                              | (dollars in thousands) |          |                         |        | (dollars in thousands) |          |                         |        |
| Income tax (expense) benefit | \$ (9,787)             | \$ 4,926 | \$ (14,713)             | (299)% | \$ (27,388)            | \$ 3,131 | \$ (30,519)             | (975)% |



**Table of Contents**

For the three and nine months ended September 30, 2009, our effective tax rate was 39.3% and 38.9% on pre-tax income of \$24.9 million and \$70.5 million, respectively, as compared to an effective tax rate of (33.6)% and (7.8)% on pre-tax income of \$14.7 million and \$39.9 million for the three and nine months ended September 30, 2008, respectively. For the three and nine months ended September 30, 2009, our effective income tax rate differed from the federal statutory tax rate mainly due to the effects of nondeductible share-based compensation and state tax expense, both partially offset by federal and state research and development tax credits. Our effective tax rate for the three and nine months ended September 30, 2009 was nearer the statutory tax rate than in the same periods of 2008, primarily due to the one-time net tax benefit of \$6.6 million recorded in the three and nine months ended September 30, 2008 against net deferred tax assets in the U.S. as well as a tax provision of \$0.2 million to reserve an uncertain tax position in a foreign jurisdiction. Our effective tax rates for the three and nine months ended September 30, 2008 were lower than the statutory federal income tax rate of 35% due primarily to the one-time tax items noted above as well as our use of net operating loss carryforwards, or NOLs, and research and development tax credits to offset our U.S. taxable income, partially offset by the impact of taxes owed in relation to the income generated by our foreign subsidiaries.

We expect our annual effective income tax rate, exclusive of discrete items, to remain relatively consistent for the remainder of 2009.

*Net income*

The following table sets forth our net income.

|            | Three Months Ended     |           | Period-to-Period Change |       | Nine Months Ended      |           | Period-to-Period Change |    |
|------------|------------------------|-----------|-------------------------|-------|------------------------|-----------|-------------------------|----|
|            | September 30, 2009     | 2008      | \$                      | %     | September 30, 2009     | 2008      | \$                      | %  |
|            | (dollars in thousands) |           |                         |       | (dollars in thousands) |           |                         |    |
| Net income | \$ 15,122              | \$ 19,588 | \$ (4,466)              | (23)% | \$ 43,076              | \$ 43,017 | \$ 59                   | 0% |

Net income decreased \$4.5 million for the three months ended September 30, 2009 most notably due to the one-time tax benefit recorded in the third quarter of 2008 that did not recur in the current year. Net income remained consistent for the nine months ended September 30, 2009 compared to the same periods in 2008 due to the items discussed above.

*Liquidity and Capital Resources**Resources*

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

*Cash and cash equivalents.* Our cash and cash equivalents at September 30, 2009 of \$407.5 million were held for working capital purposes and were invested primarily in money market funds. We do not enter into investments for trading or speculative purposes. Restricted cash, which totaled \$0.8 million and \$0.9 million at September 30, 2009 and December 31, 2008, respectively, was not included in cash and cash equivalents and was held as collateral for letters of credit related to vendor and lease agreements.

**Table of Contents**

The following table sets forth our net cash flows from operating, investing and financing activities for the periods indicated:

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2009</b>                                | <b>2008</b> |
|   | <b>(dollars in thousands)</b>              |             |
| Net cash provided by operating activities | \$ 53,365                                  | \$ 137,265  |
| Net cash (used in) investing activities   | \$ (23,680)                                | \$ (7,253)  |
| Net cash provided by financing activities | \$ 8,608                                   | \$ 2,596    |

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

The following table sets forth our cash provided by operating activities:

|                                  | <b>Nine Months Ended<br/>September 30,</b> |             |               |
|----------------------------------|--|-------------|---------------|
|                                  | <b>2009</b>                                | <b>2008</b> | <b>Change</b> |
|                                  | <b>(dollars in thousands)</b>              |             |               |
| <b>Received from:</b>            |  |             |               |
| Customers                        | \$ 221,778                                 | \$ 270,690  | \$ (48,912)   |
| Interest                         | 1,123                                      | 7,081       | (5,958)       |
| <b>Payments for:</b>             |  |             |               |
| Employee compensation            | (71,691)                                   | (65,392)    | (6,299)       |
| Inventory                        | (35,590)                                   | (41,950)    | 6,360         |
| Professional and consulting fees | (12,652)                                   | (15,256)    | 2,604         |
| Other operating expenses         | (24,522)                                   | (14,093)    | (10,429)      |
| Income taxes                     | (25,081)                                   | (3,815)     | (21,266)      |
|                                  | \$ 53,365                                  | \$ 137,265  | \$ (83,900)   |

For the nine months ended September 30, 2009, net cash provided by operating activities was \$53.4 million as compared to \$137.3 million for the same period in 2008. During the nine months ended September 30 2009, we received \$221.8 million from our customers, a decrease of \$48.9 million compared to the same period in 2008. This decrease was due primarily to the timing of billing and collections of customer orders. The decrease in cash received from interest of \$6.0 million was due primarily to lower rates of return earned on our money market investments. Our cash received from customers and interest was partially offset by cash payments related to employee compensation, inventories, professional and consulting fees, income taxes and various other operating expenses, as set forth in the table above. The increase in cash paid for employee compensation of \$6.3 million was due primarily to increases in salary and related expenses, partially offset by lower commission payments, as discussed above. The decrease in cash paid for inventories of \$6.4 million was due primarily to lower purchases of inventory. The decrease in cash paid for professional and consulting fees of \$2.6 million was due primarily to a partial insurance reimbursement for legal fees associated with our litigation defense. The increase in payments for other operating expenses of \$10.4 million was due primarily to increases in travel, trial and demonstration equipment, rent and other expenses due to expansion of our operations and our increased number of employees. The increase in cash paid for income taxes of \$21.3 million was due primarily to estimated payments related to federal and state income taxes due to our full utilization of substantially all of our remaining NOL carryforwards in 2008.

*Investing activities.* Cash from investing activities consisted primarily of capital expenditures and proceeds from maturities of short-term investments associated with our investment balances. The \$23.7 million of cash used in investing activities for the nine months ended September 30, 2009 consisted primarily of \$22.8 million of capital expenditures and a \$1.0 million advance to an unconsolidated company. The \$7.3 million of cash used in investing activities for the nine months ended September 30, 2008 consisted primarily of \$16.8 million of capital expenditures, partially offset by \$9.6 million of maturities of short-term investments. Purchases of property and equipment for the nine months ended September 30, 2009 increased \$6.0 million as compared with the same period in 2008, primarily due to an increase in research and development equipment purchases for quality assurance and customer lab testing facilities.



**Table of Contents**

*Financing activities.* Cash from financing activities consisted primarily of proceeds received from exercises of stock options and purchases of our restricted common stock. For the nine months ended September 30, 2009, cash from financing activities increased by \$6.0 million as compared to the same period in 2008.

At September 30, 2009 and December 31, 2008, we had no long-term debt outstanding and our restricted cash was our only asset pledged as collateral.

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

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

*Requirements*

*Capital expenditures.* We have made capital expenditures primarily for testing and evaluation systems and equipment to support product development and customer service, as well as for leasehold improvements and other general purposes to support our growth. For the nine months ended September 30, 2009, our capital expenditures totaled \$22.8 million, of which \$1.0 million was a software license to be used in our products. We expect capital expenditures to be approximately \$27 to \$30 million for 2009, primarily related to purchases of test equipment, equipment to support product development and customer service, leasehold improvements and other general purposes to support our growth. In conjunction with our merger agreement with Cisco, capital expenditures are limited to certain levels. We believe these levels are sufficient to meet our expansion requirements consistent with our plans, but should additional requirements arise, our ability to make certain capital expenditures may be limited.

*Contractual obligations and requirements.* As of September 30, 2009, our commitments under operating leases and purchase obligations were as set forth below.

|                             | Total                  | Remainder of<br>2009 | 1 - 3<br>Years | 4 - 5<br>Years | More than<br>5 Years |
|-----------------------------|------------------------|----------------------|----------------|----------------|----------------------|
|                             | (dollars in thousands) |                      |                |                |                      |
| Operating leases            | \$ 7,131               | \$ 821               | \$ 5,027       | \$ 1,283       | \$                   |
| Purchase obligations        | 23,696                 | 23,521               | 175            |                |                      |
| Contractual obligations (1) | 1,000                  |                      | 1,000          |                |                      |
| Total                       | \$ 31,827              | \$ 24,342            | \$ 6,202       | \$ 1,283       | \$                   |

(1) Represents the remaining payment amount on the purchased software license.

