GLENAYRE TECHNOLOGIES INC
Form 10-Q
August 06, 2004

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended **June 30, 2004**

o 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 **0-15761**

GLENAYRE TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE	**98-0085742**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
11360 LAKEFIELD DRIVE, DULUTH, GEORGIA	**30097**
(Address of principal executive offices)	(Zip Code)

(770) 283-1000

(Registrant s telephone number, including area code)

NOT APPLICABLE

(Former name, former address and former fiscal year, if changed since last report)

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 x No o

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

The number of shares outstanding of the Registrant s common stock, par value $.02 per share, at July 30, 2004 was 66,673,518 shares.

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Report of Independent Registered Public Accounting Firm

Glenayre Technologies, Inc. Board of Directors and Stockholders Atlanta, Georgia

We have reviewed the condensed consolidated balance sheet of Glenayre Technologies, Inc. and Subsidiaries as of June 30, 2004, and the related condensed consolidated statements of operations for the three month and six month periods ended June 30, 2004 and 2003, the condensed consolidated statement of stockholders equity for the six months ended June 30, 2004, and the condensed consolidated statements of cash flows for the six months ended June 30, 2004 and 2003. These financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Glenayre Technologies, Inc. and Subsidiaries as of December 31, 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for the year then ended not presented herein, and in our report dated March 18, 2004 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2003, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

Atlanta, Georgia
August 3, 2004

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GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	June 30, 2004	December 31, 2003
	(unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 47,606	$ 65,853
Short-term investments	38,998	33,007
Restricted cash	258	3,148
Accounts receivable, net	9,198	9,769
Inventories, net	7,710	5,828
Other current asset, discontinued operations	3,249	3,374
Prepaid expenses and other current assets	3,196	3,180
Total Current Assets	110,215	124,159
Property, plant and equipment, net	8,744	8,365
Other assets	787	831
TOTAL ASSETS	$ 119,746	$ 133,355
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 2,092	$ 3,142
Deferred revenue	4,599	4,369
Accrued liabilities	15,896	20,695
Accrued liabilities, discontinued operations	4,079	7,567
Total Current Liabilities	26,666	35,773
Other liabilities	3,619	4,000
Accrued liabilities, discontinued operations - noncurrent	617	3,350
Stockholders Equity:		
Preferred stock, $.01 par value; authorized: 5,000,000 shares, no shares issued and outstanding		
Common stock, $.02 par value; authorized: 200,000,000 shares, outstanding: 2004 - 66,653,325 shares; 2003 - 66,384,928 shares	1,333	1,327
Contributed capital	362,528	362,273
Accumulated deficit	(275,017)	(273,368)

Total Stockholders Equity	88,844	90,232
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 119,746	$ 133,355

See Notes to Condensed Consolidated Financial Statements.

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GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three months Ended June 30,	
	2004	**2003**
REVENUES:		
Product sales	$ 7,201	$10,420
Service revenues	5,025	4,208
Total Revenues	12,226	14,628
COST of REVENUES (exclusive of depreciation shown separately below):		
Cost of sales	2,685	5,593
Cost of services	2,239	2,729
Total Cost of Revenues	4,924	8,322
GROSS MARGIN (exclusive of depreciation shown separately below):	7,302	6,306
OPERATING EXPENSES:		
Selling, general and administrative expense	5,016	5,563
Provision for doubtful receivables, net of recoveries	28	(47)
Research and development expense	3,216	4,774
Restructuring expense	75	1,582
Depreciation expense	419	264
Total Operating Expenses	8,754	12,136
OPERATING LOSS	(1,452)	(5,830)
OTHER INCOME (EXPENSES):		
Interest income	249	469
Interest expense	(5)	(9)
Gain (loss) on disposal of assets, net		
Other gain (loss), net	(14)	3

