

UTSTARCOM INC  
Form 10-K  
March 09, 2004

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D. C. 20549

**FORM 10-K**

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

**For the Fiscal Year Ended December 31, 2003.**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

Commission File Number: 000-29661

**UTSTARCOM, INC.**

(Exact name of registrant as specified in its charter)

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

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

**1275 Harbor Bay Parkway**  
**Alameda, California**  
(Address of principal executive offices)

**94502**  
(Zip Code)

**(510) 864-8800**

(Registrant's telephone number, including area code)

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

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

**Common stock, \$0.00125 par value**  
(Title of class)

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

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

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting stock held by non-affiliates of the registrant as of the last business day of the registrant's most recently completed second fiscal quarter was approximately \$2,893,028,280 based upon the closing price of \$35.64 reported for such date on The Nasdaq National Market. For purposes of this disclosure, shares of Common Stock held by persons who hold more than 10% of the outstanding shares of Common Stock and shares held by officers and directors of the registrant, have been excluded in that such persons may be deemed to be affiliates. This determination is not necessarily conclusive for other purposes.

As of February 29, 2004 the registrant had 117,110,056 outstanding shares of Common Stock.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2004 are incorporated herein by reference in Part III.

### UTSTARCOM, INC.

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#### PART I

**ADDITIONAL INFORMATION**

UTStarcom and CommWorks are registered as a trademark in the United States. UTStarcom, CommWorks and PAS are registered as trademarks in China.

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

Unless specifically stated, information in this Annual Report on Form 10-K assumes an exchange rate of 8.2775 Renminbi for one U.S. dollar, the exchange rate in effect as of December 31, 2003.

UTStarcom's public filings, including our annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K, are available free of charge at our website, [www.utstar.com](http://www.utstar.com). The information contained on our website is not being incorporated herein.

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**ITEM 1 BUSINESS**

**OVERVIEW**

We design, manufacture and sell telecommunications equipment and products and provide services associated with their operation. Our products are deployed and installed exclusively by telecommunications wireless and wireline service providers. We provide an extensive range of products for transportation of voice, data and video traffic for service providers around the world. Our business is conducted globally in China, Japan, India, the Central and Latin American region, North America, the European, Middle Eastern and African region and southeastern and northern Asia. Historically, substantially all of our sales have been to service providers in China.

UTStarcom was incorporated in 1991 in Delaware. Our headquarters are based in Alameda, California, with research and design operations in New Jersey, Chicago, China and India. Our primary mailing address is 1275 Harbor Bay Parkway, Alameda, California, 94502. We can be reached by telephone at (510) 864-8800, and our website address is [www.ustar.com](http://www.ustar.com). All Securities and Exchange Commission filings can be found under the Investor Relations section of the website, and are available free of charge.

**STRATEGY**

Our objective is to be a leading global provider of Internet Protocol ("IP") networking products and services. We differentiate ourselves with products designed, developed and commercialized to reduce network complexity, integrate high performance capabilities and that allow a simple transition to next generation networks. This results in deployment, maintenance and upgrades that are both economical and efficient, allowing operators to earn a high return on their investment.

Our strategy is built upon the following key concepts:

lowering the deployment and utilization costs of our customers' IP networks;

offering our customers an increased number of features and enhanced functionality; and

providing tailored products and services to suit customers' needs.

We intend to implement our strategy by:

**Expanding and leveraging our presence in China**

Over the course of several years, we have built an extensive administrative, research and development, manufacturing, sales and support infrastructure in China that we believe is critical to our success both within China and also on a global basis. This infrastructure allows us to quickly identify service providers' needs and to focus our engineering, product development and sales and marketing efforts to address those needs. We believe this strategy has helped us become a leading communications equipment and services provider in China. In addition, the

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low-cost research and development and manufacturing capabilities in China allow us to be competitive on a cost and pricing basis for our products. Finally, by virtue of its large population base and low teledensity, or the number of telephones per person in a region, the China market provides a highly conducive platform for UTStarcom to deploy our most advanced technology in substantial volume. This provides a model for success that we hope to leverage when pursuing other customer relationships on a global basis.

We intend to further capitalize on China's favorable market conditions, including its large population, low teledensity and strong demand for communications services. We intend to expand our presence in this market by:

increasing the number of sales and support staff and offices in China;

developing new products to address the demands of our existing and future customer base;

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utilizing China's low cost manufacturing and research and development capabilities to further improve efficiencies in our manufacturing and research and development processes; and

growing our local research and development and manufacturing capabilities.

### **Intensifying our global market diversification**

Our target customers consist of the largest, most well established global telecommunications service providers. In addition, we target smaller, emerging carriers, such as Yahoo!BB in Japan and Reliance Infocomm in India, who focus on driving IP-based voice, video and data services.

In May 2003, we acquired the CommWorks division of US-based 3Com Corporation in order to further extend our sales presence outside of China. We believe this acquisition has significantly enhanced our ability to gain access to the largest and most well established operators in North America and Europe. We intend to continue to seek additional acquisitions and to use partnerships to solidify our market position and expand our technology portfolio and sales channels in these markets.

We believe emerging markets beyond China present us with significant opportunities for growth. According to a November 2003 RHK, Inc. report, two thirds of the world's six billion inhabitants still do not have access to, and cannot afford basic telecommunications services. We believe that many developing regions see a correlation between increased teledensity and improved economic growth, recognizing the need to invest in a telecommunications infrastructure in order to compete globally and overcome economic disparities. Our strategy is to develop products and design services specifically tailored to the needs and level of affordability of these emerging-market service providers and their customers. In addition, we recognize that to be successful in these emerging markets, it is important to commit to establishing a local presence, as we have already done in China. This commitment often includes a local sales and support presence and where practical, local research and development and manufacturing capability. To date, we have deployed products in a number of emerging communications markets outside of China, including markets in India, southeastern and northern Asia, Latin America and Africa. We continue to explore major growth potential in global markets outside of China and believe that many of these markets are ideal candidates for our products and services.