The table above does not reflect unrecognized tax benefits of \$2.9 million, the timing of which is uncertain.

*Off-Balance-Sheet Arrangements*

In the normal course of business, we may enter into agreements with our customers which require us to secure performance bonds that guarantee our execution of certain obligations under the agreements.

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

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

## **Table of Contents**

### *Recent Accounting Standards*

In January 2009, we adopted the accounting standard for fair value measurement for all non-financial assets and non-financial liabilities that are recognized or disclosed at fair value in the financial statements on a non-recurring basis. The adoption of this standard did not have a material impact on our consolidated financial statements.

In January 2009, we adopted the accounting standard for determining whether instruments granted in share-based payment transactions are participating securities. This standard provides that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform to the provisions in this standard. The adoption of this standard did not have a material impact on our consolidated financial statements.

In January 2009, the accounting standard for business combinations became effective for us. This standard significantly changes the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, in process research and development and restructuring costs. In addition, under this statement, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. This standard may have a material impact on our consolidated financial statements if or when we enter into a business combination.

In January 2009, the accounting standard for noncontrolling interests in consolidated financial statements became effective for us. This standard changes the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity. This new consolidation method significantly changes the accounting for transactions with minority interest holders. The adoption of this standard did not have an impact on our consolidated financial statements.

In June 2009, we adopted the accounting standard that amends the requirements for disclosures about fair value of financial instruments in annual, as well as in interim financial statements. This standard requires those disclosures in all interim financial statements. The adoption of this standard did not have a material impact on our consolidated financial statements.

In June 2009, the accounting standard for determining whether a market is not active and a transaction is not distressed, became effective for us. This standard provides additional authoritative guidance in determining whether a market is active or inactive and whether a transaction is distressed, is applicable to all assets and liabilities (i.e., financial and nonfinancial) and will require enhanced disclosures. This standard did not have an impact on our consolidated financial statements.

In June 2009, the accounting standard for recognition and presentation of other-than-temporary impairments became effective for us. This standard amends the other-than-temporary impairment guidance for debt and equity securities. The adoption of this standard did not have an impact on our consolidated financial statements.

In June 2009, we adopted the standard regarding the general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The disclosures required by this standard are reflected in Note 1 of our consolidated financial statements.

In June 2009, the FASB issued a new standard pertaining to the consolidation of variable interest entities that requires an analysis to determine whether a variable interest gives the entity a controlling financial interest in a variable interest entity. This standard also requires an ongoing reassessment of the primary beneficiary of the variable interest entity and eliminates the quantitative approach previously required for determining whether an entity is the primary beneficiary. This standard is effective for fiscal years beginning after November 15, 2009. We are currently evaluating the impact of adopting the provisions of this standard.

In August 2009, we adopted the accounting standard pertaining to measuring liabilities at fair value. This standard provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using one or more of the following methods: 1) a valuation technique that uses a) the quoted price of the identical liability when traded as an asset or b) quoted prices for similar liabilities or similar liabilities when traded as assets and/or 2) a valuation technique that is consistent with the fair value measurements accounting standard. This standard also clarifies that when estimating the fair value of a liability, a reporting entity is not required to adjust to include inputs relating to the existence of transfer restrictions on that liability. The adoption of this standard did not have an impact on our consolidated financial statements.





**Table of Contents**

In September 2009, the Financial Accounting Standards Board, or FASB, Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles become effective for us for interim and annual periods. The Codification does not change GAAP, but combines all authoritative standards, such as those issued by the FASB, the American Institute of Certified Public Accountants and the Emerging Issues Task Force, into a comprehensive, topically organized online database. The Codification is the single source of authoritative GAAP applicable for all non-governmental entities, except for rules and interpretive releases of the SEC. The codification did not have a material impact on our consolidated financial statements.

In October 2009, the FASB issued an accounting standard for multiple-deliverable revenue arrangements, which amends previously issued guidance to require an entity to use an estimated selling price when vendor specific objective evidence or acceptable third party evidence does not exist for any products or services included in a multiple element arrangement. The arrangement consideration should be allocated among the products and services based upon their relative selling prices, thus eliminating the use of the residual method of allocation. This standard also requires expanded qualitative and quantitative disclosures regarding significant judgments made and changes in applying this guidance. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. We are currently evaluating the impact of adopting the provisions of this standard.

In October 2009, the FASB issued an accounting standard for certain revenue arrangements that include software elements. This standard amends previously issued guidance to exclude tangible products containing software components and non-software components that function together to deliver the product's essential functionality. Entities that sell joint hardware and software products that meet this scope exception will be required to follow the guidance for multiple-deliverable revenue arrangements. This standard is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption and retrospective application are also permitted. We are currently evaluating the impact of adopting the provisions of this standard.

---

**Table of Contents**

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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

*Foreign Currency Exchange Risk*

Our international customer transactions are predominantly denominated in either U.S. dollars or Euros. Accordingly, we have exposure to changes in the exchange rates between the U.S. dollar and the Euro. We currently do not enter into foreign currency hedging transactions. In addition, the functional currency of our foreign operations in Europe, Asia and South America is the U.S. dollar. Accordingly, all assets and liabilities of these foreign subsidiaries are remeasured into U.S. dollars using the exchange rates in effect at the balance sheet date, with the exception of certain non-monetary items which are remeasured at historical rates. Revenues and expenses of these foreign subsidiaries are remeasured into U.S. dollars at the average rates in effect during the period. Any differences resulting from the remeasurement of assets, liabilities and operations of these subsidiaries are recorded in foreign currency gain (loss) in our consolidated statements of operations. If the foreign currency exchange rates had fluctuated by 10% as of September 30, 2009 and December 31, 2008, our foreign exchange gain or loss would have fluctuated by approximately \$4.1 million and \$0.6 million, respectively.

*Impact of Inflation*

We believe that our revenue and results of operations have not been significantly impacted by inflation during the past three fiscal years. We do not believe that our revenue and results of operations will be significantly impacted by inflation in future periods.

*Interest Rate Risk*

At September 30, 2009, we had unrestricted cash and cash equivalents totaling \$407.5 million. At December 31, 2008, we had unrestricted cash and cash equivalents totaling \$369.4 million. These amounts were invested primarily in money market funds. In periods of financial market volatility, we may hold a greater proportion of our unrestricted cash and cash equivalents in money market funds that invest solely in government securities, which may result in lower yields on these balances. The unrestricted cash and cash equivalents were held for working capital purposes. We do not enter into investments for trading or speculative purposes. Due to the short-term nature of these investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. Declines in interest rates, however, would reduce future investment income.

**ITEM 4. CONTROLS AND PROCEDURES**

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2009. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, or Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2009, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

On October 15, 2009, we agreed with UTStarcom, Inc. to settle all legal disputes between the two companies. Under the settlement, we made a one-time payment to UTStarcom in the amount of \$3.5 million and received a perpetual royalty-free license to UTStarcom patents. Included in the settlement was the dismissal of two pending litigations in the United States District Courts for the Northern District of Illinois (filed on May 8, 2007) and the Northern District of California (filed on February 16, 2005). During the three months ended September 30, 2009, we recognized the \$3.5 million settlement payment as a charge to general and administrative expense.

On October 14, 2009, we, our directors and Cisco were named as defendants in a putative class action complaint, captioned *Whitmeyer v. Starent Networks Corp., et al.*, C.A. No. 09-4378-BLS, filed in the Superior Court, Business Litigation Session, of Suffolk County of the Commonwealth of Massachusetts. That action, purportedly brought on behalf of a class of stockholders, alleges that our directors breached their fiduciary duties in connection with the proposed merger by, among other things, failing to maximize stockholder value, fully inform themselves of Starent's market value, obtain the best financial and other terms, and act in the best interests of public stockholders, and seeking to benefit themselves improperly. The suit further alleges that we and Cisco aided and abetted the directors' purported breaches. Plaintiff seeks declaratory, injunctive and other equitable relief, including to enjoin us and Cisco from consummating the merger, in addition to fees and costs. On October 28, 2009, the defendants filed an answer to the complaint.

On October 20, 2009, we, our directors and Cisco were named as defendants in a second putative class action complaint, captioned *Laborers Local 235 Benefit Funds v. Starent Networks Corp., et al.*, C.A. No. 5002, filed in the Court of Chancery of the State of Delaware. On November 3, 2009, the Plaintiff filed a Verified Amended Complaint. In the amended complaint, the Plaintiff purports to represent a class of stockholders and seeks equitable relief, including to enjoin us and Cisco from consummating the merger, in addition to fees and costs. Plaintiff alleges in the amended complaint that our directors breached their fiduciary duties by, among other things, agreeing to a proposed merger in which the consideration is unfair and inadequate, failing to take steps to maximize stockholder value, and putting their own interests above those of stockholders, and that the preliminary proxy statement we filed with the SEC on October 30, 2009 included materially misleading information concerning the merger. The amended complaint further alleges that Cisco aided and abetted the directors' purported breaches. Also on November 3, 2009, the Plaintiff filed a Motion for Preliminary Injunction seeking to enjoin the merger, and a Motion for Expedited Proceedings. The defendants have yet to file a response to these motions.

We believe that the claims asserted in both these suits are without merit.

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

**ITEM 1A. RISK FACTORS**

*These are risks and uncertainties that could cause actual results to differ materially from the results contemplated by the forward-looking statements contained in this Quarterly Report on Form 10-Q. Because of these factors, as well as other variables affecting our operating results, past financial performance should not be considered as a reliable indicator of future performance and investors should not use historical trends to anticipate results or trends in future periods. These risks are not the only ones facing us. Please also see Cautionary Statement in Part I, Item 2 of this Quarterly Report on Form 10-Q. The following discussion highlights certain risks which may affect future operating results. These are the risks and uncertainties we believe are most important for our existing and potential stockholders to consider. Additional risks and uncertainties not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also impair our business operations. If any of the following risks or uncertainties actually occurs, our business, financial condition and operating results would likely suffer.*

***Risks Related to the Merger***

***Our proposed merger with Cisco may be delayed or not occur at all for a variety of reasons, including the possibility that the merger agreement is terminated prior to the completion of the merger.***

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

The merger agreement with Cisco may be terminated at any time before the completion of the merger, under certain circumstances, including:

by mutual written consent;

by either Cisco or us, if the merger has not been completed by June 12, 2010 with such date to be extended to October 12, 2010, if certain required regulatory approvals are not received or certain other orders are in effect or certain governmental actions are pending, but all other conditions have been satisfied;

by either Cisco or us, if any governmental entity has issued an order, decree or ruling or taken any other action having the effect of permanently prohibiting the closing of the merger that is final and nonappealable;

by either Cisco or us, if our stockholders do not adopt the merger agreement at the special meeting and, in our case, the failure to obtain stockholder approval is not the result of our violation of the merger agreement;

**Table of Contents**

by either Cisco or us, if the other party is in material breach of the merger agreement following notice and an opportunity to cure such breach, if curable;

by Cisco, prior to our stockholders' adoption of the merger agreement, upon the occurrence of any of the following, each a Triggering Event:

our board of directors withholds, withdraws, qualifies, amends or modifies its recommendation to our stockholders to vote in favor of adoption of the merger agreement;

we fail to include such recommendation in our proxy statement;

we fail to convene or hold the special meeting as required under the merger agreement;

any of our directors or officers materially breaches the provisions of the merger agreement regarding our obligations for the special meeting, the recommendation of our board of directors, or non-solicitation of other acquisition proposals;

our board of directors approves or publicly recommends any other acquisition proposal;

we enter into any letter of intent or other agreement accepting any other acquisition proposal;

our board of directors fails to reaffirm its recommendation to our stockholders to vote in favor of adoption of the merger agreement within ten business days after Cisco's request in response to an acquisition proposal or material modification to an acquisition proposal; or

following the commencement of a tender or exchange offer by a party other than Cisco, our board of directors fails to recommend the rejection of such tender or exchange offer or fails to reaffirm its recommendation to our stockholders to vote in favor of adoption of the merger agreement; or

by us, prior to our stockholders' adoption of the merger agreement, upon a change of recommendation for a superior offer and following payment to Cisco of a termination fee of \$63.5 million.

***During the pendency of the merger with Cisco, we may not be able to enter into a business combination with another party because of restrictions in the merger agreement.***

Covenants in the merger agreement limit our ability to make acquisitions or complete other transactions that are not in the ordinary course of business pending completion of the merger with Cisco. While the merger agreement is in effect, and subject to limited exceptions, we have agreed that we will not, directly or indirectly:

solicit, initiate, knowingly encourage, knowingly facilitate or knowingly induce any acquisition proposal or the making of any inquiry or proposal that would reasonably be expected to lead to an acquisition proposal;

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

enter into, participate in, maintain or continue any communications or negotiations regarding, or furnish to any person any non-public information with respect to, or take any other action knowingly facilitating, any acquisition proposal;

agree to, accept, approve, endorse or recommend any acquisition proposal;

enter into any letter of intent or any other contract relating to any acquisition proposal;

submit any acquisition proposal to the vote of our stockholders; or

grant any waiver or release under any standstill or similar agreement with respect to us or our subsidiaries or any class of our equity securities.

---

## **Table of Contents**

At any time prior to obtaining stockholder approval, our board of directors may nevertheless in response to an unsolicited bona fide written acquisition proposal following the date of the merger agreement that is not otherwise obtained in violation of the restrictions set forth in the immediately preceding bullet points and that our board of directors determines in good faith is or would reasonably be expected to lead to a superior offer to the merger:

enter into discussions with the person making the acquisition proposal; and furnish to the person making the acquisition proposal non-public information with respect to us and our subsidiaries pursuant to a confidentiality agreement.

Subject to the satisfaction of certain conditions, our board may withdraw or modify its recommendation to our stockholders for adoption of the merger agreement. In the event that our board withdraws or modifies its recommendation in a manner adverse to Cisco and the merger agreement is terminated, we may be required to pay a termination fee of \$63.5 million to Cisco.

***Class action litigation could require us to incur significant costs and suffer management distraction, as well as delay and/or enjoin our potential merger with Cisco.***

On October 14, 2009, we, our directors and Cisco were named as defendants in a putative class action complaint, captioned *Whitmeyer v. Starent Networks Corp., et al.*, C.A. No. 09-4378-BLS, filed in the Superior Court, Business Litigation Session, of Suffolk County of the Commonwealth of Massachusetts. That action, purportedly brought on behalf of a class of stockholders, alleges that our directors breached their fiduciary duties in connection with the proposed merger by, among other things, failing to maximize stockholder value, fully inform themselves of Starent's market value, obtain the best financial and other terms, and act in the best interests of public stockholders, and seeking to benefit themselves improperly. The suit further alleges that we and Cisco aided and abetted the directors' purported breaches. Plaintiff seeks declaratory, injunctive and other equitable relief, including to enjoin us and Cisco from consummating the merger, in addition to fees and costs. On October 28, 2009, the defendants filed an answer to the complaint.

On October 20, 2009, we, our directors and Cisco were named as defendants in a second putative class action complaint, captioned *Laborers Local 235 Benefit Funds v. Starent Networks Corp., et al.*, C.A. No. 5002, filed in the Court of Chancery of the State of Delaware. On November 3, 2009, the Plaintiff filed a Verified Amended Complaint. In the amended complaint, the Plaintiff purports to represent a class of stockholders and seeks equitable relief, including to enjoin us and Cisco from consummating the merger, in addition to fees and costs. Plaintiff alleges in the amended complaint that our directors breached their fiduciary duties by, among other things, agreeing to a proposed merger in which the consideration is unfair and inadequate, failing to take steps to maximize stockholder value, and putting their own interests above those of stockholders, and that the preliminary proxy statement we filed with the SEC on October 30, 2009 included materially misleading information concerning the merger. The amended complaint further alleges that Cisco aided and abetted the directors' purported breaches. Also on November 3, 2009, the Plaintiff filed a Motion for Preliminary Injunction seeking to enjoin the merger, and a Motion for Expedited Proceedings. The defendants have yet to file a response to these motions.

In addition, even though we believe these lawsuits are without merit, our potential merger with Cisco could be delayed and/or enjoined by a court of competent jurisdiction, either of which could substantially harm our business.

