NEXT LEVEL COMMUNICATIONS INC
Form 10-K
March 19, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000
OR

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

FOR THE TRANSITION PERIOD FROM ____________ TO ____________ .

COMMISSION FILE NO. 0-27877

NEXT LEVEL COMMUNICATIONS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	95-3342408
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

6085 STATE FARM DRIVE
ROHNERT PARK, CA 94928
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (707) 584-6820

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT:

TITLE OF CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
COMMON STOCK, PAR VALUE $0.01	NASDAQ NATIONAL MARKET

Indicate by check mark whether 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 [X] 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. [ ]

The aggregate market value of the voting stock held by non-affiliates of the registrant was $153,977,320 as of February 28, 2001.

As of February 28, 2001, the registrant had 84,712,240 outstanding shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

DOCUMENTS	FORM 10-K REFERENCES
Portions of our Definitive Proxy Statement for our upcoming Annual Meeting of Stockholders	Items 10-13

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PART I

ITEM 1. BUSINESS

The statements in this report that are forward-looking are based on current expectations and beliefs and involve numerous risks and uncertainties that could cause actual results to differ materially. For a discussion of the factors that could cause actual results to differ materially from the forward-looking statements, see "Risk Factors" and such other risks and uncertainties as set forth below in this report or detailed in our other Securities and Exchange Commission reports and filings.

OVERVIEW

We design and market broadband communications equipment that enables telephone companies and other communications service providers to cost-effectively deliver a full suite of voice, high-speed data and digital video services over the existing copper telephone wire infrastructure. Service providers who deploy our equipment can either offer voice, data and video services in a single product offering or offer each service separately depending on subscriber demand and the service provider's objectives. We believe that by installing our equipment, telephone companies and other emerging communications service providers will be able to capitalize on, and compete effectively in, the emerging market for integrated voice, data and video services. Our products consist of equipment located at the telephone company's central office or exchange, in the field and at the subscriber's home or business.

We commenced operations in July 1994 and recorded our first sale in September 1997. From January 1998 until November 1999, we operated through Next Level Communications L.P., which was formed as the result of the transfer of all of the net assets, management and workforce of a wholly owned subsidiary of General Instrument. In November 1999, the business and assets of that partnership were merged into Next Level Communications, Inc. as part of our recapitalization. In November 1999, we completed an initial public offering of our common stock, raising approximately $177.0 million in net proceeds. In January 2000, General Instrument was acquired by Motorola, Inc., making us an indirect subsidiary of Motorola. As a result of the transactions that occurred in connection with our recapitalization, Motorola, through General Instrument, owns 64,103,724 shares of our common stock constituting approximately 76% of our outstanding common stock on a fully diluted basis as of December 31, 2000. Kevin Kimberlin Partners, LP (an affiliate of our former General Partner, Spencer Trask) and its affiliates own, including shares issuable upon exercise of outstanding warrants, 7,221,892 shares of common stock in the aggregate, constituting approximately 8% of our outstanding common stock on a fully diluted basis as of December 31, 2000.

Our equipment is designed to provide the following key benefits:

Flexible, Integrated Products. Our products are designed with the flexibility to allow our customers to deliver voice, data and video services in a single packaged offering or to offer them individually. This flexibility allows telephone companies to immediately serve the varying needs of their diverse end-user base, including residential, corporate and telecommuter customers. As a result, telephone companies can generate significant incremental revenue from their existing networks by using our system. By offering the flexibility inherent in an integrated system, our products enable telephone companies to effectively time their network equipment expenditures and rapidly introduce new services as demand warrants.

Cost Effective Product Deployment. Our product design reduces the cost and complexity often associated with deploying multiple services to end users. Because telephone companies often use separate equipment for each communications service, they require multiple equipment purchases, installations, training procedures, maintenance procedures and network management packages. In contrast,

our products deliver all services from a single system. By integrating many traditionally separate functions, our products allow telephone companies to incrementally add services by simply installing new modules into our existing equipment, rather than purchasing entirely new infrastructure equipment. Additionally, our products installed in the house or office deliver video and data services from a single networked set-top box, thus eliminating the need for set-top boxes or modems for different services or separately located TVs and PCs. We believe our products provide cost savings, reduce trouble calls and ease installation compared to other equipment that

often consists of separate systems, each of which corresponds to one service and which may not operate effectively together.

Complete Solution For Delivery of Voice, Data and Video. By supplying equipment for the telephone company central office, the field and the subscriber's home or office, we offer a single integrated system for the delivery of voice, data and video services. With our products, telephone companies initially deploying voice service can subsequently activate data and/or video service with a simple addition and installation of equipment at the subscriber's home or office. We believe the flexibility found in our products cannot currently be accomplished by attempting to integrate multiple systems from multiple vendors.

Reliable and Compatible Technology. Because our products provide multiple services, including voice, they are engineered to comply with rigorous industry standards for reliability and safety. We have also designed our products to operate with existing telephone company switches and billing systems, thereby minimizing the cost of using our products.

Security. We believe that our products produce greater security compared to cable systems that are based on shared network design in which data is broadcast to all users simultaneously. Security has always been important to individuals and businesses in voice transmission and is becoming increasingly important as e-commerce applications and video-on-demand services become more prevalent.

PRODUCTS

Our products include equipment located at a telephone company's central office, in the field and at a subscriber's home or business.

Broadband Digital Terminal. The Broadband Digital Terminal is the central element of our product suite, providing centralized access to both broadband and narrowband core networks and related voice, data and video services. The Broadband Digital Terminal is typically located in a telephone company's central office, or at a remote building basement or hut where it connects with central office equipment including voice and data switches and billing systems. On the subscriber side, the Broadband Digital Terminal provides high-speed connections to remote Universal Service Access Multiplexers or Broadband Network Units that can support several thousand telephone subscribers or combinations thereof. The Broadband Digital Terminal has the capacity for broadband applications such as video-on-demand and high definition television. Also, because the Broadband Digital Terminal supports different remote terminals, changes to network layouts or transmission media, copper or fiber, do not require different Broadband Digital Terminals.

Universal Service Access Multiplexer. We designed the Universal Service Access Multiplexer to use existing copper wire to connect to a customer's home or office. This product can be connected with fiber optic cable to the Broadband Digital Terminal. Each Universal Service Access Multiplexer can support up to 32

video and/or data subscribers via Very High Bit Rate Digital Subscriber Line of Asymmetric Digital Subscriber Line technology or up to 96 voice subscribers. By using modular components, a single Universal Service Access Multiplexer enables multiple voice, data and video services. The Universal Service Access Multiplexer can be deployed in the telephone company's central office or remotely. Because the Universal Service Access Multiplexer is flexible in terms of where it can be located in the network, as well as the services it can support, its use can reduce both the costs and the complexity of deploying new high-speed data and video services.

Broadband Network Unit. The Broadband Network Unit is used with Fiber to the Curb installations where fiber optic cable is deployed up to a location relatively close to the customer's home or office. The Broadband Network Unit supports voice, data and video services, and can be mounted on a telephone pole, a pedestal or a wall. The Broadband Network Unit provides voice, high-speed data and video service for clusters of up to 16 video and/or data and up to 36 voice subscribers. Our Broadband Network Unit is particularly suited to situations where a new network is being built, or where existing copper wire is being upgraded by the installation of fiber optic cable as the transmission medium for residences or larger apartment buildings or offices. The advanced design and environmentally secure housing of the Broadband Network Unit helps to reduce in-field trouble calls.

N(3) Residential Gateway. Our N(3) Residential Gateway product is a single set-top box that delivers integrated data and video services. One N(3) Residential Gateway enables multiple televisions and PCs to be served from the same copper line coming into the customer's home or office. Traditionally, the high cost of customer home or office equipment for broadband services has been a limiting factor in the deployment of broadband services to multiple televisions or personal computers. Historically, a customer would have to obtain multiple modems or set-top boxes to support services to multiple televisions or personal computers. In contrast, our N(3) Residential Gateway simultaneously provides three independent high quality digital video streams that can be distributed throughout a home or office using standard coaxial cable. The N(3) Residential Gateway also supports enhanced telephone services, such as an indicator on the television that a message is waiting on the customer's answering machine or service as well as on-screen caller ID. The data port in our N(3) Residential Gateway supports high-speed connectivity to the Internet or remote work-at-home access.

N(3) ETHERset. Our N(3) ETHERset is a data-only, desktop device that provides a powerful, low-cost solution for delivering high-speed Internet or data services to subscribers in residences, small businesses, branch offices and the like. Individual or multiple PCs can be connected to a single N(3) ETHERset.

Element Management Systems. Our products can be managed remotely by our N(3)View-1 Element Management System and our N(3) View-2 Service Manager. The View-1 Element Management System enables service providers to manage our equipment and their other systems and products. The View-2 Service Manager enables service providers to manage delivery of voice, data and video services to their customers.

CUSTOMERS

We market and sell our products through our direct sales force to service providers. For the year ended December 31, 2000, approximately 56% of our sales were to Qwest. Additionally, we have increased our sales to the local, independent and international telephone companies in the current year. During the year ended December 31, 2000, we had 62 customers that purchased at least

$100,000 of our products.

Qwest: In August 1997, we entered into an agreement with Qwest (formerly US WEST) through which Qwest may purchase, without obligation to do so, up to 450,000 N(3) Residential Gateways and associated central office and field equipment, in eight of the 14 states in which Qwest currently operates over a five-year period. We recorded our first sale to Qwest in September 1997 for deployment of video and data service to Qwest's customers in Phoenix, Arizona. In October 1998, Qwest selected our product to provide voice applications in six of the 14 states that Qwest serves. Sales to Qwest represented 56% of our revenues in 2000, 67% in 1999 and 68% in 1998. As a result of the merger between U S WEST and Qwest, Qwest slowed its purchases of our equipment while it re-evaluates its plans regarding the deployment of VDSL across its network. Sales to Qwest in the future are dependent upon their decision regarding the deployment of our product.

Others: Our customers also include Hutchinson Telephone, Paul Bunyan Rural Telephone, Chibardun Telephone, Horizon, New ULM, Washington, Wood County, Hickory Tech, Clearlake, Cablevision, Bell Canada, All West and Northstar Telephone.

TECHNOLOGY

We believe the following key technologies have been instrumental in our ability to provide what we believe is the world's only integrated, complete solution for the delivery of integrated voice, high-speed data and digital video services over the existing telephone copper wires.

Advanced Application Specific Circuits Architecture. Applications Specific Circuits are custom-designed silicon circuits that are optimized for a specific task or set of tasks. These circuits are critical because they are performance-optimized to minimize gate counts, packaging size, power dissipation and cost. In addition, one of these circuits may be the only way to provide a new or novel function that is not available in an off-the-shelf circuit. Our engineers have substantial experience in the design of these circuits and have developed a portfolio of over 15 of these circuits, which enables flexible delivery of voice, data and video from a single system. We

will continue to pursue additional service and system level Application Specific Circuits as a mechanism for protecting our intellectual property and to achieve ongoing cost reductions.

System Design and Integration Expertise. We employ a team of experienced system design and integration engineers in our research and development group. These individuals provide research, design and development resources and ensure that our products can be integrated by our customers. System integration by our customers is required on our specific access products, equipment at the consumer's home or business, and management systems, as well as the integration of our products into our customers' networks. System integration expertise is critical to the successful deployment of new advanced full service telecommunications systems and services by our customers.

Wavelength Division Multiplexing Technology. Our system uses a technology known as wavelength division multiplexing. This technology allows multiple optical signals to be carried on the same optical fiber. In particular, this technology is used to communicate two-way voice, data and video over a single optical fiber. This enables our customers to save fiber costs and increase bandwidth.

Software and Protocol Stacks. Most of the system software in our products has been developed internally using modern design principles and processes. Where appropriate, various third-party software packages have been integrated into the access system. Some examples include the real time operating system and various protocol stack software packages.

Standards-based Architecture. We support multiple industry standards to minimize interoperability issues and leverage industry hardware and software capabilities, and improve time to market. On the customer side of the network, we are working with industry standards for asynchronous digital subscriber line and very high-speed digital subscriber line standards to support various equipment at the customer's home or business.

RESEARCH AND DEVELOPMENT

As of February 28, 2001, we had 242 full time employees and four independent contractors engaged in research and development. We believe that our future success depends on our ability:

- to adapt to the rapidly changing telecommunications environment;

- to maintain our expertise in core technologies; and

- to continue meeting and anticipating the evolving needs of telephone companies.

We continually review and evaluate technological changes affecting the telecommunications market and invest substantially in applications-based research and development. We are committed to an ongoing program of new product development that combines internal development efforts with strategic relationships and licensing or marketing arrangements relating to new products and technologies from outside sources.

We have focused our research and development expenditures for the past several years on creating a complete solution for the delivery of voice, data and video services using the existing infrastructure of telephone companies. We have also concentrated on developing the associated customer premises equipment, including our N(3) Residential Gateway, and on developing our N(3) View-1 Element Management Systems. In 2000, 1999 and 1998, research and development expenses were $55.8 million, $48.5 million and $47.1 million. We believe that our extensive experience in designing and implementing high-quality network components has enabled us to develop integrated systems solutions. We seek to constantly improve our existing products, including developing additional home and office products and higher speed interfaces for our products.

SALES AND MARKETING

We primarily market and sell our products through a direct sales force located in North America that consisted of 73 people as of February 28, 2001. To date, sales activities have been focused primarily on the regional Bell operating companies. More recently, we have focused on emerging opportunities within the local, independent and international telephone markets. We are currently expanding our sales organization to focus on these emerging customer opportunities. As of February 28, 2001, 22 sales people were focused solely on

sales to local telephone companies. Because of the potential importance of our products to our customers' networks, we focus our selling efforts at many levels within each customer's organization.

We have a variety of marketing programs and initiatives to support the sale and distribution of our products. As of February 28, 2001, we had 12 full time employees engaged in marketing activities focusing on reaching technical experts within telephone companies and creating product awareness and credibility for our systems among telephone companies. A key factor to building brand awareness for our products is promoting the success of our customers deploying our products. We seek to educate telephone companies regarding the benefits of deploying broadband-ready equipment across a diverse subscriber base. We also build our brand name through continued publicity and referral efforts in both media and industry-centered activities, including editorial presence in various trade magazines, press releases, public speaking opportunities, national and regional trade show participation, advertising, Internet-based communication and promotion, media sponsorships and participation in industry standards activities.

MANUFACTURING

We seek to deliver our products on time and defect-free by capitalizing on the experience and expertise of strategic contract manufacturers. Based on their quality assurance and strengths in the volume manufacture of our products, we have established our primary contract manufacturing relationships with SCI Systems and ACT Manufacturing. SCI Systems is responsible for manufacturing a majority of our circuit board plug-in assemblies. ACT Manufacturing is responsible for manufacturing our N3 Residential Gateway product. Using contract manufacturers allows us to reduce the costly investment in manufacturing capital, achieve economies of scale in purchasing selected components and reduce inventory warehousing.

We maintain only a limited in-house manufacturing capability for final assembly, testing and integration of our products. Our internal manufacturing expertise is focused on product design for testability, design for manufacturability and the transfer of products from development to manufacturing. Each contract manufacturer typically assembles an account team of personnel representing all the essential functions to deliver products from prototype through volume production. This team works with our design, test and manufacturing engineers, and our quality, materials, logistics and program management teams. All of our major contract manufacturers are certified under international quality standards. Although our contract manufacturers manage material procurement for the majority of the components that are incorporated in our products, we continue to manage the evaluation and selection of certain key components.

Our engineering team designs circuits and tests these designs using computer simulations. When the fundamental design is stable, our outsourced manufacturers make the circuits for testing. Upon completion of these tests, vendors such as Oki Semiconductor, Broadcom, STMicroelectronics, VLSI (Philips) and Motorola manufacture the circuit in volume. Warranty and repair support is performed off-site by our contract manufacturers and by us at our Rohnert Park, California facility.

CUSTOMER SERVICE AND SUPPORT

We believe that successful long-term relations with our customers require a service organization committed to customer satisfaction. As of February 28, 2001, we had 39 technical support employees at our headquarters or in the field. We also offer a five-day training course for all new customers prior to receiving and installing a system. To date, revenues from customer service and support have been immaterial.

We provide direct support by telephone or at a customer's office or other location at any time. To monitor service activities, we maintain a customer call tracking system. We also maintain a dial-up analog modem connection or an

Internet-based management interface to our equipment to assist with diagnostics.

COMPETITION

The market for providing equipment for local telecommunications networks is extremely competitive. The principal competitive factors in this market include, or are likely to include:

- product performance and price;

- features and reliability;

- technical support and service;

- relationships with phone companies and systems integrators;

- compliance with industry standards;

- compatibility with the products of other suppliers;

- sales and distribution capabilities;

- strength of brand name;

- long-term cost of ownership to communications providers; and

- general industry and economic conditions.

Many of our current and potential competitors have longer operating histories and greater name recognition and resources than we do. These competitors may undertake more extensive marketing campaigns than we do. In addition, these competitors may adopt more aggressive pricing policies than we do. Also, these competitors may devote substantially more resources to developing new products than we do. Many of our competitors have recently been acquired and now have even greater resources to compete with us.

Our significant current and potential competitors include Advanced Fibre Communications, Alcatel, Cisco Systems, Efficient Networks, Ericsson, Lucent Technologies, Nokia, Nortel Networks, RELTEC Corporation (acquired by BAE Systems, CNI Division, formerly GEC Marconi), Scientific Atlanta, Siemens and our largest stockholder, General Instrument/Motorola. Some of these competitors have existing relationships with our current and prospective customers, which could give them a competitive advantage over us as a preferred provider. In addition, we anticipate that other large companies, such as Matsushita Electric Industrial, which markets products under the Panasonic brand name, Microsoft, Network Computer, Philips, Sony Corp., STMicroelectronics and Toshiba America, will likely introduce products that compete with our N(3) Residential Gateway product in the future.

In addition, we are likely to face increasing competition from alternative technologies. In particular, cable operators are currently deploying products that deliver voice, high-speed data and video services over cable. Cable service providers that offer these packaged services will give subscribers the alternative of purchasing all communications services from a single service provider. If these services are implemented successfully, they will compete directly with the services offered by telephone companies using our products.

Consolidation in the telecommunications equipment industry may strengthen our competitors' position in our market. Consolidation of our competitors has

occurred, and we expect it to continue to occur in the foreseeable future. For example, Alcatel acquired DSC Communications, Lucent acquired Ascend Communications, and GEC Marconi acquired RELTEC Corporation. Acquisitions such as these further strengthen our competitors' financial, technical and marketing resources and provide access to regional Bell operating company customers. As a result, these competitors are able to devote greater resources to the development, promotion, sale and support of their products. This consolidation may allow some of our competitors to penetrate new markets that we have targeted, such as the domestic local, independent and international telephone markets. If our competitors are successful in these markets, we will be harmed.

INTELLECTUAL PROPERTY

We rely on a combination of patent, copyright and trademark laws, and on trade secrets, confidentiality provisions and other contractual provisions to protect our intellectual property. These measures afford only

limited protection. As of February 28, 2001, we had 24 issued patents in the United States and 26 issued patents in foreign countries. We have 35 pending U.S. patent applications and 99 pending international patent applications. We market our products primarily under our own name and mark. We consider our trademarks to be valuable assets. We rely on patent, trademark, trade secret and copyright laws both to protect our proprietary technology and to protect us against claims from others. We believe that we have direct intellectual property rights or rights under cross-licensing arrangements covering substantially all of our material technologies. Given the technological complexity of our systems and products, however, we cannot assure that claims of infringement will not be asserted against us or against our customers in connection with their use of our systems and products, nor can we assure the outcome of any such claims.

SOURCES AND AVAILABILITY OF MATERIALS

We contract for the manufacture of all of our products and have limited in-house manufacturing capabilities. We rely primarily on two large contract manufacturers: SCI Systems and ACT Manufacturing. For a detailed discussion of these relationships and the risks associated with our dependence upon third-party manufacturers, see "Business -- Manufacturing" and "Risk Factors."

Some parts, components and equipment used in our products are obtained from sole sources of supply. If our sole source suppliers or we fail to obtain components in sufficient quantities when required, delivery of our products could be delayed. Additional sole-sourced components may be incorporated into our equipment in the future. We do not have any long-term supply contracts to ensure sources of supply. In addition, our suppliers may enter into exclusive arrangements with our competitors, stop selling their products or components to us at commercially reasonable prices or refuse to sell their products or components to us at any price, which could harm our operating results.

ENVIRONMENTAL MATTERS

Our research and development operations are subject to certain federal, state, local and foreign environmental protection laws and regulations. These laws and regulations relate to the use, handling, storage, discharge and disposal of certain hazardous materials and wastes, the pre-treatment and discharge of process waste waters and the control of process air pollutants. We believe that we are in compliance in all material respects with applicable environmental regulations. If those laws and regulations become more stringent over time, we may not be able to comply in a timely manner, or comply at all. Compliance with new laws and regulations could create significant compliance

expenses, result in production suspension and delay, restrictions on expansion at present locations and require the acquisition of costly equipment. Non-compliance with laws and regulations could result in penalties and suspension of operations.

REGULATION OF CUSTOMERS

Although our products are not now directly subject to significant regulation by the Federal Communications Commission, or FCC, or any other federal or state communications regulatory agency, our customers and their networks, into which our products are incorporated, are subject to government regulation. Accordingly, the effects of regulation on our customers may, in turn, harm us. FCC regulatory policies affecting either the willingness or the ability of cable operators or telephone companies to offer certain services and to permit the allocation of our products on their premises, or the terms on which these companies offer the services and conduct their businesses, may impede sales of our products.

Several FCC regulatory policies may affect the degree to which or way in which incumbent local exchange carriers, which we refer to as incumbent carriers, principally the regional Bell operating companies, can or choose to make integrated voice, data and video offerings available. For example, the Telecommunications Act of 1996 requires incumbent carriers to offer their competitors cost-based access to certain parts of their networks to enable these competitors to provide telecommunications services. In response to a decision by the Supreme Court overturning the FCC's rule identifying the specific network elements that incumbent carriers must offer to their competitors, the FCC announced that, except in limited circumstances, it will not require incumbent carriers to offer their competitors access to the facilities and equipment used to provide

high-speed data services. However, the FCC has stated that it will reexamine this decision every three years and judicial appeals of the decision may follow. The 1996 Telecommunications Act also requires incumbent carriers to offer for resale, at wholesale rates, any telecommunications services that incumbent carriers offer to customers. The FCC has determined that high-speed data services are "telecommunications services," and thus incumbent carriers must offer high-speed data services for resale by competitors. The FCC also requires incumbent carriers to permit competitive carriers to collocate their equipment with the local switching equipment of the incumbents. The U.S. Court of Appeals for the D.C. Circuit recently overturned some of the FCC's collocation rules that required incumbents to permit the collocation of equipment that provides functionalities in addition to interconnection and access to unbundled network elements and the FCC is currently in the process of revising its rules.

The uncertainties caused by pending regulatory proceedings or appeals could cause potential customers to delay purchasing decisions. In addition, the outcomes of the various regulatory proceedings may cause potential customers to not deploy all of the services for which our products are designed or to delay the widespread introduction of one or more of these services. Certain members of Congress have also expressed an interest in reducing the regulation of incumbent carriers' provision of video and high-speed data services, but again there is no way to predict whether this legislation will be adopted.

The FCC also has proposed allowing incumbent carriers to offer high-speed data and video services through a structurally separate subsidiary that is not subject to the unbundling and resale requirements. Our equipment is designed to allow carriers to provide video, high-speed data, and digital voice on an integrated basis. If incumbent carriers choose to offer video or data services

through a separate affiliate, incumbent carriers may prefer vendors whose equipment does not provide for integration of service offerings. A separate affiliate may choose to purchase less sophisticated equipment because it might not be able to utilize fully our equipment's integrated features. We will not know for certain the FCC's position on the proposed separate affiliate requirement until the FCC issues an order. In a separate proceeding, the FCC released an order requiring two large incumbent carriers, SBC and Ameritech, to provide high-speed data services through a separate subsidiary as a condition to the FCC's approval of their merger. Under the terms of the order, this condition terminates when the two incumbent carriers satisfy certain requirements, but no sooner than 42 months after the merger's closing. Recently, however, the U.S. Court of Appeals for the D.C. Circuit vacated, in part, the FCC's order and held that the FCC may not permit an incumbent carrier to avoid its regulatory obligations by setting up an affiliate to offer such services.

The FCC's rules prohibit incumbent carriers from providing voice or data services along with customer premises equipment, such as our N(3) Residential Gateway, as a package offering at a single price. The FCC also currently regulates the offering of enhanced services by certain carriers, including incumbent carriers. The FCC restricts these carriers from offering, for example, Internet access services bundled with local exchange voice services. These bundling restrictions may limit the ability of incumbent carriers using our equipment to attract customers. The FCC is considering amending or repealing these bundling restrictions, but we cannot assure that rule changes will take place.

Distribution of our N3 Residential Gateway could be adversely affected by the FCC's "navigation devices" rules. Those rules require video program distributors, including those who use our system to deliver video, to allow set-top boxes and other navigation devices owned by customers or manufactured by third parties to be connected to the video program distributor's system. The rules require video program distributors to disclose technical details of their interfaces so as to permit third parties to manufacture the navigation devices and retail customers to connect them. We believe these rules are not readily applicable to our system because our N3 Residential Gateway is in many ways different from a cable set-top box, and currently there is little likelihood of an independent market for our N3 Residential Gateway separate from our entire system. However, if these rules could be applied to our N3 Residential Gateway or other parts of our system, our customers might be required to disclose proprietary technical information including patented data about our technology, to allow competing vendors to access the system.

EMPLOYEES

As of February 28, 2001, we had a total of 476 full-time employees and 14 independent contractors. Of the total number of employees, 242 were in research and development, 20 in marketing, 53 in operations, 92 in sales and sales support and 69 in administration. Of the total number of contractors, four were in research and development, two were in operations, two were in administration and six were in sales and sales support. Our employees are not represented by any collective bargaining agreement with respect to their employment, and we have never experienced an organized work stoppage. Satisfactory relations have generally prevailed between our employees and us. Our future success is heavily dependent upon our ability to hire and retain qualified technical, marketing and management personnel. The competition for personnel is intense, particularly for engineering personnel.

ITEM 2. PROPERTIES

Our principal corporate offices, which include two main buildings, are located in Rohnert Park, California. We lease one of the buildings and own the other. We also lease five sales offices, in Denver, Colorado, San Diego, California, Des Moines, Iowa, Heerenveen, Netherlands, and Ngee Ann City, Singapore. In addition, we lease two facilities for our technology department in Parsippany, New Jersey and Ho Chi Minh City, Vietnam. We also lease one office in Phoenix, Arizona for our customer service department. We believe our current facilities are suitable and adequate and have sufficient productive capacity to meet our current needs.

ITEM 3. LEGAL PROCEEDINGS

We are currently not a party to any material legal proceeding.

In April 1995, DSC Communications and DSC Technologies filed an action against us and our founders, who are former DSC employees, in the United States District Court for the Eastern District of Texas alleging breach of contract, usurpation of corporation opportunity and misappropriation of trade secrets. The complaint alleged that certain telecommunications technology known as switched digital video was misappropriated by the defendants. Following a March 1996 trial on the merits, the jury found against the defendants on all three theories, and the court awarded DSC $136.7 million in damages based on future lost profits. Following several post-trial proceedings and an appeal of a federal district court's denial of injunctive relief, on February 28, 1997, the United States Court of Appeals for the Fifth Circuit ruled that DSC was not entitled to permanent injunctive relief, since the lost profits damage award was based on the assumption that we developed a competing switched digital video system. Subsequently, we satisfied the judgment of the Texas litigation, including interest, by paying DSC $141.0 million in November 1997.

In March 1998, DSC filed an action against Next Level Communications L.P., Spencer Trask Investors LLC, General Instrument and Spencer Trask & Co., Inc., the parent of the general partner, in the Superior Court of the State of Delaware in and for New Castle County. In that action, DSC alleged that in connection with the formation of Next Level Communications L.P. and the transfer to it of the switched digital video technology, Next Level Communications L.P. and Spencer Trask Investors LLC misappropriated DSC's trade secrets; that General Instrument improperly disclosed trade secrets when it conveyed this technology to the partnership; and that Spencer Trask & Co. conspired to misappropriate DSC's trade secrets. The trade secrets at issue were the same-switched digital video technology trade secrets at issue in the Texas litigation. DSC sought actual damages for the defendants' purported unjust enrichment, disgorgement of consideration, exemplary damages and attorney's fees, all in unspecified amounts. In April 1998, the defendants filed an action in the United States District Court for the Eastern District of Texas, requesting that the federal court preliminarily and permanently enjoin DSC from prosecuting the Delaware action because by pursuing the action, DSC effectively was trying to circumvent and relitigate the Texas action, in which we had paid $141.0 million. In May 1998, the Texas court granted a preliminary injunction preventing DSC from proceeding with the Delaware action. That injunction order was appealed to the United States Court of Appeals for the Fifth Circuit. In June 1999, the Fifth Circuit affirmed the grant of the preliminary injunction. On July 15, 1999, the Texas federal court granted the Delaware defendants' motion for summary judgment

and issued its final judgment, permanently enjoining DSC from prosecuting and continuing the Delaware action.