### **Focusing on our technology innovation**

Our technology focus centers on an IP-based core network that creates a single platform for delivering multiple services to the end-user of the telecommunications network. In contrast, a traditional Asynchronous Transfer Mode ("ATM") network is based on transferring data in packets of a small, fixed size that facilitate transmission of various data types over the same network, assuring that no single type of data monopolizes the line. If a service provider operating a traditional ATM-based network wanted to offer multiple services, it would have to build, run and maintain a separate network for each service, including separate billing, network management and support functionalities. This would create a costly and inefficient model for providing services to the end user. An IP-based core network is designed so that all services can be converged into one platform with one billing, network management and support function for all services. In addition, because it is largely software-based, an IP network is by design more cost effective to run and maintain than a traditional ATM-based infrastructure. All of our products are compatible with each other and can be integrated into a single IP-based network. We intend to continue to support our IP-based wireless and wireline access services and enhance their functionality for deployment in all global markets. We also intend to continue our research and development efforts on future IP-based access services. We believe we are well positioned in this market based on our large-scale

deployments in China and Japan.

In addition, we intend to focus on delivering customer premise equipment to support the end-user. We will continue to introduce new products that offer our customers value and functionality.

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Finally, as a complement to our core access franchise, we entered the optical transport market in 2003 and intend to expand our portfolio of optical products to meet increased requirements and enhanced functionality.

## **TECHNOLOGY AND PRODUCTS**

Our technologies and products fall into three major categories:

wireless, a technology that enables end users, or subscribers, to send and receive voice and data while mobile and using wireless devices;

wireline, a technology that satisfies customer demand for high-speed, cost effective data, voice and media transport and carriage; and

switching, a diverse assembly of software and hardware based networking elements designed to replace central office telephone switches.

Our products within each of these categories include multiple hardware and software subsystems that can be offered in various combinations to suit individual subscriber needs. Our system technologies and products are based on widely adopted global communications standards and are designed to allow service providers to quickly and cost-efficiently integrate our systems into their existing networks and deploy our systems in new broadband, Internet Protocol ("IP") and wireless network rollouts. Our system technologies are also designed to allow timely and cost efficient transition to future next-generation network technologies, enabling our service provider customers to protect their initial infrastructure investments.

### **WIRELESS**

Wireless networking is one of our core technologies that refers to communications networks that enable end users to send and receive voice and data while mobile and using wireless devices such as cellular telephones, personal computers, personal digital assistants and other wireless communications devices. Wireless networks require the use of customized equipment that enables an end user or subscriber to be connected and identified when not in a fixed location within a network. We offer a broad range of wireless products and services, from handsets for individual subscribers to service platforms and core infrastructure systems for large carriers that can support millions of subscribers.

#### ***Wireless Products and Services Platform***

Our globally deployed Personnel Access Systems ("PAS"), a family of wireless access handsets, wireless consumer products and core infrastructure equipment, are designed to help our customers create new revenue opportunities with high quality voice services, rich suites of handsets and network-based services.

Our PAS wireless access system and IP-based PAS ("iPAS") wireless access systems employ micro cell radio technology and specialized handsets and enable service providers to offer subscribers both mobile and fixed access to telephone services. Our PAS wireless access architecture is designed to enable service providers to transition from wireline to wireless communication networks, allowing them to offer both mobile wireless voice and data services within a city or community. Using our products, service providers can offer new wireless services, including citywide mobility, same-number wireless extension, e-mail, mobile Internet access, short messaging and location-based services.

Our wireless products are designed to offer a full suite of integrated, customizable, value-added services, including short-message services, web browsing, e-mail, voice mail, and 64Kbps Internet access.

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### *PAS Wireless Mobile Phone Systems*

We design, manufacture, market and sell a comprehensive line of mobile and fixed wireless telephone products.

#### **Personal Access System (PAS)**

We designed our PAS equipment to meet the needs of subscribers that do not require all of the features offered by traditional cellular technology, but want more than the features offered by standard fixed-line technology, including regional mobility, a more cost-effective tariff plan, and access to value-added data services. When compared to other traditional macrocellular wireless systems, PAS offers lower deployment costs, easier radio frequency planning, higher traffic capacity, better voice quality, faster data transmission speeds, lighter handsets with lower power requirements, and better support of advanced information services.

PAS is based on microcellular technology. In comparison to more traditional macrocellular systems, PAS cell stations are small and are normally installed on existing utility poles or buildings rather than on large towers. Mounting small transmitters this way greatly reduces the cost and complexity of installation as there is neither need for a major tower construction project nor any significant tower lease fees. Additionally, mounting a small PAS cell station close to its antenna and connecting it to the network using standard telephone wire is far simpler and more cost effective than the traditional cellular approach of installing a large transmitter on the ground and running heavy coaxial cables up a tower to the antennas. PAS cell station installation takes a few hours, compared to several days to install, power, and commission a traditional wireless cell station. Because PAS uses "dynamic frequency allocation," a process where each cell "listens to" all available radio channels before selecting one for each call, the overall radio planning and engineering for PAS is very simple. While adding cells to handle more calls in a traditional cellular network requires considerable frequency planning and balancing, adding cells to a PAS network is less difficult because PAS cells can automatically determine what channels to use. This capability, combined with the low cost per cell, allows a carrier to start with a very small system serving only hundreds of subscribers and grow that system to serve millions, simply by adding small cells.

