GLOBECOMM SYSTEMS INC
Form 10-Q
May 10, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2007

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number: 000-22839

Globecomm Systems Inc.

(Exact name of Registrant as specified in its charter)

Delaware	11-3225567
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
45 Oser Avenue, Hauppauge, NY	11788
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (631) 231-9800

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of May 7, 2007, there were 16,332,404 shares of the registrant's Common Stock outstanding.

GLOBECOMM SYSTEMS INC.

Index to the March 31, 2007

Form 10-Q

		Page
	Part I – Financial Information	
Item 1.	Financial Statements	3
	Consolidated Balance Sheets – As of March 31, 2007 (unaudited) and June 30, 2006	3
	Consolidated Statements of Operations (unaudited) – For the three and nine months ended March 31, 2007 and 2006	4
	Consolidated Statement of Changes in Stockholders' Equity (unaudited) – For the nine months ended March 31, 2007	5
	Consolidated Statements of Cash Flows (unaudited) – For the nine months ended March 31, 2007 and 2006	6
	Notes to Consolidated Financial Statements (unaudited)	7
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations .	12
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	19
Item 4.	Controls and Procedures .	19
	Part II – Other Information	
Item 1.	Legal Proceedings	20
Item 1A.	Risk Factors	20
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	29
Item 3.	Defaults Upon Senior Securities	29
Item 4.	Submission of Matters to a Vote of Security Holders	29
Item 5.	Other Information	29
Item 6.	Exhibits	30
	Signatures	31

Table of Contents

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

GLOBECOMM SYSTEMS INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	March 31, 2007 (Unaudited)	June 30, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 29,768	$ 24,512
Accounts receivable, net	26,667	30,837
Inventories	16,770	13,058
Prepaid expenses and other current assets	1,718	1,131
Deferred income taxes	22	22
Total current assets	74,945	69,560
Fixed assets, net	27,368	15,510
Goodwill	7,204	7,204
Other assets	908	960
Total assets	$ 110,425	$ 93,234
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 18,644	$ 19,020
Deferred revenues	6,351	1,691
Accrued payroll and related fringe benefits	3,716	2,872
Other accrued expenses	1,921	1,966
Deferred liabilities	296	316
Total current liabilities	30,928	25,865
Other liabilities	1,077	353
Commitments and contingencies		
Stockholders' equity:		
Series A Junior Participating, shares authorized, issued and outstanding: none at March 31, 2007 and June 30, 2006	—	—
Common stock, $.001 par value, 50,000,000 shares authorized, shares issued: 16,631,668 at March 31, 2007 and 15,660,524 at June 30, 2006	17	16
Additional paid-in capital	142,022	135,673
Accumulated deficit	(60,838)	(65,892)
Treasury stock, at cost, 465,351 shares at March 31, 2007 and June 30, 2006	(2,781)	(2,781)
Total stockholders' equity	78,420	67,016
Total liabilities and stockholders' equity	$ 110,425	$ 93,234

See accompanying notes.

Table of Contents

GLOBECOMM SYSTEMS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 31, 2007	March 31, 2006	March 31, 2007	March 31, 2006
Revenues from ground segment systems, networks and enterprise solutions	$ 31,818	$ 23,735	$ 77,630	$ 69,358
Revenues from data communications services	7,299	7,306	23,927	21,171
Total revenues	39,117	31,041	101,557	90,529
Costs and operating expenses:				
Costs from ground segment systems, networks and enterprise solutions	25,225	19,616	62,502	57,842
Costs from data communications services	6,131	5,873	19,694	17,584
Selling and marketing	2,290	1,871	5,831	5,000
Research and development	440	268	963	538
General and administrative	3,033	2,379	8,398	7,187
Total costs and operating expenses	37,119	30,007	97,388	88,151
Income from operations	1,998	1,034	4,169	2,378
Interest income	391	247	1,007	703
Income before income taxes	2,389	1,281	5,176	3,081
Provision for income taxes	57	42	122	92
Net income	$ 2,332	$ 1,239	$ 5,054	$ 2,989
Basic net income per common share	$ 0.15	$ 0.08	$ 0.32	$ 0.20
Diluted net income per common share	$ 0.14	$ 0.08	$ 0.31	$ 0.19
Weighted-average shares used in the calculation of basic net income per common share	16,045	15,098	15,620	14,940
Weighted-average shares used in the calculation of diluted net income per common share	16,954	15,682	16,473	15,547

See accompanying notes.

4

Table of Contents

GLOBECOMM SYSTEMS INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
For the Nine months ended March 31, 2007
(In thousands)

(Unaudited)

	Common Stock		Additional Paid-in	Accumulated	Treasury Stock		Total Stockholders'
	Shares	Amount	Capital	Deficit	Shares	Amount	Equity
Balance at June 30, 2006	15,661	$ 16	$135,673	$(65,892)	465	$(2,781)	$67,016
Proceeds from exercise of stock options	791	1	5,028				5,029
Proceeds from exercise of warrants	180		1,101				1,101
Stock compensation expense			171				171
Tax benefit from stock compensation plan			49				49
Net income				5,054			5,054
Balance at March 31, 2007	16,632	$ 17	$142,022	$(60,838)	465	$(2,781)	$78,420

See accompanying notes.