In May 1998, actions by BroadBand Technologies, Inc. against General

Instrument and by Next Level Communications against BroadBand Technologies, pending in the United States District Court for the Eastern District of North Carolina, were dismissed with prejudice. The action brought by BroadBand related to fiber optic communications systems for delivering television signals and a patent held by BroadBand. The action brought by Next Level Communications involved contentions that BroadBand infringed two patents held by Next Level Communications relating to video compression and signal processing and that BroadBand had violated antitrust laws. These dismissals were entered pursuant to a settlement agreement under which, among other things, Next Level Communications L.P. paid BroadBand Technologies $5.0 million, which was expensed in 1998, and BroadBand Technologies and Next Level Communications L.P. have entered into a perpetual cross-license of patents applied for or issued currently or through May 2003.

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

No matters were submitted to a vote of our stockholders during the quarter ended December 31, 2000.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDERS MATTERS

During November 1999, we completed our initial public offering in which we sold 9,775,000 shares of our common stock at a price of $20.00 per share. Our common stock is listed on The Nasdaq Stock Market's National Market under the symbol "NXTV." The following table sets forth the high and low prices or our common stock for the periods indicated as reported on The Nasdaq National Market.

YEAR	HIGH	LOW
2000		
Fourth Quarter	$ 71.500	$10.375
Third Quarter	$125.563	$40.625
Second Quarter	$128.125	$50.000
First Quarter	$195.750	$60.750
1999		
Fourth Quarter	$ 74.875	$47.875

On February 28, 2001, the last reported sale price for our common stock on the Nasdaq National Market was $8.781 per share. At February 28, 2001, the number of record holders of our common stock was 158.

We have never declared or paid any cash dividends on our common stock and do not anticipate paying any cash dividends in the foreseeable future. We intend to retain all available funds and any future earnings for use in the operation of our business.

In November 1999, we completed our initial public offering through an underwritten public offering pursuant to a Registration Statement on Form S-1 (File No. 333-85999). These funds have been the principal source of liquidity for us during the year ended December 31, 2000 and were used to fund operating losses and make capital expenditures as described in the financial statements included with this report.

ITEM 6. SELECTED FINANCIAL DATA

The selected financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the historical consolidated financial statements and notes included in this report.

	YEAR ENDED DECEMBER 31,				
	2000	1999	1998	1997	1996
			(IN THOUSANDS)		
STATEMENT OF OPERATIONS DATA:					
Revenues					
Equipment	$ 146,314	$ 54,301	$ 39,243	$ 6,045	$
Software	3,777	3,296	4,587	2,266	
Total revenues	150,091	57,597	43,830	8,311	
Cost of revenues					
Equipment	116,090	51,265	37,372	10,954	
Software	141	292	261	306	
Inventory charge	9,000	--	5,800	--	
Total cost of revenues	125,231	51,557	43,433	11,260	
Gross profit (loss)	24,860	6,040	397	(2,949)	
Operating Expenses:					
Research and development	55,834	48,454	47,086	37,064	17
Selling, general and administrative	46,907	30,511	26,248	26,414	15
Litigation	--	--	5,000	--	141
Non-cash compensation charge	2,384	128,284	--	--	
Total operating expenses	105,125	207,249	78,334	63,478	173
Operating loss	(80,265)	(201,209)	(77,937)	(66,427)	(173
Interest income (expense), net	5,575	(3,564)	(3,776)	--	
Other income (expense), net	(148)	(299)	(18)	(2)	
Net loss	$ (74,838)	$ (205,072)	$ (81,731)	$ (66,429)	$ (173
Basic and diluted net loss per share (pro forma in 1999, 1998, 1997 and 1996)	$ (0.91)	$ (2.78)	$ (1.08)	$ (0.95)	$ (
Shares used to compute basic and diluted net loss per share (pro forma in 1999, 1998, 1997 and 1996)	81,929,663	71,597,834	69,967,053	69,967,053	69,967

DECEMBER 31,

	2000	1999	1998	1997	1996
			(IN THOUSANDS)		
BALANCE SHEET DATA:					
Cash and cash equivalents..................	$ 35,863	$128,752	$ 28,983	$ 377	$ -
Working capital (deficit)..................	70,265	147,948	38,564	(29,571)	(143,00
Total assets...............................	275,716	267,811	97,771	52,689	17,39
Long-term obligations, net of current portion................................	--	25,199	81,275	--	-
Total partners' deficit/stockholders' equity (deficit)........................	158,749	206,228	(14,769)	(3,702)	(172,02

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The following table sets forth unaudited statement of operations data for our eight most recent quarters ended December 31, 2000. This unaudited information has been prepared on the same basis as the annual financial statements and includes all adjustments, consisting of normal recurring items except for the noncash compensation charges in the three months ended December 31, 1999 and March 31, 2000 and the inventory charge in the three months ended December 31, 2000, that management considers necessary for a fair presentation of the financial information for the periods presented.

	THREE MONTHS ENDED				
	DECEMBER 31, 2000	SEPTEMBER 30, 2000	JUNE 30, 2000	MARCH 31, 2000	DEC
			(IN THOUSANDS)		
Revenues					
Equipment..........................	$ 30,159	$ 47,126	$ 39,340	$ 29,689	$
Software...........................	1,007	1,144	836	790	
Total revenues...............	31,166	48,270	40,176	30,479	
Cost of revenues					
Equipment..........................	22,991	36,132	32,076	24,891	
Software...........................	52	7	25	57	
Inventory charge...................	9,000	--	--	--	
Total cost of revenues........	32,043	36,139	32,101	24,948	
Gross profit (loss)..................	(877)	12,131	8,075	5,531	
Operating expenses:					
Research and development............	15,285	13,053	13,652	13,844	
Selling, general and administrative...................	12,671	13,705	10,966	9,565	
Noncash compensation charge.........	0	0	0	2,384	
Total operating expenses......	27,956	26,758	24,618	25,793	
Operating loss........................	(28,833)	(14,627)	(16,543)	(20,262)	(
Other income (expense), net...........	(67)	(30)	(46)	(5)	
Interest income (expense), net........	518	1,264	1,956	1,837	
Net loss..............................	$(28,382)	$(13,393)	$(14,633)	$(18,430)	$(

	THREE MONTHS ENDED	
	JUNE 30, 1999	MARCH 31, 1999
	(IN THOUSANDS)	
Revenues		
Equipment	$ 8,482	$ 7,947
Software	931	830
Total revenues	9,413	8,777
Cost of revenues		
Equipment	8,651	8,331
Software	84	74
Inventory charge	--	--
Total cost of revenues	8,735	8,405
Gross profit (loss)	678	372
Operating expenses:		
Research and development	11,798	11,253
Selling, general and administrative	7,593	6,791
Noncash compensation charge	0	0
Total operating expenses	19,391	18,044
Operating loss	(18,713)	(17,672)
Other income (expense), net	(17)	(230)
Interest income (expense), net	(1,210)	(1,355)
Net loss	$(19,940)	$(19,257)

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis along with selected financial data, our consolidated financial statements and the related notes included elsewhere in this report.

Some of the statements in the following discussion and elsewhere in this Form 10-K constitute forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential" or "continue" or the negative of such terms or other comparable terminology. These statements involve known and unknown risks, uncertainties, and other factors that may cause our or our industry's actual results, levels of activity, performance, or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. These factors include, among other things, those listed under "Risk Factors" and elsewhere in this Form 10-K.

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.

OVERVIEW

We design and market broadband communications equipment that enables telephone companies and other communications service providers to cost-effectively deliver a full suite of voice, data and video services over the existing copper wire telephone infrastructure. We commenced operations in July 1994 and recorded our first sale in September 1997. From January 1998 until November 1999, we operated through Next Level Communications L.P., which was formed as the result of the transfer of all of the net assets, management and workforce of a wholly owned subsidiary of General Instrument. In November 1999, the business and assets of that partnership were merged into Next Level Communications, Inc. as part of our recapitalization. In January 2000, General Instrument was acquired by Motorola, Inc., making us an indirect subsidiary of Motorola.

We generate our revenue primarily from sales of our equipment. One customer has accounted for a large part of our revenues to date, and we expect this concentration to continue in the future. Qwest, formerly U S WEST, accounted for 56%, 67% and 68% of total revenues in 2000, 1999 and 1998, respectively. As a result of the merger between U S WEST and Qwest, Qwest has slowed its purchases of our equipment while it re-evaluates its plans regarding the deployment of VDSL across its network. Sales to Qwest in the future are dependent upon their decision regarding the deployment of our product. Our agreements with our largest customers are cancelable by these customers on short notice and without penalty, and do not obligate the customers to purchase any products. In addition, our significant customer agreements generally contain fixed-price provisions. As a result, our ability to generate a profit on these contracts depends upon our ability to produce and market our products at costs lower than these fixed prices.

The timing of our revenue is difficult to predict because of the length and variability of the sales cycle for our products. Customers view the purchase of our products as a significant and strategic decision. As a result, customers typically undertake significant evaluation, testing and trial of our products before deploying them. This evaluation process frequently results in a lengthy sales cycle, typically ranging from six months to more than a year. While our customers are evaluating our products and before they place an order, if at all, we may incur substantial sales and marketing expenses and expend significant management efforts.

Revenues. Our revenues consist primarily of sales of equipment and sales of data communications software. We recognize revenue from equipment sales when contractual obligations have been satisfied, title and risk of loss have been transferred to the customer and collection of the resulting receivable is reasonably assured. We accrue a provision for estimated sales returns and other allowances as a reduction of revenue at the time of revenue recognition. Amounts received in excess of revenue recognized are recorded as deferred revenue. Software revenue consists of sales to original equipment manufacturers that supply communications software and hardware to distributors. Software license revenue is recognized when a noncancelable license agreement has been signed, delivery has occurred, the fees are fixed and determinable and collection is

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probable. The portion of revenues from new software license agreements that relate to our obligation to provide customer support are deferred based on the price charged for customer support when it is sold separately, and recognized ratably over the maintenance period. Revenue from the renewal of customer

support contracts is recognized ratably over the term of the agreement.

Cost of revenues. Cost of equipment revenue includes direct material and labor, depreciation and amortization expense on property and equipment, warranty expenses, license fees and manufacturing and service overhead.

Research and development. Research and development expense consists principally of salaries and related personnel expenses, consultant fees, prototype component expenses and development contracts related to the design, development, testing and enhancement of our products. All research and development costs are expensed as incurred.

Selling, general and administrative. Selling, general and administrative expense consists primarily of salaries and related expenses for personnel engaged in direct marketing and field service support functions, executive, accounting and administrative personnel, recruiting expenses, professional fees and other general corporate expenses.

RESULTS OF OPERATIONS

Comparison of 2000 to 1999

Revenues. Total revenues in 2000 increased to $150.1 million from $57.6 million in 1999. The increase was primarily due to an increase in equipment sales. Total revenues for the period included $146.3 million of equipment sales, compared to $54.3 million in 1999. Qwest accounted for $83.4 million of equipment revenue in 2000 as compared to $38.5 million in 1999. This increase was primarily attributable to Qwest's increased deployment in the first three quarters of 2000. As a result of the merger between U S WEST and Qwest, Qwest slowed its purchases of our equipment while it re-evaluates its plans regarding the deployment of VDSL across its network. Sales to Qwest in the future are dependent upon their decision regarding the deployment of our product. We expect to continue to derive substantially all of our revenues from sales of equipment to Qwest and local, foreign and independent telephone companies for the foreseeable future. The growth in equipment revenue in future quarters will depend upon whether and how quickly our existing customers roll out broadband services in their coverage areas and whether and how quickly we obtain new customers.

Software revenue remained comparable in both years increasing in 2000 to $3.8 million from $3.3 million in 1999. We expect demand for our software to remain relatively flat in the near term because the market for these products is mature.

Cost of Revenues. Total cost of revenues increased to $125.2 million in 2000 from $51.6 million in 1999. Included in current year cost of sales is a $9.0 million charge to inventory that was primarily related to a lower of cost or market adjustment to certain residential gateway products due to decreases in our sales price per unit and other obsolescence provisions. Our gross margin percentage including the inventory charge increased to 17% in 2000 from 10% in 1999. Excluding the inventory charge, our gross margin percentage increased to 23% in 2000 from 10% in 1999. The increase in our gross margin percentage was primarily the result of higher unit volumes, leading to greater efficiencies, including lower fixed costs per unit. We expect gross margin improvements in the latter part of 2001 as we increase sales of our higher margin products, and continue implementing cost reductions. In the future, cost of sales as a percent of sales may fluctuate due to a wide variety of factors, including: the customer mix, the product mix, the timing and size of orders which are received, the availability of adequate supplies of key components and assemblies, our ability to introduce new products and technologies on a timely basis, the timing of new product introductions or announcements by us or our competitors, price competition and unit volume.

Research and development. Research and development expenses increased to $55.8 million in 2000 from $48.5 million in 1999. The increase was primarily due to an increase in research and development personnel. We believe that continued investment in research and development is critical to attaining our strategic product

development and cost reduction objectives and, as a result, expect these expenses to increase in absolute dollars. We expense all of our research and development costs as incurred.

Selling, general and administrative. Selling, general and administrative expenses increased to $46.9 million in 2000 from $30.5 million in 1999. The increase is primarily attributable to the increase in the scale of our operations including additional personnel in our operations, administration, sales and marketing organizations, promotional expenses and other administrative expenses. We have generated higher sales expenses by hiring new sales representatives in order to increase the number and size of our customer accounts. We expect selling, general and administrative expenses to increase as required to support future revenue growth.

Non-cash compensation charge. Substantially all of our employees had been granted contingently exercisable stock options that became options to purchase our common stock upon our recapitalization in 1999. In addition, tandem stock options were granted in January 1997 to some of our employees. As a result, non-cash compensation expense was recognized upon the completion of our initial public offering based on the difference between the exercise price of these options and the initial public offering price of our common stock. The non-cash compensation expense related to these option grants was $2.4 million in 2000 and $128.3 million in 1999.

Interest income (expense), net. Interest income, net in 2000 was $5.6 million, and represents interest income earned on proceeds from our initial public offering. In 1999, interest expense, net was $3.6 million, and related to interest on a $75.0 million note and accrued interest thereon payable to General Instrument that General Instrument contributed to us in exchange for shares of our common stock immediately prior to our initial public offering.

Comparison of 1999 to 1998

Revenues. Revenues in 1999 increased to $57.6 from $43.8 million in 1998. The increase was primarily due to an increase in equipment sales. Total revenues for 1999 included $54.3 million of equipment sales, compared to $39.2 million for 1998. Qwest accounted for $38.5 equipment revenue in 1999 as compared to $29.9 in 1998. Bell Atlantic accounted for $5.4 million of equipment revenue in 1999 as compared to $8.6 million in 1998. Sales to Bell Atlantic decreased in 1999 due to the Bell Atlantic merger with NYNEX and the new company's shift in focus from network rehabilitation to the entry into the long distance market.

Software revenue in 1999 decreased to $3.3 million in 1999 as compared to $4.6 million in 1998. The decrease was primarily due to a shift in demand from 1999 to 1998.

Cost of Revenues. Total cost of revenues increased to $51.6 million in 1999 from $43.4 million in 1998. Cost of revenues in 1998 included a $5.8 million inventory charge to establish reserves primarily for obsolescence. Our gross margin percentage increased to 10% in 1999 from 1% in 1998. The increase in our gross margin percentage was primarily the result of higher unit volumes, leading to greater efficiencies, including lower fixed costs per unit.

Research and development. Research and development expenses increased to $48.5 million in 1999 from $47.1 million in 1998. The increase was primarily due to an increase in research and development personnel. Included in research and development expenses in 1998 were expenses related to spending on third party testing, development of the Residential Gateway product, and the completion of our products for voice applications.

Selling, general and administrative. Selling, general and administrative expenses were $30.5 million in 1999 compared to $26.2 million in 1998. Approximately $3.9 million of compensation expense relating to the Telenetworks acquisition is included in the amount for 1998. There was no Telenetworks compensation expense during 1999. The decrease in compensation expense was offset by an increase in other selling, general and administrative expenses due to the increase in scale of our operations including additional personnel in the sales and marketing organizations, promotional expenses and other administrative expenses.

Non-cash compensation charge. Substantially all of our employees had been granted contingently exercisable stock options that became options to purchase our common stock upon our recapitalization in

November 1999. In addition, tandem stock options were granted in January 1997 to some of our employees. As a result, non-cash compensation expense was recognized upon the completion of our initial public offering based on the difference between the exercise price of the options and the initial public offering price of our common stock. The non-cash compensation expense related to these option grants was $128.3 million in 1999.

Litigation. Litigation expenses of $5.0 million for 1998 related to the settlement cost of litigation with Broad Band Technologies. For a detailed discussion of this litigation matter, see "Legal Proceedings." Litigation expenses in 1999 were not significant and are included in selling, general and administrative expenses.

Interest expense, net. Interest expense, net was $3.6 million in 1999 remaining relatively unchanged from a net expense of $3.8 million in 1998. The net interest expense in these periods was primarily attributable to interest on a $75 million note and accrued interest thereon payable to General Instrument that General Instrument contributed to us in exchange for shares of our common stock immediately prior to our initial public offering. Interest income was $2.2 million in both 1999 and 1998 and was attributable to interest income earned on cash and cash equivalents.

LIQUIDITY AND CAPITAL RESOURCES

We have financed our operations primarily by our initial public offering of our stock and through cash contributions and borrowings from General Instrument.

Net cash used in operating activities was $88.3 million in 2000, $56.6 million in 1999 and $66.6 million in 1998. In each case, the use of cash in operating activities was primarily due to our net losses. The increase in cash used in 2000 was primarily attributable to increases in inventories and receivable balances, partially offset by an increase in liabilities. In 1999, net losses were partially offset by $128.3 million in non-cash compensation charges.

Net cash used in investing activities of $12.5 million in 2000, $78.7 million in 1999 and $9.3 million in 1998 was primarily attributable to capital

expenditures to support our engineering and testing activities. Our capital expenditures increased in 1999 due to the fact that we completed a significant portion of our build-out in that year. In 2000, net cash used in investing activities also included investments in Expanse Networks, Inc., OutReach Communications L.L.C., and Virtual Access totaling approximately $15 million, offset by the sale of $18.0 million in marketable securities. Net cash used in 1999 also included purchases of $45.2 million of marketable securities with the proceeds from our initial public offering. As we increase the scope of our operations, we expect that our capital expenditures will increase.

Net cash provided by financing activities was $7.9 million in 2000, $235.0 million in 1999 and $104.6 million in 1998. Net cash provided by financing activities in 2000 was primarily attributable to the issuance of common stock. Net cash provided by financing activities in 1999 included $177.0 million net proceeds from our initial public offering, $34.0 million contributed by General Instrument and borrowings of $24.9 million. Net cash provided by financing activities of $104.6 million in 1998 consisted of a $75.0 million loan from General Instrument, a $19.6 million capital contribution from General Instrument and a $10.0 million capital contribution from the general partner.

At December 31, 2000, we had $35.9 million of cash and cash equivalents and $70.3 million of working capital.

We have commitments with suppliers to purchase a total of approximately $75.0 million of components in 2001.

In December 1999, we entered into a revolving bank line of credit under which we have the ability to borrow up to the lesser of $50 million or the value of pledged collateral. At December 31, 2000, the balance outstanding was $25.0 million and the line was secured by $25.0 million of marketable securities.

We anticipate that operating expenses, as well as planned capital expenditures, will constitute a material use of our cash resources. In addition, we may use cash resources to fund acquisitions or investments in complementary businesses, technologies or product lines. Our long-term operating and capital lease obliga-

tions are generally less than $3.0 million per year. Other than capital lease commitments, we have no material commitments for capital expenditures. As we increase the scope of our operations, we expect that our capital expenditures will increase.

We believe that our cash on hand will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months. However, it may still be necessary to obtain additional equity or debt financing either during or after the next 12 months if we are not able to generate sufficient cash from operating activities to meet our capital expenditure and working capital needs. In the event additional financing is required, we may not be able to raise it on acceptable terms, or at all.

RECENTLY ISSUED ACCOUNTING STANDARDS

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, is effective for us beginning January 1, 2001. SFAS No. 133 requires that all derivative instruments be measured at fair value and recognized in the balance sheet as either assets or liabilities. Management has determined that the initial adoption of SFAS No. 133 will not have a material effect on our financial statements.

RISK FACTORS

You should carefully consider the risk factors set forth below.

WE HAVE INCURRED NET LOSSES AND NEGATIVE CASH FLOW FOR OUR ENTIRE HISTORY, WE EXPECT TO INCUR FUTURE LOSSES AND NEGATIVE CASH FLOW, AND WE MAY NEVER ACHIEVE PROFITABILITY

We incurred net losses of $74.8 million in 2000, $205.1 million in 1999, and $81.7 million in 1998. Our ability to achieve profitability on a continuing basis will depend on the successful design, development, testing, introduction, marketing and broad commercial distribution of our broadband equipment products.

We expect to continue to incur significant product development, sales and marketing, and administrative expenses. In addition, we depend in part on cost reductions to improve gross profit margins because the fixed-price nature of most of our long-term customer agreements prevents us from increasing prices. As a result, we will need to generate significant revenues and improve gross profit margins to achieve and maintain profitability. We may not be successful in reducing our costs or in selling our products in sufficient volumes to realize cost benefits from our manufacturers. We cannot be certain that we can achieve sufficient revenues or gross profit margin improvements to generate profitability.

OUR LIMITED OPERATING HISTORY MAKES IT DIFFICULT FOR YOU TO EVALUATE OUR BUSINESS AND PROSPECTS.

We recorded our first sale in September 1997. As a result, we have only a limited operating history upon which you may evaluate our business and prospects. You should consider our prospects in light of the heightened risks and unexpected expenses and difficulties frequently encountered by companies in an early stage of development. These risks, expenses and difficulties, which are described further below, apply particularly to us because the market for equipment for delivering voice, data and video services is new and rapidly evolving. Due to our limited operating history, it will be difficult for you to evaluate whether we will successfully address these risks.

WE EXPECT OUR QUARTERLY REVENUES AND OPERATING RESULTS TO FLUCTUATE, AND THESE FLUCTUATIONS MAY MAKE OUR STOCK PRICE VOLATILE.

Our quarterly revenues and operating results have fluctuated in the past and are likely to fluctuate significantly in the future. As a result, we believe that quarter-to-quarter comparisons of our operating results may not be meaningful. Fluctuations in our quarterly revenues or operating results may cause volatility in the price of our stock. It is likely that in some future quarter our operating results may be below the expectations of public market analysts and investors, which may cause the price of our stock to fall. Factors likely to cause variations in our quarterly revenues and operating results include:

- delays or cancellations of any orders by Qwest, which accounted for approximately 56% of our revenues in 2000, or by any other customer accounting for a significant portion of our revenues;

- variations in the timing, mix and size of orders and shipments of our products throughout a quarter or year;

- new product introductions by us or by our competitors;

- the timing of upgrades of telephone companies' infrastructure;

- variations in capital spending budgets of telephone companies; and

- increased expenses, whether related to sales and marketing, product development or administration.

The amount and timing of our operating expenses generally will vary from quarter to quarter depending on the level of actual and anticipated business activity. Because most of our operating expenses are fixed in the short term, we may not be able to quickly reduce spending if our revenues are lower than we had projected and our results of operations could be harmed.

OUR CUSTOMER BASE OF TELEPHONE COMPANIES IS EXTREMELY CONCENTRATED AND THE LOSS OF OR REDUCTION IN BUSINESS FROM EVEN ONE OF OUR CUSTOMERS, PARTICULARLY QWEST, COULD CAUSE OUR SALES TO FALL SIGNIFICANTLY.

A small number of customers have accounted for a large part of our revenues to date. We expect this concentration to continue in the future. If we lose one of our significant customers, our revenues could be significantly reduced. Qwest accounted for 56%, 67% and 68% of total revenues in 2000, 1999 and 1998. Our agreements with our customers are cancelable by these customers on short notice, without penalty, do not obligate the customers to purchase any products and are not exclusive. Accordingly, we may lose revenues from our significant customers at any time, which could have a material adverse effect on us. As a result of the merger between U S WEST and Qwest, Qwest slowed its purchases of our equipment while it re-evaluates its plans regarding the deployment of VDSL across its network. Sales to Qwest in the future are dependent upon their decision regarding the deployment of our product. A significant reduction in purchases of our equipment by Qwest could have a material effect on us.

CONSOLIDATION AMONG TELEPHONE COMPANIES MAY REDUCE OUR SALES.

Consolidation in the telecommunications industry may cause delays in the purchase of our products and cause a reexamination of strategic and purchasing decisions by our customers. In addition, we may lose relationships with key personnel within a customer's organization due to budget cuts, layoffs, or other disruptions following a consolidation. For example, our sales to NYNEX, previously one of our largest clients, have decreased significantly as a result of a shift in focus resulting from its merger with Bell Atlantic. In addition, as a result of the merger between US WEST and Qwest, Qwest has slowed its purcahses of our equipment while it re-evaluates its plans regarding the deployment of VDSL across its network.

BECAUSE OUR SALES CYCLE IS LENGTHY AND VARIABLE, THE TIMING OF OUR REVENUE IS DIFFICULT TO PREDICT, AND WE MAY INCUR SALES AND MARKETING EXPENSES WITH NO GUARANTEE OF A FUTURE SALE.

Customers view the purchase of our products as a significant and strategic decision. As a result, customers typically undertake significant evaluation, testing and trial of our products before deployment. This

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evaluation process frequently results in a lengthy sales cycle, typically ranging from nine months to more than a year. Before a customer places an order, we may incur substantial sales and marketing expenses and expend significant management efforts. In addition, product purchases are frequently subject to unexpected administrative, processing and other delays on the part of our customers. This is particularly true for customers for whom our products represent a very small percentage of their overall purchasing activities. As a

result, sales forecasted to be made to a specific customer for a particular quarter may not be realized in that quarter; and this could result in lower than expected revenues.

WE MAY NOT BE ABLE TO OBTAIN SUFFICIENT FINANCING TO FUND OUR BUSINESS AND, AS A RESULT, WE MAY NOT BE ABLE TO GROW AND COMPETE EFFECTIVELY.

We may need to raise additional funds if our estimates of revenues or capital requirements change or prove inaccurate. If we cannot raise these funds, we may not be able to grow our business. We may need additional capital if we need to respond to unforeseen technological or marketing hurdles or if we desire to take advantage of unanticipated opportunities. In addition, we expect to review potential acquisitions that would complement our existing product offerings or enhance our technical capabilities that could require potentially significant amounts of capital. Funds may not be available at the time or times needed on terms acceptable to us, if at all. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market opportunities, to make acquisitions, to develop new products or to otherwise respond to competitive pressures effectively.

A SIGNIFICANT MARKET FOR OUR PRODUCTS MAY NOT DEVELOP IF TELEPHONE COMPANIES DO NOT SUCCESSFULLY DEPLOY BROADBAND SERVICES SUCH AS HIGH-SPEED DATA AND VIDEO.

Telephone companies have just recently begun offering high-speed data services, and most telephone companies have not offered video services at all. Unless telephone companies make the strategic decision to enter the market for providing broadband services, a significant market for our products may not develop. Sales of our products largely depend on the increased use and widespread adoption of broadband services and the ability of our customers to market and sell broadband services, including video services, to their customers. Certain critical issues concerning use of broadband services are unresolved and will likely affect their use. These issues include security, reliability, speed and volume, cost, government regulation and the ability to operate with existing and new equipment.

Even if telephone companies decide to deploy broadband services, this deployment may not be successful. Our customers have delayed deployments in the past and may delay deployments in the future. Factors that could cause telephone companies not to deploy, to delay deployment of, or to fail to deploy successfully the services for which our products are designed include the following:

- industry consolidation;
- regulatory uncertainties and delays affecting telephone companies;
- varying quality of telephone companies' network infrastructure and cost of infrastructure upgrades and maintenance;
- inexperience of telephone companies in obtaining access to video programming content from third party providers;
- inexperience of telephone companies in providing broadband services and the lack of sufficient technical expertise and personnel to install products and implement services effectively;
- uncertain subscriber demand for broadband services; and
- inability of telephone companies to predict return on their investment in broadband capable infrastructure and equipment.

Unless our products are successfully deployed and marketed by telephone companies, we will not be able to achieve our business objectives and increase our revenues.

GOVERNMENT REGULATION OF OUR CUSTOMERS AND RELATED UNCERTAINTY COULD CAUSE OUR CUSTOMERS TO DELAY THE PURCHASE OF OUR PRODUCTS.

The Telecommunications Act requires telephone companies, such as the regional Bell operating companies, to offer their competitors cost-based access to some elements of their networks, including facilities and equipment used to provide high-speed data and video services. These telephone companies may not wish to make expenditures for infrastructure and equipment required to provide broadband services if they will be forced to allow competitors access to this infrastructure and equipment. The Federal Communications Commission, or FCC, announced that, except in limited circumstances, it will not require incumbent carriers to offer their competitors access to the facilities and equipment used to provide high-speed data services. Nevertheless, other regulatory and judicial proceedings relating to telephone companies' obligations to provide elements of their network to competitors are pending. The FCC also requires incumbent carriers to permit competitive carriers to collocate their equipment with the local switching equipment of the incumbents. The FCC's collocation rules recently have been vacated in part and continue to be subject to regulatory and judicial proceedings. The uncertainties caused by these regulatory proceedings may cause these telephone companies to delay purchasing decisions at least until the proceedings and any related judicial appeals are completed. The outcomes of these regulatory proceedings, as well as other FCC regulation, may cause these telephone companies not to deploy services for which our products are designed or to further delay deployment. Additionally, telephone companies' deployment of broadband services may be slowed down or stopped because of the need for telephone companies to obtain permits from city, state or federal authorities to implement infrastructure.