Total Other Income	230	463
LOSS FROM OPERATIONS BEFORE INCOME TAXES	(1,222)	(5,367)
Provision for income taxes	19	
LOSS FROM CONTINUING OPERATIONS	(1,241)	(5,367)
INCOME (LOSS) FROM DISCONTINUED OPERATIONS (NET OF INCOME TAX/BENEFIT)	3,808	(1,104)
NET INCOME (LOSS)	$ 2,567	$ (6,471)
INCOME (LOSS) PER WEIGHTED AVERAGE COMMON SHARE:		
Loss from continuing operations	$ (0.02)	$ (0.08)
Income (loss) from discontinued operations	0.06	(0.02)
Net income (loss) per weighted average common share	$ 0.04	$ (0.10)
INCOME (LOSS) PER COMMON SHARE ASSUMING DILUTION:		
Loss from continuing operations	$ (0.02)	$ (0.08)
Income (loss) from discontinued operations	0.06	(0.02)
Net income (loss) per weighted average common share	$ 0.04	$ (0.10)

See Notes to Condensed Consolidated Financial Statements.

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GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Six Months Ended June 30,	
	2004	**2003**
REVENUES:		
Product sales	$13,038	$ 19,827
Service revenues	9,382	8,144
Total Revenues	22,420	27,971
COST of REVENUES (exclusive of depreciation shown separately below):		
Cost of sales	8,541	9,309
Cost of services	4,386	5,330
Total Cost of Revenues	12,927	14,639
GROSS MARGIN (exclusive of depreciation shown separately below):	9,493	13,332
OPERATING EXPENSES:		
Selling, general and administrative expense	9,319	13,519
Provision for doubtful receivables, net of recoveries	(64)	(215)
Research and development expense	6,637	9,983
Restructuring expense	112	1,804
Depreciation expense	816	408
Total Operating Expenses	16,820	25,499
OPERATING LOSS	(7,327)	(12,167)
OTHER INCOME (EXPENSES):		
Interest income	524	927
Interest expense	(214)	(42)
Gain (loss) on disposal of assets, net	(6)	14
Other gain (loss), net	(66)	96

Total Other Income	238	995
LOSS FROM OPERATIONS BEFORE INCOME TAXES	(7,089)	(11,172)
Provision for income taxes	53	28
LOSS FROM CONTINUING OPERATIONS	(7,142)	(11,200)
INCOME FROM DISCONTINUED OPERATIONS (NET OF INCOME TAX/BENEFIT)	5,493	202
NET LOSS	$ (1,649)	$ (10,998)
INCOME (LOSS) PER WEIGHTED AVERAGE COMMON SHARE (1):		
Loss from continuing operations	$ (0.11)	$ (0.17)
Income from discontinued operations	0.08	0.00
Net loss per weighted average common share	$ (0.02)	$ (0.17)
INCOME (LOSS) PER COMMON SHARE - ASSUMING DILUTION (1):		
Loss from continuing operations	$ (0.11)	$ (0.17)
Income from discontinued operations	0.08	0.00
Net loss per weighted average common share	$ (0.02)	$ (0.17)

(1) Income (loss) per weighted average common share amounts are rounded to the nearest $.01; therefore, such rounding may impact individual amounts presented.

See Notes to Condensed Consolidated Financial Statements.

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GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(In thousands)
(Unaudited)

	Common Stock Shares	Common Stock Amount	Contributed Capital	Accumulated Deficit	Total Stockholders Equity
Balances, January 1, 2004	66,385	$1,327	$362,273	$(273,368)	$90,232
Net loss				(1,649)	(1,649)
Shares issued for Employee Stock Purchase Plan and option exercises	268	6	255		261
Balances, June 30, 2004	66,653	$1,333	$362,528	$(275,017)	$88,844

See Notes to Condensed Consolidated Financial Statements.

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GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30, 2004	2003
	(In thousands)	
NET CASH USED IN OPERATING ACTIVITIES	$(11,316)	$ (7,919)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(1,201)	(2,806)
Investment in short-term securities	(5,991)	(5,841)
NET CASH USED IN INVESTING ACTIVITIES	(7,192)	(8,647)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock	261	235
Purchase of treasury stock		(34)
NET CASH PROVIDED BY FINANCING ACTIVITIES	261	201
NET DECREASE IN CASH AND CASH EQUIVALENTS	(18,247)	(16,365)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	65,853	64,116
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 47,606	$ 47,751
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest	$ 197	$ 42
Income taxes	347	22

See Notes to Condensed Consolidated Financial Statements.