Table of Contents

GLOBECOMM SYSTEMS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended	
	March 31, 2007	March 31, 2006
Operating activities:		
Net income	$ 5,054	$ 2,989
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,229	2,287
Provision for doubtful accounts	457	379
Stock compensation expense	171	105
Tax benefit from stock compensation plan	49	—
Changes in operating assets and liabilities:		
Accounts receivable	3,713	526
Inventories	(3,712)	(3,991)
Prepaid expenses and other current assets	(587)	(126)
Other assets	52	73
Accounts payable	(376)	(368)

Deferred revenue	4,660	(2,586)
Accrued payroll and related fringe benefits	844	(61)
Other accrued expenses	(45)	—
Other liabilities	704	(238)
Net cash provided by (used in) operating activities	13,213	(1,011)
Investing activities:		
Purchases of fixed assets	(14,087)	(1,332)
Net cash used in investing activities	(14,087)	(1,332)
Financing activities:		
Proceeds from exercise of stock options	5,029	1,996
Proceeds from exercise of warrants	1,101	440
Net cash provided by financing activities	6,130	2,436
Effect of foreign currency translation on cash	—	(22)
Net increase in cash and cash equivalents	5,256	71
Cash and cash equivalents at beginning of period	24,512	25,609
Cash and cash equivalents at end of period	$ 29,768	$ 25,680

See accompanying notes.

6

Table of Contents

GLOBECOMM SYSTEMS INC.
Notes to Consolidated Financial Statements
March 31, 2007
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all material adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results for such periods have been included. The consolidated balance sheet at June 30, 2006 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The results of operations for the three and nine months ended March 31, 2007, are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2007, or for any future period.

The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the fiscal year ended June 30, 2006 and the accompanying notes thereto contained in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on September 13, 2006.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Globecomm Network Services Corporation (''GNSC''), and Globecomm Systems Europe Limited (collectively, the ''Company''). On June 30, 2006, the Company liquidated the Globecomm Systems Europe Limited entity. All significant intercompany balances and transactions have been eliminated in consolidation.

Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Revenue Recognition

The Company recognizes revenue in accordance with Staff Accounting Bulletin No. 104 (''SAB 104''), Revenue Recognition, for its production-type contracts that are sold separately as standard satellite ground segment systems when persuasive evidence of an arrangement exists, the selling price is fixed or determinable, collectibility is reasonably assured, delivery has occurred and the contractual performance specifications have been met. The Company's standard satellite ground segment systems produced in connection with these contracts are typically short-term (less than twelve months in term) and manufactured using a standard modular production process. Such systems require less engineering, drafting and design efforts than the Company's long-term complex production-type projects. Revenue is recognized on the Company's standard satellite ground segment systems upon shipment and acceptance of factory performance testing which is when title transfers to the customer. The amount of revenues recorded on each standard production-type contract is reduced by the customer's contractual holdback amount, which typically requires 10% to 30% of the contract value to be retained by the customer until installation and final acceptance is complete. The customer generally becomes obligated to pay 70% to 90% of the contract value upon shipment and acceptance of factory

---

performance testing. Installation is not deemed to be essential to the functionality of the system since installation does not require significant changes to the features or capabilities of the system, does not require complex software integration and interfacing and the Company has not experienced any difficulties installing such equipment. In addition, the customer or other third party vendors can install the system. The estimated relative fair value of the installation services is determined by management, which is typically less than the customer's contractual holdback percentage. If the holdback is less than the fair value of installation, the Company will defer recognition of revenues, determined on a contract-by-contract basis equal to the fair value of the installation services. Payments received in advance by customers are deferred until shipment and are presented as deferred revenues in the accompanying consolidated balance sheets.

The Company recognizes revenue using the percentage-of-completion method of accounting upon the achievement of certain contractual milestones in accordance with Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, for its non-standard, complex production-type contracts for the production of satellite ground segment systems and equipment that are generally integrated into the customer's satellite ground segment network. The equipment and systems produced in connection with these contracts are typically long-term (in excess of twelve months in term) and require significant customer-specific engineering, drafting and design effort in order to effectively integrate all of the customizable earth station equipment into the

customer's ground segment network. These contracts generally have larger contract values, greater economic risks and substantive specific contractual performance requirements due to the engineering and design complexity of such systems and related equipment. Progress payments received in advance by customers are netted against the inventory balances in the accompanying consolidated balance sheets.

Contract costs generally include purchased material, direct labor, overhead and other direct costs. Anticipated contracted losses are recognized, as they become known.

Revenues from data communications services are derived primarily from Internet-based services. Service revenues from Internet access are recognized ratably over the period in which services are provided. Payments received in advance of providing Internet access services are deferred until the period such services are provided and are presented as deferred revenues in the accompanying consolidated balance sheets.

Costs from Ground Segment Systems, Networks and Enterprise Solutions

Costs from ground segment systems, networks and enterprise solutions consist primarily of the costs of purchased materials (including shipping and handling costs), direct labor and related overhead expenses, project-related travel and living costs and subcontractor salaries.

Costs from Data Communications Services

Costs from data communications services relating to Internet-based services consist primarily of satellite space segment charges, Internet connectivity fees, voice termination costs and network operations expenses. Satellite space segment charges consist of the costs associated with obtaining satellite bandwidth (the measure of capacity) used in the transmission of services to and from the satellites leased from operators. Network operations expenses consist primarily of costs associated with the operation of the Network Operation Center, on a twenty-four hour a day, seven-day a week basis, including personnel and related costs and depreciation.

Research and Development

Research and development expenditures are expensed as incurred.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment, which is a revision of SFAS 123 (''SFAS 123R''). SFAS 123R

Table of Contents

eliminates the ability to account for share-based compensation under the intrinsic value method permitted by APB 25. This requires the Company to adopt the fair value model for recognizing compensation expense for employee stock options, and has the effect of reducing the Company's reported net income and net income per share.

On July 1, 2005, the Company adopted SFAS 123R using a modified prospective application, as permitted under SFAS 123R. Under this application, the Company records compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Stock compensation expense was approximately $12,000 and $171,000 for the three and nine months ended March 31, 2007, respectively. Stock compensation expense was approximately $2,000 and $105,000 for the three and nine months ended March 31, 2006. As of March 31, 2007, there was approximately $208,000 of unrecognized compensation cost related to non-vested stock-based compensation. The cost is expected to be recognized over a weighted-average period of 3.3 years.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price of businesses over the fair value of the identifiable net assets acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and other indefinite life intangible assets are no longer amortized, but instead tested for impairment at least annually. The impairment test for goodwill uses a two-step approach, which is performed at the reporting unit level. Step one compares the fair value of the reporting unit (calculated using a discounted cash flow method) to its carrying value. If the carrying value exceeds the fair value, there is a potential impairment and step two must be performed. Step two compares the carrying value of the reporting unit's goodwill to its implied fair value (i.e., fair value of the reporting unit less the fair value of the unit's assets and liabilities, including identifiable intangible assets). If the carrying value of goodwill exceeds its implied fair value, the excess is required to be recorded as an impairment. There have been no events during the nine months ended March 31, 2007 that would result in any goodwill impairment.

Other Liabilities

Other liabilities consist primarily of security deposits received from customers for long term projects which are due to the customer beyond one year from the balance sheet date.

Income Taxes

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of the net deferred tax assets is dependent upon the generation of future taxable income prior to the expiration of any net operating loss carryforwards. For the nine months ended March 31, 2007 and the year ended June 30, 2006, due to the uncertainty regarding the Company's ability to utilize its net operating losses in the future, the Company provided a valuation allowance against its previously recorded deferred tax assets except for approximately $22,000, representing state investment tax credit carryforwards that will be utilized to offset state capital taxes on the Company's combined state tax return. The tax provision was approximately $57,000 and $122,000 for the three and nine months ended March 31, 2007, respectively, and $42,000 and $92,000 for the three and nine months ended March 31, 2006, respectively. The tax provision represents the estimated federal alternative minimum tax for the period.

In June 2006, the FASB issued FASB Interpretation (''FIN'') No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109 (''FIN 48''), which clarifies the accounting for uncertainty in income tax positions. FIN 48 requires that the Company recognize in its financial statements the impact of an income tax position if that income tax position is more likely than not of being sustained on audit, based on technical merits of the income tax position. The provisions of FIN 48 are effective as of the beginning of the Company's 2008 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on its financial statements.

9

Table of Contents

Product Warranties

The Company offers warranties on its contracts, the specific terms and conditions of which vary depending upon the contract and work performed. Generally, a basic limited warranty, including parts and labor, is provided to customers for one year. The Company can recoup certain of these costs through product warranties it holds with its original equipment manufacturers, which typically are one year in term. Historically, warranty expense has been minimal, however, management periodically assesses the need for any additional warranty reserve.

2. Basic and Diluted Net Income Per Common Share

The Company computes net income per share in accordance with the provisions of SFAS No. 128, Earnings Per Share. Basic net income per common share is computed by dividing the net income for the period by the weighted-average number of common shares outstanding for the period. For diluted earnings per share the weighted average shares include the incremental common shares issuable upon the exercise of stock options and warrants (using the treasury stock method). The incremental common shares for stock options and warrants are excluded from the calculation of diluted net income per share, if their effect is anti-dilutive. Diluted net income per share for the three and nine months ended March 31, 2007, excludes the effect of approximately 422,000 and 557,000 stock options in the calculation of the incremental common shares, respectively, as their effect would have been anti-dilutive. Diluted net income per share for the three and nine months ended March 31, 2006, excludes the effect of approximately 1,945,000 and 1,948,000 stock options and warrants in the calculation of the incremental common shares, respectively, as their effect would have been anti-dilutive.

3. Inventories

Inventories consist of the following:

	March 31, 2007 (Unaudited)	June 30, 2006
	(In thousands)	
Raw materials and component parts	$ 99	$ 110
Work-in-progress	17,839	14,564
	17,938	14,674
Less progress payments	1,168	1,616
	$ 16,770	$ 13,058

4. Segment Information

The Company operates through two business segments. Its ground segment systems, networks and enterprise solutions segment, through Globecomm Systems Inc., is engaged in the design, assembly and installation of ground segment systems and networks. Its data communications services segment, through GNSC, provides satellite communication services capabilities.

The Company’s reportable segments are business units that offer different products and services. The reportable segments are each managed separately because they provide distinct products and services.

Table of Contents

The following is the Company's business segment information for the three and nine months ended March 31, 2007 and 2006 and as of March 31, 2007 and June 30, 2006:

	Three Months Ended		Nine Months Ended	
	March 31, 2007	March 31, 2006	March 31, 2007,	March 31, 2006
	(Unaudited) (In thousands)			
Revenues:				
Ground segment systems, networks and enterprise solutions	$ 31,818	$ 23,825	$ 77,660	$ 69,910
Data communications services	7,376	7,844	24,369	22,169
Intercompany eliminations	(77)	(628)	(472)	(1,550)
Total revenues	$ 39,117	$ 31,041	$ 101,557	$ 90,529
Income from operations:				
Ground segment systems, networks and enterprise solutions	$ 1,830	$ 528	$ 2,640	$ 1,449
Data communications services	163	488	1,512	803
Interest income	391	247	1,007	703
Intercompany eliminations	5	18	17	126
Income before income taxes	$ 2,389	$ 1,281	$ 5,176	$ 3,081
Depreciation and amortization:				
Ground segment systems, networks and enterprise solutions	$ 327	$ 313	$ 962	$ 896
Data communications services	426	458	1,314	1,445
Intercompany eliminations	(11)	(18)	(47)	(54)
Total depreciation and amortization	$ 742	$ 753	$ 2,229	$ 2,287
Expenditures for long-lived assets:				
Ground segment systems, networks and enterprise solutions	$ 4,694	$ 139	$ 5,991	$ 519
Data communications services	3,776	199	8,096	813
Total expenditures for long-lived assets	$ 8,470	$ 338	$ 14,087	$ 1,332

	March 31, 2007 (Unaudited)	June 30, 2006
	(In thousands)	
Assets:		
Ground segment systems, networks and enterprise solutions	$ 161,006	$ 145,125
Data communications services	19,726	13,256
Intercompany eliminations	(70,307)	(65,147)
Total assets	$ 110,425	$ 93,234

5. Line of Credit

On October 31, 2006, the Company entered into a secured credit facility with Citibank, N.A, which expires on November 30, 2007. The credit facility is comprised of: (1) a $25 million borrowing base line of credit (the ‘‘Line’’), which is available for standby letters of credit, commercial letters of credit and loans; (2) a bridge line of credit in the amount of $7 million, which is to support equipment purchases; and (3) a foreign exchange line in the amount of $10 million. If there are direct borrowings under the Line, the commercial letters of credit and loans may not be drawn in amounts in excess of

11

Table of Contents

$20 million. The Line bears interest at the prime rate or LIBOR plus 200 basis points, at the discretion of the Company, and is collateralized by a first priority security interest on all of the assets of the Company. The Company can be advanced up to 80% of eligible accounts receivable and 100% of unrestricted cash. The credit facility provides that the Company may borrow and apply letters of credit against the availability under the line of credit. In addition, the credit facility contains certain financial and other covenants, deposit requirements, monthly reporting provisions and other requirements. The credit facility is uncommitted and advances are subject to Citibank, N.A.’s approval. As of March 31, 2007, no borrowings were outstanding under this credit facility, however, there were standby letters of credit of approximately $16.3 million, which were applied against and reduced the amounts available under this credit facility.

6. Subsequent Event

On May 2, 2007, the Company acquired from Lyman Bros., Inc. (‘‘Lyman’’) substantially all of the assets and assumed certain liabilities of GlobalSat, LLC (the ‘‘Assets’’), 100% of the equity interests of Lyman Maryland Properties, LLC and Turbo Logic Associates, LLC, both Delaware limited liability companies and wholly-owned subsidiaries of Lyman (the ‘‘Companies’’). Together, the assets and the Companies comprise the GlobalSat division of Lyman. GlobalSat is a global provider of satellite-based telecommunications services. Headquartered in Metropolitan Washington D.C., it employs approximately 70 U.S. Government cleared staff worldwide and has a high concentration of recurring service revenues in the government marketplace. The GlobalSat business will operate in the data communication services segment under the name of Globecomm Services Maryland LLC and will be a wholly-owned subsidiary of the Company.

The Company acquired the GlobalSat business for a purchase price of $18.4 million in cash, subject to certain working capital adjustments. The purchase price was funded in part through a five-year $16.0 million acquisition term loan (‘‘Acquisition Loan’’) provided by Citibank, N.A. The Acquisition Loan bears interest at the prime rate or LIBOR plus 225 basis points, at the discretion of the Company, and is collateralized by a first priority security interest on all of the assets of the Company, including the GlobalSat assets. The Acquisition Loan contains certain financial and other covenants, deposit requirements, monthly reporting provisions and other requirements and can be repaid by the Company at any time without premium or penalty.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

You should read the following discussion of our financial condition and results of operations with the consolidated financial statements and related notes included elsewhere in this Quarterly Report on Form 10-Q. This discussion contains, in addition to historical information, forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, based on our current expectations, assumptions, estimates and projections. These forward-looking statements involve risks and uncertainties. Our actual results could differ materially from those

anticipated in these forward-looking statements as a result of certain factors, such as, among others, uncertain demand for our services and products due to economic and industry-specific conditions, the risks associated with operating in international markets, our dependence on a limited number of contracts for a high percentage of our revenues, and the performance of the GlobalSat business following its acquisition. These risks and others are more fully described in the ‘‘Risk Factors’’ section of this Quarterly Report and in our other filings with the Securities and Exchange Commission, including our Annual Report on Form 10-K and Quarterly Reports on Form 10-Q. We undertake no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future.

Overview

Our business is global and subject to technological and business trends in the telecommunications marketplace. We derive much of our revenue from government and government related entities (‘‘government marketplace’’) and developing countries. Our business is therefore affected by geopolitical developments involving areas of the world in which our customers are located, particularly in developing countries and areas of the world involved in armed conflicts.

Table of Contents

The products and services we offer include: pre-engineered systems, systems design and integration services, managed network services and life cycle support services. To provide these products and services, we engineer all the necessary satellite and terrestrial facilities as well as provide the integration services required to implement those facilities. We also operate and maintain managed networks and provide life cycle support services on an ongoing basis. Our customers generally have network service requirements that include point-to-point or point-to-multipoint connections via a hybrid network of satellite and terrestrial facilities. In addition to the government marketplace, these customers are communications service providers, commercial enterprises, and media and content broadcasters.

Since our products and services are often sold into areas of the world which do not have fiber optic land-based networks, a substantial portion of our revenues are derived from, and are expected to continue to be derived from, developing countries. These countries carry with them more enhanced risks of doing business than in developed areas of the world, including the possibility of armed conflicts or the risk that more advanced land-based telecommunications will be implemented over time.

In the three months ended March 31, 2007, 54% of our revenues were generated by two customers in the government marketplace. Although the identity of customers and contracts may vary from period to period, we have been, and expect to continue to be, dependent on revenues from a small number of customers or contracts in each period in order to meet our financial goals. From time to time these customers are located in developing countries or otherwise subject to unusual risks.

Revenues related to contracts for ground segment systems, networks and enterprise solutions and data communications services have been fixed-price contracts in a majority of cases. Profitability of such contracts is subject to inherent uncertainties as to the cost of performance. In addition to possible errors or omissions in making initial estimates, cost overruns may be incurred as a result of unforeseen obstacles, including both physical conditions and unexpected problems encountered in engineering design and testing. Since our business is frequently concentrated in a limited number of large contracts, a significant cost overrun on any contract could have a material adverse effect on our business, financial condition and results of operations.

Contract costs generally include purchased material, direct labor, overhead and other direct costs. Anticipated contract losses are recognized, as they become known. Costs from ground segment systems, networks and enterprise solutions consist primarily of the costs of purchased materials (including shipping and handling costs), direct labor and related overhead expenses, project-related travel and living costs and subcontractor salaries. Costs from data communications services consist primarily of satellite space segment charges, voice termination costs, network operations expenses and Internet connectivity fees. Satellite space segment charges consist of the costs associated with obtaining satellite bandwidth (the measure of capacity) used in the transmission of services to and from the satellites leased from operators. Network operations expenses consist primarily of costs associated with the operation of the network operations center on a twenty-four hour a day, seven day a week basis, including personnel and related costs and depreciation. Selling and marketing expenses consist primarily of salaries, travel and living costs for sales and marketing personnel. Research and development expenses consist primarily of salaries and related overhead expenses. General and administrative expenses consist of expenses associated with our management, finance, contract and administrative functions.

Critical Accounting Policies

Certain of our accounting policies require judgment by management in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. These judgments are based on our historical experience, the terms of existing contracts, our observance of trends in the industry, information provided by our customers, and information available from other outside sources, as appropriate. Actual results may differ from these judgments under different assumptions or conditions. Our accounting policies that require management to apply significant judgment include:

13

Table of Contents

Revenue Recognition

We recognize revenue in accordance with Staff Accounting Bulletin No. 104 (‘‘SAB 104’’), Revenue Recognition, for our production-type contracts that are sold separately as standard satellite ground segment systems when persuasive evidence of an arrangement exists, the selling price is fixed or determinable, collectibility is reasonably assured, delivery has occurred and the contractual performance specifications have been met. Our standard satellite ground segment systems produced in connection with these contracts are typically short-term (less than twelve months in term) and manufactured using a standard modular production process. Such systems require less engineering, drafting and design efforts than our long-term complex production-type projects. Revenue is recognized on our standard satellite ground segment systems upon shipment and acceptance of factory performance testing which is when title transfers to the customer. The amount of revenues recorded on each standard production-type contract is reduced by the customer’s contractual holdback amount, which typically requires 10% to 30% of the contract value to be retained by the customer until installation and final acceptance is complete. The customer generally becomes obligated to pay 70% to 90% of the contract value upon shipment and acceptance of factory performance testing. Installation is not deemed to be essential to the functionality of the system since installation does not require significant changes to the features or capabilities of the equipment, does not require complex software integration and interfacing and we have not experienced any difficulties installing such equipment. In addition, the customer or other third party vendors can install the equipment. The estimated relative fair value of the installation services is determined by management, which is typically less than the customer’s contractual holdback percentage. If the holdback is less than the fair value of installation, we will defer recognition of revenues, determined on a contract-by-contract basis equal to the fair value of the installation services. Payments received in advance by customers are deferred until shipment and are presented

as deferred revenues.

We recognize revenue using the percentage-of-completion method of accounting upon the achievement of certain contractual milestones in accordance with Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, for our non-standard, complex production-type contracts for the production of satellite ground segment systems and equipment that are generally integrated into the customer's satellite ground segment network. The equipment and systems produced in connection with these contracts are typically long-term (in excess of twelve months in term) and require significant customer-specific engineering, drafting and design effort in order to effectively integrate all of the customizable earth station equipment into the customer's ground segment network. These contracts generally have larger contract values, greater economic risks and substantive specific contractual performance requirements due to the engineering and design complexity of such systems and related equipment. Progress payments received in advance by customers are netted against the inventories balance.

The timing of our revenue recognition is primarily driven by achieving shipment, final acceptance or other contractual milestones. Project risks including project complexity, political and economic instability in certain regions in which we operate, export restrictions, tariffs, licenses and other trade barriers which may result in the delay of the achievement of revenue milestones. A delay in achieving a revenue milestone may negatively impact our results of operations.

Costs from Ground Segment Systems, Networks and Enterprise Solutions

Costs related to our production-type contracts and our non-standard, complex production-type contracts rely on estimates based on total expected contract costs. Typically, these contracts are fixed price projects. We use estimates of the costs applicable to various elements which we believe are reasonable. Our estimates, are assessed continually during the term of these contracts and costs are subject to revisions as the contract progresses to completion. These estimates are subjective based on management assessment of project risk. These risks may include project complexity and political and economic instability in certain regions in which we operate. Revisions in cost estimates are reflected in the period in which they become known. A significant revision in an estimate may negatively impact our results of operations. In the event an estimate indicates that a loss will be incurred at completion, we record the loss as it becomes known.

Table of Contents

Goodwill Impairment

Goodwill represents the excess of the purchase price of businesses over the fair value of the identifiable net assets acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and other indefinite life intangible assets are no longer amortized, but instead tested for impairment at least annually. The impairment test for goodwill uses a two-step approach, which is performed at the reporting unit level. Step one compares the fair value of the reporting unit (calculated using a discounted cash flow method) to its carrying value. If the carrying value exceeds the fair value, there is a potential impairment and step two must be performed. Step two compares the carrying value of the reporting unit's goodwill to its implied fair value (i.e., fair value of the reporting unit less the fair value of the unit's assets and liabilities, including identifiable intangible assets). If the carrying value of goodwill exceeds its implied fair value, the excess is required to be recorded as an impairment charge. The impairment test is dependent upon estimated future cash flows of the data communication services segment. There have been no events during the

nine months ended March 31, 2007 that would result in any goodwill impairment.

Deferred tax assets

In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income prior to the expiration of any net operating loss carryforwards. Due to the uncertainty regarding our ability to utilize the net operating losses in the future, we have provided a valuation allowance against the operating losses and temporary differences.

Allowances for Doubtful Accounts

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We assess the customer's ability to pay based on a number of factors, including our past transaction history with the customer and the creditworthiness of the customer. An assessment of the inherent risks in conducting our business with foreign customers is also made since a significant portion of our revenues is international. Management specifically analyzes accounts receivable, historical bad debts, customer concentrations, customer creditworthiness and current economic trends. If the financial condition of our customers were to deteriorate in the future, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories

Inventories consist primarily of work-in-progress from costs incurred in connection with specific customer contracts, which are stated at the lower of cost or market value. In assessing the realizability of inventories, we are required to make estimates of the total contract costs based on the various elements of the work-in-progress. It is possible that changes to these estimates could cause a reduction in the net realizable value of our inventories.

Results of Operations

Three and Nine Months Ended March 31, 2007 and 2006

Revenues from Ground Segment Systems, Networks and Enterprise Solutions. Revenues increased by $8.1 million, or 34.1%, to $31.8 million for the three months ended March 31, 2007 and increased by $8.3 million, or 11.9%, to $77.6 million for the nine months ended March 31, 2007, compared to $23.7 million and $69.4 million for the three and nine months ended March 31, 2006, respectively. The increase in revenues was primarily driven by the increase in the pre-engineered systems product line revenue in the government marketplace.

Revenues from Data Communication Services. Revenues remained consistent at $7.3 million for the three months ended March 31, 2007 and 2006 and increased by $2.8 million, or 13.0%, to

---

Table of Contents

$23.9 million for the nine months ended March 31, 2007, compared to $21.2 million for the nine months ended March 31, 2006. Although revenues were consistent for the three months ended March 31, 2007 and 2006, the revenue within the life cycle support services increased due to an increase in the government marketplace offset by a decrease in telephony services due to increased competition. The increase in the nine months ended March 31, 2007

was primarily due to an increase in life cycle support services in the government marketplace and the sale of equipment and services to a major U.S enterprise customer, partially offset by a decrease in telephony services due to increased competition.

Costs from Ground Segment Systems, Networks and Enterprise Solutions. Costs from ground segment systems, networks and enterprise solutions increased by $5.6 million, or 28.6%, to $25.2 million for the three months ended March 31, 2007 and increased by $4.7 million, or 8.1% to $62.5 million for the nine months ended March 31, 2007, compared to $19.6 million and $57.8 million for the three and nine months ended March 31, 2006, respectively. The gross margin increased to 20.7% and 19.5% for the three and nine months ended March 31, 2007 from 17.4% and 16.6% for the three and nine months ended March 31, 2006, respectively. This increase in gross margin for the three and nine months ended March 31, 2007 was mainly attributable to increased revenue related to the pre-engineered systems product line in the government marketplace, in particular one and two customers, respectively with higher than our usual gross margins.

Costs from Data Communications Services. Costs from data communications services increased by $0.3 million, or 4.4%, to $6.1 million for the three months ended March 31, 2007 and increased by $2.1 million, or 12.0%, to $19.7 million for the nine months ended March 31, 2007, compared to $5.9 million and $17.6 million for the three and nine months ended March 31, 2006, respectively. The gross margin decreased to 16.0% for the three months ended March 31, 2007 and increased to 17.7% for the nine months ended March 31, 2007, from 19.6% and 16.9% for the three and nine months ended March 31, 2006, respectively. The decrease in gross margin for the three months ended March 31, 2007 is primarily the result of lower margins in telephony services due to increased minutes termination costs and increased competition.The increase in the gross margin for the nine months ended March 31, 2007 was primarily a result of an increase in revenue in the government marketplace within life cycle support services which has higher margin than the other service offerings, partially offset by the decrease in margin in the telephony service offering. The gross margin percentage experienced in the nine months ended March 31, 2007 is higher than our historical norm and higher than the gross margin percentage expected for the remainder of fiscal year 2007.

Selling and Marketing. Selling and marketing expenses increased by $0.4 million, or 22.4%, to $2.3 million for the three months ended March 31, 2007 and increased by $0.8 million, or 16.6%, to $5.8 million for the nine months ended March 31, 2007, compared to $1.9 million and $5.0 million for the three and nine months ended March 31, 2006, respectively. The increase is a result of an increase in salary and salary related expenses for additional marketing personnel pursuing business in the government marketplace, travel and living expenses related to marketing efforts exploring new markets and expenses related to the sales office in Afghanistan.

Research and Development. Research and development expenses increased by $0.2 million, or 64.2%, to $0.4 million for the three months ended March 31, 2007 and increased by $0.4 million, or 79.0%, to $1.0 million for the nine months ended March 31, 2007, compared to $0.3 million and $0.5 million for the three and nine months ended March 31, 2006, respectively. The increase was principally due to costs associated with developing the next version of AxxSys[R] Network Management System on the ‘‘.Net’’ operating system called AxxSys[R] Orion and additional efforts enhancing the cellular hosted switch offering.

General and Administrative. General and administrative expenses increased by $0.7 million, or 27.5%, to $3.0 million for the three months ended March 31, 2007 and increased by $1.2 million, or 16.8%, to $8.4 million for the nine months ended March 31, 2007, compared to $2.4 million and $7.2 million for the three and nine months ended March 31, 2006, respectively. The increase in general and administrative expenses was due to an increase in fringes primarily due to the increase in the Company’s pay for performance plan, salary increases due to an increase in headcount and an increase in bad debt expense in the data communications service business.

Table of Contents

Interest Income. Interest income increased by $0.1 million, or 58.3%, to $0.4 million for the three months ended March 31, 2007 and increased by $0.3 million, or 43.2%, to $1.0 million for the nine months ended March 31, 2007, compared to $0.2 million and $0.7 million for the three and nine months ended March 31, 2006, respectively, as a result of increased interest rates coupled with an increase in the balance of cash and cash equivalents.

Liquidity and Capital Resources

At March 31, 2007, we had working capital of $44.0 million, including cash and cash equivalents of $29.8 million, net accounts receivable of $26.7 million, inventories of $16.8 million, prepaid expenses and other current assets of $1.7 million, offset by $18.6 million in accounts payable, $6.4 million in deferred revenues and $5.9 million in accrued expenses and other current liabilities.

During the nine months ended March 31, 2007, we generated significant cash flow from operations, which in large part was applied to major capital improvements described below. We do not expect that capital expenditures during the fiscal year ending June 30, 2008 will be at the same levels as we have experienced this fiscal year.

Net cash provided by operating activities during the nine months ended March 31, 2007 was $13.2 million, which primarily related to net income of $5.1 million, an increase in deferred revenue of $4.7 million due to timing differences between project billings and revenue recognition milestones resulting from specific customer contracts, a decrease in accounts receivable of $3.7 million due to the timing of billings and collections from customers, a non-cash item representing depreciation and amortization expense of $2.2 million primarily related to the network operations center and satellite earth station equipment and an increase in accrued payroll and related fringe benefits of $0.8 million due to the timing of payroll and the increase in the company's pay for the performance plan, partially offset by an increase in inventory of $3.7 million due to the timing of shipments of certain jobs.

Net cash used in investing activities during the nine months ended March 31, 2007 was $14.1 million, which primarily related to the purchase of network operations center and teleport assets primarily for a large program that we anticipate will be in service on July 1, 2007. In addition, we are upgrading our facility to meet the requirements of our increase in business levels. We estimate an additional $3 million in capital expenditures for the remainder of the year ending June 30, 2007 primarily for the network operations center, teleport, and facility upgrade for both this large program and other requirements due to the increase in business levels. We will use our existing working capital to meet these capital expenditure requirements.

Net cash provided by financing activities during the nine months ended March 31, 2007 was $6.1 million, which related to proceeds from the exercise of stock options and warrants.

On May 2, 2007, we acquired from Lyman Bros., Inc. substantially all of the assets and the assumed certain liabilities of GlobalSat, LLC and 100% of the equity interests of Lyman Maryland Properties, LLC and Turbo Logic Associates, LLC which is collectively known as the GlobalSat business. GlobalSat is a global provider of satellite-based telecommunications services. Headquartered in Metropolitan Washington D.C., the GlobalSat business employs approximately 70 U.S. Government cleared staff worldwide and has a high concentration of recurring service revenues in the government marketplace.

Pursuant to the terms of the Purchase Agreement, we acquired the GlobalSat business for a purchase price of $18.4 million in cash, subject to certain working capital adjustments. The purchase price was funded, in part, through a five-year $16.0 million acquisition term loan (''Acquisition Loan'') provided by Citibank, N.A. The Acquisition Loan bears interest at the prime rate or LIBOR plus 225 basis points, at our discretion, and is collateralized by a first

priority security interest on all of our assets, including the GlobalSat assets.

At March 31, 2007, we had a credit facility in place with Citibank, N.A, which expires on November 30, 2007. The credit facility is comprised of: (1) a $25 million borrowing base line of credit (the ‘‘Line’’), which is available for standby letters of credit, commercial letters of credit and loans; (2) a bridge line of credit in the amount of $7 million, which is to support equipment purchases; and

(3) a foreign exchange line in the amount of $10 million. If there are direct borrowings under the Line, the commercial letters of credit and direct borrowings may not be drawn in amounts in excess of $20 million. The Line bears interest at the prime rate or LIBOR plus 200 basis points, at our discretion, and is collateralized by a first priority security interest on all of our assets. We can be advanced up to 80% of eligible accounts receivable and 100% of unrestricted cash. The credit facility provides that we may borrow and apply letters of credit against the availability under the Line. In addition, the credit facility contains certain financial and other covenants, deposit requirements, monthly reporting provisions and other requirements. The credit facility is uncommitted and advances are subject to Citibank, N.A.’s approval. As of March 31, 2007, no borrowings were outstanding under the credit facility; however, there were standby letters of credit of approximately $16.3 million, which were applied against and reduced the amounts available under the facility.

We lease satellite space segment services and other equipment under various operating lease agreements, which expire in various years through 2009. Future minimum lease payments due on these leases through March 31, 2008 are approximately $6.8 million.

At March 31, 2007, we had contractual obligations and other commercial commitments as follows (in thousands):