UTSTARCOM INC
Form 424B1
July 19, 2001

Filed Pursuant to Rule 424(b)(1)
Registration No. 333-63356

PROSPECTUS

9,000,000 Shares

[LOGO OF UTSTARCOM]

Common Stock

UTStarcom is selling 6,050,000 shares and UTStarcom stockholders are selling 2,950,000 shares.

The shares are quoted on The Nasdaq National Market under the symbol "UTSI." On July 18, 2001, the last sale price of the shares as reported on The Nasdaq National Market was $21.77 per share.

Investing in the common stock involves risks that are described in the "Risk Factors" section beginning on page 6 of this prospectus.

	Per Share	Total
Public offering price	$20.00	$180,000,000
Underwriting discount	$.99	$8,910,000
Proceeds, before expenses, to UTStarcom	$19.01	$115,010,500
Proceeds, before expenses, to the selling stockholders	$19.01	$56,079,500

The underwriters may also purchase up to an additional 1,350,000 shares from UTStarcom, at the public offering price, less the underwriting discount, within 30 days from the date of this prospectus to cover over-allotments.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The shares will be ready for delivery on or about July 24, 2001.

Merrill Lynch & Co.

Salomon Smith Barney

Banc of America Securities LLC

HSBC

U.S. Bancorp Piper Jaffray

The date of this prospectus is July 18, 2001.

[INSIDE FRONT COVER PAGE]

PHOTOGRAPHS, DESCRIPTIONS AND CAPTIONS

Photographs depicting UTStarcom product line.

Top: Color photos of WACOS, our IP-based multiservice softswitch. Caption: "WACOS is an IP-based multiservice softswitch that is designed to provide voice over IP gateway functions, broadband and narrowband remote access services and associated billing, provisioning and service management operations support systems. WACOS enables service providers' migration from existing circuit switched platforms to a next-generation, IP-based packet-switched architecture."

Middle: Color photos of PAS, our wireless access system. Caption: "The PAS wireless access system transforms existing copper networks into high-capacity wireless networks capable of providing both voice and data services within a city or community. When integrated with our WACOS platform, our IP-based PAS system enables service providers to quickly and economically deploy wireless services in urban or suburban areas where minimal or no legacy infrastructure exists."

Bottom: Color photos of AN-2000, our broadband access platform. Caption: "The AN-2000 broadband access platform is a flexible access platform that enables the delivery of broadband voice and data services over fiber, copper or wireless transmission media. AN-2000 is designed to deliver today's revenue-generating services while enabling migration to next-generation technologies and services."

[INSIDE GATE-FOLD OF FRONT COVER PAGE]

IMAGES, DIAGRAM, DIAGRAM DESCRIPTIONS AND CAPTIONS.

1. Center: Diagram of a linked communications network depicting our AN-2000 platform, PAS system and WACOS platform.

2. Center left: Diagram of an AN-2000 deployment. Traditional voice service connects to a central office switch over a standard digital interface. The central office switch connects to a remotely located AN-2000 central office terminal over a standard digital interface. Internet services connect to a data switch, which connects to the same central office terminal over a standard digital interface. The central office terminal connects to two AN-2000 remote terminals. The connections are made through a high performance robust digital transmission technology, known as SDH. A computer using our Netman software is connected to the central office terminal and the remote terminals. The remote terminals connect to subscribers to provide wireline telephone service, leased line, ISDN and xDSL.

3. Center middle: Diagram of a PAS deployment. Traditional voice service connects to a central office switch over a standard digital interface. Internet service connects to a data switch over a standard digital interface. The central office and data switches each connect to two separate PAS remote terminals over a standard digital interface. A PAS air traffic

controller connects to each of the PAS remote terminals. A computer using our Netman software is connected to a PAS air traffic controller and the PAS remote terminals. The PAS remote terminals connect to radio port controllers over a standard digital interface. The radio port controllers provide wireless city-wide mobile phone, wireless local loop and mobile data services.

4. Center right: Diagram of a WACOS deployment. A private backbone connected to Internet service is connected to the local access network through a backbone/Internet gateway. A wireless gateway and a V5/PSTN gateway are located on the access network. The gateways connect with the PAS system and AN-2000 platform. The gateways also allow for large-scale wireless mobile phone service, voice over IP and broadband access. The system also provides network management, customer care, billing, an operations support system and softswitch and mobility management.

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You should rely only on the information contained or incorporated by reference in this prospectus. We have not, and the underwriters have not, authorized any person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. Information contained on our Web site is not part of this prospectus. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate as of the date on the front cover of this prospectus only. Our business, financial condition, results of operations and prospects may have changed since that date.

UTStarcom is registered as a trademark in the United States. UTStarcom, WACOS, PAS, Airstar and WLL are registered as trademarks in China. This prospectus also includes product names, trade names and trademarks of other companies. All other product names, trade names and trademarks appearing in this prospectus are the property of their respective holders.

In this prospectus, references to and statements regarding China refer to the People's Republic of China, excluding Hong Kong, Macau and Taiwan, references to "U.S. dollars," or "$" are to United States Dollars, and references to "Renminbi" are to Renminbi, the legal currency of China.

Unless specifically stated, information in this prospectus assumes:

- an exchange rate of 8.3 Renminbi for one U.S. dollar, the exchange rate in effect as of March 31, 2001; and

- the underwriters will not exercise their over-allotment option and no other person will exercise any other outstanding options or warrants.

PROSPECTUS SUMMARY

This summary highlights selected information contained elsewhere in, or incorporated by reference into, this prospectus. You should read the entire prospectus carefully, including "Risk Factors" and the information incorporated by reference, including the consolidated financial statements and related notes, before making an investment decision.

UTStarcom, Inc.

We design and market wireline and wireless broadband enabled access and switching equipment that supports migration to next generation IP-based networks. To date, substantially all of our sales have been to service providers in China. Our integrated suite of products provides migration to next generation networks and allows service providers to offer efficient and expandable voice, data and Internet access services. Because our systems are based on widely adopted international communications standards, service providers can easily integrate our systems into their existing networks and deploy our systems in new broadband, Internet Protocol and wireless network rollouts. Internet Protocol, or IP, refers to a set of rules developed for communicating information over the Internet.

China has one of the fastest growing communications markets in the world. Growth in China's communications equipment and services markets is being driven by the government's commitment to develop a communications infrastructure, pent-up demand for communication services and robust economic growth. While growth in China's communications market is currently driven predominantly by voice services, the increasing demand for data services presents a growing opportunity. Gartner Group estimates that Internet subscribers in China will grow from 8.9 million in 1999 to 51.0 million in 2004, representing a compound annual growth rate of 41.8%. China's ability to invest heavily in its communications infrastructure is fueled by the country's strong economic activity. The Economist Intelligence Unit estimates that China's gross domestic product will grow at a compound annual rate of 7.7% through 2005.

Service providers require network solutions that address all of their access needs and offer migration to next generation networks. These service providers require products that enable them to quickly, and with minimal incremental investment, address the changing demands of their subscribers for expanded and more advanced services over time. Given the rapid growth in emerging communications markets such as China, network solutions must be scalable so that the same architecture can provide an affordable entry level solution for as few as hundreds of subscribers, yet economically extend to hundreds of thousands of subscribers over time. In addition, service providers require products that provide an integrated product solution and an economical migration path to next generation networks. Our wireless and wireline broadband enabled access and switching equipment is designed to deliver the following key benefits to service providers:

Migration to Next Generation Networks. Our products are designed with the flexibility to allow service providers to deliver voice, data and video services on a platform which offers the ability to migrate to next generation broadband wireline and wireless networks based on IP and open standards. Our products enable service providers to effectively time their network equipment expenditures and rapidly introduce new services as demand warrants.

Flexibility for Voice and Data Services. We have designed our systems to offer a high degree of flexibility in terms of the number of subscribers and types of traffic delivered to those subscribers. This flexibility is particularly important in China, as the communications services market is undergoing rapid change and growth. Our access systems allow service providers to quickly and cost-effectively implement upgrades for new services, including high-speed data capability, compared to alternative solutions which may require the purchase of an entirely new system to provide these services.

Modular, Scalable Solutions. All of our products are based on a modular design, using a combination of off-the-shelf components and proprietary hardware and software modules. By delivering a modular system, we enable service providers to purchase only the functionality and capacity needed and to purchase additional functionality and capacity over time as subscriber demand warrants. Furthermore, as demand for communications services in China grows, our scalable products will allow service providers to grow from a small initial subscriber base to hundreds of thousands of subscribers in a cost-effective and efficient manner.

Open Standards-Based Platform. Our products are designed to comply with widely adopted international open communication standards for multi-vendor interoperability, which are consistent with standards established by the Ministry of Information Industry, the regulatory body that oversees telecommunications in China. Our open platforms allow service providers to connect our products to equipment from multiple vendors and thus integrate multiple voice and data traffic types within one system. Our compliance with open standards lowers costs by permitting service providers to shorten evaluation times and ease integration of our products with other systems in the service providers' networks.

Local Presence. We have established a strong local presence in China that allows us to be responsive to the needs of service providers and their subscribers. We manufacture our products primarily at two facilities located in the cities of Huizhou in Guangdong province and Hangzhou in Zhejiang province that are owned by joint ventures between us and affiliates of the corresponding Telecommunications Administrations. By using local facilities in China, we have helped create new jobs within the provinces and strengthened our relationships with the Telecommunications Administrations in some of China's most modernized and rapidly growing provinces. We also maintain 12 sales and customer support sites in China that allow us to deploy a customer support representative onsite anywhere in China within 24 hours. Additionally, through our relationships at the national, provincial and local levels, we receive a flow of information on market changes and insight into service provider needs and related opportunities.

Our objective is to be a leading provider of wireline and wireless broadband enabled access and switching equipment. The principal elements of our strategy are as follows:

- leverage our installed base of systems and service provider relationships to capitalize on an increasing demand for data and broadband services;

- continue to develop products and technologies for market-driven solutions and penetrate the emerging IP-based switching market;

- further capitalize on China's large population, low teledensity and strong demand for communications services by increasing our sales, support and development staff and delivering new, market-driven products and technologies; and

- leverage our success in China to address other growing communications markets.