#### **IP-based Personal Access System (iPAS)**

Our iPAS wireless system employs our mSwitch softswitch platform and allows service providers to transition from their current wireline network to an IP-based wireless network and offer their subscribers new wireless services, including citywide mobility, same-number wireless extension, e-mail, mobile Internet access, short messaging and location-based services.

#### **Handsets**

We also design and sell a variety of handsets that range from basic, low-cost models to high-functionality, higher-cost models that offer color displays, up to 32 different ring tones, bilingual short message service ("SMS") and Internet access and email capability. We believe our strategy of designing handsets in-house, licensing, and manufacturing, and direct-sourcing handset components gives us the flexibility to meet demand while offering the broadest line of PAS handsets to our customers.

### *2G CDMA System*

Our second generation ("2G") code division multiple access (or CDMA, a wireless standard) wireless data products, which are based on the IS-95A standard, enable service providers to offer wide area wireless data service to end users on IS-95A-compatible networks. Our 2G CDMA products meet the open wireless standards and the standards of the United States standardization body, TIA/EIA.

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#### **2G CDMA Wireless Data Product**

We provide 2G CDMA wireless data equipment that enables service providers to converge wireless voice services with newer data applications. Our product is a hardware and software platform that serves as a gateway from the wireless network, giving subscribers access to the Internet, corporate intranets, public switched telephone network dial-up, and fax services. Our product is designed to meet a service provider's demands for a high capacity, expandable platform.

### *3G W-CDMA and TD-CDMA Systems*

We are developing and testing a suite of products and services for 3G wireless networks that support the open 3G wireless standards (wideband-code division multiple access, or W-CDMA and time division-synchronous code division multiple access, or TD-SCDMA) defined under 3GPP, the international standardization body, and the standards of TIA/EIA, the United States Standardization body. Our 3G enhanced wireless data products are designed to be capable of delivering data at much higher speeds, enabling cost savings and new revenue-generating services for our customers.

We have entered into strategic alliances with Matsushita (Panasonic), interWAVE and Datang Mobile to co-design and jointly develop 3G wireless systems based on the open wireless standards. At the end of 2003, Panasonic Mobile Communications Co., Ltd. and we announced a joint venture to focus on the design, development, and manufacture of 3G telecommunications equipment.

### **3G CDMA2000 Wireless Data Product**

We are developing and testing a CDMA2000 wireless data product that is designed to offer CDMA service providers a cost-effective, seamless way to deploy high-speed packet data services worldwide. It is designed to allow service providers to offer uninterrupted services on their existing networks during a transition to more advanced networks.

Our CDMA2000 wireless data product is designed to be compatible with all standards-based wireless equipment, giving service providers enormous flexibility when designing and developing their networks. In addition, its open, standards-based architecture is designed to provide the scalability and flexibility required by service providers for easy deployment of services and applications.

### *Transition from Personal Access Systems to 3G Wireless Systems*

Our iPAS and 3G wireless systems are both based on our mSwitch softswitch platform, which is designed for future IP-based next generation networks. Because we have designed these systems to operate on the same platform, our iPAS system core network equipment can be upgraded to support both iPAS and 3G wireless services simultaneously.

## **WIRELINE**

Our wireline products are designed to satisfy customer demand for high speed and cost effective data, voice and multimedia transport. Our wireline technology enables high-speed voice, video and data transmissions over broadband IP-based networks.

Digital subscriber line ("DSL") technology enables high-speed data and content transfer while providing simultaneous telephone communications over the same fixed copper line. Our IP-based DSL Access Multiplexers ("DSLAMs") enable high-speed access and deliver services to residential and commercial subscribers using broadband technology.

### *Wireline Products and Services Platform*

Our broadband wireline networking platform, which we call the AN-2000 platform:

enables network transition from narrowband to broadband with IP;

uses Asynchronous Transfer Mode ("ATM") technology, a network technology based on transferring data in packets of a small, fixed size that facilitate transmission of various data types over the same network, assuring that no single type of data

monopolizes the line; and

provides multi-service access support.

Our wireline products and services enable the delivery of both broadband service and traditional voice, video and data services to subscribers via a copper, fiber or a wireless transmission facility.

#### *AN-2000 Platform*

We offer our AN-2000 platform in three variations featuring IP, ATM and multi-service access capabilities:

##### **Multi-Service Access Node (AN-2000)**

Our AN-2000 Multi-Service Access Node ("AN-2000 MSN") platform is an integrated broadband access platform that delivers a mix of broadband and traditional voice and data services via copper, fiber or wireless transmission.

##### **IP-Based Digital Subscriber Line Access Multiplexer (DSLAM) (AN-2000-IB)**

Our AN2000-IB platform represents a new generation of DSLAM products and services that do not require ATM networking and are therefore compatible with IP-based networks. We have designed our AN2000-IB to meet a variety of customer needs, such as commercial or residential applications, Internet access, email, file transfer or virtual private networks.

##### **Voice over IP Media Gateway (iAN-2000)**

Our iAN-2000 is a media gateway product that converts incoming analog or digitized voice, fax or modem signals from a traditional phone network into IP voice packets.

The media gateway also terminates the incoming signaling information, used for controlling a telephone call, and generates IP-based signaling messages, which are sent to the softswitch, where all the service intelligence resides for the delivery of telephone services for call processing.

#### *Television over IP (TVoIP) System*

##### **MediaSwitch**

Our MediaSwitch technology family is a suite of products and services that enable a service provider to deliver broadcast television and on-demand video services to residential and commercial premises.