### ***Risks Related to Our Business and Industry***

***We compete in new and rapidly evolving markets and have a limited operating history, which makes it difficult to predict our future operating results.***

We were incorporated in August 2000, and deployed our first commercial product in the first quarter of 2003. We have a limited operating history in an industry characterized by rapid technological change, changing customer needs, evolving industry standards and frequent introductions of new products and services. We believe our limited operating history and the characteristics of our industry make it difficult to forecast our future operating results. You should consider and evaluate our prospects in light of risks faced by companies such as ours, which include challenges in accurate financial planning as a result of limited historical data and the uncertainties resulting from a relatively limited time period in which to implement and evaluate our business strategies, as compared to companies with longer operating histories.

***Our past operating results have fluctuated significantly, and likely will continue to fluctuate significantly, which makes it difficult to predict our operating results and could cause our operating results to fall below expectations.***

Our operating results have historically fluctuated significantly from period to period and we expect our operating results to continue to fluctuate due to a variety of factors, many of which are outside of our control. As a result, comparing our operating results on a period-to-period basis may



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

not be meaningful. You should not rely on our past results as an indication of our future performance. If our revenues or operating results fall below the expectations of investors or securities analysts or below any guidance we may provide to the market, the price of our common stock could decline.

In addition to other risk factors listed in this Risk Factors section, factors that may affect our operating results include:

announcements and/or developments with respect to our proposed merger with Cisco;

fluctuations in demand, sales cycles and prices for our products and services;

reductions in customers' budgets for mobile network infrastructure purchases and delays in their purchasing decisions;

the timing of recognizing revenue in any given period as a result of software revenue recognition rules;

the sale of our products in the timeframes we anticipate, including the number and size of orders in each period;

the level of our customer concentration and our ability to generate purchases in any particular period from large customers;

our ability to develop, introduce and ship in a timely manner new products and product enhancements that meet customer requirements;

**Table of Contents**

the timing of product releases or upgrades by us or by our competitors;

any significant changes in the competitive dynamics of our markets, including new entrants or substantial discounting of products;

our ability to control costs, including our operating expenses and the costs of the components we purchase;

costs related to litigation, claims and other contingencies;

increases in our effective tax rate due to the use of substantially all of our accumulated net operating loss carryforwards in prior periods;

fluctuations in exchange rates; and

general economic conditions in our domestic and international markets.

***We depend on a limited number of customers for a substantial portion of our revenues. The loss of a key customer or any significant adverse change in the size or terms of orders from a key customer could significantly reduce our revenues.***

We derive a substantial portion of our revenues from a limited number of customers partly due to the nature of the mobile communications industry. For example, for the nine months ended September 30, 2009, we had one customer that accounted for 70% of our revenues. We had two customers for the nine months ended September 30, 2008 that each accounted for more than 10% of our revenues and in the aggregate accounted for 80% of our revenues. In addition, we do not have long-term volume purchase contracts with our customers or other commitments that ensure future sales of our products to existing customers. The loss of any key customer, or our inability to generate anticipated revenue from them, would significantly and adversely affect our business, financial condition and results of operations. In addition, a change in the timing or size of a purchase by any one of our key customers can result in significant variations in our revenue and operating results from period to period. Our operating results for the foreseeable future will continue to depend on our ability to effect sales to a small number of customers. Any revenue growth will depend on our success selling additional products to our large customers and expanding our customer base to include additional customers that deploy our products in large-scale networks serving significant numbers of subscribers.

Moreover, many of our key customers are large mobile operators that have substantial purchasing power and leverage in negotiating contractual arrangements with us. These customers may require us to agree to terms and conditions that could result in increased costs and decreased revenues that could adversely affect our operating results.

***We rely on a single line of products focused on a single market. If the market for those products does not develop as we anticipate, our revenues may decline or fail to grow, which would adversely affect our operating results.***

We derive, and expect to continue to derive, all of our revenues from a single line of products that provide network functions and services to mobile operators' packet core networks. The market for our products is relatively new and still evolving, and it is uncertain whether our products will achieve and sustain high levels of demand and market acceptance. Our success will depend to a substantial extent on the willingness of mobile operators to continue to implement packet-based, multimedia network infrastructure. Factors that could impair the rate of growth of multimedia networks include:

lower than anticipated demand by subscribers for multimedia services;

budgetary constraints of mobile operators;

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

uncertainties on the part of mobile operators as to the particular 3G or 4G access technologies they select for deployment in their networks; and

delays in the development or availability of all the network elements necessary for the mobile operator to deploy its next-generation multimedia network.

If mobile operators do not continue to implement packet core networks, the market for our products may not continue to develop or may develop more slowly than we expect, either of which would significantly adversely affect our revenues and profitability.

***The market in which we compete is highly competitive and competitive pressures from existing and new companies may have a material adverse effect on our business, revenues, growth rates and market share.***

We compete in a highly competitive industry that is influenced by many factors, including customer demands for:

reliable, high performance products;

---

**Table of Contents**

system ability to handle increasing amounts of network traffic and service integration capabilities;

system intelligence;

breadth of network interoperability, access independence and standards support;

high levels of customer support and customer interaction; and

competitive pricing.

We expect competition in the mobile network infrastructure industry to intensify significantly in the future. Other companies may introduce new products in the markets we serve or intend to enter. This competition could result in increased pricing pressure, reduced profit margins, increased sales and marketing expenses and failure to increase, or the loss of, market share, any of which would likely seriously harm our business, operating results or financial condition.

Competitive products may in the future have better performance, lower prices and broader acceptance than our products. Our primary competitors include Cisco Systems, Inc., Huawei Technologies Co., Ltd., LM Ericsson Telephone Co., and Nokia Siemens Networks B.V., each of which has a longer operating history, greater name recognition, a larger customer base and significantly greater financial, technical, sales, marketing and other resources than we do. Potential customers may prefer to purchase from their existing suppliers rather than a new supplier regardless of product performance or features. In addition, many of our competitors have a broader range of products and may be able to offer concessions to potential customers on bundled purchases that we are not able to match because we currently offer only a single line of products. We also face competition from a number of companies with more limited market share either generally or by geography and newer market entrants.

If our market continues to develop and expand, we could face increased competition from other established companies, as well as emerging companies. For example, OEMs, system integrators and distributors currently selling our products could market products and services that compete with our products and services. In addition, some of our competitors have made acquisitions or entered into partnerships or other strategic relationships with one another to offer a more comprehensive solution than they individually had offered. We expect this trend to continue as companies attempt to strengthen or maintain their market positions in an evolving industry and as companies enter into partnerships, or are acquired. Many of the companies driving this consolidation trend have significantly greater financial, technical and other resources than we do and are better positioned to acquire and offer complementary products and technologies. The companies resulting from these possible consolidations may create more compelling product offerings and be able to offer greater pricing flexibility, making it more difficult for us to compete effectively, including on the basis of price, sales and marketing programs, technology or product functionality. Continued industry consolidation may adversely impact customers' perceptions of the viability of smaller and even medium-sized technology companies and consequently customers' willingness to purchase from such companies. These pressures could materially adversely affect our business, operating results and financial condition.

***Our sales cycles can be long and unpredictable, and our sales efforts require considerable time and expense.***

Our sales cycles typically are long and unpredictable, and our sales efforts require considerable time and expense. Our sales efforts involve educating our customers about the use and benefit of our products, including their technical capabilities and potential cost savings. Customers typically undertake a significant evaluation process before making a purchase, in some cases over twelve months. We spend substantial time and resources in our sales efforts without any assurance that our efforts will produce any sales. In addition, product purchases are frequently subject to budget constraints, multiple approvals, and unplanned administrative, processing and other delays. Our long sales cycle may cause our revenues and operating results to fluctuate significantly.

***Demand for our products depends on the rate that mobile operators expand and enhance their mobile networks in order to provide multimedia services.***

Our future success as a provider of network infrastructure products and services for mobile operators ultimately depends on the continued growth of the mobile communications industry and, in particular, the continued deployment and expansion of mobile multimedia services. Increased demand by mobile subscribers for voice communications and multimedia services delivered over mobile network systems will be

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

necessary to justify capital expenditure commitments by mobile operators to invest in the improvement and expansion of their networks. Demand for multimedia services might not continue to increase if there is limited availability or market acceptance of mobile devices designed for such services, the multimedia content offered through mobile networks does not attract widespread interest or the quality of service available through mobile networks does not meet customer expectations. If long-term expectations for mobile multimedia services are not realized or do not support a

---

**Table of Contents**

sustainable business model, operators may not commit significant capital expenditures to upgrade their networks to provide these services, the demand for our products and services will decrease, and we may not be able to sustain or increase our levels of revenues or profitability in the future.

*A significant portion of our future revenues depends on our ability to further penetrate the GSM/UMTS market and our failure to do so could significantly interfere with our future growth.*

The two principal radio access interfaces in use today for mobile communications are Code Division Multiple Access, or CDMA, and Global System for Mobile Communications/Universal Mobile Telecommunications System, or GSM/UMTS. To date, we have achieved our highest number of deployments in the CDMA market, which has transitioned faster to high-bandwidth networks. However, significantly more operators worldwide currently utilize GSM/UMTS than CDMA technologies. In order to continue our growth, we believe it is important that we continue to expand into the GSM/UMTS market. To date, we have established relationships with a number of GSM/UMTS operators, and we intend to devote significant sales and marketing resources to further penetrate the GSM/UMTS market. If GSM/UMTS operators do not transition or delay their transition to high-bandwidth networks, or if we are unable to establish relationships with additional GSM/UMTS operators, we may not be able to grow our business as expected and our results of operations will be adversely affected.

*We rely on OEMs, system integrators and distributors to sell some of our products, and our failure to develop and manage our distribution channels could adversely affect our business.*

For our sales to mobile operators, we rely in part on establishing and maintaining successful relationships with original equipment manufacturers, or OEMs, system integrators and distributors. Our revenues depend in part on the effective performance of these distribution relationships. By utilizing these indirect sales channels we may have less contact with the end users of our products, thereby potentially making it more difficult for us to establish brand awareness, ensure proper delivery and installation of our products, service ongoing customer requirements and respond to evolving customer needs. Developing relationships with qualified OEMs, system integrators and distributors and training them in our technology and product offerings requires significant time and resources. In order to develop and expand our distribution channels, we must continue to scale and improve our processes and procedures that support our OEM, system integrator and distributor relationships, including investment in systems and training. We have no minimum purchase commitments with any of our OEMs, system integrators or distributors, and our contracts with them generally do not prohibit them from offering products or services that compete with ours. Our competitors may be effective in providing incentives to existing and potential OEMs, system integrators and distributors to favor their products or to prevent or reduce sales of our products. Our OEMs, system integrators and distributors may choose not to offer our products exclusively or at all. Our failure to establish and maintain successful relationships with our OEMs, system integrators and distributors could adversely affect our business, operating results and financial condition.

*If network functions and services similar to those offered by our products are incorporated into existing or new mobile network infrastructure products, demand by mobile operators for our products may diminish.*

Mobile network infrastructures are continually evolving with changing industry standards and the introduction of new technologies and network elements. Network functions and services provided by our products located within the packet core network may be provided by different network elements within these networks. Other providers of mobile network infrastructure products may add network functions and services provided by our products to their existing products or offer new products with similar characteristics for different parts of the network infrastructure.

The inclusion of, or the announcement of an intent to include, functionality and services perceived to be similar to those offered by our products in competitor products within or outside the packet core network could have an adverse effect on our ability to market and sell our products. Furthermore, even if the network functions and services offered by our competitors are more limited than those provided by our products, a significant number of customers may elect to accept limited functionality or services in lieu of adding our products to their network. The adoption of these competitive products or different approaches to network infrastructure by mobile operators could have an adverse effect on our business, operating results and financial condition.

*The applications of existing or future accounting standards could result in significant fluctuations in our operating results.*

Under the existing revenue recognition accounting standards, even if we deliver products to, and collect cash from, a customer in a given fiscal period, we may be required to defer recognizing revenue from the sale of such product until a future period when all the conditions necessary for revenue recognition have been satisfied. Conditions that can cause delays in revenue recognition include arrangements that have undelivered elements for which we have not yet established vendor specific objective evidence of fair value; requirements that we deliver services for significant enhancements or modifications to customize our software for a particular customer; or material customer acceptance criteria. Our

customer contracts typically include one or more of these types of conditions. Therefore, we often must defer revenue recognition for a period of time after our products are

---

**Table of Contents**

delivered and billed to a customer, and such deferral may extend over one or more fiscal quarters. The period of deferral, if any, depends on the specific terms and conditions of each customer contract, and therefore it is difficult for us to predict with accuracy at the beginning of any fiscal period the amount of revenues that we will be able to recognize from anticipated customer shipments in that period. Moreover, any changes in interpretations and guidance to the revenue recognition accounting standards could have a significant effect on our reported financial results.

***We may have difficulty acquiring new customers due to the high costs of switching mobile network infrastructure providers or equipment.***

Mobile network operators typically make substantial investments when deploying mobile network infrastructure. Once a mobile network operator has deployed infrastructure for a particular portion of their network, it is often difficult and costly to switch to another vendor's infrastructure. Unless we are able to persuasively demonstrate that our products offer performance, functionality or cost advantages that materially outweigh a customer's expense of switching from a competitor's product, it will be difficult for us to generate sales once that competitor's equipment has been deployed. Accordingly, if a customer has already deployed a competitor's product for their network infrastructure, it may be difficult for us to sell our products to that customer.

***Our ability to sell our products is highly dependent on the quality of our support and services offerings, and our failure to offer high quality support and services would have a material adverse effect on our sales and results of operations.***

Once our products are deployed within our customers' networks, our customers depend on our support organization to resolve issues relating to our products. A high level of support is critical for the successful marketing and sale of our products and future enhancements. If we, or our OEMs, system integrators or distributors, do not effectively assist our customers in deploying our products, help our customers quickly resolve post-deployment issues, and provide effective ongoing support, it would adversely affect our ability to sell our products to existing customers and could harm our reputation with potential customers. In addition, as we expand our operations internationally, our support organization will face additional challenges, including those associated with delivering support, training and documentation in languages other than English. As a result, our failure to maintain high quality support and services could have a material adverse effect on our business, operating results and financial condition.

***The mobile network infrastructure industry is, and likely will continue to be, characterized by rapid technological changes in networks and standards, which will require us to develop new products and product enhancements, and could render our existing products obsolete.***

Mobile operators have been aggressively upgrading their networks, and new industry standards for access technologies, such as third generation, or 3G, and more advanced fourth generation, or 4G, technologies continue to evolve. Continuing technological changes in the mobile communications industry and in the mobile network infrastructure industry could undermine our competitive position or make our products obsolete, either generally or for particular types of services. Our future success will depend upon our ability to accurately predict and respond to new technology standards. We must develop and introduce a variety of new capabilities and enhancements to our existing product offerings, as well as introduce new product offerings, to address the changing standards and technological needs of the network infrastructure market. A failure to accurately predict and respond to evolving technologies, to introduce on a timely basis new products and enhancements in response to evolving technologies and standards, or to address changing needs in our current markets or expand into new markets may cause existing and potential customers to forego purchases of our products or purchase from our competitors. The introduction of new products embodying new technologies or the emergence of new industry standards could render our existing products uncompetitive from a pricing standpoint, obsolete or unmarketable.

***Our products are complex and may take longer to develop than anticipated and we may not recognize revenues from new products or product enhancements until after we have incurred significant development costs.***

Some of our products must be tailored to meet customer specifications. As a result, we often develop new features and enhancements to our products. These product enhancements often take substantial time to develop because of their complexity and because customer specifications sometimes change during the development cycle. We often do not recognize revenue from our new products or enhancements until we have incurred significant development costs, and our operating results will suffer if sales of new products or enhancements fail to meet expectations.

***There is no assurance that our research and development investments will lead to successful new products or enhancements.***

We will continue to invest in research and development for the introduction of new products and enhancements to existing products designed to improve the capacity, data processing rates and features of our products and services. We must also continue to develop new features and functionality for our products based on specific customer requests and anticipated market needs. However, research and development in the mobile network infrastructure industry is complex, expensive and subject to uncertainty. We believe that we must continue to dedicate a significant amount of resources to our research and development





---

## **Table of Contents**

efforts to maintain our competitive position. If we continue to expend a significant amount of resources on research and development and our efforts do not lead to the successful introduction of products or product enhancements that are competitive in the marketplace, there could be a material adverse effect on our business, operating results, financial condition and market share. We may not be able to anticipate market needs and develop products and product enhancements that meet those needs, and any new products or product enhancements that we introduce may not achieve any significant degree of market acceptance.

***If our products do not interoperate with our customers' networks, installations will be delayed or cancelled, which would harm our business.***

Our products must interoperate with our customers' existing networks, which often have different specifications, utilize multiple protocol standards and products from multiple vendors and contain multiple generations of products that have been added over time. If we find errors in the existing software or defects in the hardware used in our customers' networks or problematic network configurations or settings, as we have in the past, we may have to modify our software or hardware so that our products will interoperate with our customers' networks. This could cause longer installation times for our products or order cancellations and could harm our relationship with existing and future customers, any of which would adversely affect our business, operating results and financial condition.

In addition, our customers may require that we demonstrate that our products interoperate with network elements offered by our competitors, and we may need our competitors' cooperation to conduct such testing and validation. Any unwillingness of our competitors to cooperate with us in performing these interoperability tests or our inability to demonstrate interoperability would likely have an adverse effect on our ability to market our products.

***Our products are highly technical and may contain undetected software or hardware errors, which could cause harm to our reputation and adversely affect our business.***

Our products are highly technical and complex. When deployed, they are critical to the mobile operator networks. Our products have contained and may contain undetected errors, defects or security vulnerabilities. Some errors in our products may only be discovered after a product has been installed and used by mobile operators. Any errors, defects or security vulnerabilities discovered in our products after commercial release could result in loss of revenues or delay in revenue recognition, loss of customers and increased service cost, any of which could adversely affect our business, operating results and financial condition. In addition, we could face claims for product liability, tort or breach of warranty, including claims relating to changes to our products made by our OEMs, system integrators or distributors. Our contracts with customers generally contain provisions relating to warranty disclaimers and liability limitations, which may be ineffective. Defending a lawsuit, regardless of its merit, is costly and may divert management's attention away from the business and adversely affect the market's perception of us and our products. In addition, if our business liability insurance coverage is inadequate or future coverage is unavailable on acceptable terms or at all, our operating results and financial condition could be adversely impacted.

***We are susceptible to shortages or price fluctuations in our supply chain. Any shortages or price fluctuations in components used in our products could delay shipment of our products, which could materially adversely affect our business.***

Shortages in components that we use in our products are possible and our ability to predict the availability of such components may be limited. Some of these components are available only from single or limited sources of supply. The process of qualifying alternate sources for components, if available at all, may be time consuming, difficult and costly. In addition, the lead times associated with certain components are lengthy and preclude rapid changes in quantity requirements and delivery schedules. Any growth in our business or the economy is likely to create greater pressures on us and our suppliers to project overall component demand accurately and to establish appropriate component inventory levels. In addition, increased demand by third parties for the components we use in our products may lead to decreased availability and higher prices for those components. We carry very little inventory of our products and product components, and we rely on our suppliers to deliver necessary components to our contract manufacturer in a timely manner based on forecasts we provide. We generally rely on purchase orders rather than long-term contracts with our suppliers. As a result, even if available, we may not be able to secure sufficient components at reasonable prices or of acceptable quality to build products in a timely manner, which would seriously impact our ability to deliver products to our customers, and our business, operating results and financial condition would be adversely affected.

***We depend on a single contract manufacturer with whom we do not have a long-term supply contract, and changes to this relationship may result in delays or disruptions that could harm our business.***

We depend on Plexus Corp., an independent contract manufacturer, to manufacture and assemble our products. We rely on purchase orders with our contract manufacturer and do not have long-term supply arrangements in place. As a result, our contract



---

## **Table of Contents**

manufacturer is not obligated to supply products to us for any specific period, quantity or price. Our orders may represent a relatively small percentage of the overall orders received by our contract manufacturer from its customers. As a result, fulfilling our orders may not be considered a priority by our contract manufacturer in the event the contract manufacturer is constrained in its ability to fulfill all of its customer obligations in a timely manner.

It is time consuming and costly to qualify and implement a contract manufacturer relationship. Therefore, if our contract manufacturer suffers an interruption in its business, or experiences delays, disruptions or quality control problems in its manufacturing operations, or we have to change or add additional contract manufacturers, our ability to ship products to our customers would be delayed and our business, operating results and financial condition would be adversely affected.

***If we fail to predict accurately our manufacturing requirements, we could incur additional costs or experience manufacturing delays that could harm our business.***

We provide demand forecasts to our contract manufacturer. If we overestimate our requirements, our contract manufacturer may assess charges or we may have liabilities for excess inventory, each of which could negatively affect our gross margins. Conversely, because lead times for required materials and components vary significantly and depend on factors such as the specific supplier, contract terms and the demand for each component at a given time, if we underestimate our requirements, our contract manufacturer may have inadequate materials and components required to produce our products, which could interrupt manufacturing of our products and result in delays in shipments and deferral or loss of revenues.

***If we fail to retain our key personnel, we may not be able to achieve our anticipated level of growth and our business could suffer.***

Our future depends, in part, on our ability to attract and retain key personnel, including the continued contributions of our executive officers and other key technical personnel, each of whom would be difficult to replace. In particular, Ashraf M. Dahod, our president, chief executive officer and chairman is critical to the management of our business and operations, as well as the development of our strategic direction. The loss of services of Mr. Dahod or other executive officers or key personnel or the inability to continue to attract qualified personnel could have a material adverse effect on our business. Mr. Dahod is not a party to an employment agreement with us and, therefore, may terminate his employment with us at any time, with no advance notice. The replacement of Mr. Dahod would involve significant time and expense and may significantly delay or prevent the achievement of our business objectives.

***Competition for our employees is intense, and we may not be able to attract and retain the highly skilled employees that we need to support our business.***

Competition for highly skilled technical personnel is extremely intense and we continue to face difficulty identifying and hiring qualified personnel in many areas of our business. In particular, we face significant challenges hiring and retaining personnel in India for research and development activities because the market for such personnel is increasingly competitive. We may not be able to hire and retain such personnel at compensation levels consistent with our existing compensation and salary structure. Many of the companies with which we compete for hiring experienced employees have greater resources than we have and may be able to offer more attractive terms of employment. In addition, we invest significant time and expense in training our employees, which increases their value to competitors who may seek to recruit them. If we fail to retain our employees, we could incur significant expenses replacing employees and the quality of our products and services and our ability to provide such products and services could diminish, resulting in a material adverse affect on our business. Furthermore, in making employment decisions, particularly in high-technology industries, candidates often consider the value of the equity they are to receive in connection with their employment. Therefore, significant volatility in the price of our stock may adversely affect our ability to attract or retain personnel.

***Our international sales and operations subject us to additional risks that may adversely affect our operating results.***

Over the last several years, we derived a significant portion of our revenues from customers outside the United States, and we continue to expand our international operations. As of September 30, 2009, approximately 65% of our employees were located outside of the United States, including 523 employees located in India. In addition, we have sales and technical support personnel in numerous countries worldwide. We expect to continue to add personnel in additional countries. Any continued expansion into international markets will require significant resources and management attention and will subject us to new regulatory, economic and political risks, and we cannot be sure that any further international expansion will be successful. Among the risks we believe are most likely to affect us with respect to our international operations are:

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

the difficulty of managing and staffing international offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;

**Table of Contents**

difficulties in enforcing contracts and collecting accounts receivable and longer payment cycles, especially in emerging markets;

our ability to comply with differing technical standards and certification requirements outside North America;

reduced protection for intellectual property rights in some countries;

new and different sources of competition;

internationalization of our products to meet local customs or the needs of local marketing organizations;

compliance with multiple, conflicting, and changing laws and regulations, including employment, tax, trade, privacy, and data protection laws and regulations;

laws and business practices, which may vary from country to country and may favor local competitors; and

tariffs and trade barriers, import/export controls and other regulatory or contractual limitations on our ability to sell or develop our products in certain foreign markets.

Our operating results and cash flows are subject to fluctuations due to changes in foreign currency exchange rates, particularly changes in the British pound sterling, the Euro and the Indian rupee. These fluctuations could negatively affect our operating results and could cause our net income or loss to vary from quarter to quarter. We do not currently engage in currency hedging activities to limit the risk of exchange rate fluctuations.

As we continue to expand our business globally, our success will depend, in large part, on our ability to anticipate and effectively manage these and other risks associated with our international operations. Our failure to manage any of these risks successfully could harm our international operations and reduce our international sales, adversely affecting our business, operating results and financial condition.

***We may need additional capital in the future, which may not be available to us on favorable terms, or at all, and may dilute your ownership of our common stock.***

We have historically relied on outside financing and cash from operations to fund our operations, capital expenditures and expansion. We may require additional capital from equity or debt financing in the future to:

take advantage of strategic opportunities including more rapid expansion of our business or the acquisition of complementary products, technologies or businesses; and

develop new products or enhancements to existing products.

We may not be able to secure timely additional financing on favorable terms, or at all. The terms of any additional financing may place limits on our financial and operating flexibility. If we raise additional funds through further issuances of equity, convertible debt securities or other securities convertible into equity, our existing stockholders could suffer significant dilution in their percentage ownership of our company, and any new securities we issue could have rights, preferences and privileges senior to those of holders of our common stock. If we are unable to obtain adequate financing or financing on terms satisfactory to us, if and when we require it, our ability to grow or support our business and to respond to business challenges could be significantly limited.

***We may engage in future acquisitions that could disrupt our business, cause dilution to our stockholders and harm our business, operating results or financial condition.***

We have, from time to time, evaluated acquisition opportunities and may pursue acquisition opportunities in the future. We have very little experience consummating acquisitions, and therefore our ability as an organization to make acquisitions is unproven. We may not be able to find suitable acquisition candidates and we may not be able to complete acquisitions on favorable terms, if at all. If we do complete acquisitions, we may not ultimately strengthen our competitive position or achieve our goals, or such acquisitions may be viewed negatively by customers, financial markets or investors. In addition, any acquisitions that we make could lead to difficulties in integrating personnel and operations from the acquired businesses and in retaining and motivating key personnel from these businesses. Acquisitions may disrupt our ongoing operations, divert management from day-to-day responsibilities, increase our expenses or adversely impact our business, operating results and financial condition. Future acquisitions may reduce our cash available for operations and other uses and could result in an increase in amortization expense related to identifiable assets acquired, potentially dilutive issuances of equity securities or the incurrence of debt, which could harm our business, operating results and financial condition.

---

**Table of Contents**

*If we fail to manage future growth effectively, our business could be harmed.*

We have expanded our operations significantly since inception and anticipate that further significant expansion will be required. For example, our revenues increased from \$59.7 million in 2005 to \$254.1 million in 2008, and \$237.5 million for the nine months ended September 30, 2009 and the number of our employees increased from 200 at the beginning of 2005 to 1,009 as of September 30, 2009. This growth has placed significant demands on our management, as well as our financial and operational resources. If we do not effectively manage our future growth, the efficiency of our operations and the quality of our products could suffer, which could adversely affect our business and operating results. To effectively manage this growth, we will need to continue to:

implement appropriate operational, financial and management controls, systems and procedures, including continued implementation of our enterprise-wide financial system;

expand our manufacturing capacity and scale of production;

expand our sales, marketing and distribution infrastructure and capabilities, in the United States and internationally; and

provide adequate training and supervision to maintain high quality standards.

*Failure to maintain effective internal controls over financial reporting and disclosure controls and procedures could adversely affect our business and the market price of our common stock, and impair our ability to timely file our SEC reports.*

The Sarbanes-Oxley Act of 2002 requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. We perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Our compliance with Section 404 will continue to require that we incur substantial expense and expend significant management time on compliance-related issues. If we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of our stock could decline and we could be subject to sanctions or investigations by the NASDAQ Stock Market, the Securities and Exchange Commission or other regulatory authorities, which would require additional financial and management resources.

*Disruptions in financial markets may adversely impact availability and cost of credit and business and consumer spending patterns.*

Disruptions in the financial markets have had and may continue to have an adverse effect on the U.S. and world economy, which could negatively impact business and consumer spending patterns. Current tightening of credit in financial markets also adversely affects the ability of our customers and suppliers to obtain financing for significant purchases and operations and could result in a decrease in or cancellation of orders for our products. In particular, the availability of financing may be critical to the expansion plans of mobile operators. Further, changes in employment and consumer spending patterns may slow the adoption of data-enabled wireless devices and reduce the growth of data traffic for mobile operators, which could result in delays or cancellations of upgrades and new purchases of our products. There is no assurance that government responses to the disruptions in the financial markets will restore business and consumer confidence, stabilize the markets or increase liquidity and the availability of credit.

*We are subject to governmental export and import controls that could subject us to liability or impair our ability to compete in international markets.*

Our products are subject to United States export controls and may be exported outside the United States only with the required level of export license or through an export license exception, because we incorporate encryption technology into our products. In addition, various countries regulate the import of certain encryption technology and have enacted laws that could limit our ability to distribute our products or could limit our customers' ability to implement our products in those countries. Changes in our products or changes in export and import regulations may create delays in the introduction of our products in international markets, prevent our customers with international operations from deploying our products throughout their networks or, in some cases, prevent the export or import of our products to certain countries altogether. Any change in export or import laws and regulations, shifts in approach to the enforcement or scope of existing laws and regulations, or change in the countries,



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

persons or technologies targeted by such regulations, could result in decreased use of our products by, or in our decreased ability to export or sell our products to, existing or potential customers with international operations. Any decreased use of our products or limitation on our ability to export or sell our products would likely adversely affect our business, operating results and financial condition.

---

**Table of Contents**

*We are subject to U.S. laws and regulations that prohibit certain practices that may be common in certain foreign countries in which we operate; failure to adhere to these laws and regulations could negatively affect our business and operating results.*

Our international operations are subject to certain U.S. laws and regulations applicable to us, including the Foreign Corrupt Practices Act. Moreover, local laws and customs in many countries differ significantly from those in the United States. In many foreign countries, particularly in those with developing economies, it is common for others to engage in business practices that are prohibited by our internal policies and procedures or United States regulations applicable to us. Although we implement policies and procedures designed to ensure compliance with these laws and policies, there can be no assurance that all of our employees, contractors and agents will not take actions in violation of them. Violations of laws or key control policies by our employees, contractors or agents could result in financial reporting problems, fines, penalties, or prohibition on the importation or exportation of our products and could adversely affect our business and operating results.

*Compliance with environmental matters and worker health and safety laws could be costly, and noncompliance with these laws could have a material adverse effect on our results of operations, expenses and financial condition.*

Some of our operations use substances regulated under various federal, state, local and international laws governing the environment and worker health and safety, including those governing the discharge of pollutants into the ground, air and water, the management and disposal of hazardous substances and wastes, and the cleanup of contaminated sites. Some of our products are subject to various federal, state, local and international laws governing chemical substances in electronic products. We could be subject to increased costs, fines, civil or criminal sanctions, third-party property damage or personal injury claims if we violate or become liable under environmental and/or worker health and safety laws.

In January 2003, the European Union, or EU, issued two directives relating to chemical substances in electronic products. The Waste Electrical and Electronic Equipment Directive, referred to as WEEE, requires producers of electrical goods to pay for specified collection, recycling, treatment and disposal of past and future covered products. The deadline for enacting and implementing the WEEE directive was August 13, 2004, although extensions were granted in some countries. Producers became financially responsible under WEEE related legislation beginning in August 2005. The other directive, the Restriction on the use of certain Hazardous Substances, referred to as RoHS, restricts lead and other hazardous substances in electronic equipment placed on the EU market after July 1, 2006. If we fail to continue to comply with these directives, we may suffer a loss of revenues, be unable to sell our products in certain markets and countries, be subject to penalties and fines or suffer a competitive disadvantage. Similar legislation could be enacted in other jurisdictions, including in China, Japan or the United States, and the scope of new legislation with respect to currently unregulated substances is uncertain. Costs to comply with WEEE or RoHS related legislation or similar future legislation, if applicable, could include costs associated with modifying our products, recycling and other waste processing costs, legal and regulatory costs and insurance costs. We are currently in compliance with these directives; however, we have incurred significant costs related to compliance with current requirements. The costs to comply with current and future environmental and worker health and safety laws may have a material adverse effect on our results of operations, expenses and financial condition.

**Risks Related to Our Intellectual Property**

*Our ability to compete and the success of our business could be jeopardized if we are unable to rely on our patent rights.*

Our success and ability to compete depends in part upon our ability to obtain protection in the United States and other countries for our products by establishing and maintaining intellectual property rights relating to or incorporated into our technology and products. We own a variety of patents and patent applications in the United States and corresponding patents and patent applications in foreign jurisdictions. However, we have not obtained patent protection in each market in which we plan to compete. To date, our patent portfolio has not prevented other companies from competing against us, and we do not know how successful we would be if we sought to enforce our patent rights against suspected infringers. Our pending and future patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Even if issued, patents may be challenged, narrowed, invalidated or circumvented, which could limit our ability to stop competitors from marketing similar products or limit the length of term of patent protection we may have for our products. Changes in either patent laws or in interpretations of patent laws in the United States and other countries may diminish the value of our intellectual property or narrow the scope of our patent protection. Any circumstance or change that results in patent protection not being available for our products could adversely affect our business, financial condition and results of operations.

---

## **Table of Contents**

***If we are unable to protect the confidentiality of our unpatented proprietary information and know-how, the value of our technology and products could be adversely affected.***

In addition to patented technology, we rely upon unpatented proprietary technology, processes and know-how. We generally seek to protect this information in part by confidentiality agreements with our employees, consultants and third parties. These agreements may be breached, and we may not have adequate remedies for any such breach. In addition, our trade secrets may otherwise become known or be independently developed by competitors. If we are unable to protect the confidentiality of our proprietary information and know-how, the value of our technology and products could be adversely affected, which could in turn adversely affect our business, financial condition and results of operations.

***Claims by others that we infringe their proprietary technology could force us to incur significant costs.***

Third parties have asserted in the past, and may assert in the future, claims that our products infringe patents or patent applications under which we do not hold licenses or other rights. Third parties may own or control these patents and patent applications in the United States and abroad. These third parties in the past have brought, and could in the future bring, claims against us that would cause us to incur substantial expenses and, if successfully asserted against us, could cause us to pay substantial damages. Further, if a patent infringement suit were brought against us, we could be forced to stop or delay manufacturing or sales of the product that is the subject of the suit. In addition, we could be forced to redesign the product that uses any allegedly infringing technology.

We cannot assure you that in the future third parties will not assert that our technology violates their intellectual property rights or that we will not be the subject of a material intellectual property dispute. Regardless of the merit of any particular claim that our technology violates the intellectual property rights of others, responding to such claims may require us to:

incur substantial expenses and expend significant management efforts;

pay damages;

cease making, licensing or using products that are alleged to incorporate the intellectual property of others;

enter into potentially unfavorable royalty or license agreements in order to obtain the right to use necessary technologies; and

expend additional development resources to redesign our products.

We may also be required to indemnify customers, distributors or systems integrators for their use of the intellectual property associated with the current suit or for other third-party products that are incorporated into our products and that infringe the intellectual property rights of others. If we are unable to resolve our legal obligations by settling or paying an infringement claim or a related indemnification claim as described above, we may be required to refund amounts that we had received under the contractual arrangement with the customers, distributors or systems integrators.

In addition to infringement claims against us, we may become a party to other types of patent litigation and other proceedings, including interference proceedings declared by the United States Patent and Trademark Office and opposition proceedings in the European Patent Office, regarding intellectual property rights with respect to our products and technology. The cost to us of any patent litigation or other proceeding, even if resolved in our favor, could be substantial. Some of our competitors may be able to sustain the costs of such litigation or proceedings more effectively than we can because of their greater financial resources. Uncertainties resulting from the initiation and continuation of patent litigation or other proceedings could have a material adverse effect on our ability to compete in the marketplace. Patent litigation and other proceedings may also require significant commitments of time by our management.

***Our use of open source could impose limitations on our ability to commercialize our products.***

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

We incorporate open source software into our products. Although we monitor our use of open source software closely, the terms of many open source licenses to which we are subject have not been interpreted by United States or foreign courts, and there is a risk that such licenses could be construed in a manner that imposes unanticipated conditions or restrictions on our ability to commercialize our products. In such event, we could be required to seek licenses from third parties in order to continue offering our products, to re-engineer our products or to discontinue sales of our products, any of which could materially adversely affect our business.

**Table of Contents**

*We rely on the availability of licenses for intellectual property from third parties, and if these licenses are not available to us on commercially reasonable terms, product sales and development may be delayed.*

We incorporate certain third-party technologies, including software programs, into our products and may need to utilize additional third-party technologies in the future. However, licenses to relevant third-party technology may not continue to be available to us on commercially reasonable terms, or at all. Therefore, we could face delays in product releases until alternative technology can be identified, licensed or developed, and integrated into our current products. These delays, if they occur, could materially adversely affect our business.

**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS*****(b) Use of Proceeds from Public Offerings of Common Stock***

In June 2007, we completed an initial public offering of common stock pursuant to a Registration Statement on Form S-1 (Registration No. 333-141092) which the SEC declared effective on June 5, 2007. Pursuant to the registration statement, we registered the offering and sale of an aggregate of 12,115,067 shares of our common stock, of which 10,580,226 shares were sold by us including 1,580,226 shares sold in connection with the underwriters' option described below, and 1,534,841 shares were sold by certain stockholders, at a price of \$12.00 per share. The underwriters exercised their option to purchase the additional 1,580,226 shares of our common stock at the initial public offering price of \$12.00 per share on June 8, 2007 and the offering closed on June 11, 2007. The underwriters for the offering were Goldman, Sachs & Co., Lehman Brothers, J.P.Morgan and Thomas Weisel Partners LLC.

We raised a total of \$127.0 million in gross proceeds from the initial public offering, or approximately \$116.0 million in net proceeds after deducting underwriting discounts and commissions of \$8.9 million and other estimated offering costs of approximately \$2.1 million. The selling stockholders received a total of approximately \$18.4 million in gross proceeds from the initial public offering or approximately \$17.1 million of net proceeds after deducting the underwriting discounts. We have invested the remaining net proceeds in cash and cash equivalents, primarily money-market mutual funds. None of the remaining net proceeds were paid, directly or indirectly, to directors, officers, persons owning ten percent or more of our equity securities, or any of our other affiliates.

In October 2007, we completed a public offering of common stock pursuant to a Registration Statement on Form S-1 (Registration No. 333-146717) which the SEC declared effective on October 31, 2007. Pursuant to the registration statement, we registered the offering and sale of an aggregate of 8,000,000 shares of our common stock, of which 3,880,000 shares were sold by us and 4,120,000 shares were sold by certain stockholders, at a price of \$24.00 per share. The underwriters for the offering were Goldman, Sachs & Co., Lehman Brothers, J.P.Morgan and Thomas Weisel Partners LLC.

We raised a total of \$93.1 million in gross proceeds from the public offering, or approximately \$88.1 million in net proceeds after deducting underwriting discounts and commissions of \$4.4 million and other estimated offering costs. The selling stockholders received a total of approximately \$98.9 million in gross proceeds from the public offering or approximately \$94.2 million of net proceeds after deducting the underwriting discounts. We have invested the remaining net proceeds in cash and cash equivalents, primarily money-market mutual funds. None of the remaining net proceeds were paid, directly or indirectly, to directors, officers, persons owning ten percent or more of our equity securities, or any of our other affiliates.

**ITEM 6. EXHIBITS**

The following is an index of the exhibits included in this report:

**Exhibit**

| No.  | Description   |
|------|---|
| 2.1  | Agreement and Plan of Merger, incorporated by reference to Exhibit 2.1 to the registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on October 14, 2009. |
| 10.1 | Form of Voting Agreement, incorporated by reference to Exhibit 10.1 to the registrant's Current Report on Form 8-K, filed with the Securities and Exchange Commission on October 14, 2009.    |
| 31.1 | Certification of Chief Executive Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.            |
| 31.2 | Certification of Chief Financial Officer, pursuant to Securities Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.            |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                |



**Table of Contents**

**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.

**STARENT NETWORKS, CORP.**

*(Registrant)*

Date: November 6, 2009

By: */s/* ASHRAF M. DAHOD  
**Ashraf M. Dahod**  
**President and Chief Executive Officer**  
**(Principal Executive Officer)**

Date: November 6, 2009

By: */s/* PAUL J. MILBURY  
**Paul J. Milbury**  
**Vice President, Operations and**  
**Chief Financial Officer**  
**(Principal Financial Officer)**

Date: November 6, 2009

By: */s/* GEORGE W. HALE  
**George W. Hale**  
**Vice President, Finance and**  
**Corporate Controller**  
**(Principal Accounting Officer)**