Service providers have installed approximately 4.6 million lines of our PAS wireless access system, which we believe is the most widely deployed wireless local access system in China. Approximately

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3.0 million lines of our wireline AN-2000 broadband access platform have been deployed in China, including installations in the six largest regional communications markets. Our newest product, WACOS, is targeted at the emerging broadband, IP-based switching and wireless markets. In addition to our efforts in mainland China, one of our customers recently announced the launch of service for the first PAS network in Taiwan, and we have shipped our AN-2000 product to a service provider in India.

We incorporated in Delaware as Unitech Industries Inc. in 1991. In 1994, we changed our name to Unitech Telecom, Inc. In 1995, we acquired StarCom Network Systems, Inc. and changed our name to UTStarcom, Inc. Our principal executive offices are located at 1275 Harbor Bay Parkway, Alameda, California, 94502 and our telephone number is (510) 864-8800.

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The Offering

Common stock offered by UTStarcom............	6,050,000 shares
Common stock offered by the selling stockholders................................	2,950,000 shares
Shares outstanding after the offering........	104,007,063 shares
Use of proceeds..............................	We estimate that our net proceeds from this offering without exercise of the over-allotment option will be approximately $114.0 million based on a public offering price of $20.00 per share. We intend to use these net proceeds for general corporate purposes, including research and development, expansion of our sales and marketing

	organization, and working capital. We may also use a portion of the proceeds from this offering to acquire or invest in complementary businesses, technologies or products. We will not receive any proceeds from the sale of shares by the selling stockholders.
Risk factors...............................	See "Risk Factors" and other information included in this prospectus for a discussion of factors you should carefully consider before deciding to invest in shares of the common stock.
Nasdaq National Market symbol...............	UTSI

The number of shares that will be outstanding after the offering is based on the number of shares outstanding as of May 31, 2001 and excludes:

- options to purchase 13,666,082 shares of common stock outstanding under our stock option plans at a weighted average exercise price of $9.44 per share, and 4,210,343 additional shares available for grant under our stock option plans as of May 31, 2001;
- 3,760,195 shares of common stock reserved for issuance under our 2000 Employee Stock Purchase Plan as of May 31, 2001; and
- 32,000 shares of common stock reserved for issuance upon the exercise of warrants outstanding as of May 31, 2001, at a weighted average exercise price of $2.50 per share.

The number of shares outstanding after the offering assumes that the underwriters' over-allotment option is not exercised. If the over-allotment option is exercised in full, we will issue and sell an additional 1,350,000 shares.

SUMMARY CONSOLIDATED FINANCIAL DATA

The summary consolidated financial data below should be read together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and the related notes incorporated by reference into this prospectus.

	Year Ended December 31,					Three Months Ended March 31,	
	1996	1997	1998	1999	2000	2000	2001
						(unaudited)	

(in thousands, except per share data)

Consolidated Statement of Operations Data:							
Net sales	$35,542	$75,597	$105,167	$187,516	$368,646	$58,587	$119,181
Gross profit	13,220	26,802	41,025	74,813	128,181	20,613	41,413
Operating income (loss)	1,237	(3,390)	3,013	16,719	33,780	(2,583)	13,399
Net income (loss) applicable to common stockholders	(310)	30	(300)	(18,514)	27,013	(4,249)	9,362
Earnings (loss) per share:							
Basic(1)	$ (0.04)	$ 0.00	$ (0.04)	$ (2.13)	$ 0.34	$ (0.12)	$ 0.10
Diluted(2)	$ (0.04)	$ 0.00	$ 0.00	$ (2.13)	$ 0.27	$ (0.12)	$ 0.09
Shares used in per share calculations:							
Basic(1)	8,344	7,320	7,582	8,678	79,696	35,867	95,873
Diluted(2)	8,344	7,320	77,050	8,678	101,867	35,867	104,262

	March 31, 2001	
	Actual	As Adjusted(3)
	(unaudited) (in thousands)	
Consolidated Balance Sheet Data:		
Cash and cash equivalents(4)	$175,535	$289,546
Working capital	383,892	497,903
Total assets	642,054	756,065
Total short-term debt	55,427	55,427
Total long-term debt	12,048	12,048
Total stockholders' equity	428,764	542,775

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(1) Based on the number of shares outstanding as of March 31, 2001. Excludes (i) options to purchase 14,525,512 shares of our common stock that were outstanding under our stock option plans as of March 31, 2001 with a weighted average exercise price of $8.30 per share, and 3,481,343 additional shares that were available for grant under the stock option plans, (ii) 3,816,656 shares of common stock reserved for issuance under our 2001 Employee Stock Purchase Plan as of March 31, 2001, and (iii) 32,000 shares of common stock reserved for issuance upon the exercise of warrants outstanding as of March 31, 2001 with a weighted average exercise price of $2.50 per share.

(2) Based on the number of shares outstanding as of March 31, 2001. Excludes (i) 3,481,343 shares available for grant under the stock option plans as of March 31, 2001, and (ii) 14,525,512 stock options outstanding as of March 31, 2001 with a weighted average exercise price of $8.30 per share and 32,000 warrants outstanding as of March 31, 2001 with a weighted average exercise price of $2.50 per share, if anti-dilutive.

(3) Adjusted to reflect the receipt of the estimated net proceeds from the sale of 6,050,000 shares of common stock offered by us in this prospectus at a public offering price of $20.00 per share, after deducting the underwriting discount and estimated offering expenses.

(4) Includes restricted cash of $5.1 million as of March 31, 2001.

RISK FACTORS

You should carefully consider the risks described below before making a decision to buy our common stock. The risks and uncertainties described below are not the only ones facing our company. If any of the following risks actually occur, our business could be harmed, the trading price of our common stock could decline and you may lose all or part of your investment. You should also refer to the other information contained in or incorporated by reference into this prospectus, including the financial statements and related notes incorporated herein.

Risks Relating to Our Company

Our future sales are unpredictable, our operating results are likely to fluctuate from quarter to quarter, and if we fail to meet the expectations of securities analysts or investors, our stock price could decline significantly

Our quarterly and annual operating results have fluctuated in the past and are likely to fluctuate in the future due to a variety of factors, some of which are outside of our control. As a result, period to period comparisons of our operating results are not necessarily meaningful or indicative of future performance. Furthermore, it is possible that in some future quarters our operating results will fall below the expectations of securities analysts or investors. If this occurs, the trading price of our common stock will likely decline.

Factors that may affect our future operating results include:

- the timing, number and size of orders for our products, as well as the relative mix of orders for each of our products, particularly the volume of lower margin telephone handsets;

- the evolving and unpredictable nature of the economic, regulatory and political environments in China and other countries in which we market or plan to market our products;

- aggressive price reductions by our competitors;

- currency fluctuations;

- market acceptance of our products and product enhancements;

- write-downs or write-offs of excess or obsolete inventory;

- the lengthy and unpredictable sales cycles associated with sales of our products combined with the impact of this variability on our suppliers' ability to provide us with components on a timely basis; and

- longer collection periods for accounts receivable in China and other countries.

The limited performance history of some of our products, our limited forecasting experience and processes and the emerging nature of our target markets make forecasting our future sales and operating results difficult. Our expense levels are based, in part, on our expectations regarding future sales, and these expenses are largely fixed, particularly in the short term. In addition, to enable us to promptly fill orders, we maintain inventories of finished goods, components and raw materials. As a result, we commit to considerable costs in advance of anticipated sales. Accordingly, we may not be able to reduce our costs in a timely manner to compensate for any unexpected shortfall between forecasted and actual sales. Any significant shortfall of sales may require us to maintain higher levels of inventories of finished goods, components and raw materials than we require, thereby increasing our risk of inventory obsolescence and corresponding inventory write-downs and write-offs. We may not have adequate reserves to offset write-downs or write-offs.

We have only recently become profitable and may not be able to sustain profitability

We have only recently become profitable and may not be able to remain profitable in future periods. As of March 31, 2001, we had retained earnings of only $1.6 million. We anticipate continuing to incur significant sales and marketing, research and development and general and administrative expenses, and, as a result, we will need to generate higher revenues to remain profitable. Numerous factors could negatively impact our results of operations, including a decrease in sales, price pressures and significant fixed costs. Our past results should not be relied on as an indication of our future performance, and our results for the first quarter of 2001 should not be used as an indication of expected results for the full year.

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

We face intense competition in our target markets and expect competition to increase. Our principal competitors in our various product lines include:

- AN-2000: Advanced Fibre Communications, Inc.; Alcatel Alsthom CGE, S.A.; Datong Telecom Technology Co. Ltd.; Huawei Technology Co., Ltd.; Lucent Technologies, Inc.; and Zhongxing Telecommunications Equipment.

- PAS: Lucent and Zhongxing.

- WACOS: Alcatel; Cisco Systems, Inc.; Clarent Corporation; Ericsson LM Telephone Co.; Huawei; Lucent; Motorola, Inc.; Nokia Corporation; Nortel Networks Corporation; Nuera Communications, Inc.; Siemens AG; Sonus Networks, Inc.; and Zhongxing.

We are increasingly facing competition from domestic companies in China. We believe that our strongest competition in the future may come from these companies, many of which operate under lower cost structures and more favorable governmental policies and have much larger sales forces than we do. Furthermore, other companies not presently offering competing products may also enter our target markets. Many of our existing and potential competitors may have significantly greater financial, technical, product development, sales, marketing and other resources than we do. As a result, our competitors may be able to respond more quickly to new or emerging technologies and changes in service provider requirements. Our competitors may also be able to devote greater resources than we can to the development, promotion and sale of new products and offer significant discounts on handsets or other products. These competitors may also be able to offer significant financing arrangements to service providers, in some cases facilitated by government policies, which is a competitive advantage in selling systems to service providers with limited financial and foreign currency resources. Increased competition is likely to result in price reductions, reduced gross profit as a percentage of net sales and loss of market share, any one of which could materially harm our business, financial condition and results of operations.