This product family includes a media console that provides Internet access, broadcast TV, video on demand and video conferencing services to the subscribers.

#### *Optical Transport System*

Our optical networking products are designed to provide a broad range of functions, including:

interfacing with a variety of bit rates;



scaling of central offices to support higher-bandwidth services;

providing the core of the network where incremental, high-bandwidth capacity is required to connect multiple central offices; and

enabling service providers to continue a rapid transition from legacy products to next generation networks.

### **NetRing**

NetRing is the name of our optical product line that supports multi-service transport capabilities required by service providers. Different NetRing systems deliver the following target applications:

Our NetRing 600 and NetRing TX-60 products provide voice and data services for multi-tenant unit, office building, and enterprise campus applications.

Our mid-range NetRing 2500 and NetRing TX-160 products offer voice and data transport when a larger bandwidth and capacity is required.

Our high-end NetRing 10000 and NetRing TX-200 products provide service for metro core or regional transport applications, when an even larger bandwidth and capacity is required.

### ***SWITCHING***

Our IP-based, multi-service soft switching architecture is a diverse assembly of software-and hardware-based networking elements designed to replace traditional central office telephone switches. Our architecture delivers multiple services including providing comprehensive broadband and narrowband access, call control of telephone and data communications and delivering next generation features not offered by the traditional fixed line switching infrastructure.

Our soft switching technology helps our service provider customers increase revenue while reducing churn by supporting a wide range of new customer enabling services. Service providers can use our switching products when transitioning to an upgraded network, allowing them to utilize their existing network infrastructure and protecting their initial investment.

#### ***Switching Products and Services Platform***

Softswitch, where all the service intelligence resides for the delivery of telephone services, is the industry name for the IP-based approach to telephony switching that has the potential to reduce the cost of long distance and local exchange switching and to create differentiated telephony services. A softswitch can support a wide array of functions, including address translation, service monitoring and assurance, billing authorization, and supplementary services like call forwarding and call conferencing.

#### **mSwitch Platform**

The mSwitch platform, which combines softswitch functionality with our wireless technology, supports our iPAS-based wireless infrastructure. This combination allows our mSwitch platform to provide expandable, mobile switching centers that can operate with our PAS system. By focusing on mobility services, mSwitch is targeting one of the most complex and commercially important segments of softswitch applications.

We believe that our mSwitch softswitching architecture was one of the first to provide mobile switching functionality. Mobile telephony and information delivery services are among the most demanding and complex, requiring wireless mobile networks to track subscribers' locations dynamically whether or not they are on a telephone call.

Our mSwitch platform is designed to be a cost-effective, flexible and expandable networking platform designed to replace traditional central office switches. This platform delivers multiple services, including broadband and narrowband remote access services on an IP-based packet-switching infrastructure via wireless and wireline networks. It allows customers to increase their revenue opportunities by supporting a wide range of new services.

The mSwitch platform is designed to reliably transport data along with signaling, control, and management information. The architecture includes operations support systems for associated billing, provisioning, and service management.

#### ***NETWORK MANAGEMENT (UNMS/iNetman)***

We provide a powerful and user-friendly graphical user interface-based network management solution for the operation, administration and maintenance of our products. The network management system provides fault management, configuration management, accounting management, performance management and security management in accordance with standards required by local governments and/or carriers to assist the service providers in smooth network operation.

### **MARKETS AND CUSTOMERS**

#### **Our Global Market Deployment**

Our products and services are being deployed and implemented throughout the world such as in China, Japan, India, the Central and Latin American region, the European, Middle Eastern and African region, North America and southeastern and northern Asia. China continues to be our single largest market, representing 86% of our overall revenue for the year ended December 31, 2003. Japan and the United States represent the largest markets outside of mainland China for 2003. Other emerging markets including Vietnam, Thailand and Taiwan continue to contribute to global sales outside of China, while increasing amounts of sales are being made in North America and the Central and Latin American region, including Brazil, Mexico, Guatemala and Honduras.

#### **Global Customers**

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

During 2003, the provincial-level telecommunications service entities continued to consolidate telecommunications purchasing decisions by province. As a result of this consolidation trend, all customers were grouped together by province, and each province is treated as one customer. Giving effect to this consolidation, in 2003, the Hei Long Jiang province accounted for 11% of net sales. In 2002, sales to the Zhejiang province accounted for 18% and sales to Softbank BB Corporation, an affiliate of SOFTBANK America Inc., a related party, accounted for 13% of net sales.

#### **Global Sales and Service**

Our worldwide sales organization consists of managers, sales representatives, network consultants and technical support personnel. We have field sales offices in our served geographies including China, Japan, India, the Central and Latin American region, the North American, European, Middle Eastern and African region and Southeast and North Asia. The majority of our products and services are sold and serviced by our direct sales and support staff.

In addition to our product offerings, we provide a broad range of service offerings, including technical support services. Our service offerings complement our products with a range of consulting, technical, project, quality and maintenance support-level services including

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24-hour support through technical assistance centers. Technical support services are designed to help ensure that our products operate efficiently, remain highly available, and benefit from the most up-to-date system software. These services enable customers to protect their network investments and minimize downtime for systems running mission-critical applications.

### China's Market

China is currently our largest market for our wireless and switching products. China will continue to be an important market for our current and future technologies and product development for the foreseeable future. To support this large and growing market, we have sales offices, manufacturing facilities and research and development centers throughout China that enable us to react and respond to our customers' needs in an expeditious manner.

China continues to be one of the fastest-growing, largest communications market in the world, and the Chinese government has committed to developing a powerful communications infrastructure in order to support strong demand for communications services in support of robust economic growth in the region. According to China's State Statistics Bureau, China's gross domestic product (GDP) grew 9.1% in 2003, and the GDP per capita surpassed \$1,000.00 USD in 2003. The bureau also estimates that China's GDP will grow by approximately 7% through 2005. We believe that China will continue to focus on its telecommunications infrastructure for the foreseeable future. Please refer to the table below for information, provided by China's Ministry of Information Industry, regarding the increasing telecommunications spending in China:

	2003	% increase over 2002
(in millions)		
Telecommunications revenue	\$ 55.9	14%
Telecommunications capital expenditure	\$ 26.6	9%
Fixed line subscribers	263.3	16%
Cellular subscribers	268.7	19%

Despite the increased teledensity rate of China's fixed-line and cellular telephony to 20% and 21%, respectively, in 2003, the teledensity remains relatively low in comparison to that of developed countries. In contrast, fixed-line teledensity rates for the United Kingdom, France, Japan and the United States were 59%, 57%, 59%, and 66% respectively, according to a report published by the International Telecommunication Union in June 2003. We believe that China's low teledensity will continue to drive the growth in its telecommunications market.

Although voice services predominantly drive China's communications market growth, the increasing demand for data services also presents a growing opportunity in China. According to data provided by the MII, Internet users in China reached 79.5 million by the end of 2003, an increase of over 30% from 2002. In order to support this growth in data traffic, service providers in China must continue to

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expand their networks. In 2003, China's broadband users increased from 2.5 million at the beginning of the year to approximately 10 million at the close of 2003.

The following chart presents relevant historical and estimated data related to the development of China's telecommunications, based on information provided by the MII:

	1999	2000	2001	2002	2003
China's population (Millions)	1,258	1,267	1,276	1,286	1,293
China's GDP per capita (RMB)	6,551	7,081	7,543	7,930	9,047
<b>Fixed-line Telephone</b>					
Subscribers (Millions)	108.8	144.8	180.4	214.4	263.3
Teledensity	9%	11%	14%	17%	20%
<b>Mobile Telephone</b>					
Subscribers (Millions)	43.2	84.5	144.8	206.6	268.7
Teledensity	3%	7%	11%	16%	21%

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	1999	2000	2001	2002	2003
<b>Internet</b>					
Users (Millions)	8.9	22.5	33.7	59.1	79.5
Teledensity	1%	2%	3%	5%	6%

### **Global Markets Outside of China**

We have continued to offer our products in growing communications markets outside of mainland China, establishing global sales operations in Asia, the Central and Latin American region, the European, Middle Eastern and African region and North America. We continue to penetrate these markets in several ways:

through direct sales offices located in key market regions,

by licensing our technology to local manufacturers where import taxation is favorable,

by developing local sales agency and distributor relationships within specific market regions, and

by establishing sales relationships with original equipment manufacturers.

Our sales division began establishing regional offices and local direct sales representative offices to provide support for our expanding global sales operations.

#### *Japan*

The significant majority of our global sales outside of China are derived from Japan. Japan was our largest wireline products market in 2003. One of our key customers in Japan is Yahoo! BB, a related party. According to the Japan Ministry of Public Management, Yahoo! BB is the leading provider of broadband service in Japan with over 3.6 million IP-based ADSL lines at December 31, 2003, representing over 34% of the total market within the region. Yahoo! BB continues to expand and deploy our AN-2000 IP-DSLAM (Broadband Access Platform) and mSwitch equipment in support of their Voice over Broadband and 12, 26 and 45 Mbps ADSL services. In December 2003, we signed \$40 million in expansion contracts for additional IP-DSLAM deployments with Yahoo! BB.

We have begun to offer our mSwitch and MediaSwitch products and services in Japan and conducted trials in the Japanese market. We anticipate further growth in Japan specifically within the wireline and switching product sectors, as well as with our TVoIP (broadcast television and video on demand over IP) systems in Japan.

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#### *India*

We offer our AN-2000 Multi-Service Access products and services in India. With over one million access lines deployed today, we anticipate that we will continue to implement and deploy our products and conduct trials with several operators, including Reliance Telecommunications Inc.

In addition, we continue research and development at our facility on the outskirts of New Delhi. We are focusing on developing the India market and as well as on global research and development initiatives. We have also established local manufacturing of our AN-2000 technology in association with Himachal Futuristic Communications Limited.

According to a July 2003 estimate by the Department Of Telecommunications India, India has a population of 1,049,700,118 and a low fixed line teledensity of approximately 4.4%. We believe that India represents a substantial potential market for our wireless, wireline and switching products and services.

#### *Central and Latin America*

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We have successfully established sales and service operations in support of the Central and Latin American region, and anticipate growth in this market in fiscal year 2004.

Targeting, but not limited to, countries like Brazil, Mexico, Panama, Haiti, Honduras and Guatemala, we have shipped equipment for service providers and continue to perform extensive testing and certification for telecommunications carriers within these regions.

We announced our first PAS deployments with Multifon in Honduras in 2003.

### *North America and the European, Middle Eastern and African Region*

Our market presence in North America and the European, Middle Eastern and African region grew in 2003, and we established sales and service operations to support these regions.

We offer our mSwitch, MediaSwitch, PAS, and AN-2000 products and services in both North America and the European, Middle Eastern and African region. We expect to continue to conduct trials within these regions in 2004.

Specifically, we have seen increased demand for our wireless data products as a result of increased consumer demand for faster and more comprehensive data services. New camera phones, messaging and other high demand data content products and services increase demand for our wireless data systems.

In 2003, we were awarded new contracts for our enhanced service and optical equipment and expect growth to continue within these regions.

### *Southeast and North Asia*

Southeast and North Asia, another of our target markets, has a combined population of over 169 million people according to the CIA World Fact Book 2003. We have established business operations in various countries in this region including, but not limited to, Vietnam, Thailand and Taiwan. We have local sales and service operations to support this region, and at the close of fiscal year 2003, we had over 1.2 million lines of PAS wireless capacity deployed.

We expect continued growth in this region for the foreseeable future, given the growth objectives set forth by primary service providers like Vietnam Posts & Telecommunications ("VNPT") through 2005 including optimizing the existing telecommunications network at local and long-distance levels, applying modern access technology and a goal to reach a teledensity of 8 lines per 100 inhabitants by the year 2005, according to an ITU July 2003 report.

We already have PAS deployments at VNPT; as such, we believe that our wireless, wireline and switching products are well positioned to aid in VNPT's overall growth plans.

Vietnam continued to show growth in 2003. We announced additional contracts with VNPT for expansion in both Ho Chi Minh and Hanoi for 2003 and expect new PAS expansion contracts and deployments in additional cities in 2004.

In Taiwan in 2003, we entered into expansion contracts with First International Telecommunications Corporation of Taiwan ("FITEL") in Kaohsiung; and anticipate future growth and expansion in 2004.

### **Competition**

We compete in the telecommunications equipment market, providing products and services for transporting data, voice and video traffic across traditional and IP based networks.

As we expand into new markets, we will face competition from both existing and new competitors, including existing companies with strong technological, marketing and sales positions in those markets.

Our principal competitors within our current product sectors include the following:

**WIRELESS**

PAS systems: Lucent Technologies, Inc. and Zhongxing Telecommunications Equipment Corporation.

PAS handsets: China PTIC Information Industry Corporation; Zhongxing Telecommunications Equipment Corporation; Lucent Technologies, Inc.; Amoi Electronics Company, Ltd.; Huawei Technologies Co, Ltd; Kyocera Corporation; Nippon Electric Corporation; and Sanyo Electric Company, Ltd.

**WIRELINE**

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

**SWITCHING**

mSwitch: Alcatel Alsthom CGE, S.A.; Cisco Systems, Inc.; Clarent Corporation; Ericsson LM Telephone Co.; Huawei Technology Co., Ltd.; Lucent Technologies, Inc.; Motorola, Inc.; Nokia Corporation; Nortel Networks Corporation; Nuera Communications, Inc.; Siemens AG; Sonus Networks, Inc.; and Zhongxing Telecommunications Equipment Corporation.

**OPERATIONS**

**EMPLOYEES**

As of December 31, 2003, we employed a total of approximately 5,500 full-time employees. We also from time to time employ part-time employees and hire contractors. Of the total number of full-time employees at December 31, 2003, approximately 2,300 were in research and development, approximately 600 were in manufacturing, approximately 2,200 were in marketing, sales and support, and approximately 400 were in administration. We had approximately 4,560 employees located in China, approximately 720 employees located in the United States, and approximately 220 employees in

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other countries. Our employees are not represented by any collective bargaining agreement, and we have never experienced a work stoppage. We believe that we have good employee relations.

**SALES, MARKETING AND CUSTOMER SUPPORT**

We pursue a direct sales and marketing strategy in China, targeting sales to individual telecommunications bureaus and to manufacturers or equipment distributors with closely associated customers. We maintain sales and customer support sites in Beijing, Chengdu, Fuzhou, Guangzhou, Hangzhou, Jinan, Kunming, Nanning, Nanjing, Inner Mongolia, Shanghai, Shenyang, Wuhan, Xian, and Zhengzhou. We also sell through relationships with regional government-owned telecommunications manufacturing companies, which act as agents in the sale of our products to telecommunications bureaus.

We believe our customer support services in China allow us to offer our customers high quality service. Our customer service operation in Hangzhou is co-located with our manufacturing joint venture and serves as both a technical resource and liaison to our product development organization. In China, customer service technicians are distributed in the regional sales and customer support sites to provide a local presence. We provide additional support on a 24-hour, 365-day basis from our customer support center in Hangzhou in the form of field dispatch personnel, who also provide training on installation, operation and maintenance of equipment. As of December 31, 2003, we employed approximately 1,800 people in sales, marketing and customer support in China.

Our sales efforts in markets outside of China combine direct sales, original equipment manufacturers, distributors, resellers, agents and licensees. We maintain sales and customer support sites in Iselin, New Jersey, to address North American markets; in Tokyo, Japan, to address the Japan market; in Gurgaon, India, to address the Indian market; in Miami, Florida and Mexico City, Mexico, to address the Latin American markets; in Frankfurt, Germany, to address the European and African markets; in Manila, Philippines, to address the Philippine market; in Taipei, Taiwan, to address the Taiwan market; in Hanoi, Vietnam, to address the Vietnam market; and in Shanghai, China, to address other Pacific Rim markets.

## **MANUFACTURING, ASSEMBLY AND TESTING**

We manufacture or engage in the final assembly and testing of our mSwitch, PAS systems and handsets and AN-2000 products at our manufacturing facility in the Chinese province of Zhejiang. The manufacturing operations consist of circuit board assembly, final system assembly, software installation and testing. We assemble circuit boards primarily using surface mount technology. Assembled boards are individually tested prior to final assembly and tested again at the system level prior to system shipment. We use internally developed functional and parametric tests for quality management and process control and have developed an internal system to track quality statistics at a serial number level.

Our manufacturing facility is ISO 9001-2000 certified. ISO 9001-2000, an upgrade from ISO 9002 certification, requires that the certified entity establish, maintain and follow an auditable quality process including documentation requirements, development, training, testing and continuous improvement which is periodically audited by an independent outside auditor.

We contract with third parties in China to undertake high volume assembly and manufacturing of our handsets and we conduct final assembly, testing and packaging at our own facilities. In addition, we generally use third parties for high volume assembly of circuit boards.

We have also contracted with various suppliers to provide PAS wireless base station components for distribution under the UTStarcom label. In China, we undertake final assembly and test our wireless infrastructure products at our own facilities and have recently begun to manufacture some of these products ourselves.

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## **RESEARCH AND DEVELOPMENT**

We believe that continued and timely development and introduction of new and enhanced products are essential if we are to maintain our competitive position. While we use competitive analyses and technology trends as factors in our product development plans, the primary input for new products and product enhancements comes from soliciting and analyzing information about service providers' needs. Our relationships with China's Ministry of Information Industry and Telecommunications Administration and individual telecommunications bureaus and our full-service post-sale customer support in China provide our research and development organization with insight into trends and developments in the marketplace. The insight provided from these relationships allows us to develop market-driven products such as PAS, mSwitch and IP-DSLAM. We maintain a strong relationship between our research centers in the U.S. and China. We rotate engineers between the U.S. and China to further integrate our research and development operations. We have been able to cost-effectively hire highly skilled technical employees from a large pool of qualified candidates in China. We have also started a development center in Gurgaon, India to take advantage of the talent pool available there, and to support our operation in India. Our research and development centers are ISO 9001-2000 certified.

In the past we have made, and expect to continue to make, significant investments in research and development. Our research and development expenditures totaled \$155.3 million in 2003, \$86.2 million in 2002 and \$59.8 million in 2001.

## **INTELLECTUAL PROPERTY**

Our ability to compete is dependent in part on our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as confidentiality agreements and licensing arrangements, to establish and protect our proprietary rights. To date, we have relied primarily on proprietary processes and know-how to protect our intellectual property. We hold U.S. and foreign patents for our existing products expiring between 2014 and 2021, and have patents pending in both the U.S. and in foreign countries. In addition, we have, from time to time, chosen to abandon previously filed applications. Patents may not issue and any patents issued may not cover the scope of the claims sought in the applications. Our U.S. patents do not afford any intellectual property protection in China or other international jurisdictions. Moreover, we have applied for but have not yet obtained, patents in China and Taiwan. Please refer to discussion of risks associated with our intellectual property in section entitled "Management's Discussion and Analysis of Financial Statement Results of Operations Factors Affecting Future Operating Results."

## **ITEM 2 PROPERTIES**

We lease properties in the United States, China and globally; these properties are used for corporate headquarters, sales and support offices, research and development and manufacturing purposes.

We lease approximately 420,000 square feet of property in the United States and globally (apart from China). In the United States, we have approximately 345,000 square feet of leased property used for the following purposes: approximately 63,000 square feet for our corporate

headquarters in Alameda, 107,000 square feet for research and development and 175,000 square feet for sales. The remaining property is comprised of global leased property: approximately 56,000 square feet are global sales and support offices, approximately 12,000 square feet are used for research and development and approximately 7,000 square feet are for our regional headquarters in Hong Kong.

We lease approximately 930,000 square feet of property in China. Approximately 64,000 square feet are for corporate headquarters in Beijing, approximately 180,000 square feet are for sales and

support offices, approximately 522,000 square feet are used for manufacturing, and approximately 164,000 square feet are used for research and development.

In 2001, we purchased the rights to use 49 acres of land located in Zhejiang Science and Technology Industry Garden of Hangzhou Hi-tech Industry Development Zone. As of December 31, 2003, we had completed the foundation and groundwork of a facility to be located there, have commenced construction of the building, and anticipate completion during fiscal year 2004.

We believe our existing facilities and equipment are well maintained and in good operating condition, and we believe our facilities are sufficient to meet our needs for the foreseeable future.

### ITEM 3 LEGAL PROCEEDINGS

On October 31, 2001, a complaint was filed in United States District Court for the Southern District of New York against us, some of our directors and officers and various underwriters for our initial public offering. Substantially similar actions were filed concerning the initial public offerings for more than 300 different issuers, and the cases were coordinated as *In re Initial Public Offering Securities Litigation*, 21 MC 92. In April 2002, a consolidated amended complaint was filed in the matter against us, captioned *In re UTStarcom, Initial Public Offering Securities Litigation*, Civil Action No. 01-CV-9604. Plaintiffs allege violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 through undisclosed improper underwriting practices concerning the allocation of IPO shares in exchange for excessive brokerage commissions, agreements to purchase shares at higher prices in the aftermarket and misleading analyst reports. Plaintiffs seek unspecified damages on behalf of a purported class of purchasers of our common stock between March 2, 2000 and December 6, 2000. Our directors and officers have been dismissed without prejudice pursuant to a stipulation. On February 19, 2003, the Court granted in part and denied in part a motion to dismiss brought by defendants including us. The order dismisses all claims against us except for a claim brought under Section 11 of the Securities Act of 1933, which alleges that the registration statement filed in accordance with the IPO was misleading. A proposal has been made for the settlement and release of claims against the issuer defendants, including us. The settlement is subject to a number of conditions, including approval of the proposed settling parties and the court. If the settlement does not occur, and litigation against us continues, we believe we have valid defenses and we intend to defend the case vigorously. The total amount of the loss associated with the above litigation is not determinable at this time. Therefore we are unable to currently estimate the loss, if any, associated with the litigation.

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

### ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.



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

	<u>High</u>	<u>Low</u>
<b><i>Fiscal 2002</i></b>		
First Quarter	\$ 33.95	\$ 20.25
Second Quarter	27.03	18.58
Third Quarter	20.82	12.57
Fourth Quarter	21.10	15.66
<b><i>Fiscal 2003</i></b>		
First Quarter	\$ 23.90	\$ 16.56
Second Quarter	35.86	19.70
Third Quarter	46.45	31.18
Fourth Quarter	39.07	30.85

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 closing sales prices per share of our common stock as reported on The Nasdaq National Market for the periods indicated. As of February 29, 2004 we had approximately 199 stockholders of record.

To date, we have not paid any cash dividends on our common stock. We currently anticipate that we will retain any available funds to finance the growth and operation of our business and we do not anticipate paying any cash dividends in the foreseeable future. Certain present or future agreements may limit or prevent the payment of dividends on our common stock, for example, our convertible debt requires that we have to provide notice of our intent to pay certain dividends. Additionally, our cash held in foreign countries may be subject to certain control limitations or repatriation requirements, limiting our ability to use this cash to pay dividends.

**Equity Compensation Plan Information**

The following table sets forth information, as of December 31, 2003, about equity awards under our equity compensation plans:

Plan category(1)	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation plans approved by security holders(2)	13,149,059(3)\$	17.92	7,673,957(4)
Equity compensation plans not approved by security holders	1,551,813(5)\$	28.55(6)	61,700(7)
<b>Total</b>	<b>14,700,872</b>	<b>\$ 18.97</b>	<b>7,735,657</b>

(1) See Note 16 of our "Notes to Consolidated Financial Statements" for a description of our equity compensation plans.

(2) Includes the 1997 Stock Plan which provides for an annual increase in the number of shares available for issuance under the plan equal to the lesser of (i) 4% of the outstanding Shares on

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such date, (ii) 6,000,000 shares or (iii) a lesser amount determined by the Board, and the 2000 Employee Stock Purchase Plan, which provides for an annual increase in the number of shares available for issuance under the plan equal to the lesser of (i) 2% of the outstanding shares on such date, (ii) 2,000,000 shares or (iii) a lesser amount determined by the Board.

- (3) Includes shares of common stock to be issued upon exercise of options granted under our 1995 Stock Plan, 1997 Stock Plan and 2001 Director Option Plan.
- (4) Includes 3,272,754 shares of common stock available for issuance under our 2000 Employee Stock Purchase Plan, 3,521,203 shares of common stock available for issuance under our 1997 Stock Plan and 880,000 shares of common stock available for issuance under our 2001 Director Option Plan.
- (5) Includes 1,438,300 options outstanding under the 2003 Non-Statutory Stock Option Plan, a maximum of 73,637 performance shares outstanding under the Advanced Communication Devices Corporation Incentive Program and a maximum of 39,876 performance shares outstanding under the Issanni Communications, Inc. Incentive Program. Does not include 14,841 shares, 14,929 shares and 32,000 shares of common stock subject to outstanding options and warrants with a weighted-average exercise price of \$10.77 that were assumed in our acquisitions of Advanced Communication Devices Corporation, Rollingstreams Systems, Ltd. and Lin Tech Communications, respectively.
- (6) Represents the average weighted exercise price of 1,438,300 options outstanding under the 2003 Non-Statutory Stock Option Plan. Excludes performance shares outstanding under the Advanced Communication Devices Corporation Incentive Program and the Issanni Communications, Inc. Incentive Program because performance shares do not have an exercise price.
- (7) Includes 61,700 shares of common stock available for issuance under our 2003 Non-Statutory Stock Option Plan.

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### ITEM 6 SELECTED CONSOLIDATED FINANCIAL DATA

You should read the selected consolidated financial data set forth below in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our Consolidated Financial Statements and the Notes thereto included elsewhere in this report. Historical results are not necessarily indicative of results that may be expected for any future period.

	Year Ended December 31,				
	2003	2002	2001	2000	1999
	(in thousands, except per share data)				
<b>Consolidated Statement of Operations Data:</b>					
Net sales	\$ 1,964,332	\$ 981,806	\$ 626,840	\$ 368,646	\$ 187,516
Gross profit	636,168	345,472	224,548	128,181	74,813
Operating income	274,732	145,962	76,728	33,780	16,719
Income from continuing operations	202,251	107,862	56,954	27,993	13,119
Net income (loss) available to common stockholders	202,251	107,862	56,954	27,013	(18,514)
Basic earnings (loss) per share:					
Income (loss) from continuing operations	\$ 1.95	\$ 0.98	\$ 0.56	\$ 0.35	\$ (1.94)
Income (loss) from discontinued operations					(0.19)
Cumulative effect on prior years of the application of SAB 101 "Revenue Recognition in Financial Statements"				(0.01)	
Net income (loss) <sup>(1)</sup>	\$ 1.95	\$ 0.98	\$ 0.56	\$ 0.34	\$ (2.13)

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Year Ended December 31,

Diluted earnings (loss) per share:

Income (loss) from continuing operations	1.64	0.94	\$ 0.52	\$ 0.28	\$ (1.94)
Income (loss) from discontinued operations					(0.19)
Cumulative effect on prior years of the application of SAB 101 "Revenue Recognition in Financial Statements"				(0.01)	
Net income (loss)	\$ 1.64	\$ 0.94	\$ 0.52	\$ 0.27	\$ (2.13)

Proforma amounts assuming application of SAB101 "Revenue Recognition in Financial Statements" is applied retroactively: