

GLENAYRE TECHNOLOGIES INC

Form 10-Q/A

August 15, 2005

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q/A
(Amendment No. 1)**

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

For the quarterly period ended **June 30, 2005**

☐ **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

(State or Other Jurisdiction of
Incorporation or Organization)

98-0085742

(I.R.S. Employer
Identification No.)

**825 8TH AVENUE, 23RD FL, NEW YORK, NEW
YORK**

(Address of principal executive offices)

10019

(Zip Code)

(212) 333-8478

(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 ☒ No ☐

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

The number of shares outstanding of the Registrant's common stock, par value \$.02 per share, at July 29, 2005 was 67,162,726 shares.

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INTRODUCTORY NOTE

Glenayre Technologies, Inc. (Glenayre or the Company) is filing this Amendment No. 1 (Amendment No. 1) to the Form 10-Q originally filed August 9, 2005 (the original filing) to make certain corrections to the pro forma financial information for the three and six month periods ended June 30, 2005 contained in Note 5 to the Condensed Consolidated Financial Statements included in the original filing. The need to amend the original filing to make the corrections resulted from the Company's receiving new information regarding the revenues and net income of the acquired business from Universal Music Group subsequent to the date of the original filing. Except as set forth above and for such other changes as required by applicable law, no attempt has been made in this Amendment No. 1 to modify or update the disclosures as presented in the original filing and this Amendment No. 1 does not reflect events occurring after the date of the original filing on August 9, 2005.

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Glenayre Technologies, Inc. and Subsidiaries

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PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

Glenayre Technologies, Inc. and Subsidiaries

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, 2005, and the related Condensed Consolidated Statements of Operations for the three month and six month periods ended June 30, 2005 and 2004, the Condensed Consolidated Statement of Stockholders' Equity for the six months ended June 30, 2005, and the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2005 and 2004. These financial statements are the responsibility of the Company's management.

We conducted our review 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 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 review, 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, 2004, 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 7, 2005 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, 2004, is fairly stated, in all material respects, in relation to the Consolidated Balance Sheet from which it has been derived.

As discussed in Note 5 to the Condensed Consolidated Financial Statements, the Company has restated its pro forma disclosures for the three and six month periods ended June 30, 2005.

/s/ Ernst & Young LLP

Atlanta, Georgia

August 9, 2005 except for Note 5,

as to which the date is

August 15, 2005

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GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	6/30/05 (Unaudited)	12/31/04
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 63,999	\$ 82,691
Short-term investments		12,180
Restricted cash	875	30
Accounts receivable, net	39,972	7,695
Current portion of long-term receivable	5,523	
Inventories, net	18,588	6,163
Prepaid expenses and other current assets	7,128	2,863
Total Current Assets	136,085	111,622
Restricted cash	39,769	
Property, plant and equipment, net	44,600	8,812
Long-term receivable	7,806	
Intangible assets	66,961	
Other assets	2,116	848
TOTAL ASSETS	\$ 297,337	\$ 121,282
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 25,068	\$ 3,552
Deferred revenue	11,026	3,754
Accrued liabilities	42,819	11,912
Accrued liabilities, discontinued operations	2,601	3,284
Current portion of long-term debt	24,942	
Total Current Liabilities	106,456	22,502
Other liabilities	14,359	3,497
Pension obligation	20,218	
Long-term debt	60,772	
Accrued liabilities, discontinued operations noncurrent	60	98
Total Liabilities	201,865	26,097
Minority Interest in Subsidiary Company	772	
Stockholders' Equity		

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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:		
2005 67,160,226 shares; 2004 66,820,124 shares	1,343	1,336
Contributed capital	363,242	362,698
Accumulated deficit	(269,149)	(268,849)
Cumulative translation adjustment	(736)	
Total Stockholders' Equity	94,700	95,185
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 297,337	\$ 121,282

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)

	Three months ended June 30	
	(unaudited)	
	2005	2004
REVENUES:		
Product sales	\$30,429	\$ 7,201
Service revenues	12,325	5,025
Total Revenues	42,754	12,226
COST OF REVENUES:		
Cost of sales	19,667	2,713
Cost of services	7,857	2,273
Total Cost of Revenues	27,524	4,986
GROSS MARGIN:	15,230	7,240
OPERATING EXPENSES:		
Selling, general and administrative expense	12,091	5,103
Provision for doubtful receivables, net of recoveries	16	28
Research and development expense	3,953	3,486
Restructuring expense	1	75
Amortization of intangible assets	566	
Total Operating Expenses	16,627	8,692
OPERATING LOSS	(1,397)	(1,452)
OTHER INCOME (EXPENSES):		
Interest income	571	249
Interest expense	(505)	(5)
Gain on currency swap, net	262	
Translation loss, net	(1,300)	
Other gain (loss), net	25	(14)
Total Other Income (Expenses)	(947)	230
LOSS FROM OPERATIONS BEFORE INCOME TAXES	(2,344)	(1,222)
Provision for income taxes	134	19
LOSS FROM CONTINUING OPERATIONS	(2,478)	(1,241)

INCOME FROM DISCONTINUED OPERATIONS (NET OF INCOME TAX/BENEFIT)	388	3,808
NET INCOME (LOSS)	\$ (2,090)	\$ 2,567
INCOME (LOSS) PER WEIGHTED AVERAGE COMMON SHARE (1):		
Loss from continuing operations	\$ (0.04)	\$ (0.02)
Income from discontinued operations	0.01	0.06
Net income (loss) per weighted average common share	\$ (0.03)	\$ 0.04
INCOME (LOSS) PER COMMON SHARE ASSUMING DILUTION (1):		
Loss from continuing operations	\$ (0.04)	\$ (0.02)
Income from discontinued operations	0.01	0.06
Net income (loss) per weighted average common share	\$ (0.03)	\$ 0.04

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

	Six months ended June 30	
	(unaudited)	
	2005	2004
REVENUES:		
Product sales	\$44,087	\$13,038
Service revenues	16,589	9,382
Total Revenues	60,676	22,420
COST OF REVENUES:		
Cost of sales	23,822	8,596
Cost of services	10,324	4,453
Total Cost of Revenues	34,146	13,049
GROSS MARGIN:	26,530	9,371
OPERATING EXPENSES:		
Selling, general and administrative expense	19,085	9,490
Provision for doubtful receivables, net of recoveries	26	(64)
Research and development expense	6,982	7,160
Restructuring expense	(11)	112
Amortization of intangible assets	566	
Total Operating Expenses	26,648	16,698
OPERATING LOSS	(118)	(7,327)
OTHER INCOME (EXPENSES):		
Interest income	1,101	524
Interest expense	(512)	(214)
Loss on disposal of assets, net	(1)	(6)
Gain on currency swaps, net	262	
Translation loss, net	(1,300)	
Other gain (loss), net	33	(66)
Total Other Income (Expenses)	(417)	238
LOSS FROM OPERATIONS BEFORE INCOME TAXES	(535)	(7,089)
Provision for income taxes	163	53
LOSS FROM CONTINUING OPERATIONS	(698)	(7,142)

INCOME FROM DISCONTINUED OPERATIONS (NET OF INCOME TAX/BENEFIT)	398	5,493
NET LOSS	\$ (300)	\$ (1,649)
INCOME (LOSS) PER WEIGHTED AVERAGE COMMON SHARE (1):		
Loss from continuing operations	\$ (0.01)	\$ (0.11)
Income from discontinued operations	0.01	0.08
Net loss per weighted average common share	\$ (0.00)	\$ (0.02)
INCOME (LOSS) PER COMMON SHARE ASSUMING DILUTION (1):		
Loss from continuing operations	\$ (0.01)	\$ (0.11)
Income from discontinued operations	0.01	0.08
Net loss per weighted average common share	\$ (0.00)	\$ (0.02)

(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.

Table of Contents**GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY****(In thousands)****(Unaudited)**

	Common Stock		Contributed	Accumulated	Other	Comprehensive
	Shares	Amount	Capital	Deficit	Comprehensive	Income
					Income	(Loss)
Balances, January 1, 2005	66,820	\$1,336	\$362,698	\$(268,849)	\$ 0	
Net income (loss)				(300)		\$ (300)
Foreign currency translation					(736)	(736)
Comprehensive income (loss)						\$ (1,036)
Shares issued for ESP Plan and option exercises	340	7	544			
Balances, June 30, 2005	67,160	\$1,343	\$363,242	\$(269,149)	\$ (736)	

See Notes to Condensed Consolidated Financial Statements.

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GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Six months ended June 30,	
	2005	2004
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	\$ 8,491	\$(11,316)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(1,597)	(1,201)
Maturities of (investment in) short-term securities	12,180	(5,991)
Asset and share purchase of EDC, net of cash acquired	(67,262)	
Increase in restricted cash related to acquisition	(16,500)	
NET CASH USED IN INVESTING ACTIVITIES	(73,179)	(7,192)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term borrowing, net of costs	45,444	
Proceeds from sale of LLC interest in subsidiary	772	
Issuance of common stock	551	261
NET CASH PROVIDED BY FINANCING ACTIVITIES	46,767	261
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(771)	
NET DECREASE IN CASH AND CASH EQUIVALENTS	(18,692)	(18,247)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	82,691	65,853
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 63,999	\$ 47,606

SUPPLEMENTAL INFORMATION OF NON-CASH INVESTING AND FINANCING ACTIVITIES

On May 31, 2005 the Company completed the acquisition of the North American and central European CD and DVD manufacturing and distribution operations from Universal Music Group (Universal) (see Note 2).

Depreciation and amortization of intangible assets included in Net Cash Provided By (Used In) Operating Activities:

	Six months ended June 30,	
	2005	2004
	(In thousands)	
Depreciation included in cost of sales	\$1,036	\$123
Depreciation included in selling, general and administrative expense	342	171
Depreciation included in research and development expense	643	523
Amortization of intangible asset	566	

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. Business and Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of Glenayre Technologies, Inc. and Subsidiaries (Glenayre or 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 for the periods presented have been included. All significant inter-company accounts and transactions have been eliminated in consolidation. Operating results for the three and six months ended June 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

The Company's Messaging Business is an established global provider of network-based messaging and communication systems and software that enable applications including voice messaging, multimedia messaging and other enhanced services. The Company's Messaging Business customers are communications service providers (CSPs) around the world, including wireless and fixed network carriers, as well as broadband and cable service providers. The Messaging Business's products enable CSPs to provide their customers with a variety of messaging and enhanced services such as voice mail, video mail, missed call notification, and text and picture messaging.

On May 31, 2005, the Company completed the acquisition of the North American and central European CD and DVD manufacturing and distribution operations from Universal Music Group. The EDC operation manufactures and distributes CD's, DVD's and other multimedia throughout the United States and Europe. The results of EDC are included in the Company's consolidated results since June 1, 2005. See Note 7 for information regarding ownership and voting interest.

2. Acquisition

On May 31, 2005 the Company completed the acquisition of the North American and central European CD and DVD manufacturing and distribution operations from Universal Music Group (Universal) for a purchase price of approximately \$122.2 million. The results of operations of the acquired operations have been included in the consolidated financial statements of the Company since the acquisition date. The acquisition was made through Entertainment Distribution Company, LLC (EDC), a newly formed division of Glenayre. The acquisition was a strategic opportunity for the Company to become an industry leader in providing pre-recorded products and distribution services to the entertainment industry. As part of the transaction, EDC entered into 10-year supply agreements with Universal under which it will become the exclusive manufacturer and distributor for Universal's CD and DVD requirements for North America and central Europe (see Note 6).

The North American CD and DVD manufacturing and distribution operations were acquired under an Asset Purchase Agreement. The central European CD and DVD manufacturing and distribution operations were acquired under a Share Purchase Agreement.

The acquired assets include Universal's manufacturing and distribution operations in Hanover, Germany, its manufacturing operations in Grover, North Carolina, and its distribution operations in Fishers, Indiana, Reno, Nevada and Wilkes-Barre, Pennsylvania. EDC is leasing all of the facilities with the exception of the manufacturing facility in Grover, North Carolina, which it acquired from Universal.

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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)

The purchase price paid at closing was \$82.6 million and is subject to post-closing adjustments that are not expected to be material. Of the purchase price paid at closing, \$30.5 million was for the U.S. operations, \$43.9 million (\$35.2 million) was for the central European operations, and the balance constituted transaction expenses. Additionally, under the terms of the supply contracts entered into as part of the transaction, EDC is obligated to pay to Universal future scheduled amounts with a net present value totaling approximately \$39.6 million. This long-term obligation is scheduled to be paid as follows: approximately \$5.6 million is payable on December 15, 2005, approximately \$8.0, \$13.4, \$13.8 and \$1.4 million is payable on each of May 31, 2006 through 2009, respectively, and approximately \$400,000 is payable on each of December 15, 2006 through 2014, respectively. Approximately 46% of the total obligation is payable in Euros.

EDC was capitalized with a \$35 million equity capital contribution from Glenayre. Following the closing, members of EDC management purchased \$772,000 of Glenayre's equity interest. In addition, certain profits interests were issued at closing to EDC management, Universal and the Company's financial advisor that will entitle these parties to up to thirty percent of EDC's profits, after Glenayre has received a return of its equity capital contribution and certain internal rate of return hurdles and other conditions have been met.

To fund the balance of the purchase price and provide for working capital needs, EDC obtained a senior secured credit facility with Wachovia Bank, National Association for an aggregate principal amount of \$56.5 million consisting of a term facility of \$46.5 million repayable over five years, and a revolving credit facility of \$10.0 million. Glenayre collateralized \$16.5 million of the credit facility by depositing cash in the same amount with the lender on the closing date.

The acquisition was accounted for as a purchase business combination in accordance with SFAS 141, *Business Combinations*. The purchase price is being allocated to the related tangible and identifiable intangible assets acquired and liabilities assumed based on their respective estimated fair values on the acquisition date. Identifiable intangible assets acquired include 10-year manufacturing and distribution services supply agreements between EDC and Universal Music Group (see Note 6). In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, the fair values of the identifiable intangible assets are being amortized over their estimated useful lives in a manner that best reflects the economic benefits derived from such assets. As of June 30, 2005, the purchase price is being allocated to the assets and liabilities based upon their estimated fair value at the date of the acquisition as noted below. Included in the assets purchased was \$38.4 million (\$30.8 million) of cash contributed by the seller. \$30.6 million (\$24.5 million) of the cash contributed was to fund certain net liabilities assumed by EDC as described below, and the remaining \$7.8 million (\$6.2 million) was to meet certain German regulatory requirements. The preliminary allocation was based on real estate appraisals obtained for land and buildings, on net book values for furniture and equipment, and on preliminary calculations of the present value of the cash flows of the supply agreements. These estimated values are subject to change upon the finalization of the valuations. Valuations for the profits interests granted to the investment banker, Universal and certain EDC management, and for management members' right to force sell (put) their ownership to EDC, LLC or the Company have not been finalized, and therefore allocations for these items have not yet been assigned.

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

(in millions)	Estimated Fair Value at Acquisition Date
Cash	38.4
Accounts Receivable	5.7
Other receivables	2.3
Inventories	10.1
Prepaid Assets	1.8
Property, Plant & Equipment	36.8
Long-term Receivable from Universal**	21.1
Deferred Financing Fees	1.0
Intangible Assets	68.6
Accounts Payable and Accrued Expenses	(27.9)
Long term Liabilities	(35.7)
 Total	 \$ 122.2

** Under the terms of the share purchase agreement relating to the acquisition of Universal's central European operations, the seller will reimburse EDC for \$51.7 million relating to the liabilities net of accounts receivable and other receivables assumed by EDC at the acquisition date.

Amounts not paid or received in future periods for these assumed liabilities and receivables, with the exception of the pension obligation, will be adjusted through the seller receivable. To fund the payment of these obligations, Universal contributed \$30.6 million (24.5 million) of cash at the time of the acquisition and will contribute the remaining \$21.1 million (16.9 million) as future obligations become due. \$24.1 million (19.3 million) of the cash contributed at the acquisition will be held in escrow until May 31, 2010 to fund various long-term pension and employee loan obligations, many of which extend beyond 2010.

3. Summary of Significant Accounting Policies

The following accounting policies relate to the messaging division only or both messaging and entertainment divisions. See Note 3a for new significant accounting policies related to operations acquired during the second quarter of 2005. For further information, refer to the consolidated financial statements and footnotes thereto included in the Glenayre Technologies, Inc. Annual Report on Form 10-K, as amended, for the year ended December 31, 2004.

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.

Consolidation

The consolidated financial statements include the accounts of Glenayre Technologies, Inc. and its majority-owned subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation. The consolidated accounts include 100% of assets and liabilities of its majority owned subsidiaries, and the ownership interests of minority investors are recorded as minority interest. The Company does not have any equity or cost method investments.

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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 whose functional currency is the local currency have been translated into United States dollars using the current exchange rate in effect at the balance sheet date for assets and liabilities and average exchange rates during each reporting period for results of operations.

For international operations for which the functional currency is the United States dollar, transactions denominated in currencies other than the United States dollar are translated into United States dollars. The resulting gains or losses on currency translation are included in earnings and amounted to a gain of \$14,000 and loss of \$67,000 for the six months ended June 30, 2005 and 2004, respectively.

Fair Value of Financial Instruments

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

The use of derivative instruments is limited to non-trading purposes. The estimated fair values of derivative instruments are calculated based on market rates. These values represent the estimated amounts the Company would receive or pay to terminate agreements, taking into consideration current market rates and the current credit-worthiness of the counterparties. In accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the derivatives held by the Company do not qualify as hedges and accordingly the Company records the gains and losses from the derivative instruments in earnings.

Deferred Financing Costs

Certain costs associated with debt financing are capitalized and included in other non-current assets on the consolidated balance sheet. These costs are amortized to interest expense over the term of the debt agreement. Amortization of deferred financing costs included in interest expense was approximately \$30,000 for the three and six months ended June 30, 2005.

Stock-Based Compensation

The Company grants stock options and issues shares under option plans and an employee stock purchase plan as described in Note 21(b). 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 to the pro forma results of continuing operations whereby stock-based compensation is computed under the fair value method required by Statement of Financial Accounting Standards No. 123. 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.

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries**

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

	Three months Ended June 30,		Six months Ended June 30,	
	2005	2004	2005	2004
Loss from continuing operations-as reported	\$ (2,478)	\$ (1,241)	\$ (698)	\$ (7,142)
Pro forma stock option expense	(447)	(308)	(785)	(547)
Loss from continuing operations-pro forma	(2,925)	\$ (1,549)	\$ (1,483)	\$ (7,689)
Income (loss) from continuing operations per common share as reported	\$ (0.04)	\$ (0.02)	\$ (0.01)	\$ (0.11)
Pro forma stock option expense	(0.01)		(0.01)	
Loss from continuing operations per common share pro forma	\$ (0.05)	\$ (0.02)	\$ (0.02)	\$ (0.11)
Loss from continuing operations, assuming dilution as reported	\$ (0.04)	\$ (0.02)	(0.01)	\$ (0.11)
Pro forma stock option expense	(0.01)		(0.01)	
Loss from continuing operations, assuming dilution pro forma	\$ (0.05)	\$ (0.02)	\$ (0.02)	\$ (0.11)

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. 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. 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 was issued in accordance with alternatives prescribed by FSP No. FAS 106-1 which was effective for the Company beginning with the year ended December 31, 2003. FSP No. FAS 106-1 was superseded by FSP No. FAS 106-2 on May 19, 2004 and is effective for the first interim or annual period beginning after June 15, 2004. The Company has two alternative methods of transition: retroactive application to the date of enactment or prospective application from the date of adoption. The Company is unable to determine whether benefits provided by its plan are actuarially equivalent to Medicare Part D and is unable to determine if the Company's plan qualifies for the subsidy under the Act. Consequently, the measure of the Accumulated Post-retirement Benefit Obligation ("APBO") and net periodic post-retirement benefit cost do not reflect any amount associated with the subsidy. The regulations issued in January of 2005 indicated that the Centers for Medicare and Medicaid Services would provide further guidance on methods required to demonstrate actuarial equivalence.

In November of 2004, FASB issued Statement No. 151, *Inventory Costs*, an amendment of Accounting Research Bulletin No. 43, Chapter 4 ("SFAS 151"). The amendments made by SFAS 151 clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The FASB's goal is to promote convergence of accounting standards internationally by adopting

language similar to that used in the International Accounting

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Standard 2, *Inventories* adopted by the International Accounting Standards Board (IASB). The Boards noted that the wording of the original standards were similar, but were concerned that the differences would lead to inconsistent application of those similar requirements. The guidance is effective for inventory costs incurred during the Company's year beginning January 1, 2006. The Company does not believe that the adoption of the new standard will have a material impact on its financial position.

The FASB issued FSP No. 109-2, *Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004* to provide guidance under FASB issued Statement No. 109, *Accounting for Income Taxes* (SFAS 109) regarding the American Jobs Creation Act of 2004 (the Jobs Act) enacted on October 22, 2004. The Jobs Act provides for a special one-time dividends received deduction on the repatriation of certain foreign earnings to a US taxpayer. The Company has evaluated the effect of the Jobs Act on its plan for reinvestment and repatriation of foreign earnings and determined that it will not use the one-time deduction due to its net operation loss carryovers that are available to offset income from future dividend payments.

On December 16, 2004, the FASB issued Statement No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which is a revision of SFAS 123. SFAS 123R supersedes APB 25 and amends FASB Statement No. 95, *Statement of Cash Flows*. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

On April 14, 2005 the Securities and Exchange Commission announced the adoption of a new rule that amends the compliance dates for SFAS 123R. Under the new rule public companies will now be required to adopt SFAS 123R by their first fiscal year after June 15, 2005. The Company expects to adopt SFAS 123R on January 1, 2006.

SFAS 123R permits public companies to adopt its requirement using one of two methods:

1. A modified prospective method in which compensation cost is recognized beginning with the effective date
 - (a) based on the requirements of SFAS 123R all share-based payments granted after the effective date and
 - (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date.
2. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

The Company plans to adopt SFAS 123R using the modified-prospective method.

Both SFAS 123 and SFAS 123R require measurement of fair value using an option-pricing model. Although the Company currently uses the Black-Scholes model, the Company may determine that a lattice model provides a better estimate of fair value for its employee stock options. The Company has not determined which model it will use for new awards issued and for awards modified, repurchased or cancelled on or after the effective date, January 1, 2006. All awards granted prior to January 1, 2006 will maintain their grant-date value as calculated under SFAS 123. The future compensation cost for the portion of these awards that are unvested (the service period continues after date of adoption) will be based on their grant-date value adjusted for estimated forfeitures. The Company currently adjusts the pro forma expense for forfeitures only as they occur. The pro forma expense is allocated to the service period based on the accelerated attribution method, and all the awards have graded service vesting. This method will continue for compensation costs recognized for these awards granted prior to the effective date. Under the new standard, the Company may use a straight line or accelerated attribution method and is considering both alternatives for awards issued after the effective date.

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Reclassifications

Certain items in the prior year Condensed Consolidated Financial Statements have been reclassified to conform to the current presentation.

3a. Significant Accounting Policies (Entertainment Division only)

The following are significant accounting policies for the Entertainment division. See Note 3 for discussion of additional significant accounting policies.

Revenues

Revenue is comprised of product sales and service revenue earned from the fulfillment of services. Revenue from product sales is recognized upon delivery, and is recorded net of fixed credits for defective products.

For certain components, including printed materials, the Company may act as an agent for the customer and the customer reimburses the Company for any incurred costs plus a handling fee. The reimbursement for the costs is reported as a reduction to expense and the handling fees are recognized as revenue.

Services revenue is recognized as services are performed.

Cost of Sales, Selling General and Administrative Costs

Cost of sales includes direct and indirect manufacturing and distribution costs. Selling, General and Administrative costs include indirect overhead costs.

Shipping Costs

The Company does not incur shipping costs for its primary customer. See segment information in Note 23 for information regarding customers. For all other customers, shipping costs reimbursed by customers for invoice charges such as postage, freight packing and small order surcharges are recorded as revenue.

Inventories

Inventories are valued using first in first out and average cost methods, which approximate cost, and are recorded at the lower of cost or net realizable value.

Property, Plant and Equipment

Property, plant and equipment acquired in the purchase transaction are carried at fair value based on appraisals.

Depreciation is computed using the straight-line method based on the estimated remaining useful life of the assets.

Accounting for Internal Use Software

In accordance with AICPA Statement of Position No. 98-1 Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, direct internal and external costs incurred to develop computer software for internal use, including website development costs, are capitalized during the application development stage. Application development stage costs generally include software configuration, coding, installation and testing. Costs of significant upgrades and enhancements that result in additional functionality are also capitalized. Costs incurred for maintenance and minor upgrades and enhancements are expensed as

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incurred. Capitalized software costs are depreciated over the estimated useful life of the underlying project on a straight line basis, generally not exceeding three years.

4. Risks and Uncertainties

Concentrations of Credit Risk

Financial instruments potentially subjecting the Company to concentrations of credit risk consist of temporary cash investments, currency swap and trade accounts receivable. The Company places its temporary cash investments and currency swap with large diversified entities with operations throughout the U.S., Germany and Canada. The Company is exposed to credit-related losses in the event of non-performance by the parties in these contracts. See Note 9.

The Company's customer base for the messaging division is comprised primarily of communications service providers resulting in a concentration of credit risk in the telecommunication industry. The Entertainment division's primary customer is Universal Music Group. See Note 2. The Company believes its reserves for bad debt are adequate considering its concentrations of credit risk.

Concentrations of Suppliers

EDC has a limited number of suppliers who are able to provide it with its raw materials. In Germany all polystyrene is purchased from a single supplier and all polycarbonate is purchased from a single supplier. In the United States all polycarbonate is purchased from a single supplier and substantially all printed material is purchased from two suppliers. These inputs are crucial to the production of CDs and DVDs and while there are alternative suppliers of these products, it would be disruptive to EDC's production if any of these companies were unable to deliver its product to EDC.

Workforce Subject to Collective Bargaining Agreements

In Germany, approximately 76% of EDC's workforce of 858 employees is unionized. However, collective bargaining agreements negotiated by the unions cover all non-exempt staff. Exempt staff is approximately 4% of the total. In the United States, approximately 30% of EDC's workforce of 913 employees is unionized and subject to collective bargaining agreements. None of these collective bargaining agreements expire within one year.

5. Restatement of Pro Forma Financial Information

Subsequent to filing its second quarter Form 10-Q, the Company identified corrections to the pro forma financial information that will be included in the Company's Form 8-K/A related to the acquisition of Universal Music Group's North American and central European manufacturing and distribution operations (UM&L) by the Company's EDC division. The following table is restated to include these adjustments. The unaudited financial information in the table below summarizes the combined results of operations of Glenayre and UM&L, on a pro forma basis, as though the companies had been combined as of the beginning of each of the periods presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition (see Note 2) had taken place at the beginning of each of the periods presented. The pro forma financial information for the three and six months ended June 30, 2005 includes the business combination accounting effect on historical UM&L revenues and costs, and acquisition costs reflected in Glenayre's and UM&L's historical statements of operations for periods prior to the acquisition.

The unaudited pro forma financial information for the three and six months ended June 30, 2004 and 2005 combines the historical results for Glenayre and UM&L for those periods.

Three Months Ended
June 30, 2005
Restatement As

(in thousands, except per share data)	As		
	Previously Reported	Adjustments	Restated
Total revenues	\$89,928	\$ 1,780	\$91,708
Net income (loss) from continuing operations	\$ (5,079)	\$ 1,774	\$ (3,305)
Net income (loss) from discontinued operations	\$ 388	\$	\$ 388
Net income (loss)	\$ (4,691)	\$ 1,774	\$ (2,917)
Basic net income (loss) per share	\$ (0.07)	\$ 0.03	\$ (0.04)
Diluted net income (loss) per share	\$ (0.07)	\$ 0.03	\$ (0.04)

Three Months Ended June 30, 2004			
(in thousands, except per share data)	As		
	Previously Reported	Restatement Adjustments	As Restated
Total revenues	\$65,014	\$	\$65,014
Net income (loss) from continuing operations	\$ 1,648	\$	\$ 1,648
Net income (loss) from discontinued operations	\$ 3,808	\$	\$ 3,808
Net income (loss)	\$ 5,456	\$	\$ 5,456
Basic net income (loss) per share	\$ 0.08	\$	\$ 0.08
Diluted net income (loss) per share	\$ 0.08	\$	\$ 0.08

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(in thousands, except per share data)	Six Months Ended June 30, 2005		
	As Previously Reported	Restatement Adjustments	As Restated
Total revenues	\$ 172,557	\$ 4,166	\$ 176,723
Net income (loss) from continuing operations	\$ (6,741)	\$ 4,025	\$ (2,716)
Net income (loss) from discontinued operations	\$ 398	\$	\$ 398
Net income (loss)	\$ (6,343)	\$ 4,025	\$ (2,318)
Basic net income (loss) per share	\$ (0.09)	\$ 0.06	\$ (0.03)
Diluted net income (loss) per share	\$ (0.09)	\$ 0.06	\$ (0.03)

(in thousands, except per share data)	Six Months Ended June 30, 2004		
	As Previously Reported	Restatement Adjustments	As Restated
Total revenues	\$ 134,252	\$	\$ 134,252
Net income (loss) from continuing operations	\$ (7,671)	\$	\$ (7,671)
Net income (loss) from discontinued operations	\$ 5,493	\$	\$ 5,493
Net income (loss)	\$ (2,178)	\$	\$ (2,178)
Basic net income (loss) per share	\$ (0.03)	\$	\$ (0.03)
Diluted net income (loss) per share	\$ (0.03)	\$	\$ (0.03)

6. Intangible Assets

As a result of the EDC acquisition, certain long-term intangible assets were identified and recorded at their estimated fair value of \$67.5 million. Amortization expense was \$0.6 million for the three months and six months ended June 30, 2005.

These intangibles include the North American and central European CD and DVD manufacturing and distribution services agreements between EDC and Universal Music Group, which have 10-year terms and no minimum order requirements. The fair value assigned to the agreements was based on the present value of estimated future cash flows and is being amortized over the ten-year terms beginning in June 2005.

The Company has not yet completed the allocation of the purchase price for the EDC acquisition. Additional information could come to our attention that may require a revision to the preliminary allocation of the purchase price to the intangible assets.

7. EDC, LLC Agreement Profits Interests***EDC Profits Interests***

Upon the completion of the acquisition of the North American and central European CD and DVD manufacturing and distribution operations from Universal, EDC, a majority-owned subsidiary of the Company, issued profits interests to certain key employees, Universal and the Company's financial advisor, that will entitle these parties to up to 30% of EDC's profits after the Company has received a return of its equity capital contribution, and certain internal rate of return hurdles and other profitability conditions have been met. No payments were required from these parties to acquire the profits interests.

The estimated fair value of the profits interests at the date of grant will be independently appraised and will represent the probability-weighted present value of estimated future cash flows to those profits interests. The fair value of the profits interests granted to Universal and the financial advisor will be included in the acquisition costs of EDC. The fair value of the profits interests granted to key employees will result in compensation expense. The unearned compensation will be amortized over the vesting schedule one-third immediately upon grant and two-thirds ratably in each of the two years after grant. Included in EDC's results for the quarter ended June 30, 2005 is a charge of \$745,000 for the vested portion of the Profits Interests that were granted to key employees in June, 2005, and \$62,000 for the amortization of the unvested portion.

Minority interest

As part of the EDC acquisition described in Note 2, the Company sold 772 Class A units of EDC it owned (representing 2.2% of EDC's outstanding units) to two key employees at the fair value of \$1,000 per unit upon which such Class A Units were automatically converted into Class B units. The Class A and Class B Units carry equivalent economic rights. In addition, the Company issued profits interests to certain key employees, Universal and the Company's financial advisor, that will entitle these parties to up to 30% of EDC's profits after the Company has received a return

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of its equity capital contribution, and certain internal rate of return hurdles and other profitability conditions have been met. The profits interests do not carry any voting rights. The Company owns 97.8% of EDC's voting units. If EDC does not undergo an initial public offering prior to the earlier of (1) May 31, 2015 and (2) the date on or after May 31, 2013 on which the terms of all EDC's manufacturing and distribution agreements with Universal Music Group shall have been extended to a term ending on or after May 31, 2018, holders of Class B units and profits interests would have the right to sell their interests to the Company at fair value over a five-year period.

8. Restricted Cash

Long-term restricted cash at June 30, 2005 includes \$16.5 million of cash deposited with Wachovia to EDC's credit facility and \$23.3 million (€ 19.3 million Euros) being held in escrow to fund various pension and employee loan obligations of EDC's German operation and as part of the acquisition, one of Universal's subsidiaries deposited funds into an escrow account controlled by an Escrow Agreement restricting the disbursement of the funds. Universal and the Company participate in determining and approving disbursement. The earnings on the funds are paid to EDC monthly. On June 1, 2010, the restrictions expire for any remaining funds in escrow will be released to EDC. Included in the current portion of restricted cash is \$0.7 million of customer performance bonds, and letters of credit for leased space and a tax bond totaling \$0.1 million.

9. Financial Instruments

SFAS NO. 107, *Disclosures About Fair Value of Financial Instruments*, requires the disclosure of the fair value of all financial instruments. Financial instruments recorded at fair value include cash and cash equivalents, trade accounts receivable, other current and long-term liabilities and all derivative instruments.

Short-term Investments

All short-term investments mature in one year, or less. Short-term investments consist of highly liquid investments purchased with original maturities of greater than three months and less than twelve months when purchased. The following is a summary of held-to-maturity securities:

	Amortized Cost (Net Carrying Amount)	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 30, 2005				
Obligation of U.S. government agencies	\$	\$	\$	\$
Other short-term investments				
	\$	\$	\$	\$
December 31, 2004				
Obligation of U.S. government agencies	\$ 5,127	\$	\$	\$ 5,127
Other short-term investments	7,053			7,053
	\$ 12,180	\$	\$	\$12,180

Currency Rate Swap

The Company entered into a cross currency rate swap agreement with a commercial bank on May 31, 2005. The Company's objective is to manage foreign currency exposure arising from its loan to its German subsidiary, acquired

in May of 2005, and is therefore for purposes other than trading. The loan is denominated in Euros and repayment is due on demand, or by May 31, 2010. According to Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation*, the Company will report the foreign currency exchange gains or losses attributable to changes in the US\$/Euro exchange rate on the currency

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swap in earnings. In accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the derivatives held by the Company do not qualify as hedges and accordingly the Company records the gains and losses from the derivative instruments in earnings.

The swap matures in five years. The significant terms of the swap are as follows:

The Company will make quarterly payments, commencing August 31, 2005, based on a notional amount of 21,300,000 at the EUR LIBOR plus 3.12%;

The Company will receive quarterly payments, based on a notional amount of \$26.0 million at the USD LIBOR plus 3%; and

The Company will exchange with the counterparty the above notional amounts upon maturity of the swap agreement.

As of June 30, 2005, the swap is carried at its fair value of approximately \$262,000. The fair value of the currency rate swap was calculated based on mathematical approximations of market values derived from the commercial banks proprietary models as of a given date. These valuations are calculated on a mid-market basis and do not include a bid/offered spread that would be reflected in an actual price quotation. Therefore, the actual price quotations for unwinding these transactions would be different. These valuations and models rely on certain assumptions regarding past, present and future market conditions and are subject to change at any time. Valuations based on other models or assumptions may yield different results.

Long-Term Debt

The carrying amount of the commercial bank term loan, including the current portion, as of June 30, 2005 was approximately \$46.5 million. The carrying value of the payable to Universal is the net present value of future payments discounted using the Company's incremental borrowing rate when incurred. The fair value of the obligations shown in the table below was estimated using discounted cash flow analysis, based on the Company's current incremental borrowing rates. For additional details, see Note 18. Financial instruments at June 30, 2005 consisted of the following:

(in millions)	Carrying Amount	Fair Value
Commercial bank term loan	\$ 46.5	\$46.3
Payable to Universal	\$ 39.2	\$39.1

10. Accounts Receivable

Accounts receivable related to continuing operations consisted of:

	June 30, 2005	December 31, 2004
Trade receivables	\$40,648	\$ 8,139
Less: allowance for doubtful accounts	(676)	(444)
	\$39,972	\$ 7,695

The increase is primarily due to acquisition of EDC division (See Note 2).

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11. Inventories

Inventories, net of reserves, related to continuing operations consisted of:

	June 30, 2005	December 31, 2004
Raw materials	\$ 13,689	\$ 2,745
Work-in-process	1,435	586
Finished goods	3,464	2,832
	\$ 18,588	\$ 6,163

At June 30, 2005 and December 31, 2004, reserves were approximately \$3.2 million and \$2.7 million, respectively. 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 Messaging division, 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.

The increase in inventories is primarily due to the addition of the Entertainment division's inventories.

12. Property, Plant and Equipment and Impairment of Long-Lived Assets

Property, plant and equipment related to the Company's continuing operations at June 30, 2005 and December 31, 2004 consisted of:

	2005	2004
Land	\$ 1,676	\$ 676
Buildings and improvements	13,743	5,039
Equipment	34,062	5,988
	49,481	11,703
Less: Accumulated depreciation	(4,881)	(2,891)
	\$ 44,600	\$ 8,812

The increase in property, plant and equipment is primarily due to the addition of the Entertainment division.

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13. Estimated Warranty Costs

The Company generally warrants its Messaging products for one year after sale and a provision for estimated warranty costs is recorded at the time of sale. Factors affecting the Company's warranty liability include the number of units sold, historical and anticipated rates of warranty claims and cost per claim. The following is a year to date summary of activity of the Company's continuing operations warranty obligation for 2005.

Balance at January 1, 2005	\$573
Provision for warranty obligations	46
Settlements of warranty obligations	(45)
Balance at March 31, 2005	\$574
Provision for warranty obligations	82
Settlements of warranty obligations	(74)
Balance at June 30, 2005	\$582

The Company also offers post-installation extended warranty and support services, known as Glenayre Care, for its Messaging products and services to customers. One year of Glenayre Care is generally included in the price of the Company's product. A portion of the product revenue equal to the fair value of the Glenayre Care is deferred at the time the sale of the product is recorded and recognized ratably over the support period. Once this service period expires, 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 is recognized ratably over the contracted support period. Deferred revenue at June 30, 2005 related to product sales and to the sale of post-installation support services was approximately \$4.1 million of the \$11.0 million of deferred revenue.

The Company's EDC division provides its customers with a fixed credit as a compensation for defective products. Revenue for CD and DVD product are recorded net of the fixed credit. Actual expenses for defective products are recorded in cost of goods sold.

14. 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 2005, the Company recorded net favorable adjustments to its original estimates associated with the Company's 2003 restructuring activities of \$12,000 primarily related to a reduction in accrued lease cancellation costs.

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. The Company recorded net favorable adjustments to its original estimates associated with the Company's 2001 and 2003 restructuring activities of \$21,000 primarily related to a reduction in accrued severance benefits.

During the second quarter of 2004, the Company recorded a restructuring charge of \$88,000 for severance and outplacement services related to the reduction of the Company's 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.

The following is a summary of activity for the six months ended June 30, 2005 related to restructuring reserves:

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Messaging

	Severance and Benefits	Lease Cancellation and Other Exit Costs	Total
Balance at January 1, 2005	\$ 27	\$ 233	\$260
Expense accrued			
Credits and changes in estimates		(12)	(12)
Payments		(93)	(93)
Balance at March 31, 2005	\$ 27	\$ 128	\$155
Expense accrued			
Credits and changes in estimates	(16)	16	
Payments	(11)	(59)	(70)
Balance at June 30, 2005	\$ 0	\$ 85	\$ 85

15. Discontinued Operations

In May 2001, the Company began exiting its Wireless Messaging (Paging) business and refocusing all of its strategic efforts on the Enhanced Services Messaging business segment. As a result, the Paging segment was reported as a disposal of a segment of business in the second quarter 2001 in accordance with APB Opinion No. 30, *Reporting the Results of Operations*. Accordingly, the operating results of the Paging segment have been classified as a discontinued operation for all periods presented in the Company's Consolidated Statements of Operations. Additionally, the Company has reported all of the Paging segment assets at their estimated net realizable value in the Company's unaudited Condensed Consolidated Balance Sheet as of June 30, 2005. All business transactions related to the Paging segment, with the exception of existing contractual obligations, ceased in May 2002, the end of the transition period. Results for discontinued operations consist of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Gain on disposal before income taxes	\$428	\$3,822	\$491	\$4,201
Income Tax Benefit (Provision)	(40)	(14)	(93)	1,292
Gain on disposal of discontinued operations	388	3,808	398	5,493
Income from discontinued operations	\$388	\$3,808	\$398	\$5,493

In the first quarter of 2005, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, a net decrease in the loss on disposal of \$63,000 was recorded. The Company recorded income of \$74,000 primarily due to a settlement received from Pilot Pacific Properties, Inc. and its

associated companies. This income was offset by the adjustments to the original estimates, related primarily to international office closures, of \$11,000.

In the second quarter of 2005, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, a net decrease in the loss on disposal of \$428,000 was recorded. The Company recorded income of \$53,000 primarily due to a settlement and previously reserved accounts receivable receipts.

Additional reductions of \$375,000 were recorded primarily related to the release of a reserve for the Lynnvew Ridge litigation (see Note 22).

In the first quarter of 2004, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, a net decrease in the loss on disposal of \$379,000 was recorded. The adjustments to the original estimates related primarily to better than anticipated recoveries received from paging customers and to asset and inventory liquidations. In addition, the Company recorded a

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\$1.3 million reduction in its tax liability relating to the discontinued operations primarily due to receiving a favorable assessment for several prior tax years relating to one of the Company's foreign subsidiaries.

In the second quarter of 2004, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, a net decrease in the loss on disposal of \$3.8 million was recorded. \$1.5 million of this decrease was a reduction to the Company's liability for legal and other costs associated with its former Vancouver facility as a result of entering into a favorable settlement agreement with Pilot Pacific Properties Inc. and its associated companies subsequent to June 30, 2004. The remaining \$2.3 million decrease was primarily due to i) reductions in the liability for costs related to performance obligations the Company has with its various paging customers as third parties have the capability to provide the necessary support, ii) the collection of previously reserved accounts receivable and iii) additional inventory liquidations.

16. Accrued Liabilities

Accrued liabilities at June 30, 2005 and December 31, 2004 consisted of:

	June 30, 2005	December 31, 2004
Accrued salaries and benefits	\$13,625	\$ 1,127
Accrued income taxes	5,215	4,993
Accrued royalty expense	1,624	236
Accrued transaction costs	3,007	
Accrued vacation	3,087	644
Current portion of long-term liabilities	2,379	
Other accruals	13,882	4,912
	\$42,819	\$11,912

The increase in accrued liabilities is primarily due to the EDC acquisition.

17. Other Liabilities

Other liabilities at June 30, 2005 and December 31, 2004 consisted of:

June 30,