Moreover, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties, including Telecommunications Administrations, Telecommunications Bureaus and other local organizations, to increase their ability to address the needs of prospective customers in our target markets. Accordingly, alliances among competitors or between competitors and third parties may emerge and rapidly acquire significant market share. To remain competitive, we believe that we must continue to partner with Telecommunications Administrations and other local organizations, maintain a high level of investment in research and development and in sales and marketing, and manufacture and deliver products to service providers on a timely basis and without significant defects. If we fail to meet any of these objectives, our business, financial condition and results of operations could be harmed.

The introduction of inexpensive wireless telephone service or other competitive services in China may also have an adverse impact on sales of our PAS system in China. We may not be able to compete successfully against current or future competitors, and competitive pressures in the future may materially adversely affect our business, financial condition and results of operations.

The success of our business depends on a relatively small number of large system deployments, and any cancellation, reduction or delay in these deployments could harm our business

Our business is characterized by large system deployments for a relatively small number of service providers. For the year ended December 31, 2000, one customer, Hangzhou Telecommunications Bureau, accounted for 12.1% of our net sales. In the three months ended March 31, 2001, one customer, Shaoxing Telecommunications Bureau, accounted for 14.0% of our net sales. Our dependence on large system deployments makes our ability to provide systems in a timely manner critically important to our business. We have in the past experienced delays and encountered other difficulties in the installation and implementation of our systems. Various factors could cause future delays, including technical problems and the shortage of qualified technicians. Any delays or difficulties in deploying our systems, or the cancellation of any orders by service providers, could significantly harm our business and lead to fluctuations in our operating results.

Our business may suffer if we are unable to collect payments from our customers on a timely basis

Our customers often must make a significant commitment of capital to purchase our products. As a result, any downturn in a customer's business that affected the customer's ability or willingness to pay us could harm our financial condition. Moreover, accounts receivable collection cycles historically tend to be much longer in China than in other markets. The failure of any of our customers to make timely payments could require us to write-off accounts receivable or increase our accounts receivable reserves, either of which could adversely affect our operating results and financial condition.

A decline in business activity during China's Lunar New Year may result in decreased sales during our first quarter

Business activity in China declines considerably during the first quarter of each year in observance of the Lunar New Year. As a result, sales during the first quarter of our fiscal year have typically been lower than sales during the fourth quarter of the preceding fiscal year, and we expect this trend to continue. We do not have the ability to forecast with any degree of certainty the impact of the decreased business activity during the Lunar New Year on our sales and operating results.

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

The emerging market for communications equipment in developing countries is characterized by rapid technological developments, frequent new product introductions and evolving industry and regulatory standards. Our success will depend in large part on our ability to enhance our network access and switching technologies and develop and introduce new products and product enhancements that anticipate changing service provider requirements and technological developments. We may need to make substantial capital expenditures and incur significant research and development costs to develop and introduce new products and enhancements. If we fail to timely develop and introduce new products or enhancements to existing products that effectively respond to technological change, our business, financial condition and results of operations could be materially adversely affected.

From time to time, our competitors or we may announce new products or product enhancements, services or technologies that have the potential to replace or shorten the life cycles of our products and that may cause customers to defer purchasing our existing products, resulting in inventory obsolescence. Future technological advances in the communications industry may diminish or inhibit market acceptance of our existing or future products or render our products obsolete.

Even if we are able to develop and introduce new products, they may not gain market acceptance. Market acceptance of our products will depend on various factors including:

- our ability to obtain necessary approvals from regulatory organizations;
- the perceived advantages of the new products over competing products;

- our ability to attract customers who have existing relationships with our competitors;
- product cost relative to performance; and
- the level of customer service available to support new products.

Specifically, sales of PAS, our wireless access system, will depend in part upon consumer acceptance of the mobility limitations of this service relative to other wireless service systems, such as GSM or CDMA. If our existing or new products fail to achieve market acceptance for any reason, our business could be seriously harmed.

Our business will suffer if we are unable to deliver quality products on a timely and cost effective basis

Our operating results depend on our ability to manufacture products on a timely and cost effective basis. In the past, we have experienced reductions in yields as a result of various factors, including defects in component parts and human error in assembly. If we experience deterioration in manufacturing performance or a delay in production of any of our products, we could experience delays in shipments and cancellations of orders. Moreover, networking products frequently contain undetected software or hardware defects when first introduced or as new versions are released. In addition, our products are often embedded in or deployed in conjunction with service providers' products, which incorporate a variety of components produced by third parties. As a result, when a problem occurs, it may be difficult to identify the source of the problem. These problems may cause us to incur significant warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relation or reputation problems or loss of customers, any one of which could harm our business.

We contract with third parties in China to undertake high volume manufacturing and assembly of our handsets. In addition, we sometimes use third parties for high volume assembly of circuit boards. We do not have any long-term contracts with these third party manufacturers, and in the event that these manufacturers are unable or unwilling to continue to manufacture our products, we may be unable to secure alternative manufacturers or could experience delays in qualifying new manufacturers. We currently manufacture internally only a very limited quantity of our handsets. However, if future demand for our handsets requires additional manufacturing capacity, we may invest in and build additional manufacturing facilities, most likely in China. However, new manufacturing facilities may not attain the same quality or level of efficiencies as those of our existing third party manufacturers.

We depend on some sole source and other key suppliers for handsets, components and materials used in our products, and if these suppliers fail to provide us with adequate supplies of high quality products at competitive prices, our competitive position, reputation and business could be harmed

Some components and materials used in our products are purchased from a single supplier or a limited group of suppliers. If any supplier is unwilling or unable to provide us with high quality components and materials in the quantities required and at the costs specified by us, we may not be able to find alternative sources on favorable terms, in a timely manner, or at all. Our inability to obtain or to develop alternative sources if and as required could result in delays or reductions in manufacturing or product shipments. Moreover, these suppliers may delay product shipments or supply us with inferior quality products. If any of these events occur, our competitive position, reputation and business could suffer.

Our ability to source a sufficient quantity of high quality components used in our products may be limited by China's import restrictions and duties. We require a significant number of imported components to manufacture our products in China. Imported electronic components and other imported goods used in the operation of our business are subject to a variety of permit requirements, approval procedures and import duties. Failure to obtain necessary permits or approvals, administrative actions by China's government to limit imports of certain components, or non-payment of required import duties could subject us to penalties and fines and could adversely affect our ability to manufacture and sell our products in China. In addition, import duties increase the cost of our products and may make them less competitive.

In particular, an integral component of our PAS system is the handset used by subscribers to make and receive mobile telephone calls. Our inability to obtain a sufficient number of high quality components and assemblies for handsets could severely harm our business. A worldwide shortage of handsets existed in 2000, and there continues to be a shortage of low-priced handsets, which we have found to be popular with many consumers in China. We have only used third parties to assemble and manufacture handsets in China for us for a limited period of time. These manufacturers may be unable to produce adequate quantities of high-quality handsets to meet the demand of our customers.

China's government recently imposed tariffs on certain imports from Japan, including mobile handsets and handset assemblies such as those used in our PAS system, which may adversely affect our results of operations if we are unable to secure a sufficient quantity of handsets from sources outside of Japan

As a result of a trade dispute with Japan, in June 2001 the Tariff Policy Commission of the State Council of China imposed a special tariff on certain Japanese imports, including mobile handsets and handset assemblies, such as those used in our PAS system. The special tariff could result in additional charges of up to 100% of the cost of the affected products. We have relied on manufacturers in Japan to source a portion of our handsets and handset assemblies. Although we believe we will be able to increase our handset manufacturing capacity in China and secure additional supply from sources outside Japan, we may not be able to do so in a cost-effective manner, or at all. If we are unable to cost-effectively manufacture or source sufficient quantities of handsets and handset assemblies from suppliers outside of Japan, we believe that our handset revenue and gross profit from handset sales could be materially adversely impacted by the tariff.

If we are unable to expand our direct sales operation in China and indirect distribution channels elsewhere or successfully manage our expanded sales organization, our operating results may suffer

Our distribution strategy focuses primarily on developing and expanding our direct sales organization in China and our indirect distribution channels outside of China. We may not be able to successfully expand our direct sales organization in China and the cost of any expansion may exceed the revenue generated from these efforts. Even if we are successful in expanding our direct sales organization in China, we may not be able to compete successfully against the significantly larger and better-funded sales and marketing operations of current or potential competitors. In addition, if we fail to develop relationships with significant international sales and marketing partners or if these partners are not successful in their sales or marketing efforts, we may be unsuccessful in our expansion efforts outside China.

We expect average selling prices of our products to decrease which may reduce our revenues, and, as a result, we must introduce new products and reduce our costs in order to maintain profitability

The average selling prices for communications access and switching systems and subscriber terminal products, such as handsets, in China have been declining as a result of a number of factors, including:

- increased competition;

- aggressive price reductions by competitors; and

- rapid technological change.

We anticipate that average selling prices of our products will decrease in the future in response to product introductions by us or our competitors or other factors, including price pressures from customers. Therefore, we must continue to develop and introduce new products and enhancements to existing products that incorporate features that can be sold at higher average selling prices. Failure to do so could cause our revenues and gross profit, as a percentage of net sales, to decline.

Our cost reduction efforts may not allow us to keep pace with competitive pricing pressures or lead to improved gross profit, as a percentage of net sales. In order to be competitive, we must continually reduce the

cost of manufacturing our products through design and engineering changes. We may not be successful in these efforts or delivering our products to market in a timely manner. Any redesign may not result in sufficient cost reductions to allow us to reduce the prices of our products to remain competitive or to improve or maintain our gross profit, as a percentage of net sales.

Shifts in our product mix may result in declines in gross profit, as a percentage of net sales

Our gross profit, as a percentage of net sales, varies among our product groups. Our gross profit, as a percentage of net sales, is generally higher on our access network system products and is significantly lower on our handsets. We also anticipate that the gross profit, as a percentage of net sales, may be lower for our newly developed products due to start-up costs and may improve as unit volumes increase and efficiencies can be realized. Our overall gross profit, as a percentage of net sales, has fluctuated from period to period as a result of shifts in product mix, the introduction of new products, decreases in average selling prices for older products and our ability to reduce manufacturing costs. As a result of a growth in sales of lower margin handsets over the past few quarters, we have experienced a decline in overall gross profit, as a percentage of net sales. We are likely to continue to experience downward pressure on our gross profit, as a percentage of net sales.