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Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Tabular amounts in thousands except per share data)
(Unaudited)

1. Summary of Significant Accounting Policies

Description of Business

Glenayre Technologies, Inc. and Subsidiaries (Glenayre or the Company) is an established provider of network-based messaging and communications systems and software. Applications enabled by the Company s products include voice messaging, multimedia messaging and other enhanced telephony services. The Company designs, manufactures, markets and services its products principally under the Glenayre name. The Company s customers are communications service providers (CSPs) including wireless and fixed network carriers, as well as broadband and cable service providers. The Company s products make it possible for CSPs to provide a variety of messaging services including voice mail, one-number services, voice-activated dialing and picture messaging to their customers. Glenayre s executive offices are located in the Atlanta metropolitan area.

The Company s operations also include its Wireless Messaging (Paging) business, which the Company began exiting in May 2001. Consequently, the operating results of the Paging segment are reported as discontinued operations in the accompanying financial statements. See Note 3.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and 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 adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany accounts and transactions are eliminated in consolidation. Operating results for the three and six months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. Glenayre s financial results in any quarter are highly dependent upon various factors, including the timing and size of customer orders and the shipment of products for large orders. Large orders from customers can account for a significant portion of products shipped in any quarter. Accordingly, the shipment of products in fulfillment of such large orders can dramatically affect the results of operations of any single quarter.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Glenayre Technologies, Inc. Annual Report on Form 10-K for the year ended December 31, 2003.

Use of 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 financial statements and accompanying notes. Actual results could differ from those estimates.

Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. These investments generally consist of high-grade commercial paper, bank certificates of deposit, treasury bills, notes or agency securities guaranteed by the U.S. Government and repurchase agreements backed by U.S. Government securities.

The Company maintains cash and cash equivalents with various financial institutions. These financial institutions are large diversified entities with operations throughout the U.S. and Company policy is designed to limit exposure to any one institution. The Company performs periodic evaluations of the relative credit standing of those financial institutions that are considered in the Company s investment strategy.

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Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Tabular amounts in thousands except per share data)
(Unaudited)

Restricted cash at June 30, 2004 consists of time deposits pledged as collateral to secure letters of credit, substantially all of which expire in less than one year.

Short-Term Investments

Short-term investments consist of highly liquid investments purchased with original maturities of greater than three months and less than twelve months.

Accounts Receivable, Net

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. On a quarterly basis the Company applies a reserve calculation based on the aging of its receivables and either increases or decreases its estimate of doubtful accounts accordingly. If the financial condition of the Company s customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required, which such allowances, if any, would be recorded in the period the impairment is identified.

Inventories

Inventories are valued at the lower of average cost or market. In assessing the ultimate realization of inventories, the Company is required to make judgments as to future demand requirements and compare these with the current or committed inventory levels. The reserve requirements generally increase as projected demand requirements decrease due to market conditions, technological and product life cycle changes, and longer than previously expected usage periods. The Company has experienced changes in required reserves in recent periods due to the discontinuances of product lines, as well as declining market conditions. As a result, charges for obsolescence and slow-moving inventory were approximately $89,000 and $665,000 during the six month periods ended June 30, 2004 and 2003, respectively. At June 30, 2004 and December 31, 2003, inventories of $7.7 million and $5.8 million, respectively, were net of reserves of approximately $3.6 million for both periods. It is possible that significant changes in required inventory reserves may continue to occur in the future if there is a further decline in market conditions or if additional product lines are discontinued. In connection with the introduction of new products and services as well as in an effort to demonstrate its products to new and existing customers, the Company, from time to time, delivers new product test systems for demonstration and test to customer third-party locations. The Company expenses the cost associated with new product test equipment upon shipment from the Company s facilities.

Property, Plant and Equipment

Property, plant and equipment, including internally developed software, are stated at cost less accumulated depreciation. Depreciation is computed principally using the straight-line method based on the estimated useful lives of the related assets (buildings, 20 years; furniture, fixtures and equipment, 3-7 years; internally developed software, 5-10 years).

Impairment of Long-Lived Assets

The Company records the impairment or disposal of long-lived assets according to Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. The Company reviews the recoverability of its long-lived assets, including buildings, equipment and internal use software when events or changes in circumstances occur that indicate that the carrying value of the asset may not be recoverable. The assessment of possible impairment is based on the Company s ability to recover the carrying value of the asset from the expected future pre-tax cash flows of the related operations. To the extent that the asset is not recoverable, the Company measures the impairment based on the projected discounted cash flows of the asset over the remaining useful life. The measurement of impairment requires management to make estimates of these cash flows related to long-lived assets, as well as other fair value determinations. No impairment was recorded during the six months ended June 30, 2004.

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Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Tabular amounts in thousands except per share data)
(Unaudited)

Foreign Currency Translation

The accounts of foreign subsidiaries have been translated into U.S. dollars using the current exchange rate in effect at the balance sheet date for monetary assets and liabilities; and for non-monetary items, the exchange rates in effect when acquired. Revenues and expenses are translated into U.S. dollars using average exchange rates, except for depreciation, which is translated at the exchange rate in effect when the related assets were acquired. The resulting gains or losses on currency translations, which are not significant, are included in the unaudited condensed consolidated statements of operations or as a cumulative exchange adjustment in the unaudited condensed consolidated statements of stockholders equity.

Revenue Recognition

The Company recognizes revenues in accordance with Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*; as amended by SAB No. 104, *Revenue Recognition;* Emerging Issues Task Force (EITF) Issue No. 00-21: *Revenue Arrangements with Multiple Deliverables;* Statement of Position (SOP) 97-2, *Software Revenue Recognition*; EITF Issue No. 03-5, *Applicability of AICPA Statement of Position 97-2, Software Revenue Recognition, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software;* and related interpretations. The Company recognizes revenue for products sold at the time delivery occurs and acceptance is determinable, collection of the resulting receivable is deemed probable, the price is fixed and determinable and evidence of an arrangement exists. Certain products sold by the Company have operating software embedded in the configuration of the system. Existing customers may purchase product enhancements and upgrades after such enhancements or upgrades are developed by the Company based on a standard price list in effect at the time such product enhancements and upgrades are purchased. The Company typically has no significant performance obligations to customers after the date products, product enhancements and upgrades are delivered, except for product warranties (see *Estimated Warranty Costs* below).

The Company allocates revenue on arrangements involving multiple elements to each element based on the relative fair value of each element. The Company s determination of fair value of each element in multiple-element arrangements is based on vendor-specific objective evidence (VSOE). The Company limits its assessment of VSOE for each element to the price charged when the same element is sold separately or to that price set by the Company s pricing authority for new products. The Company has analyzed all of the elements included in its multiple-element arrangements and determined that it has sufficient VSOE to allocate revenue to each element.

The Company recognizes service revenues from installation and repair services based on a standard price list in effect when such services are provided to customers. Installation is typically not essential to the functionality of the products sold and is usually inconsequential or perfunctory to the sale of the products. In instances where installation is essential to the functionality of the product sold, recognition of the product related revenue is deferred until the installation is completed. Revenues derived from contractual post installation support services are recognized ratably over the contract support period.

The Company records estimated reductions to revenue for customer programs and incentive offerings including special pricing agreements and other volume-based incentives. If market conditions were to decline, the Company may take actions to increase customer incentive offerings possibly resulting in an incremental reduction of revenue at the time the incentive is offered.

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Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Tabular amounts in thousands except per share data)
(Unaudited)

Significant Customers

During the six months ended June 30, 2004, Alltel Communications, Nortel Networks (an OEM partner, as described below), Nextel Communications and U.S. Cellular, individually accounted for approximately 20%, 14%, 13%, and 11%, respectively, of the Company s total revenue from continuing operations. During the six months ended June 30, 2003, Nextel Communications and Nortel Networks (an OEM partner) individually accounted for approximately 23% and 17%, respectively, of the Company s total revenue from continuing operations. Nortel sells the Company s products to several end user customers, including T-Mobile, whose purchases of Glenayre s products from Nortel represented approximately 8% and 14% of the Company s total revenues during the six months ended June 30, 2004 and 2003, respectively.

Product Related Software Costs

Product related computer software development costs are expensed as incurred in accordance with SFAS No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*. Such costs are required to be expensed until the point of technological feasibility is established. Costs, which may otherwise be capitalized after such point, are generally not significant and are therefore expensed as incurred.

Internal Use Software Development Costs

The Company capitalizes the cost associated with the internal development of major business process application software in accordance with Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. The Company expenses preliminary project assessment, research and development, re-engineering and application maintenance costs. No costs were capitalized for the six months ended June 30, 2004 or 2003.

Estimated Warranty Costs

The Company generally warrants its products for one year after sale and a provision for estimated warranty costs is recorded at the time of sale. Factors that affect the Company s warranty liability include the number of units sold, historical and anticipated rates of warranty claims and cost per claim. On a quarterly basis the Company assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. Should actual warranty experience differ from previous estimates, additional adjustments may be required. The following is a summary of activity of the Company s continuing operations warranty obligation for the six months ended June 30, 2004:

Balance at January 1, 2004	$1,257
Provision for and changes in warranty obligations	24
Payments of warranty obligations	(370)
Recoveries of warranty obligations	373
Balance at March 31, 2004	1,284

Provision for and changes in warranty obligations	(158)
Payments of warranty obligations	(320)
Recoveries of warranty obligations	310
Balance at June 30, 2004	$1,116

The Company also offers post installation extended warranty and support services, known as Glenayre Care, for its products and services to customers. The Company s customers generally enter into Glenayre Care agreements of varying terms, which typically require payment in advance of the performance of the extended warranty service. Revenue derived from post installation support services are recognized ratably over the contracted support period. Deferred revenue at June 30, 2004 related to post installation support services was approximately $1.1 million of the $4.6 million of deferred revenue.

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Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Tabular amounts in thousands except per share data)
(Unaudited)

Stock-Based Compensation

The Company grants stock options and issues shares under option plans and an employee stock purchase plan as described in Note 10. The Company accounts for stock option grants and shares sold under the employee stock purchase plan in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25); and, accordingly, records compensation expense for options granted and sales made at prices that are less than fair market value at the date of grant or sale. No compensation expense is recognized for options granted to employees with an exercise price equal to the fair value of the shares at the date of grant.

The following table compares the Company s results of continuing operations as reported, in which stock-based compensation expense is recorded under the intrinsic value method per APB 25, as compared to the pro forma results of continuing operations whereby stock-based compensation is computed under the fair value method. For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense on a straight-line basis over the options vesting period, for each of the three and six month periods ended June 30, 2004 and 2003:

	Three months Ended June 30,		Six months Ended June 30,	
	2004	2003	2004	2003
Loss from continuing operations - as reported	$(1,241)	$(5,367)	$(7,142)	$(11,200)
Pro forma stock option expense (1)	(308)	(28)	(547)	(269)
Loss from continuing operations pro forma	$(1,549)	$(5,395)	$(7,689)	$(11,469)
Loss from continuing operations per common share - as reported	$ (0.02)	$ (0.08)	$ (0.11)	$ (0.17)
Pro forma stock option expense				
Loss from continuing operations per common share - pro forma	$ (0.02)	$ (0.08)	$ (0.11)	$ (0.17)
Loss from continuing operations, assuming dilution - as reported	$ (0.02)	$ (0.08)	$ (0.11)	$ (0.17)
Pro forma stock option expense				

Loss from continuing operations, assuming dilution - pro forma	$ (0.02)	$ (0.08)	$ (0.11)	$ (0.17)

(1) As a result of terminations in 2004 and 2003 resulting from restructuring activities and voluntary terminations, a credit to the pro forma stock option expense was included in the June 30, 2004 and 2003 pro forma stock option expense. The credit for the three months was approximately $26,000 and $214,000, respectively, or $0.00 per share for each quarter. The credit for the six months ended June 30, 2004 and 2003 was approximately $104,000 and $290,000, respectively, or $0.00 per share for each period. This credit related to the pro forma stock option expense previously recognized for these employees in prior periods.

Income Taxes

Income taxes are accounted for using the liability method in accordance with SFAS No. 109, *Accounting for Income Taxes* (FAS 109). Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary

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Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Tabular amounts in thousands except per share data)
(Unaudited)

differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Commitments and Contingencies

During the ordinary course of business contingencies arise resulting from an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the acquisition of an asset or the reduction of a liability or the loss or impairment of an asset or the incurrence of a liability. When loss contingencies exist, including but not limited to, pending or threatened litigation, actual or possible claims and assessments, collectability of receivables or obligations related to product warranties and product defects or statutory obligations, the likelihood of the future event or events occurring generally will confirm the loss or impairment of an asset or the incurrence of a liability. The Company accounts for such contingencies in accordance with the provisions of Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*.

Fair Value of Financial Instruments

The carrying amount of cash and cash equivalents, trade accounts and notes receivable, and other current and long-term liabilities approximates their respective fair values.

Income (Loss) Per Common Share

The Company computes income (loss) per common share pursuant to SFAS No. 128, *Earnings per Share*. The computation of basic income (loss) per share is based on the weighted average number of common shares outstanding during the period. The computation of diluted income (loss) per share is based on the weighted average number of common shares outstanding plus, when their effect is dilutive, potential common stock consisting of shares subject to stock options. There were no shares of potential common stock included in the calculation of diluted income (loss) per share for the three and six months ended June 30, 2004 and 2003 as their effect would be antidilutive for those periods. See Note 10.

Impact of Recently Issued Accounting Standards

In response to the December 8, 2003 enactment of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act), the FASB issued Financial Staff Position (FSP) No. FAS 106-1 and 106-2. The Act introduced a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. FSP No. FAS 106-1 and 106-2 are effective for the Company beginning with the year ended December 31, 2003 and the interim period ended September 30, 2004, respectively. Under FAS 106-1 the Company elected to defer recognition of the effects of the Act on its post retirement benefit plan until authoritative guidance on the accounting for the federal subsidy is issued in accordance with alternatives prescribed by FSP No. FAS 106-1. FSP No. FAS 106-2 is applicable if i) the prescription drug benefits available under the plan to some or all participants for some or all future years are actuarially equivalent to Medicare Part D and thus qualify for the subsidy under the Act and ii) the expected subsidy will offset or reduce the employer s share of the cost of the underlying postretirement prescription drug coverage on which the subsidy is based. The measures of the APBO or net periodic postretirement benefit cost do not currently reflect any amount associated with the subsidy, as allowed by FSP No. 106-2, because the Company is unable to conclude whether the benefits provided by the plan are actuarially equivalent to Medicare Part D under the Act. Under FAS 106-2, once the Company determines applicability, the Company has two alternative methods of transition: i) retroactive application to the date of enactment or ii) prospective application from the date of adoption.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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(Unaudited)

Reclassifications

Certain items in the prior year consolidated financial statements have been reclassified to conform to the current presentation.

2. Business Restructuring of Continuing Operations

Effective January 1, 2003, the Company changed its method of accounting for restructuring activities to conform with Statement of Financial Accounting Standard No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

During the first quarter of 2004, the Company recorded a restructuring charge of $58,000 for severance and outplacement services related to the reduction of the Company s workforce in the first and second quarter of 2003. Additionally, the Company recorded net favorable adjustments to its original estimates associated with the Company s 2003 restructuring activities of $21,000 primarily related to a reduction in accrued severance benefits.

During the second quarter of 2004, the Company recorded restructuring charges of $88,000 for severance and outplacement services primarily related to the reduction of the Company s manufacturing workforce in April 2004. Additionally, the Company recorded net favorable adjustments to its original estimates associated with the Company s 2003 restructuring activities of $13,000 primarily related to a reduction in accrued severance benefits.

During the first quarter of 2003, the Company recorded a restructuring charge of $234,000 for severance and outplacement services related to the reduction of the Company s workforce by approximately 19 positions impacting several functional areas within the Company. Additionally, the Company recorded net favorable adjustments to its original estimates associated with the Company s 2002 and 2001 restructuring activities of $12,000 primarily related to a reduction in accrued severance benefits.

During the second quarter of 2003, the Company recorded a restructuring charge of $1.4 million for severance and outplacement services related to the reduction of the Company s workforce by approximately 64 positions impacting several functional areas within the Company. In addition to the restructuring charge, a net favorable adjustment of $41,000 was recorded related to the original estimates associated with the Company s 2003 first quarter restructuring charge for severance. Additionally, the Company recorded a restructuring charge of $183,000 related to lease cancellation and other exit costs expected to be incurred by the Company through October 2006.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Tabular amounts in thousands except per share data)
(Unaudited)

The following is a summary of activity for the six months ended June 30, 2004 related to the restructuring reserves: