

UTStarcom Looks Ready to Launch

By [Gary Dvorchak](#) | Dec 10, 2014 | 1:00 PM EST

Today we get the second installment of what I am dubbing "value week." Monday we [looked at STR Holdings](#) (STRI), a turnaround play in the solar industry that is trading below cash with a transformative strategic transaction as a catalyst. Today I want to revisit **UTStarcom** (UTSI).

I first highlighted UTStarcom [nearly two years ago](#) as a name whose shares were trading at the company's cash level, but which was executing a turnaround in its core business of telecom equipment. I visited company headquarters this week and met with Min Xu, the new chief financial officer -- and the result has been my continued enthusiasm about the idea.

My original thesis saw a turn in the telecom business as UTStarcom focused on restructuring to embark on a new product direction -- expanding its video-over-IP products to address the growing trend of consumers watching video over the Internet, rather than on traditional cable channels. Beyond this, UTStarcom also offered the safety of a stock trading at cash.

The latter element of the thesis certainly played out, as this stock has been rock-solid around its cash level despite ups and downs in the broader market -- though obviously it didn't need the cash support over the last two years, seeing as the market has been in a tremendous rally mode. The former element of the thesis is finally coming to fruition, albeit more slowly than what I had originally hoped.

As a reminder, UTStarcom manufactures carrier-class broadband products, which enable high-speed voice, video and data access and transport over internet protocol (IP)-based networks. UTStarcom's switches target mobile backhaul, metro aggregation, broadband access and wifi-data offloading. The company's market capitalization is \$100 million, and consensus analyst estimates call for 2014 sales of around \$124 million. UTStarcom has \$90 million in cash and no debt, so the market is valuing the ongoing business at \$10 million, or less than 10% of sales.

Checking in this week, we see that UTStarcom is starting to get traction in key new product initiatives. An important product that will ramp in 2015 is the TN765, a high-speed switch for metro-area Internet networks. The company had expected a quicker ramp in 2014, but it found that carriers are jumping straight past 40-gigabit installations to 100 gigabit, reflecting the ongoing rapid growth of internet traffic. All this is pushing the TN765 ramp to 2015. Next year should also see the ramp of carrier-class wifi offloading products -- very important with the growth of mobile data and 4G-speed networks -- and software-defined network equipment, or SDN.

UTStarcom historically has sold into two major geographies: Japan (mainly to **Softbank**, a former large shareholder) and India. Japan is stable, while India continues to ramp. The company expects the Softbank relationship to enable sales into **Sprint** (S) in the U.S., so it opened an office in Silicon Valley in California to serve the U.S. market. The company is also starting to penetrate Korea, and is now selling to the largest telecom provider in Taiwan. Geographic expansion could accelerate sales growth in the 2016-and-beyond time frame.

The most recent quarter showed some evidence of the turn, although real traction is unlikely before mid-2015. Revenue was up sequentially and beat the consensus estimate, and gross margin gained as well. Earnings before interest, taxes, depreciation and amortization (EBITDA) was close to breakeven. UTStarcom did see some sales from the fourth quarter

shift into the third, which caused the beat, so management was cautious on guidance. I am looking for revenue growth of 13% in 2015 and positive cash flow.

The new management team is very shareholder-friendly, which should also help the valuation -- especially since this is a China-based company, a fact that can cause consternation among some investors. The CFO is a former Wall Street analyst, and he "gets it" -- he understands how investors think and what they need in terms of disclosure.

UTStarcom announced a \$40 million stock-buyback authorization, which can be used to support the stock as needed. UTStarcom has only two analysts covering it -- the most recent being Chicago-based boutique Greenridge Global -- but the company is courting more. I expect to see additional initiations in 2015 as the turn in fundamentals takes root.

The valuation story may be even more compelling than it seems, too. Clearly \$10 million is a ridiculously low valuation for a business with more than \$100 million in annual sales and the prospect of restored profitability. Additionally, UTStarcom has a portfolio of investments in various startup media and telecom companies. Analysts estimate the value of that portfolio at between \$50 million and \$150 million. UTStarcom is examining ways to monetize that portfolio as another catalyst for value realization.

A major risk to the story is the company's exposure to Japan, from which it generates 50% of its revenue. The collapsing Japanese yen will eventually cause pricing and margin pressure, or result in reduced demand. The company is aware of this, of course, and is focused on expansion in other geographies as an offset, since hedging cannot fully counter the yen depreciation over time.

Although the wait has been long since my early-2013 posting, I still like the UTStarcom story and believe 2015 could be the year that the stock gets revalued to appropriate levels. I think it will be one of my better ideas for the year ahead.