Service providers sometimes evaluate our products for long and unpredictable periods, which causes the timing of purchases and our results of operations to be unpredictable

The period of time between our initial contact with a service provider and the receipt of an actual purchase order may span a year or more. During this time, service providers may subject our products to an extensive and lengthy evaluation process before making a purchase. The length of these qualification processes may vary substantially by product and service provider, making our results of operations unpredictable. We may incur substantial sales and marketing expenses and expend significant management effort during this process, which ultimately may not result in a sale. These qualification processes often make it difficult to obtain new customers, as service providers are reluctant to expend the resources necessary to qualify a new supplier if they have one or more existing qualified sources.

Our inability to exercise complete control over our subsidiaries may be detrimental to our business

A considerable portion of our operations is and will continue to be conducted through direct and indirect subsidiaries. For example, we own an 88% interest in a joint venture which operates the Zhejiang manufacturing facility and a 51% interest in a joint venture which operates the Guangdong manufacturing facility. Even though we own a majority interest in these joint ventures, we do not have sole power to control all of the policies and decisions of these jointly-owned ventures.

Under the law of China governing Sino-foreign joint ventures, equity holders exercise rights primarily through the board of directors, which constitutes the highest authority of the joint venture. Although we own a majority of the Guangdong joint venture, we are only entitled to appoint a minority of the directors to the joint venture's board of directors, which prevents us from controlling the actions of the board. Moreover, even though we hold a majority of the board seats in the Zhejiang joint venture, the law in China requires unanimous approval of the board of directors for some significant corporate actions, including:

- amendment of the Articles of Association of the joint venture;
- liquidation or dissolution of the joint venture;
- any increase, decrease or transfer of equity interests of any party to the joint venture; and
- a merger of the joint venture with another economic entity.

Our operating results and cash flow depend on the operating results and cash flow of our subsidiaries and the payment of funds by those subsidiaries to us. These subsidiaries are separate and distinct legal entities

and have no obligation, contingent or otherwise, to pay dividends or otherwise provide financial benefits to us. Moreover, with respect to our Guangdong manufacturing joint venture, any payment of dividends to us must be agreed to by our joint venture partner, whose interests in receiving dividend distributions may not coincide with ours. In addition, applicable law in some countries, including China, limits the ability of a subsidiary to pay dividends for various reasons including the absence of sufficient distributable reserves. In the event of any insolvency, bankruptcy or similar proceedings, creditors of the subsidiaries would generally be entitled to priority over us with respect to assets of the affected subsidiary. In addition, because our joint venture partners in both Zhejiang and Guangdong provinces are affiliated with the provincial Telecommunications Administrations that operate the telecommunication networks in these areas, if we fail to maintain these joint ventures, sales to our customers located in these areas may decrease.

Our multi-national operations subject us to various business, economic, political, regulatory and legal risks

We market and sell our products in mainland China and other markets, including India and Taiwan. The expansion of our existing multi-national operations and entry into additional international markets will require significant management attention and financial resources. Multi-national operations are subject to inherent risks, including:

- difficulties in designing products that are compatible with varying international communications standards;
- longer accounts receivable collection periods and greater difficulty in accounts receivable collection;
- unexpected changes in regulatory requirements;
- changes to import and export regulations, including quotas, tariffs and other trade barriers;
- delays or difficulties in obtaining export and import licenses;
- potential foreign exchange controls and repatriation controls on foreign earnings;

- exchange rate fluctuations and currency conversion restrictions;
- the burdens of complying with a variety of foreign laws and regulations;
- difficulties and costs of staffing and managing multi-national operations;
- reduced protection for intellectual property rights in some countries;
- potentially adverse tax consequences; and
- political and economic instability.

Multi-national companies are required to establish intercompany pricing for transactions between their separate legal entities operating in different taxing jurisdictions. These intercompany transactions are subject to audit by taxing authorities in the jurisdictions in which multi-national companies operate. An additional tax liability may be incurred if it is determined that intercompany pricing was not done at arm's length. We believe we have adequately estimated and recorded our liability arising from intercompany pricing, but an additional tax liability may result from audits of our intercompany pricing policies.

In markets outside of China, we rely on a number of original equipment manufacturers, third-party distributors, resellers, agents and licensors to market and sell our network access products. If these original equipment manufacturers, distributors, resellers, agents or licensors fail to provide the support and effort necessary to service developing markets effectively, our ability to maintain or expand our operations outside of China will be negatively impacted. We may not successfully compete in these markets, our products may not be accepted and we may not successfully overcome the risks associated with international operations.

Our international sales are generally denominated in local currencies. Due to the limitations on converting Renminbi, we are limited in our ability to engage in currency hedging activities in China. Fluctuations in currency exchange rates in the future may have a material adverse effect on our results of operations.

Our failure to meet international and governmental product standards could be detrimental to our business

Many of our products are required to comply with numerous governmental regulations and standards, which vary by market. As standards for products continue to evolve, we will need to modify our products or develop and support new versions of our products to meet emerging industry standards, comply with government regulations and satisfy the requirements necessary to obtain approvals. Our inability to obtain regulatory approval and meet established standards could delay or prevent our entrance into or force our departure from some markets.

Our recent growth has strained our resources, and if we are unable to manage and sustain our growth, our operating results will be negatively affected

We have recently experienced a period of rapid growth, and we must continue to expand our operations to address potential market opportunities. If we fail to implement or improve systems or controls or to manage any future growth and expansion effectively, our business could suffer.

Our expansion has placed and will continue to place a significant strain on our management, operational, financial and other resources. To manage our growth effectively, we will need to take various actions, including:

- enhancing management information systems and forecasting procedures;
- further developing our operating, administrative, financial and accounting systems and controls;
- maintaining close coordination among our engineering, accounting, finance, marketing, sales and operations organizations, both in the U.S. and internationally;
- expanding, training and managing our employee base; and
- expanding our finance, administrative and operations staff.

Our success is dependent on continuing to hire and retain qualified personnel, and if we are not successful in attracting and retaining these personnel, our business would be harmed

The success of our business depends in significant part upon the continued contributions of key technical and senior management personnel, many of whom would be difficult to replace. In particular, our success depends in large part on the knowledge, expertise and services of Hong Liang Lu, our President and Chief Executive Officer, and Ying Wu, our Executive Vice President and Chief Executive Officer of China Operations. The loss of any key employee, the failure of any key employee to perform satisfactorily in his or her current position or our failure to attract and retain other key technical and senior management employees could have a significant negative impact on our operations.

To effectively manage our recent growth as well as any future growth, we will need to recruit, train, assimilate, motivate and retain qualified employees. Competition for qualified employees is intense, and the process of recruiting personnel with the combination of skills and attributes required to execute our business strategy can be difficult, time-consuming and expensive. We are actively searching for research and development engineers and sales and marketing personnel, who are in short supply. Additionally, we have a need for and have experienced difficulty in finding qualified accounting personnel knowledgeable in U.S. and

China accounting standards. If we fail to attract, hire, assimilate or retain qualified personnel, our business would be harmed.

Competitors and others have in the past and may in the future attempt to recruit our employees. In addition, companies in the communications industry whose employees accept positions with competitors frequently claim that the competitors have engaged in unfair hiring practices. We may be the subject of these types of claims in the future as we seek to hire qualified personnel. Some of these claims may result in material litigation and disruption to our operations. We could incur substantial costs in defending ourselves against these claims, regardless of their merits.

Any acquisitions that we undertake could be difficult to integrate, disrupt our business, dilute our stockholders and harm our operating results

We may acquire complementary businesses, products and technologies. Any anticipated benefits of an acquisition may not be realized. We have in the past and will continue to evaluate acquisition prospects that would complement our existing product offerings, augment our market coverage, enhance our technological capabilities, or that may otherwise offer growth opportunities. Acquisitions of other companies may result in dilutive issuances of equity securities, the incurrence of debt and the amortization of expenses related to goodwill and other intangible assets. In addition, acquisitions involve numerous risks, including difficulties in the assimilation of operations, technologies, products and personnel of the acquired company, diversion of management's attention from other business concerns, risks of entering markets in which we have no direct or limited prior experience, and the potential loss of key employees of ours and the acquired company.

We may experience difficulty in identifying, forming and maintaining new business ventures that are important to the development of our business, and investments in these ventures may not generate returns

We have invested, and expect to continue to invest, significant capital in new business ventures that are important to the development of our business. We may not be able to continue to identify suitable parties for new ventures and investments in the future. The failure to form or maintain new ventures, or to identify suitable investment opportunities, could significantly limit our ability to expand our operations. Many of our investments have been in privately held companies, many of which can still be considered in the start-up or development stages. These investments are inherently risky as the market for the technologies or products they have under development are typically in the early stages and may never materialize. We have recognized an impairment charge in respect of our long-term investments, and we may incur future investment losses. Moreover, these new ventures or investments require significant management time and will present significant challenges. These activities may not be successful and we may not realize returns on these activities. Additionally, if any venture or investment fails, our business could be negatively impacted.

We may be unable to adequately protect our intellectual property and may be subject to claims that we infringe the intellectual property of others, either of which could substantially harm our business

We rely on a combination of patents, copyrights, trademarks, trade secret laws and contractual obligations to protect our technology. We have applied for 16 patents in the United States, three of which have been issued. We have also filed patent applications in other countries. Additional patents may not be issued on our pending patent applications and our issued patents may not be upheld. Moreover, we have not yet obtained, and may not be able to obtain patents in China on our products or the technology that we use to manufacture our products. Our subsidiaries and joint ventures in China rely upon our trademarks, technology and know-how to manufacture and sell our products. We cannot guarantee that these and other intellectual property protection measures will be sufficient to prevent misappropriation of our technology or that our competitors will not independently develop technologies that are substantially equivalent or superior to ours. In addition, the legal systems of many foreign countries, including China, do not protect intellectual property rights to the same

extent as the legal system of the United States. If we are unable to adequately protect our proprietary information and technology, our business, financial condition and results of operations could be materially adversely affected.

The increasing dependence of the communications industry on proprietary technology has resulted in frequent litigation based on allegations of the infringement of patents and other intellectual property. In the future we may be subject to litigation to defend against claimed infringements of the rights of others or to determine the scope and validity of the proprietary rights of others. Future litigation also may be necessary to enforce and protect our intellectual property rights. Any intellectual property litigation could be costly and could cause diversion of management's attention from the operation of our business. Adverse determinations in any litigation could result in the loss of our proprietary rights, subject us to significant liabilities or require us to seek licenses from third parties which may not be available on commercially reasonable terms, if at all. We could also be subject to court orders preventing us from manufacturing or selling our products.

Business interruptions could adversely affect our business

Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure and other events beyond our control. We do not have a detailed disaster recovery plan. Our headquarters facility in the State of California is currently subject to electrical blackouts as a consequence of a shortage of available electrical power. In the event these blackouts continue or increase in severity, they could disrupt the operations at our headquarters. In addition, we do not carry sufficient business interruption insurance to compensate us for losses that may occur as a result of these blackouts or other events and any losses or damages incurred by us could have a material adverse effect on our business.

Risk Relating to the Structure and Regulation of China's Telecommunications Industry

China's telecommunications industry is subject to extensive government regulation

China's telecommunications industry is heavily regulated by the Ministry of Information Industry. The Ministry of Information Industry has broad discretion and authority to regulate all aspects of the telecommunications and information technology industry in China, including managing spectrum bandwidths, setting network equipment specifications and standards and drafting laws and regulations related to the electronics and telecommunications industries. Additionally, the Ministry of Information Industry can decide what types of equipment may be connected to the national telecommunications networks, the forms and types of services that may be offered to the public, the rates that are charged to subscribers for those services and the content of material available in China over the Internet. If the Ministry of Information Industry sets standards with which we are unable to comply or which render our products noncompetitive, our ability to sell products in China may be limited, resulting in substantial harm to our operations.

At the end of May 2000, we became aware of an internal notice, circulated within the Ministry of Information Industry, announcing a review of PHS-based telecommunications equipment for future installation into China's telecommunications infrastructure. The Ministry of Information Industry requested service providers to temporarily halt new deployments of PHS-based telecommunications equipment, including our PAS system, pending conclusion of a review by the Ministry of Information Industry. Subsequently, at the end of June 2000, the Ministry of Information Industry issued a notice stating that it had concluded its review of PHS-based equipment and that the continued deployment of PHS-based systems, such as our PAS system, in China's county-level cities and towns and villages would be permitted. In addition, the notice stated that deployments within large and medium-sized cities would only be allowed in very limited areas of dense population, such as campuses, commercial buildings and special development zones. The notice confirmed, however, that new city-wide deployments of our PAS system in large and medium cities would not be permitted. Failure of the Ministry of Information Industry to permit the sale or deployment of our PAS system, or the sale or deployment of our other products, or the imposition of additional limitations on their sale in the

future could have a material adverse effect on our business and financial condition. The Ministry of Information Industry may conduct further reviews or evaluations of PHS-based telecommunications equipment or may change its position regarding PHS-based systems in the future.

China's telecommunications regulatory framework is in the process of being developed, which has led to uncertainties regarding how to conduct our business in China

China does not yet have a national telecommunications law. The Ministry of Information Industry, under the direction of the State Council, is currently preparing a draft of the Telecommunications Law of the People's Republic of China for ultimate submission to the National People's Congress for review and adoption. It is unclear if and when the Telecommunications Law will be adopted. If the Telecommunications Law is adopted, we expect it to become the basic telecommunications statute and the source of telecommunications regulations in China. We do not know the nature and scope of regulation that the Telecommunications Law would create. Accordingly, we cannot predict whether it will have a positive or negative effect on us or on some or all aspects of our business.

China's telecommunications regulatory framework is in the process of being developed. In September 2000, the State Council issued the Telecommunications Regulations of the People's Republic of China, known as the Telecom Regulations. The Telecom Regulations cover telecommunications services and market regulations, pricing, interconnection and connection, as well as telecommunications construction and security issues. In May 2001, the Ministry of Information Industry issued the Administrative Measures of Network Access Licenses to implement the Telecom Regulations. Regulations in this area often require subjective interpretation and, given the relative infancy of the Telecom Regulations and the implementing regulations, we do not know how the regulations will be interpreted or enforced. As a result, our attempts to comply with these regulations may be deemed insufficient by the appropriate regulatory agencies, which could subject us to penalties that adversely affect our business.

We do not have some of the licenses we are required to have to sell our network access products in China

Under China's current regulatory structure, the communications products that we offer in China must meet government and industry standards, and a network access license for the equipment must be obtained. Without the license, the equipment is not allowed to be connected to public telecommunications networks or sold in China. Moreover, we must ensure that the quality of the telecommunications equipment for which we have obtained a network access license is stable and reliable, and may not lower the quality or performance of other installed licensed products. The State Council's product quality supervision department, in concert with the Ministry of Information Industry, will perform spot checks to track and supervise the quality of licensed telecommunications equipment and publish the results of such spot checks.

The regulations implementing these requirements are not very detailed, have not been applied by a court and may be interpreted and enforced by regulatory authorities in a number of different ways. We have obtained the required network access licenses for our AN-2000 platform. We have applied for, but have not yet received, a network access license for our PAS system. Based upon conversations with the Ministry of Information Industry, we understand that our PAS system is considered to still be in the trial period and that sales of our PAS system may continue to be made by us during this trial period, but a license will ultimately be required. Network access licenses will also be required for most additional products that we are selling or may sell in China, including our WACOS platform. If we fail to obtain the required licenses, we could be prohibited from making further sales of the unlicensed products, including our PAS system, in China, which would substantially harm our business, financial condition and results of operations. Our counsel in China has advised us that China's governmental authorities may interpret or apply the regulations with respect to which licenses are required and the ability to sell a product while a product is in the trial period in a manner that is inconsistent with the information received by our counsel in China, either of which could have a material adverse effect on our business and financial condition.

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Software incorporated in our products has not been registered in accordance with relevant Chinese regulations, and our ability to sell the products incorporating the software may be affected

In October 2000, the Ministry of Information Industry issued regulations which prohibit the production and sale of software products, or products incorporating software, in China unless the software is registered with the government. We are in the process of applying for registration of our software. Based upon verbal advice received from the Ministry of Information Industry, we believe that since these regulations only recently came into effect, we will be able to continue to sell products incorporating our software during the period in which the regulations are being implemented and our applications are pending. However, this implementation period may not last long enough for us to complete the registration of our software. Moreover, the Chinese government may interpret or apply the regulations in such a way as to prohibit sales of products incorporating our unregistered software prior to registration. If the government prohibits sales pending registration, or if we fail in our efforts to register our software, we could be prohibited from making further sales of products incorporating our unregistered software in China, which could substantially harm our business and financial condition.

Most of our customers in China are part of the China Telecom system and are subject to its ultimate control

Our main customers in China are the local Telecommunications Bureaus, which operate under China Telecom, China's state-owned fixed line operator, and are subject to its ultimate control. Accordingly, China Telecom may issue policy statements or make other decisions which govern the equipment purchasing decisions of most of our customers in China. For example, in late 1999 China Telecom prohibited all Telecommunications Bureaus from purchasing PHS systems, such as our PAS systems, for implementation in large cities, even before these sales were prohibited by the Ministry of Information Industry. As virtually all of our sales are generated from our operations in China, other decisions by China Telecom restricting or prohibiting the sales or deployment of our products could cause substantial harm to our business.

Our business may suffer if the China Telecom system undergoes further restructuring

In February 1999, the State Council approved a restructuring plan for the China Telecom system, under which the telecommunications operations of the

China Telecom system were separated along four business lines: fixed line, mobile, paging and satellite communications services. Following the announcement, we observed a reduction in orders from Telecommunications Bureaus, which we attributed to the uncertainties surrounding the restructuring and the ultimate impact the restructuring would have on the Telecommunication Bureaus. In May 2001, China media sources reported that China Telecom would undergo further restructuring in an effort to stimulate additional competition in the telecommunications market. As the details and timing of the proposed restructuring are not yet publicly known, we cannot be certain what impact the restructuring will have on our business operations. However, we may experience another decline in orders and related revenues similar to that which we experienced following the 1999 restructuring, resulting from uncertainty among our Telecommunications Bureau customers associated with any new restructuring. Moreover, following any restructuring, China Telecom or any other entity that may replace it as a result of a restructuring may restrict or prohibit the sales of our products, which could cause substantial harm to our business.

Our ability to sell our PAS wireless system could be significantly impaired if China Telecom is granted or otherwise acquires a mobile license, which will allow China Telecom to deliver cellular services

Under the current regulatory structure, China Telecom holds and operates the fixed line telephone and data communications assets in China and is prohibited from offering cellular services. To offer wireless services to end users, the Telecommunications Bureaus must offer services that can be delivered over wireline networks, such as those delivered over our PAS wireless system. China Telecom has applied for a mobile license with the Ministry of Information Industry. If the Ministry of Information Industry grants a mobile

license to China Telecom or if China Telecom otherwise acquires a mobile license, local Telecommunications Bureaus will be free to offer cellular services, such as GSM or CDMA, to their customers and they may therefore elect not to deploy our PAS system. If this were to occur, we could lose current and potential customers for our PAS system, and our financial condition and results of operations could be harmed.

Changes in telecommunications rates or pricing policies may result in decreased demand for our products

In November 2000, the Ministry of Information Industry announced significant changes in rates for telecommunications services in China. While long distance, international, leased line and Internet connection fees were cut by up to 70%, the rates for local telephone services, which include certain types of wireless access services such as those offered over our PAS system, were increased, from approximately $0.01 per minute to approximately $0.02 per minute. The increase in rates may result in a reduced demand by end users for wireless services delivered over our PAS system and a corresponding decline in demand for our products. Additionally, the Ministry of Information Industry may implement future rate changes for wireline or wireless services in China or change telecommunications pricing policies, any of which may lead to reduced demand for our systems and products and result in a material adverse effect on our business or results of operations.

Risks Relating to Conducting Operations in China

Sales in China have accounted for substantially all of our sales, and therefore, our business, financial condition and results of operations are to a significant degree subject to economic, political and social events in China

Approximately $116.8 million, or 98.0%, of our net sales for the three months ended March 31, 2001, $364.0 million, or 98.8%, of our net sales in fiscal 2000, and $186.1 million, or 99.3%, of our net sales in fiscal 1999, occurred in China. Additionally, a substantial portion of our fixed assets are located in China. Of our total fixed assets, approximately 76.8% as of March 31, 2001, 75.0% as of December 31, 2000, and 53.7% as of December 31, 1999 were located in China. We expect to make further investments in China in the future. Therefore, our business, financial condition and results of operations are to a significant degree subject to economic, political and social events in China.

Devaluation in the value of the Renminbi and fluctuations in exchange rates could adversely affect our financial results

Exchange rate fluctuations could have a substantial negative impact on our financial condition and results of operations. We purchase substantially all of our materials in the United States and Japan and a significant portion of our cost of goods sold is incurred in U.S. dollars and Japanese yen. A significant portion of our operating expenses are incurred in U.S. dollars. At the same time, most of our sales are denominated in Renminbi. The value of the Renminbi is fixed by China's national government and is subject to changes in China's governmental policies and to international economic and political developments. China may choose to devalue the Renminbi against the U.S. dollar. Additionally, China's national government has considered from time to time whether to partially or fully abandon the official exchange rate for Renminbi to the U.S. dollar. The abandonment of this official exchange rate policy may lead to sharp depreciation of the Renminbi against the U.S. dollar and other foreign currencies and to significantly more volatility in the Renminbi exchange rate in the future, both of which would adversely affect our financial results and make our future results more subject to fluctuation.

In the past, financial markets in many Asian countries have experienced severe volatility and, as a result, some Asian currencies have experienced significant devaluation from time to time. The devaluation of some Asian currencies may have the effect of rendering exports from China more expensive and less competitive and therefore place pressure on China's government to devalue the Renminbi. Any devaluation of the Renminbi could result in an increase in volatility of Asian currency and capital markets. Future volatility of

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Asian financial markets could have an adverse impact on our ability to expand our product sales into Asian markets outside of China. Moreover, due to the limitations on the convertibility of Renminbi, we are limited in our ability to engage in currency hedging activities in China and do not currently engage in currency hedging activities with respect to international sales outside of China.

Currency restrictions in China may limit the ability of our subsidiaries and joint ventures in China to obtain and remit foreign currency necessary for the purchase of imported components and may limit our ability to obtain and remit foreign currency in exchange for Renminbi earnings

China's government imposes controls on the convertibility of Renminbi into foreign currencies and, in some cases, the remittance of currency out of China. Under the current foreign exchange control system, sufficient foreign currency may not be available to satisfy our currency needs. Shortages in the availability of foreign currency may restrict the ability of our Chinese subsidiaries to obtain and remit sufficient foreign currency to pay dividends to us, or otherwise satisfy their foreign currency denominated obligations such as payments to us for components which we export to them and for technology licensing fees. We may also experience difficulties in completing the administrative procedures necessary to obtain and remit needed foreign currency.

Our business could be substantially harmed if we are unable to convert and remit our sales received in Renminbi into U.S. dollars. Under existing foreign exchange laws, Renminbi held by our China subsidiaries can be converted into foreign currencies and remitted out of China to pay current account items such as payments to suppliers for imports, labor services, payment of interest on foreign exchange loans and distributions of dividends so long as the subsidiaries have adequate amounts of Renminbi to purchase the foreign currency. Expenses of a capital nature such as the repayment of bank loans denominated in foreign currencies, however, require approval from appropriate governmental authorities before Renminbi can be used to purchase foreign currency and then remitted out of China. This system could be changed at any time by executive decision of the State Council to impose limits on current account convertibility of the Renminbi or other similar restrictions. Moreover, even though the Renminbi is intended to be freely convertible under the current account, the State Administration of Foreign Exchange, which is responsible for administering China's foreign currency market, has a significant degree of administrative discretion in implementing the laws. From time to time, the State Administration of Foreign Exchange has used this discretion in ways which effectively limit the convertibility of current account payments and restrict remittances out of China. Furthermore, in many circumstances the State Administration of Foreign Exchange must approve foreign currency conversions and remittances. Under the current foreign exchange control system, sufficient foreign currency may not be available at a given exchange rate to satisfy our currency demands.

China closely restricts activities of foreign investors in the telecommunications industry

China's government and its agencies, including the Ministry of Information Industry and the State Council, regulate foreign investment in the telecommunications industry through the promulgation of various laws and regulations and the issuance of various administrative orders and decisions. Foreign investment enterprises, companies and individuals are prohibited from investing and participating in the operation and management of telecommunications networks without special approval by the State Council. China may promulgate new laws or regulations, or issue administrative or judicial decisions or interpretations, which would further restrict or bar foreigners from engaging in telecommunications-related activities. The promulgation of laws or regulations or the issuance of administrative orders or judicial decisions or interpretations restricting or prohibiting telecommunications activities by foreigners could have a substantial impact on our ongoing operations.

Governmental policies in China could impact our business

Since 1978, China's government has been and is expected to continue reforming its economic and political systems. These reforms have resulted in and are expected to continue to result in significant economic

and social development in China. Many of the reforms are unprecedented or experimental and may be subject to change or readjustment due to a number of political, economic and social factors. We believe that the basic principles underlying the political and economic reforms will continue to be implemented and provide the framework for China's political and economic system. New reforms or the readjustment of previously implemented reforms could have a significant negative effect on our operations. Changes in China's political, economic and social conditions and governmental policies which could have a substantial impact on our business include:

- new laws and regulations or the interpretation of those laws and regulations;
- the introduction of measures to control inflation or stimulate growth;
- changes in the rate or method of taxation;
- the imposition of additional restrictions on currency conversion and remittances abroad; and
- any actions which limit our ability to develop, manufacture, import or sell our products in China, or to finance and operate our business in China.

Economic policies in China could negatively impact our business

The economy of China differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development in various respects such as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, self-sufficiency, rate of inflation and balance of payments position. In the past, the economy of China has been primarily a planned economy subject to one- and five-year state plans adopted by central government authorities and largely implemented by provincial and local authorities which set production and development targets.

Since 1978, increasing emphasis had been placed on decentralization and the utilization of market forces in the development of China's economy. Economic reform measures adopted by China's government may be inconsistent or ineffectual, and we may not in all cases be able to capitalize on any reforms. Further, these measures may be adjusted or modified in ways which could result in economic liberalization measures that are inconsistent from time to time or from industry to industry or across different regions of the country. China's economy has experienced significant growth in the past decade. This growth, however, has been accompanied by imbalances in China's economy and has resulted in significant fluctuations in general price levels, including periods of inflation. China's government has implemented policies from time to time to increase or restrain the rate of economic growth, control periods of inflation or otherwise regulate economic expansion. While we may be able to benefit from the effects of some of these policies, these policies and other measures taken by China's government to regulate the economy could also have a significant negative impact on economic conditions in China with a resulting negative impact on our business.

China's expected entry into the WTO creates uncertainty as to the future economic and business environments in China

China is expected to enter the World Trade Organization some time late in 2001 or in 2002. Entry into the WTO will require China to further reduce tariffs and eliminate other trade restrictions. While China's entry into the WTO and the related relaxation of trade restrictions may lead to increased foreign investment, it may also lead to increased competition in China's markets from international companies. Whether or not China enters the WTO, the impact on China's economy and our business is uncertain.

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

Our subsidiaries and joint ventures located in China enjoy tax benefits in China which are generally available to foreign investment enterprises, including full exemption from national enterprise income tax for two years starting from the first profit-making year and/or a 50% reduction in national income tax rate for the

following three years. In addition, local enterprise income tax is often waived or reduced during this tax holiday/incentive period. Under current regulations in China, foreign investment enterprises that have been accredited as technologically advanced enterprises are entitled to additional tax incentives. These tax incentives vary in different locales and could include preferential national enterprise income tax treatment at 50% of the usual rates for different periods of time. All of our active subsidiaries in China were accredited as technologically advanced enterprises. The tax holidays applicable to our two principal subsidiaries, UTStarcom China and Hangzhou UTStarcom, which together accounted for approximately 98.8% of our revenues in 2000, will expire at the end of 2002. At that time, the tax rates for these two subsidiaries will increase from 7.5% to 15%, and from 10% to 15%, respectively, which will negatively impact our financial condition and results of operations.

We may be exposed to contingent tax liabilities in China resulting from our failure to withhold sufficient amounts for China's income tax purposes

We employ a number of U.S. citizens who work on a full time basis in China. These expatriate employees participate in our stock option plans and have exercised a number of options granted under the plans. The option exercises generated income which may be subject to personal income taxes under China's income tax laws. We withheld U.S. taxes in connection with these option exercises, but did not withhold China income taxes on the option exercises, and the employees have not yet paid any taxes in China which may be due. Should the employees fail to pay the income taxes, we may be liable for such taxes in our capacity as withholding agent. In the event that it is determined that taxes are due in China, we will apply for a refund from the U.S. tax authorities corresponding to the amount over-withheld in the U.S. due to the foreign tax credit which would then be applicable. In addition, our failure to collect and remit China withholding tax may also subject us to penalties.

China's legal system embodies uncertainties that could negatively impact our business

China has a civil law legal system. Decided court cases do not have binding legal effect on future decisions. Since 1979, many new laws and regulations covering general economic matters have been promulgated in China. Despite this activity to develop the legal system, China's system of laws is not yet complete. Even where adequate law exists in China, enforcement of contracts based on existing law may be uncertain and sporadic and it may be difficult to obtain swift and equitable enforcement, or to obtain enforcement of a judgment by a court of another jurisdiction. The relative inexperience of China's judiciary in many cases creates additional uncertainty as to the outcome of any litigation. Further, interpretation of statutes and regulations may be subject to government policies reflecting domestic political changes.

China has adopted a broad range of related laws, administrative rules and regulations that govern the conduct and operations of foreign investment enterprises and restrict the ability of foreign companies to conduct business in China. These laws, rules and regulations provide some incentives to encourage the flow of investment into China, but also subject foreign companies, and foreign investment enterprises, including our subsidiaries in China, to a set of restrictions which may not always apply to domestic companies in China. Although China is increasingly according foreign companies and foreign investment enterprises established in China the same rights and privileges as Chinese domestic companies in anticipation of China's entry into the WTO, these special laws, administrative rules and regulations governing foreign companies and foreign investment enterprises may still place us and our subsidiaries at a disadvantage in relation to Chinese domestic companies and may adversely affect our competitive position. Moreover, as China's legal system develops, the promulgation of new laws, changes to existing laws and the pre-emption of local regulations by national laws may adversely affect foreign investors and companies.

Many of our activities and products in China are subject to administrative review and approval by various national and local agencies of China's government. Because of the changes occurring in China's legal and regulatory structure, we may not be able to secure the requisite governmental approval for our activities and products. Failure to obtain the requisite governmental approval for any of our activities or products could substantially harm our business.

Risks Relating to the Offering and our Stock Performance

Our stock price is highly volatile

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

- actual or anticipated fluctuations in operating results;
- changes in expectations as to future financial performance or changes in financial estimates or buy/sell recommendations of securities analysts;
- changes in governmental regulations or policies in China, such as the temporary suspension of sales of our PAS system that occurred in May and June of 2000, which caused our stock price to drop;
- our, or a competitor's, announcement of new products, services or technological innovations; and
- the operating and stock price performance of other comparable companies.

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

Our existing stockholders have significant control of our management and affairs, which they could exercise against your best interests

Following the completion of this offering, SOFTBANK CORP. and its related companies will beneficially own 43.0% of our outstanding stock. As a result, SOFTBANK CORP. will have the ability to control all matters submitted to our stockholders for approval and exert significant influence over our management and affairs. This concentration of ownership may delay or prevent a change of control or discourage a potential acquiror from making a tender offer or otherwise attempting to obtain control of our company, which could decrease the market price of our common stock. Matters that could require stockholder approval include:

- election and removal of directors;
- merger or consolidation of our company; and
- sale of all or substantially all of our assets.

The interests of SOFTBANK CORP. may not always coincide with our interests. SOFTBANK CORP., acting through its designees on the Board of Directors and through its ownership of voting securities, will have the ability to control our actions irrespective of the desires of our other stockholders or directors.

Following this offering, substantial numbers of shares of our common stock will become available for sale in the public market, which could cause the market price of our stock to decline

Upon completion of this offering, 104,007,063 shares of our common stock will be outstanding, assuming no exercise of the underwriters' over-allotment option and no exercise of outstanding options or warrants after May 31, 2001. Of these shares, all of the shares sold in this offering and 35,698,988 additional shares will be freely tradable without restriction under the Securities Act, unless purchased by our officers, directors and some of our significant security holders.

Upon completion of the offering, approximately 59,308,075 shares of our common stock will be subject to restrictions under Rule 144 of the Securities Act. The market price of our common stock could drop significantly if the holders of these shares sell them or are perceived by the market as intending to sell them. In addition to the adverse effect a price decline could have on the holders of our common stock, a price decline would likely impede our ability to raise additional capital through the issuance of additional shares of our common stock or other equity securities.

In connection with this offering, we, our executive officers, our directors, the selling stockholders and SOFTBANK CORP. and its related companies have agreed, with exceptions, not to sell or transfer any common stock commencing on the date of this prospectus for a period ending 90 days after the date of this prospectus, without first obtaining the written consent of Merrill Lynch. Our executive officers and one of our non-employee directors have agreed, only with respect to their shares subject to plans adopted under Rule 10b5-1 under the Securities Exchange Act of 1934, to similar restrictions on transfers of common stock during the period commencing June 19, 2001 and ending two weeks following the date of this prospectus.

Beginning two weeks following the date of this prospectus, our executive officers and one of our non-employee directors may sell up to an aggregate of 250,000 shares of our common stock per month pursuant to plans adopted under Rule 10b5-1 at predetermined trading prices and quantities. These executive officers and that director may also sell, beginning two weeks following the date of this prospectus, an additional number of shares which they otherwise would have been able to sell under the plans but for the lock-up restrictions described above, representing up to a number of shares of our common stock equal to the product of 250,000 and the number of months, or a portion thereof, during the period commencing on June 19, 2001 and ending two weeks following the date of this prospectus. See "Management--10b5-1 Plans" and "Underwriting" for further description about the plans and the lock-up restrictions.

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

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

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

Our management may not use the proceeds of this offering in ways which increase our market share or operating results

Our management has broad discretion over the use of proceeds of this offering. In addition, our management has not designated a specific use for the proceeds of this offering. Accordingly, it is possible that our management may allocate the proceeds differently than investors in this offering would have preferred, or that we fail to maximize our return on the proceeds.

FORWARD-LOOKING STATEMENTS

This prospectus includes 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 and information relating to us that are based on the beliefs of our management as well as assumptions made by and information currently available to management. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and we are including this statement for purposes of complying with these safe harbor provisions. These forward-looking statements include but are not limited to those statements concerning the following: the growth of China's telecommunications equipment and subscriber markets; our plan to expand our presence in China and other growing telecommunications markets; our expectation that our PAS wireless access system and other communications products will continue to be allowed in China under the country's regulatory scheme; fluctuations in our overall gross profit, gross profit as a percentage of net sales, product mix and selling prices; our plans for expanding our selling and marketing campaigns; our expectation that there will be increases in selling, marketing, research and development, general and administrative expenses; the capabilities of our WACOS, PAS and AN-2000 products; our expectation that existing cash and cash equivalents will be sufficient to finance our operations for at least the next 12 months; and our estimate of the amount of net proceeds from this offering and the intended uses for those proceeds. Additional forward looking statements may be identified by the words "anticipate," "believe," "extend," "intend," "will" and similar expressions, as they relate to us or our management.

The forward-looking statements contained in this prospectus are not guarantees of future performance and are subject to risks, uncertainties and assumptions, including those set forth under "Risk Factors" and the following:

- devaluation of the Renminbi and fluctuations of exchange rates;
- changes in China's government, economic or regulatory policies;
- uncertainty regarding the commercial acceptance of our network access and switching equipment and technologies;
- uncertainty regarding our future operating results;
- our ability to introduce new and enhanced products;
- delays or losses of sales due to long sales and delivery cycles for our products;
- the possibility of lower prices, reduced gross profit as a percentage of net sales and loss of market share due to increased competition; and
- increased demands on our resources due to anticipated growth.

Investors are cautioned that these forward-looking statements are inherently uncertain. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results or outcomes could vary materially from those described in this prospectus. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements.

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USE OF PROCEEDS

We estimate our net proceeds from the sale of the 6,050,000 shares of common stock offered by us in this prospectus will be approximately $114.0 million, or approximately $139.7 million if the underwriters exercise their over-allotment option in full, based on the public offering price of $20.00 per share and after deducting the underwriting discount and estimated offering expenses. We will not receive any of the proceeds from the sale of shares by the selling stockholders.

We presently intend to use the net proceeds from this offering for general corporate purposes, including research and development, expansion of our sales and marketing organization and working capital. Our management will have broad discretion in the application of the net proceeds of this offering. Pending any use, we intend to invest the net proceeds in government securities and short-term, investment-grade, interest-bearing securities.

From time to time, we may evaluate opportunities to acquire or invest in complementary businesses, technologies or products and may use a portion of the net proceeds from this offering to enter into these type of transactions. At this time, we do not have any understandings, commitments or agreements with respect to any material acquisitions.

DIVIDEND POLICY

To date, we have not paid any cash dividends on our common stock. We currently anticipate that we will retain any available funds to finance the growth and operation of our business and we do not anticipate paying any cash dividends in the foreseeable future. Certain present or future agreements to which we are a party may limit or prevent the payment of dividends on our common stock.

PRICE RANGE OF OUR COMMON STOCK

	High	Low
Fiscal 2000		
First Quarter (from March 3, 2000)	$93.50	$41.00
Second Quarter	77.63	16.75
Third Quarter	32.88	18.00
Fourth Quarter	23.00	12.31
Fiscal 2001		
First Quarter	$28.00	$13.56
Second Quarter	27.28	12.50
Third Quarter (through July 18, 2001)	25.61	20.96

Our common stock has been traded on The Nasdaq National Market under the symbol "UTSI" since our initial public offering on March 3, 2000. The preceding table sets forth the high and low sales prices per share of our common stock as reported on The Nasdaq National Market for the periods indicated. As of March 31, 2001 we had approximately 236 stockholders of record. On July 18, 2001 the last reported sale price of our common stock on The Nasdaq National Market was $21.77 per share.

CAPITALIZATION

The following table sets forth on an unaudited basis our capitalization as of March 31, 2001 and as adjusted to reflect the sale of the 6,050,000 shares of common stock offered by us in this prospectus at a public offering price of $20.00 per share, after deducting the underwriting discount and estimated offering expenses. You should read this table in conjunction with the consolidated financial statements and notes incorporated by reference into this prospectus, and "Selected Consolidated Financial Data" included elsewhere in this prospectus.

	As of March 31, 2001	
	Actual	As Adjusted
	(in thousands, except share data)	
Long-term debt, net of current portion	$ 12,048	$ 12,048
Stockholders' equity:		
Preferred stock, $0.00125 par value; no shares issued and outstanding	$ --	$ --
Common stock, $0.00125 par value; actual--250,000,000 shares authorized, 96,172,216 shares issued and outstanding; as adjusted--104,007,063 shares issued and outstanding	122	130
Additional paid-in capital	432,207	546,210
Deferred stock compensation	(5,129)	(5,129)
Retained earnings	1,554	1,554
Notes receivable from stockholders	(292)	(292)
Other comprehensive income	302	302
Total stockholders' equity	428,764	542,775
Total capitalization	$440,812	$554,823

The table above excludes:

- 14,525,512 shares of common stock issuable upon exercise of options outstanding as of March 31, 2001 at a weighted average exercise price of $8.30 per share;

- 3,816,656 shares of common stock reserved for issuance under our 2000 Employee Stock Purchase Plan as of March 31, 2001; and

- 32,000 shares of common stock issuable upon exercise of warrants outstanding as of March 31, 2001 with a weighted average exercise price of $2.50 per share.

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DILUTION

The net tangible book value of our common stock as of March 31, 2001 was approximately $406.6 million, or $4.23 per share. Net tangible book value per share represents the amount of our total assets, excluding net intangible assets, less our total liabilities, divided by the total number of shares of our common stock outstanding.

Without taking into account any other changes in net tangible book value after March 31, 2001, other than to give effect to the sale of 6,050,000 shares of common stock offered by us in this prospectus at a public offering price of $20.00 per share and after deducting the underwriting discount and estimated offering expenses payable by us, the net tangible book value of our common stock as of March 31, 2001 would have been approximately $520.6 million, or $5.09 per share. This represents an immediate increase in net tangible book value of $0.86 per share to existing stockholders and an immediate dilution of $14.91 per share to new investors purchasing common stock in this offering. The following table illustrates this per share dilution:

Assumed public offering price per share		$ 20.00
Net tangible book value per share as of March 31, 2001	$4.23	
Increase per share attributable to new investors	0.86	
Net tangible book value per share after this offering		5.09
Dilution per share to new investors		$ 14.91

The foregoing discussion and table assume that the underwriters do not exercise their over-allotment option. This table also assumes that no options or warrants were exercised after March 31, 2001. As of March 31, 2001, there were outstanding options to purchase 5,317,691 shares of common stock, which were exercisable within 60 days of March 31, 2001 at a weighted average exercise price of $4.23 per share and outstanding warrants to purchase 32,000 shares of common stock at a weighted average exercise price of $2.50 per share. If all these options and warrants had been exercised as of March 31, 2001, our net tangible book value on that date would have been $429.2 million, or $4.23 per share, the increase in net tangible book value attributable to new investors would have been $0.82 per share and the dilution in net book value to new investors would have been $14.95 per share.

SELECTED CONSOLIDATED FINANCIAL DATA

You should read the following selected consolidated financial data in conjunction with our consolidated financial statements and the related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in or incorporated by reference into this prospectus. The consolidated statement of operations data for the years ended December 31, 1998, 1999 and 2000 and consolidated balance sheet data at December 31, 1999 and 2000 are derived from, and are qualified by reference to, our audited consolidated financial statements incorporated by reference into this prospectus. The consolidated statement of operations data for the years ended December 31, 1996 and 1997 and the consolidated balance sheet data at December 31, 1996, 1997 and 1998 have been derived from audited financial statements not included in or incorporated by reference into this prospectus. The consolidated financial statements for the three months ended March 31, 2000 and 2001 and the consolidated balance sheet data at March 31, 2001 are derived from our unaudited consolidated financial statements incorporated by reference into this prospectus and include, in the opinion of our management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation of our financial condition, the results of our operations and our cash flows for such periods. Historical results are not necessarily indicative of results to be expected in any future period, and results for the three months ended March 31, 2001 should not be viewed as an indication of results to be expected for the full year.

	Years Ended December 31,					Three Months Ended March 31,	
	1996	1997	1998	1999	2000	2000	2001
	(in thousands, except per share data)						
Consolidated Statement of Operations Data:							
Net sales	$35,542	$75,597	$105,167	$187,516	$368,646	$58,587	$119,181
Cost of sales (includes deferred stock compensation expense of $0, $0, $0, $12, $90, $0 and $0)	22,322	48,795	64,142	112,703	240,465	37,974	77,768
Gross profit	13,220	26,802	41,025	74,813	128,181	20,613	41,413
Operating expenses:							
Selling, general and administrative (includes deferred stock compensation expense of $0, $0, $390, $4,256, $4,676, $1,802 and $681)	8,042	21,211	23,211	35,122	48,055	11,064	14,131
Research and development (includes deferred stock compensation expense of $0, $0, $22, $1,285, $6,795, $4,595 and $578)	3,899	8,941	14,681	18,648	41,452	10,909	12,412
Amortization of intangible assets	42	40	120	332	4,894	1,223	1,471
In-process research and development	--	--	--	3,992	--	--	--
Total operating expenses	11,983	30,192	38,012	58,094	94,401	23,196	28,014
Operating income (loss)	1,237	(3,390)	3,013	16,719	33,780	(2,583)	13,399
Interest and other income (expenses)	858	2,033	(1,138)	(2,212)	10,829	772	452
Equity in net income (loss) of affiliated companies	(291)	73	(773)	1,348	(288)	(279)	(244)
Income (loss) before income taxes, minority interest and cumulative effect of a change in accounting principle	1,804	(1,284)	1,102	15,855	44,321	(2,090)	13,607
Income tax expense	575	400	1,423	626	14,021	918	3,652
Minority interest in (earnings) loss of consolidated subsidiaries	(743)	301	914	(2,110)	(2,307)	(261)	(593)
Income (loss) from							

continuing operations..	486	(1,383)	593	13,119	27,993	(3,269)	9,362
Income (loss) from discontinued operations............	301	1,413	(893)	(1,656)	--	--	--
Cumulative effect of the application of SAB 101 "Revenue Recognition in Financial Statements"..	--	--	--	--	(980)	(980)	--
Net income (loss).......	787	30	(300)	11,463	27,013	(4,249)	9,362
Preferred stock dividend...............	(1,097)	--	--	--	--	--	--
Beneficial conversion feature of Series F preferred stock........	--	--	--	(29,977)	--	--	--
Net income (loss) applicable to common stockholders...........	$ (310)	$ 30	$ (300)	$(18,514)	$ 27,013	$(4,249)	$ 9,362
Income (loss) per share from continuing operations:							
Basic..................	$ 0.06	$ (0.19)	$ 0.08	$ 1.51	$ 0.35	$ (0.09)	$ 0.10
Diluted................	$ 0.06	$ (0.19)	$ 0.01	$ 1.51	$ 0.27	$ (0.09)	$ 0.09
Earnings (loss) per share:							
Basic..................	$ (0.04)	$ --	$ (0.04)	$ (2.13)	$ 0.34	$ (0.12)	$ 0.10
Diluted................	$ (0.04)	$ --	$ --	$ (2.13)	$ 0.27	$ (0.12)	$ 0.09

	Years Ended December 31,					Three Months Ended March 31,	
	1996	1997	1998	1999	2000	2000	2001
	(in thousands, except per share data)						
Pro forma amounts assuming application of SAB101 "Revenue Recognition in Financial Statements" is applied retroactively:							
Net income (loss) applicable to common stockholders...........	$ (310)	$ 30	$ (300)	$(19,494)	$ 27,993	$(3,269)	$ 9,362
Earnings (loss) per share:							
Basic..................	$ (0.04)	$ --	$ (0.04)	$ (2.25)	$ 0.35	$ (0.09)	$ 0.10

Diluted................	$ (0.04)	$ --	$ --	$ (2.25)	$ 0.27	$ (0.09)	$ 0.09
Shares used in per share calculations:							
Basic..................	8,344	7,320	7,582	8,678	79,696	35,867	95,873
Diluted................	8,344	7,320	77,050	8,678	101,867	35,867	104,262

	As of December 31,					As of March 31,
	1996	1997	1998	1999	2000	2001
	(in thousands)					
Consolidated Balance Sheet Data:						
Cash and cash equivalents............	$18,246	$ 35,049	$ 17,626	$ 87,364	$149,112	$175,535
Working capital.........	34,382	59,076	57,416	128,973	369,861	383,892
Total assets............	49,610	101,097	142,121	271,788	591,837	642,054
Total short-term debt...	1,127	1,579	38,426	43,338	43,381	55,427
Long-term debt..........	--	--	--	--	12,048	12,048
Convertible preferred stock..................	39,912	--	--	--	--	--
Total stockholders' equity.................	39,519	72,513	72,336	165,720	412,319	428,764

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

The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ substantially from those anticipated in these forward-looking statements as a result of many factors, including those discussed in "Risk Factors" and elsewhere in this prospectus. The following discussion should be read in conjunction with our consolidated financial statements and related notes thereto incorporated by reference into this prospectus.

Overview

We design and market wireline and wireless broadband enabled access and switching equipment that supports migration to next generation IP-based networks. Our operations are conducted primarily by our foreign subsidiaries that manufacture, distribute, and support our products, principally in China. Our systems and products allow service providers to offer efficient and expandable voice, data and Internet access services. Because our systems are based on key international communications standards, service providers can easily integrate our systems into their existing networks and deploy our systems in new broadband, IP and wireless network rollouts.

We have only recently become profitable and may not be able to remain profitable in future periods. As of March 31, 2001, we had retained earnings of only $1.6 million. We anticipate continuing to incur significant sales and marketing, research and development and general and administrative expenses, and, as a result, we will need to generate higher revenues to remain profitable.

We have derived substantially all of our revenues from sales of communications equipment to service providers in China. Our customers often make a large initial purchase of our equipment followed by supplemental purchases of enhancements and upgrades. As a result, our largest revenue-producing customers typically vary from period to period. The evaluation period for our products by potential customers may span a year or more and our business generally depends on a relatively small number of large deployments. We sell our products in China through a direct sales force.

Approximately 98.0% of our net sales for the three months ended March 31, 2001 and approximately 98.8 % of our net sales for the twelve months ended December 31, 2000 were made in China. Accordingly, our business, financial condition and results of operations are likely to be influenced by the political, economic and legal environment in China, and by the general state of China's economy. Our results may be adversely affected by, among other things, changes in the political, economic and social conditions in China, and by changes in governmental policies with respect to laws and regulations, changes in China's telecommunications industry and regulatory rules and policies, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation.

Remittances from China, which are of a capital nature, such as the repayment of bank loans denominated in foreign currencies, require approval from appropriate governmental authorities before Renminbi can be used to purchase foreign currency. Although the payment of cash dividends is permitted so long as our subsidiaries have sufficient reserves and adequate amounts of Renminbi to purchase foreign currency, regulations restrict the ability of our subsidiaries to transfer funds to us through intercompany loans and advances.

Additionally, business activity in China declines considerably during the first quarter of each year in observance of the Lunar New Year. As a result, sales during the first quarter of our fiscal ye