OUR CUSTOMERS AND POTENTIAL CUSTOMERS WILL NOT PURCHASE OUR PRODUCTS IF THEY DO NOT HAVE THE INFRASTRUCTURE NECESSARY TO USE OUR PRODUCTS.

The copper wire infrastructures over which telephone companies may deliver voice, data and video services using our products vary in quality and reliability. As a result, some of these telephone companies may not be able to deliver a full set of voice, data and video services to their customers, despite their intention to do so, and this could harm our sales. Even after installation of our products, we remain highly dependent on telephone companies to continue to maintain their infrastructure so that our products will operate at a consistently high performance level. Infrastructure upgrades and maintenance may be costly, and telephone companies may not have the necessary financial resources. This may be particularly true for our smaller customers and potential customers such as independent telephone companies and domestic local telephone companies. If our current and potential customers' infrastructure is inadequate, we may not be able to generate anticipated revenues from them.

IF COMPETING TECHNOLOGIES THAT OFFER ALTERNATIVE SOLUTIONS TO OUR PRODUCTS ACHIEVE WIDESPREAD ACCEPTANCE, THE DEMAND FOR OUR PRODUCTS MAY NOT DEVELOP.

Technologies that compete with our products include other telecommunications-related wireline technologies, cable-based technologies, fixed wireless technologies and satellite technologies. If these alternative technologies are chosen by our existing and potential customers, our business, financial condition and results of operations could be harmed. In particular, cable operators are currently deploying products that will be capable of delivering voice, high-speed data and video services over cable, including

products from General Instrument, our principal stockholder, and Motorola, its parent. Our technology may not be able to compete effectively against these technologies on price, performance or reliability.

Our customers or potential customers that also offer cable-based services may choose to purchase cable-based technologies. Cable service providers that offer not only data and video but also telephony over cable systems will give subscribers the alternative of purchasing all communications services from a single communications service provider, allowing the potential for more favorable pricing and a single point of contact for bill payment and customer service. If these services are implemented successfully over cable connections, they will compete directly with the services offered by telephone companies using our products. In addition, several telephone companies have commenced the marketing of video services over direct broadcast satellite while continuing to provide voice and data services over their existing copper wire

infrastructure. If any of these services are accepted by consumers, the demand for our products may not develop and our ability to generate revenues will be harmed.

WE FACE INTENSE COMPETITION IN PROVIDING EQUIPMENT FOR TELECOMMUNICATIONS NETWORKS FROM LARGER AND MORE WELL-ESTABLISHED COMPANIES, AND WE MAY NOT BE ABLE TO COMPETE EFFECTIVELY WITH THESE COMPANIES.

Many of our current and potential competitors have longer operating histories, greater name recognition and significantly greater financial, technical, marketing and distribution resources than we do. These competitors may undertake more extensive marketing campaigns, adopt more aggressive pricing policies and devote substantially more resources to developing new products than we are able to, which could result in the loss of current customers and impair our ability to attract potential customers.

Our significant current competitors include Advanced Fibre Communications, Alcatel, Cisco Systems, Efficient Networks, Ericsson, Lucent Technologies, Nokia, Nortel Networks, RELTEC (acquired by BAE Systems, CNI Division, formerly GEC Marconi), Scientific Atlanta, Siemens and our largest stockholder, General Instrument/Motorola, as well as emerging companies that are developing new technologies. Some of these competitors have existing relationships with our current and prospective customers. In addition, we anticipate that other large companies, such as Matsushita Electric Industrial which markets products under the Panasonic brand name, Microsoft, Network Computer, Philips, Sony, STMicroelectronics and Toshiba America, will likely introduce products that compete with our N(3) Residential Gateway product in the future. Our customer base may be attracted by the name and resources of these large, well-known companies and may prefer to purchase products from them instead of us.

CONSOLIDATION OF OUR COMPETITORS MAY CAUSE US TO LOSE CUSTOMERS AND NEGATIVELY AFFECT OUR SALES.

Consolidation in the telecommunications equipment industry may strengthen our competitors' positions in our market, cause us to lose customers and hurt our sales. For example, as a result of the merger between US WEST and Qwest, Qwest has slowed its purchases of our equipment while it re-evaluates its plans regarding the deployment of VDSL across its network. In addition, Alcatel acquired DSC Communications, Lucent acquired Ascend Communications and BAE Systems, CNI Division, formerly GEC Marconi, acquired RELTEC. Acquisitions such as these may strengthen our competitors' financial, technical and marketing resources and provide them access to regional Bell operating companies and other potential customers. Consolidation may also allow some of our competitors to

penetrate new markets that we have targeted, such as domestic local, independent and international telephone companies. This consolidation may negatively affect our ability to increase revenues.

IF WE DO NOT RESPOND QUICKLY TO CHANGING CUSTOMER NEEDS AND FREQUENT NEW PRODUCT INTRODUCTIONS BY OUR COMPETITORS, OUR PRODUCTS MAY BECOME OBSOLETE.

Our position in existing markets or potential markets could be eroded rapidly by product advances. The life cycles of our products are difficult to estimate. Our growth and future financial performance will depend in part upon our ability to enhance existing products and develop and introduce new products that keep pace with:

- the increasing use of the Internet;

- the growth in remote access by telecommuters;

- the increasingly diverse distribution sources for high quality digital video; and

- other industry and technological trends.

We expect that our product development efforts will continue to require substantial investments. We may not have sufficient resources to make the necessary investments. If we fail to timely and cost-effectively develop new products that respond to new technologies and customer needs, the demand for our products may fall and we could lose revenues.

OUR EXECUTIVE OFFICERS AND CERTAIN KEY PERSONNEL ARE CRITICAL TO OUR BUSINESS AND THE LOSS OF THEIR SERVICES COULD DISRUPT OUR OPERATIONS AND OUR CUSTOMER RELATIONSHIPS.

None of our executive officers or key employees is bound by an employment agreement. Many of these employees have a significant number of options to purchase our common stock. Many of these options are currently vested and some of our key employees may leave us once they have exercised their options. In addition, our engineering and product development teams are critical in developing our products and have developed important relationships with our regional Bell operating company customers and their technical staffs. The loss of any of these key personnel could harm our operations and customer relationships.

COMPETITION FOR QUALIFIED PERSONNEL IN THE TELECOMMUNICATIONS EQUIPMENT INDUSTRY IS INTENSE, AND IF WE ARE NOT SUCCESSFUL IN ATTRACTING AND RETAINING THESE PERSONNEL, OUR ABILITY TO GROW OUR BUSINESS MAY BE HARMED.

Competition for qualified personnel in the telecommunications equipment industry, specifically in the Rohnert Park, California area, is intense, and we may not be successful in attracting and retaining such personnel. Failure to attract qualified personnel could harm the growth of our business.

We are actively searching for research and development engineers and sales and marketing personnel who are in short supply. Competitors and others have in the past and may in the future attempt to recruit our employees. In addition, companies in the telecommunications industry whose employees accept positions with competitors frequently claim that the competitors have engaged in unfair hiring practices. We may receive such notices in the future as we seek to hire qualified personnel and such notices may result in material litigation and related disruption to our operations.

OUR OPERATIONS AND CUSTOMER RELATIONSHIPS MAY BECOME STRAINED DUE TO RAPID EXPANSION.

We have expanded our operations rapidly since inception. We intend to continue to expand in the foreseeable future to pursue existing and potential market opportunities both inside and outside the United States. This rapid growth places a significant demand on management and operational resources. Our management, personnel, systems, procedures, controls and customer service may be inadequate to support our future operations. To manage expansion effectively, we must implement and improve our operational systems, procedures, controls and customer service on a timely basis. We expect significant strain on our order and fulfillment process and our quality control systems if significant expansion of business activity occurs. If we are unable to properly manage this growth, our operating results, reputation and customer relationships could be harmed.

OUR LIMITED ABILITY TO PROTECT OUR INTELLECTUAL PROPERTY MAY AFFECT OUR ABILITY TO COMPETE, AND WE COULD LOSE CUSTOMERS.

We rely on a combination of patent, copyright and trademark laws, and on trade secrets and confidentiality provisions and other contractual provisions to protect our intellectual property. There is no guarantee that these safeguards will protect our intellectual property and other valuable confidential information. If our methods of protecting our intellectual property in the United States or abroad are not adequate, our competitors may copy our technology or independently develop similar technologies and we could lose customers. In addition, the laws of some foreign countries do not protect our proprietary rights as fully as do the laws of the United States. If we fail to adequately protect our intellectual property, it would be easier for our competitors to sell competing products, which could harm our business.

THIRD-PARTY CLAIMS REGARDING INTELLECTUAL PROPERTY MATTERS COULD CAUSE US TO STOP SELLING OUR PRODUCTS, LICENSE ADDITIONAL TECHNOLOGY OR PAY MONETARY DAMAGES.

From time to time, third parties, including our competitors and customers, have asserted patent, copyright and other intellectual property rights to technologies that are important to us. We expect that we will increasingly be subject to infringement claims as the number of products and competitors in our market grows and the functionality of products overlaps, and our products may currently infringe on one or more United

States or international patents. The results of any litigation are inherently uncertain. In the event of an adverse result in any litigation with third parties that could arise in the future, we could be required:

- to pay substantial damages, including paying treble damages if we are held to have willfully infringed;

- to halt the manufacture, use and sale of infringing products;

- to expend significant resources to develop non-infringing technology; and/or

- to obtain licenses to the infringing technology.

Licenses may not be available from any third party that asserts intellectual property claims against us, on commercially reasonable terms, or at all. In addition, litigation frequently involves substantial expenditures and

can require significant management attention, even if we ultimately prevail. In addition, we indemnify our customers for patent infringement claims, and we may be required to obtain licenses on their behalf, which could subject us to significant additional costs.

WE DEPEND ON THIRD-PARTY MANUFACTURERS AND ANY DISRUPTION IN THEIR MANUFACTURE OF OUR PRODUCTS WOULD HARM OUR OPERATING RESULTS.

We contract for the manufacture of all of our products and have limited in-house manufacturing capabilities. We rely primarily on two large contract manufacturers: SCI Systems and ACT Manufacturing. The efficient operation of our business will depend, in large part, on our ability to have these and other companies manufacture our products in a timely manner, cost-effectively and in sufficient volumes while maintaining consistent quality. As our business grows, these manufacturers may not have the capacity to keep up with the increased demand. Any manufacturing disruption could impair our ability to fulfill orders and could cause us to lose customers.

WE HAVE NO LONG-TERM CONTRACTS WITH OUR MANUFACTURERS, AND WE MAY NOT BE ABLE TO DELIVER OUR PRODUCTS ON TIME IF ANY OF THESE MANUFACTURERS STOP MAKING OUR PRODUCTS.

We have no long-term contracts or arrangements with any of our contract manufacturers that guarantee product availability, the continuation of particular payment terms or the extension of credit limits. If our manufacturers are unable or unwilling to continue manufacturing our products in required volumes, we will have to identify acceptable alternative manufacturers, which could take in excess of three months. It is possible that a source may not be available to us when needed or be in a position to satisfy our production requirements at acceptable prices and on a timely basis. If we cannot find alternative sources for the manufacture of our products, we will not be able to meet existing demand. As a result, we may lose existing customers, and our ability to gain new customers may be significantly constrained.

OUR INABILITY TO PRODUCE SUFFICIENT QUANTITIES OF OUR PRODUCTS BECAUSE OF OUR DEPENDENCE ON COMPONENTS FROM KEY SOLE SUPPLIERS COULD RESULT IN DELAYS IN THE DELIVERY OF OUR PRODUCTS AND COULD HARM OUR REVENUES.

Some parts, components and equipment used in our products are obtained from sole sources of supply. If our sole source suppliers or we fail to obtain components in sufficient quantities when required, delivery of our products could be delayed resulting in decreased revenues. Additional sole-sourced components may be incorporated into our equipment in the future. We do not have any long-term supply contracts to ensure sources of supply. In addition, our suppliers may enter into exclusive arrangements with our competitors, stop selling their products or components to us at commercially reasonable prices or refuse to sell their products or components to us at any price, which could harm our operating results.

THE OCCURRENCE OF ANY DEFECTS, ERRORS OR FAILURES IN OUR PRODUCTS COULD RESULT IN DELAYS IN INSTALLATION, PRODUCT RETURNS AND OTHER LOSSES TO US OR TO OUR CUSTOMERS OR END USERS.

Our products are complex and may contain undetected defects, errors or failures. These problems have occurred in our products in the past and additional problems may occur in our products in the future and could result in the loss of or delay in market acceptance of our products. In addition, we have limited experience

with commercial deployment and we expect additional defects, errors and failures as our business expands from trials to commercial deployment at certain customers. We will have limited experience with the problems that could arise with any new products that we introduce. Further, our customer agreements generally include a longer warranty for defects than our manufacturing agreements. These defects could result in a loss of sales and additional costs and liabilities to us as well as damage to our reputation and the loss of our customers.

WE DO NOT HAVE SIGNIFICANT EXPERIENCE IN INTERNATIONAL MARKETS AND MAY HAVE UNEXPECTED COSTS AND DIFFICULTIES IN DEVELOPING INTERNATIONAL REVENUES.

We plan to extend the marketing and sales of our products internationally. International operations are generally subject to inherent risks and challenges that could harm our operating results, including:

- unexpected changes in telecommunications regulatory requirements;

- limited number of telephone companies operating internationally;

- expenses associated with developing and customizing our products for foreign countries;

- tariffs, quotas and other import restrictions on telecommunications equipment;

- longer sales cycles for our products; and

- compliance with international standards that differ from domestic standards.

To the extent that we generate international sales in the future, any negative effects on our international business could harm our business, operating results and financial condition. In particular, fluctuating exchange rates may contribute to fluctuations in our results of operations.

MOTOROLA MAY EXERCISE SIGNIFICANT INFLUENCE OVER OUR BUSINESS AND AFFAIRS AND OUR STOCKHOLDER VOTES AND, FOR ITS OWN REASONS, COULD PREVENT TRANSACTIONS WHICH OUR OTHER STOCKHOLDERS MAY VIEW AS FAVORABLE.

Motorola beneficially owns approximately 76% of the outstanding shares of our common stock as of December 31, 2000. Motorola will be able to exercise significant influence over all matters relating to our business and affairs, including approval of significant corporate transactions, which could delay or prevent someone from acquiring or merging with us and could prevent you from receiving a premium for your shares.

We do not know whether Motorola's plans for our business and affairs will be different than our existing plans and whether any changes that may be implemented under Motorola's control will be beneficial or detrimental to our other stockholders.

OUR PRINCIPAL STOCKHOLDER AND ITS PARENT MAY HAVE INTERESTS THAT CONFLICT WITH THE BEST INTERESTS OF OUR OTHER STOCKHOLDERS AND US AND MAY CAUSE US TO FORGO OPPORTUNITIES OR TAKE ACTIONS THAT DISPROPORTIONATELY BENEFIT OUR PRINCIPAL STOCKHOLDER.

It is possible that Motorola could be in a position involving a conflict of interest with us. In addition, individuals who are officers or directors of Motorola and of us may have fiduciary duties to both companies. For example, a conflict may arise if our principal stockholder were to engage in activities or pursue corporate opportunities that may overlap with our business. These

conflicts could harm our business and operating results. Our certificate of incorporation contains provisions intended to protect our principal stockholder and these individuals in these situations. These provisions limit your legal remedies.

THE PRICE OF OUR COMMON STOCK HAS BEEN AND MAY CONTINUE TO BE HIGHLY VOLATILE.

The stock markets have in general, and with respect to high technology companies, including us, in particular, recently experienced extreme stock price and volume volatility, often unrelated to the financial performance of particular companies. The price at which our common stock will trade in the future is likely to also be highly volatile and may fluctuate substantially due to factors such as:

- actual or anticipated fluctuations in our operating results;
- changes in or our failure to meet securities analysts' expectations;
- announcements of technological innovations by us or our competitors;
- introduction of new products and services by us or our competitors;
- limited public float of our common stock;
- conditions and trends in the telecommunications and other technology industries; and
- general economic and market conditions.

SALES OF SHARES OF OUR COMMON STOCK BY EXISTING STOCKHOLDERS COULD CAUSE THE MARKET PRICE OF OUR COMMON STOCK TO DROP SIGNIFICANTLY.

As of February 28, 2001, Motorola owned 64,103,724 shares of our common stock and Kevin Kimberlin Partners, LP and its affiliates owned 2,933,128 shares of our common stock and its affiliates held warrants to purchase an additional 4,288,764 shares of our common stock. If Motorola, Kevin Kimberlin Partners, LP and its affiliates or any of our other stockholders sell substantial amounts of common stock, including shares issued upon exercise of outstanding options and warrants, in the public market, the market price of the common stock could fall. In addition, any distribution of shares of our common stock by Motorola to its stockholders could also have an adverse effect on the market price.

Motorola and Kevin Kimberlin Partners, LP and its related persons and their transferees will be entitled to registration rights pursuant to which they may require that we register their shares under the Securities Act.

In addition, as of December 31, 2000, there were outstanding options to purchase 20,177,197 shares of our common stock. Subject to vesting provisions and, in the case of our affiliates, volume and manner of sale restrictions, the shares of common stock issuable upon the exercise of our outstanding employee options will be eligible for sale into the public market at various times.

ANTI-TAKEOVER PROVISIONS IN OUR CHARTER DOCUMENTS AND DELAWARE LAW COULD PREVENT OR DELAY A CHANGE IN CONTROL OF OUR COMPANY THAT A STOCKHOLDER MAY CONSIDER FAVORABLE.

Several provisions of our certificate of incorporation and by-laws and Delaware law may discourage, delay or prevent a merger or acquisition that a

stockholder may consider favorable. These provisions include:

- authorizing the issuance of preferred stock without stockholder approval;
- providing for a classified board of directors with staggered, three-year terms;
- prohibiting cumulative voting in the election of directors;
- restricting business combinations with interested stockholders;
- limiting the persons who may call special meetings of stockholders;
- prohibiting stockholder action by written consent;
- establishing advance notice requirements for nominations for election to the board of directors or for proposing matters that can be acted on by stockholders at stockholder meetings; and
- requiring super-majority voting to effect amendments to our certificate of incorporation and by-laws.

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Some of these provisions do not currently apply to Motorola and its affiliates.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is limited to interest rate fluctuation. We do not engage in any hedging activities and we do not use derivatives or equity investments for cash investment purposes. The marketable securities portfolio is classified as available for sale and recorded at fair value on the balance sheet. Our portfolio consists solely of corporate bonds, commercial paper and government securities, and therefore, our market risk is deemed relatively low. At December 31, 2000, we had utilized $25.0 million of our $50.0 million line of credit.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of Next Level Communications, Inc.:

We have audited the accompanying consolidated balance sheets of Next Level Communications, Inc. and subsidiary as of December 31, 2000 and 1999 and the related consolidated statements of operations, stockholders' equity/partners' deficit and cash flows for each of the three years in the period ended December 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Next Level Communications, Inc. and subsidiary as of December 31, 2000 and 1999 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

San Francisco, California
February 19, 2001

NEXT LEVEL COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 2000, 1999, 1998
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	2000	1999	1998
REVENUES			
Equipment	$ 146,314	$ 54,301	$ 39,243
Software	3,777	3,296	4,587
Total revenues	150,091	57,597	43,830
COST OF REVENUES			
Equipment	116,090	51,265	37,372
Software	141	292	261
Inventory charge	9,000	--	5,800

Total cost of revenues	125,231	51,557	43,433
Gross profit	24,860	6,040	397
OPERATING EXPENSES:			
Research and development	55,834	48,454	47,086
Selling, general and administrative	46,907	30,511	26,248
Non-cash compensation charge	2,384	128,284	--
Litigation	--	--	5,000
Total operating expenses	105,125	207,249	78,334
Operating loss	(80,265)	(201,209)	(77,937)
Interest income (expense), net	5,575	(3,564)	(3,776)
Other income (expense), net	(148)	(299)	(18)
Net loss	$ (74,838)	$ (205,072)	$ (81,731)
Basic and diluted net loss per share (pro forma in 1999 and 1998)	$ (0.91)	$ (2.78)	$ (1.08)
Shares used to compute basic and diluted net loss per share (pro forma in 1999 and 1998)	81,929,663	71,597,834	69,967,053

See notes to consolidated financial statements.

NEXT LEVEL COMMUNICATIONS, INC.

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2000 AND 1999
(IN THOUSANDS, EXCEPT SHARE DATA)

ASSETS

	2000	1999
Current Assets:		
Cash and cash equivalents	$ 35,863	$128,752
Marketable securities	--	14,971
Restricted marketable securities	25,000	--
Trade receivables, less allowance for doubtful accounts of $1,332 and $1,337, respectively	34,646	13,879
Other receivables	2,836	2,385
Inventories, net	86,764	22,553
Prepaid expenses and other	2,123	1,792
Total current assets	187,232	184,332
Restricted marketable securities	--	30,151
Property and equipment, net	53,593	48,263
Long-term investments	15,000	--
Goodwill, less accumulated amortization of $6,883 and $3,141, respectively	17,813	5,065
Other assets	2,078	--
Total Assets	$275,716	$267,811

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 53,367	$ 13,261
Accrued liabilities	32,609	11,375
Notes payable	25,000	--
Deferred revenue	5,661	11,148
Current portion of capital lease obligations	330	600
Total current liabilities	116,967	36,384
Long-term debt and capital lease obligations	--	25,199
Commitments and Contingencies		
Stockholders' Equity:		
Common stock -- $.01 par value, 400,000,000 shares authorized, 84,443,000 and 79,752,000 shares issued and outstanding, respectively	776	754
Additional paid-in-capital	438,123	412,930
Accumulated deficit	(279,910)	(205,072)
Unearned compensation	(240)	(2,384)
Total Stockholders' Equity	158,749	206,228
Total Liabilities and Stockholders' Equity	$275,716	$267,811

See notes to consolidated financial statements.

NEXT LEVEL COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY/PARTNERS' DEFICIT
YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998
(IN THOUSANDS)

	GENERAL PARTNER CAPITAL (DEFICIT)	LIMITED PARTNER CAPITAL (DEFICIT)	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	UNEA COMPEN
			SHARES	AMOUNT		
BALANCE, DECEMBER 1, 1998				$ 379,876		
Conversion of note payable into corporation into partnership		$ (3,702)		(379,876)		
Partner capital contributions	$10,000	60,664				
Net loss	(8,990)	(72,741)				
BALANCE, DECEMBER 31, 1998	1,010	(15,779)	--	--	--	
Partner capital contributions		34,000				
Recapitalization:						
Conversion of note payable into common stock			4,338	43	$ 86,710	
Conversion of general partner interest into common						

stock	(1,010)		5,863	59	951	
Conversion of limited partner interest into common stock		(18,221)	55,366	554	17,667	
Dividend to General Instrument			4,400			
Initial public offering proceeds			9,775	98	176,918	
Issuance of common stock under stock option plan			10		16	
Stock-based compensation					130,668	$(2,
Net loss						
BALANCE, DECEMBER 31, 1999	--	--	79,752	754	412,930	(2,
Issuance of common stock in connection with:						
Exercise of stock options and employee stock purchase plan			2,183	21	9,230	
Exercise of warrants			2,369			
Acquisition of SoftProse			139	1	16,861	(
Additional initial public offering expenses					(898)	
Amortization of unearned compensation						2,
Net loss						
BALANCE, DECEMBER 31, 2000	--	--	84,443	$ 776	$438,123	$ (

See notes to consolidated financial statements.

NEXT LEVEL COMMUNICATIONS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998
(IN THOUSANDS)

	2000	1999	1998
OPERATING ACTIVITIES:			
Net loss	$(74,838)	$(205,072)	$(81,731)
Adjustments to reconcile net loss to net cash used in operating activities:			
Noncash compensation charge	2,509	128,284	--
Depreciation and amortization	13,813	8,857	10,733
Loss on disposal of assets	115	338	1,162
Inventory charge	9,000	--	5,800
Changes in assets and liabilities:			
Trade receivables	(20,558)	(2,811)	(6,323)
Inventories	(73,211)	(1,883)	(13,086)
Other assets	(782)	4,993	(5,468)
Accrued interest payable to General Instrument	--	5,813	5,940
Accounts payable	40,106	(3,206)	7,926
Accrued liabilities and deferred revenue	15,532	8,120	8,414

Net cash used in operating activities..........	(88,314)	(56,567)	(66,633)
INVESTING ACTIVITIES:			
Purchases of property and equipment....................	(15,515)	(33,585)	(9,612)
Sales (purchases) of marketable securities, net.........	18,044	(45,121)	--
Long-term investments..................................	(14,988)	--	--
Proceeds from notes receivable.........................	--	56	264
Net cash used in investing activities..........	(12,459)	(78,650)	(9,348)
FINANCING ACTIVITIES:			
Initial public offering proceeds (expenses), net........	(898)	177,016	--
Issuance of common stock...............................	9,251	16	--
Proceeds from borrowings...............................	148	24,853	75,000
Repayment of capital lease obligations.................	(617)	(899)	--
Limited Partner capital contribution...................	--	34,000	19,587
General Partner capital contribution...................	--	--	10,000
Net cash provided by financing activities.......	7,884	234,986	104,587
Net (Decrease)/Increase in Cash and Cash Equivalents......	(92,889)	99,769	28,606
Cash and Cash Equivalents, Beginning of Period...........	128,752	28,983	377
Cash and Cash Equivalents, End of Period.................	$ 35,863	$ 128,752	$ 28,983
NONCASH INVESTING AND FINANCING ACTIVITIES:			
Equipment acquired under capital lease and notes payable..	--	$ 899	$ 930
Acquisition of SoftProse:			
Issuance of common stock...........................	16,862	--	--
Liabilities assumed, net...........................	91	--	--
Conversion of note payable to General Instrument into common stock..	--	86,753	41,077
Conversion of stockholders' net deficit into partnership deficit...	--	--	(3,702)
Conversion of general partner interest into common stock...	--	1,010	--
Conversion of limited partner interest into common stock...	--	18,221	--
Common stock dividend (see Note 1).......................	--	--	--
SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid for interest.................................	630	226	95
Cash paid for taxes....................................	43	1	--

See notes to consolidated financial statements.

NEXT LEVEL COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

1. ORGANIZATION AND BUSINESS

Next Level Communications, Inc. (the "Company") is a leading provider of broad-band communications systems that enable telephone companies and other emerging communications service providers to cost-effectively deliver voice, data and video services over the existing copper wire telephone infrastructure.

Next Level Communications ("NLC" or the "Limited Partner") was incorporated as a California corporation on June 22, 1994 and commenced operations in July

1994. In September 1995, NLC was acquired by General Instrument Corporation ("General Instrument").

In January 1998, NLC transferred its net assets, management and workforce to a newly formed limited partnership, Next Level Communications L.P. (the "Partnership"), in exchange for an 89% limited partnership interest. The Partnership recorded the net assets transferred at their historical cost. At the same time, Spencer Trask (the "General Partner") acquired an 11% general partner interest in the Partnership in exchange for a $10.0 million cash contribution.

On August 24, 1999 the Partnership formed the Company as a wholly owned subsidiary. Management of NLC effected a 1-for-3 reverse stock split on October 14, 1999. All share amounts in the accompanying financial statements have been restated to give effect to the reverse stock split.

On November 9, 1999, the Company issued 9,775,000 shares of common stock at $20.00 per share for net proceeds of $177,016,000 in an initial public offering (the "Offering"). Prior to the completion of the offering, the following recapitalization transactions (the "Recapitalization") occurred:

- A note payable and accrued interest to General Instrument of $86.8 million was converted into 4,337,633 shares of the Company's common stock.

- The Partnership and NLC (a wholly owned subsidiary of General Instrument) were merged into the Company. As part of this merger, the General Partner received 5,863,329 shares of the Company's common stock and General Instrument received 55,366,091 shares of the Company's common stock in exchange for their respective partnership interests.

- The Company issued a common stock dividend of 4,400,000 shares to General Instrument to reflect the additional value, $88 million, which will be received by the Company upon exercise of the warrants described below. In accordance with the Partnership agreement NLC was entitled to receive the $88 million exercise price. As a result of the Recapitalization, such amounts are to be received by the Company as these warrants are exercised. Accordingly, General Instrument received $88 million of common stock (4,400,000 shares) because it would have received that amount under the Partnership agreement.

- The General Partner's option and the Partnership agreement to acquire up to 11% of NLC upon an initial public offering was converted into warrants to acquire 8,480,102 shares of the Company's common stock at $10.38 per share. In June 2000, warrants to purchase 2,070,000 shares of common stock were exercised. The exercise price of these warrants was paid through the surrender of additional warrants to purchase 423,493 shares of common stock. In addition, in October 2000, warrants to purchase 299,000 shares of common stock were exercised. The exercise price of these warrants was paid through the surrender of additional warrants to purchase 96,000 shares of common stock. The Company did not receive any cash proceeds from either of these transactions. At December 31, 2000, warrants to acquire 5,591,609 shares of common stock were outstanding.

- Options granted to employees of the Partnership to purchase shares of NLC were converted on a one-for-one basis into options to purchase a total of 6,964,904 shares of the Company's common stock.

YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

The Recapitalization was accounted for at historical cost. The accompanying financial statements represent those of the Company from November 10, 1999, and those of the Partnership from January 1, 1998 to November 9, 1999. In January 2000, General Instrument was acquired by Motorola, Inc.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation -- These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, SoftProse, Inc. All significant intercompany transaction and balances have been eliminated.

Use of Estimates -- The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Actual results could differ from those estimates.

Revenue Recognition -- The Company recognizes revenue from equipment sales when delivery has occurred, contractual obligations have been satisfied, title and risk of loss have been transferred to the customer and collection of the resulting receivable is reasonably assured. The Company accrues a provision for estimated sales returns and other allowances as a reduction of revenue at the time of revenue recognition. Amounts received in excess of revenue recognized are recorded as deferred revenue. As of December 31, 2000 and 1999, deferred revenue primarily relates to advance payments received on equipment sales. Service revenue is recognized upon completion of the related contract.

In December 1999, the Securities and Exchange Commission released Staff Accounting Bulletin ("SAB") No. 101 Revenue Recognition in Financial Statements. SAB No. 101 provides guidance on the recognition, presentation and disclosure of revenue in financial statements. The accounting and disclosures prescribed by SAB No. 101 were effective for the Company in the fourth quarter of the year ending December 31, 2000. The Company believes that it complies with the provisions of SAB No. 101 and there was no material effect on the Company's results of operations or financial position as a result of implementing SAB No. 101.

Software license revenues are recognized when software revenue recognition criteria have been met, pursuant to Statement of Position ("SOP") 97-2, Software Revenue Recognition, as revised. License revenue is recognized when a noncancelable license agreement has been signed, delivery has occurred, the fees are fixed and determinable and collection is probable. The portion of revenues from new license agreements which relate to the Company's obligations to provide customer support are deferred, based upon the price charged for customer support when it is sold separately, and recognized ratably over the maintenance period. Revenue from the renewal of customer support contracts is recognized ratably over the term of the agreement.

Product Warranty -- The Company provides for the estimated costs to fulfill customer warranty obligations upon the recognition of the related equipment revenue. Actual warranty costs incurred are charged against the accrual when paid.

Cash Equivalents -- The Company considers all highly liquid debt instruments with a maturity of three months or less at the date of purchase to be cash equivalents.

Marketable Securities -- The Company classifies its investments as

"available-for-sale" securities based on their intended use. Gains and losses on sales of investments are determined on a specific identification basis. At December 31, 2000 and 1999, marketable securities consisted of corporate bonds and government agency securities. The difference between amortized cost and fair value representing unrealized holding gains and losses are recorded as a component of stockholders' equity as comprehensive accumulated other income

(loss). At December 31, 2000 and 1999 there was no significant difference between the fair market value and the underlying cost of these investments.

Inventories -- Inventories are stated at the lower of cost, determined on a first-in, first-out basis, or market.

Property and Equipment -- Property and equipment are stated at cost. Provisions for depreciation are based on estimated useful lives of the assets using the straight-line method. Useful lives range from 20 years for buildings, the shorter of five to ten years or the lease term for leasehold improvements and two to seven years for machinery and equipment.

Long-term investments -- Long-term investments represent preferred stock and other strategic equity holdings in nonpublic companies (see Note 4).

Goodwill -- Goodwill is being amortized on a straight-line basis over three to seven years. Statement of Financial Accounting Standards ("SFAS") No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, requires the Company to periodically review for possible impairments of its long-lived assets, whenever events and circumstances indicate that the carrying value may not be recoverable. If the undiscounted future cash flows are less than the carrying amount, the carrying amount is reduced to fair value and an impairment loss is recognized. The Company follows a similar policy to evaluate goodwill for potential impairment.

On February 14, 2001 the Financial Accounting Standards Board (the "Board") issued a revised exposure draft, Business Combinations and Intangible Assets -- Accounting for Goodwill. The proposed Statement would require that goodwill no longer be amortized and that a goodwill impairment loss be recognized if the implied fair value of a reporting unit's goodwill is less than its carrying amount. The provisions in the proposed Statement would be effective for fiscal quarters beginning after issuance of a final Statement. The Board has announced that it plans to issue a final Statement in June 2001. The Company is currently evaluating what impact this proposed Statement may have on its financial statements.

Income taxes -- Income taxes are accounted for under the asset and liability method. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and amounts used for income tax purposes. For the period from January 6, 2000 to May 17, 2000 the Company's results of operations were included in the consolidated federal income tax return of Motorola. Federal income taxes for that period of time are provided in accordance with an intercompany tax sharing agreement, whereby income taxes or credits for the Company are reported as if the Company filed a separate federal income tax return (see Note 15).

Net Loss Per Share -- Basic net loss per share excludes dilution and is

computed by dividing net loss by the weighted average number of common shares outstanding for the period. Diluted net loss per share is computed based on the weighted average number of common shares outstanding plus the dilutive effect of outstanding stock options and warrants. Diluted net loss per common share was the same as basic net loss per common share for all periods presented since the effect of any potentially dilutive common stock equivalents is excluded, as they are anti-dilutive because of the Company's losses. As a result, in 2000 25.8 million shares of common stock equivalents were not included in the calculation of diluted net loss per share because they were antidilutive. Pro forma basic and diluted net loss per share for 1999 and 1998 has been computed using the methods described in Note 13.

Fair Value of Financial Instruments -- The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short-term nature of these instruments. The fair value of marketable securities, notes payable and other debt is based upon current interest rates for debt instruments with comparable maturities and characteristics.

NEXT LEVEL COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

Comprehensive Income (Loss) -- SFAS No. 130, Reporting Comprehensive Income, requires that all items recognized under accounting standards as components of comprehensive income be reported in an annual financial statement that is displayed with the same prominence as other annual financial statements. Other comprehensive income (loss) consists of unrealized gains and losses on available-for-sale securities. Comprehensive loss was the same as net loss for all periods presented.

Certain Significant Risks and Uncertainties -- One customer comprised 56%, 67% and 68% of the Company's total revenues in 2000, 1999 and 1998, respectively. At December 31, 2000 and 1999, 25% and 79%, respectively, of the Company's trade accounts receivable were derived from this customer. The loss of this customer or any substantial reduction in orders by this customer could have a material adverse affect on the Company's operating results. Additionally, the Company relies on certain contract manufacturers to perform substantially all of its manufacturing activities. The inability of its contract manufacturers to fulfill their obligations to the Company could adversely impact future results.

The Company performs ongoing credit evaluations of its customers and generally does not require collateral from its customers. The Company maintains allowances for potential losses, and has not incurred any significant losses to date. Allowance for doubtful accounts activity consists of (in thousands):

	BALANCE AT BEGINNING OF YEAR	ADDITIONS CHARGED TO EXPENSE	DEDUCTIONS	BALANCE AT END OF YEAR
Year ended December 31:				
1998	$ 170	$320	$ --	$ 490
1999	490	896	(49)	1,337
2000	1,337	11	(16)	1,332

New Accounting Pronouncements -- SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, is effective for the Company beginning January 1, 2001. SFAS No. 133 requires that all derivative instruments be measured at fair value and recognized in the balance sheet as either assets or liabilities. Management has determined that the initial adoption of SFAS No. 133 will not have a material effect on the Company's financial statements.

Reclassifications -- Certain prior year amounts have been reclassified to conform to the current year presentation.

3. ACQUISITIONS

In 1997, General Instrument acquired all of the outstanding capital stock of Telenetworks, a specialized data protocol communications software company for $7.0 million in cash. The acquisition was accounted for using the purchase method of accounting and, accordingly, the assets acquired and liabilities assumed were recorded at their estimated fair values as of the date of acquisition. The $6.9 million excess of the purchase price over the net identifiable assets acquired was allocated to goodwill and is being amortized over seven years. In January 1998, in conjunction with the formation of the Partnership, the Limited Partner contributed the assets and liabilities of Telenetworks to the Partnership at its cost. For financial statement purposes, Telenetworks' assets, liabilities and results of operations have been included in the accompanying consolidated financial statements for all periods presented.

In July 2000, the Company acquired SoftProse, a company that provides products and development services for consumer electronics, embedded systems, real-time systems and communications systems. The purchase price of $16.9 million was comprised of the issuance of 144,781 shares of the Company's common stock. The acquisition was accounted for using the purchase method of accounting and accordingly, the assets

acquired and liabilities assumed were recorded at their estimated fair values as of the date of acquisition. Goodwill of $16.5 million arising from the acquisition is being amortized over three years.

4. LONG-TERM INVESTMENTS

In July 2000, the Company invested in OutReach Communications, L.L.C. ("OutReach") which provides integrated broadband service to independent local exchange companies. The Company contributed $7.0 million in cash in exchange for an ownership interest of approximately 18% and warrants to acquire an additional 7% interest in OutReach, exercisable only upon either of the following: the conversion of OutReach into a C Corporation and completion of an initial public offering or the sale of substantially all of OutReach's assets. The Company and OutReach have entered into a preferred vendor arrangement under which the Company provides its products to OutReach's customers. Revenue from such sales is deferred by the Company until the end user receives the products. At December 31, 2000 the Company had recorded $1.2 million of deferred revenue from OutReach.

In September 2000, the Company made an investment in Expanse Networks Inc., a developer of addressable television advertising delivery systems and software for broadband networks. The Company contributed $3.0 million in cash in exchange for an ownership interest of approximately 14%.

In November 2000, the Company made a $5.0 million cash investment in Virtual Access PLC, a network access company. The agreement requires additional investments of $10 million by the Company provided that certain development milestones are reached by Virtual Access. The Company currently holds approximately a 3% ownership interest and its potential ownership interest under the agreement is less than 20%.

5. INVENTORIES

Inventories at December 31 consist of (in thousands):

	2000	1999
Raw materials	$29,525	$11,746
Work-in-process	1,935	1,542
Finished goods	68,101	13,839
Total	99,561	27,127
Less reserves and allowances	(12,797)	(4,574)
Inventories, net	$86,764	$22,553

During the fourth quarter of 2000 the Company recorded a $9,000,000 inventory charge primarily related to a lower of cost or market adjustment to certain residential gateway products and other obsolescence provisions. In 1998, the Company recorded a charge of $5,800,000 primarily related to inventory obsolescence.

6. PROPERTY AND EQUIPMENT

Property and equipment at December 31 consist of (in thousands):

	2000	1999
Land	$ 1,889	$ 1,889
Building	22,906	22,906
Machinery and equipment	50,515	35,938
Leasehold improvements	6,511	5,930
Total	81,821	66,663
Less accumulated depreciation and amortization	(28,228)	(18,400)
Property and equipment, net	$ 53,593	$ 48,263

Machinery and equipment includes assets acquired under capital leases of $1,549,000 and $1,801,000 and related accumulated depreciation and amortization of $1,258,000 and $858,000 at December 31, 2000 and 1999, respectively.

7. OTHER ACCRUED LIABILITIES

Other accrued liabilities at December 31 consist of (in thousands):

	2000	1999
Accrued payroll and related expenses	$ 8,812	$ 4,764
Warranty reserve	5,645	2,841
Other accrued expenses	3,152	3,770
Due to Motorola (see Note 12)	15,000	--
Total	$32,609	$11,375

8. NOTES PAYABLE

In December 1999, the Company entered into a revolving bank line of credit ("Line") under which the Company may borrow up to the lesser of $50 million or the value of pledged collateral. At December 31, 2000 and 1999, the balance outstanding was $25,000,000 and $24,853,000, respectively. Interest on the Line was 9.5% at December 31, 2000. The Line matures on October 1, 2001. The Line is secured by $25,000,000 of marketable securities held by a custodian and recorded as restricted marketable securities on the consolidated financial statements.

9. STOCK OPTION PLANS

NLC Stock Option Plans

Certain employees of the Partnership were granted contingently exercisable stock options (included in the table which follows) in NLC which vest over a period ranging from two to three years and which expire in ten years. Such options were exercisable only in the event of an initial public offering or a change in control of NLC (the "Event").

In November 1999, in conjunction with the Recapitalization (see Note 1), the outstanding options granted under the NLC stock plan were converted into options to purchase 6,964,904 shares of the Company's common stock with equivalent terms and exercise prices. As a result of the initial public offering of the Company, compensation expense of $96,864,000 was recognized in 1999 related to the contingently exercisable stock options. The compensation expense was determined based on the difference between the

exercise price of the vested portion of such options and the initial offering price for the Company's common stock. The Company recorded compensation expense of $2,384,000 in 2000 related to the remaining vesting of these options, as a result of the Motorola acquisition.

In addition, in 1997, as part of a tandem stock option grant, certain employees of NLC were granted options at $1.11 per share for a total of 1.9 million shares of common stock of NLC, or options at $15.75 per share for a total of 1.5 million shares of General Instrument common stock (the "GI Options"). The NLC options were exercisable only upon an Event. The options have a ten-year life and vest over three years. At December 31, 1999, it was determined that the NLC options granted as part of the tandem stock grant were more likely to be exercised than the related GI options. As a result, the Company recorded $31,420,000 in compensation expense in 1999 related to the tandem stock grant. The compensation expense was calculated based on the difference between the exercise price of the vested portion of the NLC options and the initial offering price of the Company's common stock.

1999 Stock Plan

The Company adopted its 1999 Stock Plan effective October 1, 1999. Options to purchase 5,388,476 shares of common stock were granted under the 1999 Stock Plan. These options vest over either a three or four year period with a pro rata portion vesting after one year of service and the remaining shares vesting in equal monthly installments over the remaining months of service and expire not later than 10 years after the date of grant. No future awards under the 1999 Stock Plan will be made.

1999 Equity Incentive Plan

On October 10, 1999, the Company adopted the 1999 Equity Incentive Plan. Options to purchase 7,900,000 shares of common stock are available for grant under the plan. Depending on the grant, shares vest over either a three or four year period with a pro rata portion vesting after one year of service and the remaining shares vesting in equal monthly installments over the remaining months of service. Options expire not later than 10 years after the date of grant.

The following table summarizes activity relating to the NLC Stock Plan (including those granted as part of the tandem stock option grant) and the 1999 Stock Plan and 1999 Equity Incentive Plan (the "Plans"):

	SHARES (IN THOUSANDS)	WEIGHTED AVERAGE EXERCISE PRICE
Balance at December 31, 1997 (none exercisable)	6,914	$ 0.98
Granted	179	5.74
Canceled	(4)	1.11
Balance at December 31, 1998 (none exercisable)	7,089	1.10
Granted (fair value of $14.98)	8,109	29.29
Canceled	(281)	1.28
Exercised	(10)	1.61
Balance at December 31, 1999 (6,799 exercisable)	14,907	16.43
Granted (fair value of $47.04)	8,735	64.20
Canceled	(1,600)	60.05
Exercised	(1,865)	2.04
Balance at December 31, 2000 (7,297 exercisable)	20,177	34.98

NEXT LEVEL COMMUNICATIONS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
YEARS ENDED DECEMBER 31, 2000, 1999 AND 1998

In January 2001, the Company granted an additional 3,670,000 options at an exercise price of $8.63 per share.

The following table summarizes information about options granted under the Plans and outstanding at December 31, 2000:

	OUTSTANDING			EXERCISABLE	
EXERCISE PRICES	NUMBER OUTSTANDING AT DECEMBER 31, 2000	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE (IN YEARS)	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT DECEMBER 31, 2000	WEIGHTED AVERAGE EXERCISE PRICE
	(IN THOUSANDS)			(IN THOUSANDS)	
$ 0.85 - $ 9.66	5,186	6.6	$ 1.23	5,186	$1.24
$11.00 - $ 15.06	5,432	8.9	11.26	1,439	11
$18.00 - $ 76.07	7,228	9.2	60.52	671	65.43
$80.56 - $161.25	2,331	9.3	86.15	1	130
$ 0.85 - $161.25	20,177	8.5	34.98	7,297	9.08

1999 Employee Stock Purchase Plan

On October 10, 1999, the Company adopted the 1999 Employee Stock Purchase Plan (the "Purchase Plan") under which 1,000,000 shares of our common stock were reserved for issuance.

All employees are eligible to participate. Eligible employees may begin participating in the 1999 Employee Stock Purchase Plan at the start of any offering period each of which lasts 24 months. Overlapping offering periods start on May 1 and November 1 of each year. However, the first offering period was started on the effective date of the initial public offering of November 10, 1999 and will end on October 31, 2001. Under the Purchase Plan eligible employees may purchase the Company's common stock at a price that is the lower of 85% of either the fair market value at the beginning of the offering period or the fair market value at the end of the period.

During the year ended December 31, 2000, 318,208 shares of common stock were issued under the Purchase Plan.

Additional Stock Plan Information

The Company accounts for its stock-based awards using the intrinsic value method in accordance with APB No. 25.

SFAS No. 123, Accounting for Stock-Based Compensation, requires the disclosure of pro forma net income (loss) and net income (loss) per share had the Company adopted the fair value method. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models which were developed to estimate the fair value of freely tradable, fully

transferable options without vesting restrictions. Such options differ significantly from the Company' stock-based awards. These models require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. The Company's calculations for options granted after the offering were made using the Black-Scholes option pricing model.

The estimated fair value of an option grant is based, in part, on the estimated term of the option. Prior to the Company's initial public offering, NLC options granted under the NLC Stock Plan were not exercisable. As a result, it is not practicable to determine the expected term of NLC options and therefore it is not possible

to estimate the fair value of such options. As a result, disclosure of the estimated grant date fair value of such options and the related pro forma compensation expense for such options is not possible.

The following weighted average assumptions are included in the estimated fair value calculations of 2000 and 1999 grants for the stock option and stock purchase programs:

	2000	1999
Expected dividend yields	0%	0%
Expected stock price volatility	103.0%	70.0%
Risk fee interest rate	6.1%	5.9%
Expected term (years)	4.0	4.8

Under SFAS No. 123, had the Company recorded compensation expense based on the estimated grant date fair value for awards based on grants under the Plans and the tandem stock grant, the Company's net loss and net loss per share would have changed. The amounts below represent the pro forma amounts for fiscal 2000, 1999, and 1998 (in thousands, except for per share amounts):

	2000	1999	1998
Net loss as reported	$ (74,838)	$(205,072)	$(81,731)
Pro forma net loss, as adjusted	$(237,363)	$(213,108)	$(84,494)
Diluted net loss per share (pro forma in 1999 and 1998)	$ (0.91)	$ (2.78)	$ (1.08)
Pro forma diluted loss per share, as adjusted	$ (2.90)	$ (2.98)	$ (1.21)

10. EMPLOYEE BENEFIT PLANS

In January 2000, the Company adopted the Next Level Communications 401(k) Plan ("NLC Plan") to which employees could contribute up to 12% of the employees' salary subject to the legal maximum. The Company contributes an

amount equal to 100% of the first 5% of the employee's salary that the employee contributes. The Company's expense related to the NLC Plan was $1,421,000 in 2000. The Company's expense related to the General Instrument 401(k) Plan was $589,000 and $513,000 for 1999 and 1998, respectively.

11. COMMITMENTS AND CONTINGENCIES

The Company leases certain of its facilities and equipment under operating leases. Leases expire at various dates from 2001 to 2006 and certain facility leases have renewal options.

Future minimum lease payments at December 31, 2000 under operating leases are as follows:

2001	$2,202
2002	1,887
2003	1,586
2004	945
2005	870
Thereafter	650
Total	$8,140

Additionally, the Company leases equipment under capital leases. These leases all expire in 2001 and all contain purchase options.

Future minimum lease payments at December 31, 2000 are as follows (in thousands):

Total payments under capital leases	$349
Less amounts representing interest	(19)
Present value of net minimum lease payments	$330

Rent expense was $1.7 million, $4.3 million and $3.8 million in 2000, 1999 and 1998, respectively.

We have commitments with suppliers to purchase a total of approximately $75.0 million of components in 2001.

In May 1998, actions by Broad-Band Technologies, Inc. against General Instrument and by Next Level Communications against Broad-Band Technologies, pending in the United States District Court for the Eastern District of North Carolina, were dismissed with prejudice. These dismissals were entered pursuant to a settlement agreement under which, among other things, Next Level Communications, Inc. paid Broad-Band Technologies $5.0 million, which was expensed in 1998.

12. INCOME TAXES

For the period from January 1, 1998 through November 9, 1999, the Company was a limited partnership entity. For federal and state tax purposes, limited partnership entities pass all items of income and expense through to the respective partners of the entity. Consequently, all items of income and expense attributable to the period in which the Company was a limited partnership were allocated directly to the respective partners.

For the period from November 10, 1999 through January 5, 2000, the Company was a corporation filing its tax returns on a stand-alone basis. As a result of the acquisition by Motorola of General Instrument, from January 6, 2000 through May 17, 2000, the Company's taxable loss will be included in the consolidated federal tax return of Motorola. Subsequent to May 17, 2000, due to the exercise of various warrants and stock options, Motorola's ownership interest in the Company declined below 80% and the Company was no longer eligible to be included in Motorola's consolidated federal tax return. For the period May 18, 2000 to December 31, 2000 the Company will file its federal income tax return on a stand-alone basis.

Significant components of the Company's deferred tax assets and liabilities at December 31 were as follows (in thousands):

	2000	1999
Deferred tax assets:		
Net operating loss carryforwards	$ 69,131	$ 4,326
Capitalized research and development	31,744	28,865
Stock option compensation	1,021	--
Basis difference in property and equipment	4,111	(2,127)
Inventory reserves	5,483	1,822
Other	10,719	8,899
Total	122,209	41,785
Valuation allowance	(122,209)	(41,785)
Net deferred tax assets	$ --	$ --

No tax benefit has been recorded through December 31, 2000 because of the net operating losses incurred and full valuation allowance provided. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax assets will not be realized. The Company established a 100% valuation

allowance at December 31, 2000 and 1999 due to the uncertainty of realizing future tax benefits from its net operating loss carryforwards and other deferred tax assets.

At December 31, 2000, for tax purposes, the Company had approximately

$168,000,000 in federal net operating loss carryforwards, approximately $150,000,000 in state net operating loss carryforwards, and approximately $1,600,000 in research and development credit carryforwards. The Company's federal net operating loss carryforwards expire beginning in fiscal 2017. The Company's other net operating loss and tax credit carryforwards have various expiration dates beginning in fiscal year 2002.

Provisions of the Internal Revenue Code place a limitation (the "Section 382 Limitation") on the amount of taxable income which can be offset by net operating loss ("NOL") carryforwards after a change in control (generally a greater than 50% change in ownership). The Company's indirect acquisition by Motorola on January 5, 2000 resulted in an ownership change. The Company's federal and state NOLs on the date of the ownership change were approximately $18,000,000 and $14,000,000, respectively. Management believes that the Section 382 Limitation will not affect its ability to use its NOLs.

In December 2000, the Company received a $15 million advance from Motorola related to a tax sharing and allocation agreement. The Company received an additional $17.3 million in January 2001 and the tax agreement was finalized in February 2001. The amount advanced to the Company is based on an estimate of the present value of income tax benefits to Motorola from the inclusion of the Company's operating losses for the period from January 6, 2000 to May 17, 2000. To the extent Motorola does not achieve the expected tax benefits by September 30, 2006, the Company must repay any difference. In addition, should the Company obtain certain specified levels of financing from independent third parties, it must repay all or a portion of the advance.

13. PRO FORMA NET LOSS PER SHARE

Basic and diluted net loss per share for 1999 and 1998 is computed by dividing the pro forma net loss by the pro forma shares outstanding for the period giving effect to the Recapitalization as if it had occurred on January 1, 1997.

Pro forma basic and diluted net loss per share give effect to the contribution of the note and accrued interest thereon payable to General Instrument and the related elimination of interest expense of $5.8 million and $5.9 million for 1999 and 1998 respectively. The pro forma shares outstanding exclude warrants held by affiliates of the General Partner to purchase 8,480,102 shares of common stock and employee stock options to purchase 14,907,000 shares of common stock. Shares under these options and warrants were not included in the computation of pro forma diluted net loss per common share since the inclusion of these shares would be antidilutive.

The following is a reconciliation of the components of the pro forma basic and diluted net loss per share (in thousands except per share amounts):

	1999	1998
Net loss	$(205,072)	$(81,731)
Less: Interest expense for converted GI note payable	5,813	5,940
Pro forma basic and diluted net loss	$(199,259)	$(75,791)
Pro forma weighted average shares outstanding	71,598	69,967
Pro forma net loss, basic and diluted	$ (2.78)	$ (1.08)

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

OFFICERS AND DIRECTORS

Information concerning this item will be in our definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 for our 2001 annual meeting of stockholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information concerning this item will be in our definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 for our 2001 annual meeting of stockholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information concerning this item will be in our definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 for our 2001 annual meeting of stockholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information concerning this item will be in our definitive proxy statement to be filed pursuant to Regulation 14A under the Securities Exchange Act of 1934 for our 2001 annual meeting of stockholders and is incorporated herein by reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

FINANCIAL STATEMENTS AND SCHEDULES

The Financial Statements which are filed with this Form 10-K are set forth in the Index to Financial Statements at page 26, which immediately precedes such financial statements. No schedules are required under the applicable instructions or are inapplicable and have therefore been omitted.

EXHIBITS

The following exhibits are, as indicated below, either filed herewith or have previously been filed with the SEC and are referred to and incorporated herein by reference to such filings.

EXHIBIT

NUMBER	EXHIBIT
2.1	Form of Merger Agreement among General Instrument Corporation, Spencer Trask Investors LLC, Next Level Communications, Next Level Communications L.P. and us, which was filed as exhibit 2.1 to our registration statement on Form S-1 (file no. 333-85999) and is incorporated by reference herein.
3.1	Restated Certificate of Incorporation, which was filed as exhibit 3.1 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
3.2	Bylaws, which were filed as exhibit 3.2 to our registration statement on Form S-1 (file No. 333-85999) and are incorporated by reference herein.

EXHIBIT NUMBER	EXHIBIT
4.1	Form of Registration Rights Agreement among General Instrument Corporation, Spencer Trask Investors LLC and us, which was filed as exhibit 4.2 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
9.1	Form of Voting Trust Agreement among General Instrument Corporation, Chasemellon Shareholder Services and us, which was filed as exhibit 9.1 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.1	Form of Indemnification Agreement for our directors and officers, which was filed as exhibit 10.1 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.2	Form of Corporate and Intercompany Agreement for our directors and officers, which was filed as exhibit 10. to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.3*	1999 Equity Incentive Plan, which was filed as exhibit 10.3 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.4*	1999 Employee Stock Purchase Plan, which was filed as exhibit 10.4 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.5	Patent and Technical Information Cross-License Agreement, which was filed as exhibit 10.5 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.6**	Agreement between U S WEST Communications, Inc. and us, which was filed as exhibit 10.8 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.7**	Agreement among Telesector Resources group, Inc., General Instrument Corporation and us, which was filed as exhibit 10.8 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.

10.8**	Agreement between SCI Technology, Inc. and us, which was filed as exhibit 10.10 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.9**	Agreement between CMC Mississippi, Inc. and us, which was filed as exhibit 10.11 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.10*	1999 Stock Plan, which was filed as exhibit 10.12 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.11	Form of Warrant, which was filed as exhibit 10.13 to our registration statement on Form S-1 (file No. 333-85999) and is incorporated by reference herein.
10.12	Business Loan Agreement between Bank of America, N.A. and us, which was filed as exhibit 10.14 to our registration statement on Form S-1 (file No. 33-38618) and is incorporated by reference herein.
10.13	Form of Change of Control Agreement which was filed as exhibit 10.1 to our third quarterly report on Form 10-Q (file No. 000-27877) and is incorporated by reference herein.
23.1***	Independent Auditors' Consent

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* Management contract or compensatory plan or arrangement.

** Confidential Treatment has been granted as to certain portions of these exhibits.

*** Filed herewith.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEXT LEVEL COMMUNICATIONS, INC.

Date: March 16, 2001

By: /s/ J. MICHAEL NORRIS

J. Michael Norris
Chief Executive Officer and President

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below does hereby constitute and appoint Peter W. Keeler and Keith A. Zar, with full power of substitution and resubstitutions and full power to act without the other, his or her true and lawful attorneys-in-fact and agents to act for him or her in his or her name, place or stead, in any and all capacities, to sign any amendments to this report and to file such amendments, together with exhibits and other documents in connection therewith, with the Securities and Exchange Commission, granting to each attorney-in-fact and agent full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully as he or she might or could do in person, and ratifying and confirming all that the

attorneys-in-fact and agents, or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ PETER W. KEELER Peter W. Keeler	Chairman of the Board	March 16, 2001
/s/ J. MICHAEL NORRIS J. Michael Norris	Chief Executive Officer and President (Principal Executive Officer)	March 16, 2001
/s/ JAMES T. WANDREY James T. Wandrey	Senior Vice President, Chief Financial Officer, and Treasurer (Principal Financial and Accounting Officer)	March 16, 2001
/s/ EUGENE DELANEY Eugene Delaney	Director	March 16, 2001
/s/ LYNN FORESTER Lynn Forester	Director	March 16, 2001
/s/ FERDINAND C. KUZNIK Ferdinand C. Kuznik	Director	March 16, 2001
/s/ PAUL S. LATCHFORD Paul S. Latchford	Director	March 16, 2001
/s/ JOHN MCCARTNEY John McCartney	Director	March 16, 2001
/s/ JERRY ROSELAND Jerry Roseland	Director	March 16, 2001
/s/ RICHARD SEVERNS Richard Severns	Director	March 16, 2001

EXHIBIT INDEX

EXHIBIT NUMBER	EXHIBIT
23.1	Independent Auditors' Consent