

GLOBECOMM SYSTEMS INC
Form 10-Q
May 16, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended March 31, 2005

OR

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

For the transition period from to

Commission file number: 000-22839

Globecomm Systems Inc.

(Exact name of Registrant as specified in its charter)

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

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

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

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

As of May 11, 2005, there were 14,592,907 shares of the Registrant's common stock, \$0.001 par value, outstanding.

GLOBECOMM SYSTEMS INC.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

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

	March 31, 2005 (Unaudited)	June 30, 2004
Assets		
Current assets:		
Cash and cash equivalents	\$ 22,433	\$ 28,252
Restricted cash	3,856	1,903
Accounts receivable, net	23,430	14,318
Inventories	9,239	3,904
Prepaid expenses and other current assets	892	1,274
Deferred income taxes	83	83
Total current assets	59,933	49,734
Fixed assets, net	15,442	15,441
Goodwill	7,204	7,204
Other assets	1,026	1,096
Total assets	\$ 83,605	\$ 73,475
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 18,034	15,453
Deferred revenues	2,429	1,083
Accrued payroll and related fringe benefits	1,334	1,154
Other accrued expenses	2,117	1,676
Deferred liabilities	316	316
Total current liabilities	24,230	19,682
Deferred liabilities, less current portion	749	987
Commitments and contingencies		
Stockholders' equity:		
Series A Junior Participating, shares authorized, issued and outstanding: none at March 31, 2005 and June 30, 2004	—	—
Common stock, \$.001 par value, shares authorized: 50,000,000 at March 31, 2005 and 22,000,000 at June 30, 2004; shares issued: 15,041,258 at March 31, 2005 and 14,628,574 at June 30, 2004	15	15
Additional paid-in capital	132,569	130,503
Accumulated deficit	(71,454)	(75,198)

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Accumulated other comprehensive income	277	267
Treasury stock, at cost, 465,351 shares at March 31, 2005 and June 30, 2004	(2,781)	(2,781)
Total stockholders' equity	58,626	52,806
Total liabilities and stockholders' equity	\$ 83,605	\$ 73,475

See accompanying notes.

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

	Three Months Ended		Nine Months Ended	
	March 31, 2005	March 31, 2004	March 31, 2005	March 31, 2004
Revenues from ground segment systems, networks and enterprise solutions	\$ 23,443	\$ 18,956	\$ 69,722	\$ 55,878
Revenues from data communications services	4,741	3,305	13,149	10,544
Total revenues	28,184	22,261	82,871	66,422
Costs and operating expenses:				
Costs from ground segment systems, networks and enterprise solutions	19,520	16,180	58,595	49,282
Costs from data communications services	4,186	3,138	11,094	9,611
Selling and marketing	1,476	1,219	4,028	3,461
Research and development	231	242	703	953
General and administrative	2,463	2,118	5,165	5,115
Total costs and operating expenses	27,876	22,897	79,585	68,422
Income (loss) from operations	308	(636)	3,286	(2,000)
Other income:				
Interest income	121	63	286	191
Gain on sale of investment	—	—	40	—
Gain on sale of available-for-sale securities	132	—	132	91
Net income (loss)	\$ 561	\$ (573)	\$ 3,744	\$ (1,718)
Basic net income (loss) per common share	\$ 0.04	\$ (0.04)	\$ 0.26	\$ (0.13)
Diluted net income (loss) per common share	\$ 0.04	\$ (0.04)	\$ 0.25	\$ (0.13)
Weighted-average shares used in the calculation of basic net income (loss) per common share	14,517	14,100	14,363	13,080
Weighted-average shares used in the calculation of diluted net income (loss) per common share	15,143	14,100	14,938	13,080

See accompanying notes.

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GLOBECOMM SYSTEMS INC.
 CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
 FOR THE NINE MONTHS ENDED MARCH 31, 2005

(In thousands)

(Unaudited)

	Common Stock		Additional	Accumulated	Accumulated	Treasury Stock		Total
	Shares	Amount	Paid-in	Deficit	Other	Shares	Amount	Stockholders'
			Capital		Comprehensive			Equity
Balance at June 30, 2004	14,629	\$ 15	\$130,503	\$ (75,198)	\$ 267	465	\$ (2,781)	\$ 52,806
Proceeds from exercise of stock options	157		676					676
Proceeds from exercise of warrants	237		1,306					1,306
Issuance of common stock in connection with employee stock purchase plan	18		78					78
Issuance of stock options for services			6					6
Comprehensive income:								
Net income				3,744				3,744
Gain from foreign currency translation					10			10
Total comprehensive income								3,754
Balance at March 31, 2005	15,041	\$ 15	\$132,569	\$ (71,454)	\$ 277	465	\$ (2,781)	\$ 58,626

See accompanying notes.

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

	Nine Months Ended	
	March 31, 2005	March 31, 2004
OPERATING ACTIVITIES:		
Net income (loss)	\$ 3,744	\$ (1,718)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	2,257	2,346
Allowance for doubtful accounts, net of recovery	(1,413)	(901)
Changes in deferred liabilities	(238)	(443)
Stock compensation expense	6	8
Gain on sale of available-for-sale securities	(132)	(91)
Gain on sale of investment	(40)	—
Changes in operating assets and liabilities:		
Accounts receivable	(7,664)	(4,859)
Inventories	(5,473)	3,200
Prepaid expenses and other current assets	385	39
Other assets	71	414
Accounts payable	2,517	5,827
Deferred revenue	1,343	(5,840)
Accrued payroll and related fringe benefits	179	341
Other accrued expenses	439	370
Net cash used in operating activities	(4,019)	(1,307)
INVESTING ACTIVITIES:		
Purchases of fixed assets	(2,256)	(1,033)
Restricted cash	(1,953)	(433)
Proceeds from sale of available-for-sale securities	330	391
Repayment of promissory note from a related party	—	300
Net cash used in investing activities	(3,879)	(775)
FINANCING ACTIVITIES:		
Proceeds from exercise of warrants	1,306	—
Proceeds from exercise of stock options	676	419
Proceeds from sale of common stock in connection with employee stock purchase plan	78	54
Proceeds from private placement	—	6,170
Purchase of treasury stock	—	(333)
Net cash provided by financing activities	2,060	6,310
Effect of foreign currency translation on cash	19	73
Net (decrease) increase in cash and cash equivalents	(5,819)	4,301
Cash and cash equivalents at beginning of period	28,252	22,016
Cash and cash equivalents at end of period	\$ 22,433	\$ 26,317

See accompanying notes.

GLOBECOMM SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2005
(Unaudited)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all material adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results for such periods have been included. The consolidated balance sheet at June 30, 2004 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The results of operations for the three and nine months ended March 31, 2005, are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2005, or for any future period.

The accompanying consolidated financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the fiscal year ended June 30, 2004 and the accompanying notes thereto contained in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on September 28, 2004.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Globecomm Network Services Corporation (formerly named NetSat Express, Inc.) and Globecomm Systems Europe Limited (collectively, the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

Accounting Estimates

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

Revenue Recognition

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

recorded on each standard production-type contract is reduced by the customers' contractual holdback amount, which typically requires 10% to 30% of the contract value to be retained by the customer until installation and final acceptance is complete. The customer generally becomes obligated to pay 70% to 90% of the contract value upon shipment and acceptance of factory performance testing. Installation is not deemed to be essential to the functionality of the system since installation does not require significant changes to the features or capabilities of the system, does not require complex software integration and interfacing and the Company has not experienced any

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difficulties installing such equipment. In addition, the customer or other third party vendors can install the system. The estimated relative fair value of the installation services is determined by management, which is typically less than the customer's contractual holdback percentage. If the holdback is less than the fair value of installation, the Company will defer recognition of revenues, determined on a contract-by-contract basis equal to the fair value of the installation services. Payments received in advance by customers are deferred until shipment and are presented as deferred revenues in the accompanying consolidated balance sheets.

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

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

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

Costs from Ground Segment Systems, Networks and Enterprise Solutions

Costs related to our production-type contracts and our non-standard, complex production-type contracts rely on estimates based on total expected contract costs. These costs consist primarily of the costs of purchased materials (including shipping and handling costs), direct labor and related overhead expenses, project-related travel and living costs and subcontractor salaries. We use estimates of the costs applicable to various elements, which we believe are reasonable. Since these contract costs depend on estimates, which are assessed continually during the term of these contracts, costs are subject to revisions as the contract progresses to completion. Revision in cost estimates are reflected in the period in which they become known. In the event an estimate indicates that a loss will be incurred at completion, we record the costs in the period identified.

Costs from Data Communications Services

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

Research and Development

Research and development expenditures are expensed as incurred.

Stock-Based Compensation

The Company accounts for stock option grants using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB No.

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25"), and complies with the disclosure provisions of Statement of Financial Accounting Standards ("SFAS") No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123"), as amended by SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure ("SFAS No. 148").

Interim pro-forma information regarding net income and net loss per common share is required by SFAS No. 148, if the Company accounts for its stock options granted under the intrinsic value method. The fair value of options granted under the Company's Amended and Restated 1997 Stock Incentive Plan was estimated at the date of grant using a Black-Scholes option pricing model.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. The Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options under the Black-Scholes option valuation model.

For purposes of pro-forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro-forma information is as follows:

Three Months Ended		Nine Months Ended	
March 31, 2005	March 31, 2004	March 31, 2005	March 31, 2004
(Unaudited)			
(In thousands, except per share data)			

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Reported net income (loss)	\$	561	\$	(573)	\$	3,744	\$	(1,718)
Pro-forma stock compensation expense		(536)		(492)		(1,318)		(1,773)
Pro-forma net income (loss)	\$	25	\$	(1,065)	\$	2,426	\$	(3,491)
Reported basic net income (loss) per common share	\$	0.04	\$	(0.04)	\$	0.26	\$	(0.13)
Reported diluted net income (loss) per common share	\$	0.04	\$	(0.04)	\$	0.25	\$	(0.13)
Pro-forma basic net income (loss) per common share	\$	0.00	\$	(0.08)	\$	0.17	\$	(0.27)
Pro-forma diluted net income (loss) per common share	\$	0.00	\$	(0.08)	\$	0.16	\$	(0.27)

During the three and nine months ended March 31, 2005, compensation expense related to stock options of \$0 and \$6,000 was included in the reported net income, respectively. During the three and nine months ended March 31, 2004, compensation expense related to stock options of \$5,000 and \$8,000 was included in the reported net loss.

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment, which is a revision of SFAS 123 ("SFAS 123R"). SFAS 123R eliminates the ability to account for share-based compensation under the intrinsic value method permitted by APB 25. This will require the Company to adopt the fair value model for recognizing compensation expense for employee stock options, and would have the effect of reducing the Company's reported net income and net income per share. SFAS 123R is required to be adopted by the Company on July 1, 2005. In May 2005, in response to FAS 123R, the Board of Directors of the Company, upon recommendation of its Compensation Committee, approved an acceleration of all unvested options granted to employees and directors under the Company's Amended and Restated 1997 Stock Incentive Plan. As a result of the acceleration, options to acquire 863,165 shares of the Company's common stock became immediately exercisable. In order to prevent unintended personal benefit to directors and executive officers, the Board of Directors, upon recommendation of its

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Compensation Committee, imposed restrictions on any shares received through the exercise of accelerated options held by those individuals. These restrictions prevent their sale of stock obtained through exercise of an accelerated option prior to the earlier of the original vesting date or the individual's termination of employment. The restrictions apply to 306,220 options.

As a result of the acceleration, the Company is not expected to be required to recognize anticipated stock option expense of approximately \$0.6 million in fiscal 2006, \$0.4 million in fiscal 2007 and \$0.1 million in fiscal 2008. A one-time non-cash compensation charge of \$0.1 million will be recorded in the fourth quarter of fiscal 2005 as a result of the acceleration. The Compensation Committee took this action with the belief that it is in the best interest of the shareholders, as it would reduce the compensation expense in future periods.

In determining the equity component of its future compensation structure, the Company will take into account the impact of FAS 123R on its operating results.

Goodwill

Goodwill represents the excess of the purchase price of businesses over the fair value of the identifiable net assets acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and other indefinite life intangible assets are no longer amortized, but instead tested for impairment at least annually. The impairment test for goodwill uses a two-step approach, which is performed at the reporting unit level. Step one compares the fair value of the reporting unit (calculated using a discounted cash flow method) to its carrying value. If the carrying value exceeds the fair value, there is a potential impairment and step two must be performed. Step two compares the carrying value of the reporting unit's goodwill to its implied fair value (i.e., fair value of the reporting unit less the fair value of the unit's assets and liabilities, including identifiable intangible assets). If the carrying value of goodwill exceeds its implied fair value, the excess is required to be recorded as an impairment. There have been no events during the nine months ended March 31, 2005 that would result in any goodwill impairment.

Inventories

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

Restricted Cash

Restricted cash includes certificates of deposit used as cash collateral for bid proposals and contract performance guarantees.

Comprehensive Income

Comprehensive income for the three and nine months ended March 31, 2005 includes a foreign currency translation (loss) gain of approximately (\$74,000) and \$10,000, and the reversal of an unrealized loss on available-for-sale securities of approximately \$3,000 in the three months ended March 31, 2005. Comprehensive loss for the three and nine months ended March 31, 2004 includes a foreign currency translation gain of approximately \$53,000 and \$110,000 and an unrealized gain on available-for-sale securities of approximately \$195,000 for the nine months ended March 31, 2004.

Accounting for Derivative Instruments and Hedging Activities

SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities – an Amendment to SFAS No. 133, requires that all derivative instruments be recognized on the balance sheet at fair value. In addition, the standard specifies criteria for designation and effectiveness of hedging relationships and establishes accounting rules for reporting changes in the fair value of a derivative instrument depending on the designated type of hedge.

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The Company, at times, enters into foreign currency exchange contracts (forward contracts) to manage its exposure to currency rate fluctuations on anticipated sales and purchases. These types of exchange contracts generally qualify for accounting as designated hedges. The realized and unrealized gains and losses on qualified contracts are deferred and included as components of the related transactions. Any contracts that do not qualify as hedges for accounting purposes are marked to market with the resulting gains and losses recognized in other income or expense. At March

31, 2005 and June 30, 2004 the Company had no outstanding foreign exchange contracts.

Income Taxes

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of the net deferred tax assets is dependent upon the generation of future taxable income prior to the expiration of any net operating loss carryforwards. For the nine months ended March 31, 2005 and the year ended June 30, 2004, due to the uncertainty regarding the Company's ability to utilize its net operating losses in the future, the Company provided a valuation allowance against its previously recorded deferred tax assets except for approximately \$83,000, representing state investment tax credit carryforwards that will be utilized to offset state capital taxes on the Company's combined state tax return. The Company has used net operating loss carryforwards to offset the net income for the three and nine months ended March 31, 2005.

Product Warranties

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

2. Basic and Diluted Net Income (Loss) Per Common Share

The Company computes net income (loss) per common share in accordance with the provisions of SFAS No. 128, Earnings Per Share. Basic and diluted net income (loss) per common share is computed by dividing the net income (loss) for the period by the weighted-average number of common equivalent shares outstanding for the period. Common equivalent shares consist of the incremental common shares issuable upon the conversion of preferred stock (using an if-converted method) and incremental common shares issuable upon the exercise of stock options and warrants (using the treasury stock method). Incremental common equivalent shares were excluded from the calculation of diluted net loss per common share for the three and nine months ended March 31, 2004, as their effect was anti-dilutive. Diluted net loss per common share for the three and nine months ended March 31, 2004 excludes the effect of approximately 491,000 and 268,000 stock options, respectively, and approximately 33,000 warrants for the three months ended March 31, 2004, as their effect would have been anti-dilutive.

3. Inventories

Inventories consist of the following:

	March 31, 2005 (Unaudited)	June 30, 2004
	(In thousands)	
Raw materials and component parts	\$ 129	\$ 163
Work-in-progress	12,498	7,362
	12,627	7,525
Less progress payments	(3,388)	(3,621)
	\$ 9,239	\$ 3,904

4. Segment Information

The Company operates through two business segments. Its ground segment systems, networks and enterprise solutions segment, through Globecomm Systems Inc. and Globecomm Systems Europe

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Limited, is engaged in the design, assembly and installation of ground segment systems and networks. Its data communications services segment, through Globecomm Network Services Corporation, provides satellite communication services capabilities.

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

The following is the Company's business segment information for the three and nine months ended March 31, 2005 and 2004 and as of March 31, 2005 and June 30, 2004:

	Three Months Ended		Nine Months Ended	
	March 31,	March 31,	March 31,	March 31,
	2005	2004	2005	2004
	(Unaudited)			
	(In thousands)			
Revenues:				
Ground segment systems, networks and enterprise solutions	\$ 23,443	\$ 18,956	\$ 69,722	\$ 55,878
Data communications services	4,741	3,305	13,149	10,544
Total revenues	\$ 28,184	\$ 22,261	\$ 82,871	\$ 66,422
Income (loss) from operations:				
Ground segment systems, networks and enterprise solutions	\$ 577	\$ (89)	\$ 3,579	\$ (1,826)
Data communications services	(275)	(551)	(307)	(186)
Interest income	121	63	286	191
Gain on sale of investment	—	—	40	—
Gain on sale of available-for-sale securities	132	—	132	91
Intercompany eliminations	6	4	14	12
Net income (loss)	\$ 561	\$ (573)	\$ 3,744	\$ (1,718)
Depreciation and amortization:				
Ground segment systems, networks and enterprise solutions	\$ 271	\$ 314	\$ 879	\$ 1,068
Data communications services	503	430	1,392	1,290
Intercompany eliminations	(6)	(4)	(14)	(12)
Total depreciation and amortization	\$ 768	\$ 740	\$ 2,257	\$ 2,346
Expenditures for long-lived assets:	\$ 86	\$ 174	\$ 279	\$ 306

Ground segment systems, networks and enterprise solutions					
Data communications services	693	330	2,019	730	
Intercompany eliminations	(42)	22	(42)	(3)	
Total expenditures for long-lived assets	\$ 737	\$ 526	\$ 2,256	\$ 1,033	

March 31,
2005
(Unaudited)
June 30,
2004
(In thousands)

Assets:				
Ground segment systems, networks and enterprise solutions	\$	136,658	\$	125,534
Data communications services		14,844		11,501
Intercompany eliminations		(67,897)		(63,560)
Total assets	\$	83,605	\$	73,475

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5. Settlement Agreement

The Company reached a \$4.0 million settlement in July 2004 relating to amounts due under a contract with a major customer. The Company had recorded a \$4.5 million charge in the fourth quarter of fiscal 2003 of which \$1.5 million and \$3.0 million was included in general and administrative expenses and costs from ground segment systems, networks, and enterprise solutions, respectively. This settlement resulted in a \$0.9 million cost recovery to costs from ground segment systems, networks and enterprise solutions and a \$1.5 million bad debt recovery included in general and administrative expenses, both of which reversed a portion of the previous charge. The balance of \$1.6 million related to a \$1.2 million account receivable due to the Company, which was not subject to the charge, and covered \$0.4 million in costs to complete the program.

6. Related Party Transaction

In January 2003, the Company entered into a letter agreement with an individual who is a former executive officer and current employee of the Company, pursuant to which the Company consolidated the then outstanding loans and advances receivable from such individual into a promissory note of approximately \$321,000. Under the terms of the letter agreement the Company agreed to forgive the outstanding principal and interest amounts due on the promissory note in five annual installments, so long as the former executive officer remains an employee. In March 2005, the Company forgave the second installment of approximately \$71,000.

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

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

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

Overview

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

Contract costs generally include purchased material, direct labor, overhead and other direct costs. Anticipated contract losses are recognized in the period identified. Costs from ground segment systems, networks and enterprise solutions consist primarily of the costs of purchased materials (including shipping and handling costs), direct labor and related overhead expenses, project-related travel and living costs and subcontractor salaries. Costs from data communications services consist primarily of satellite space segment charges, Internet connectivity fees and network operations

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expenses. Satellite space segment charges consist of the costs associated with obtaining satellite bandwidth (the measure of capacity) used in the transmission of services to and from the satellite leased from operators. Network operations expenses consist primarily of costs associated with the operation of the network operations center on a twenty-four hour a day, seven-day a week basis, including personnel and related costs and depreciation. Selling and marketing expenses consist primarily of salaries, travel and living costs for sales and marketing personnel. Research and development expenses consist primarily of salaries and related overhead expenses. General and administrative expenses consist of expenses associated with our management, finance, contract and administrative functions.

Our business had been adversely affected by the global economic slowdown and, in particular, the significant challenges facing the telecommunications industry worldwide. Recently, we have seen improvement in the segments we serve, in particular within the U.S. Government and government related entities marketplace. However, some of the adverse consequences of the downturn continue to impact our business based upon the inability of some of our customers and prospects to raise capital to fund projects, particularly, in developing countries.

We currently have two significant contracts with the Ministry of Communication of the Islamic Transitional State of Afghanistan, and derived 34% of our revenues in the three months ended March 31, 2005 from these contracts. Further hostilities in Afghanistan, or in connection with any armed conflict affecting areas where our customers are located may impact our performance on these contracts, which may impact our results of operations.

Critical Accounting Policies

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

Revenue Recognition

We recognize revenue in accordance with SAB 104, Revenue Recognition, for our production-type contracts that are sold separately as standard satellite ground segment systems when persuasive evidence of an arrangement exists, the selling price is fixed or determinable, collectibility is reasonably assured, delivery has occurred and the contractual performance specifications have been met. Our standard satellite ground segment systems produced in connection with these contracts are typically short-term (less than twelve months in term) and manufactured using a standard modular production process. Such systems require less engineering, drafting and design efforts than our long-term complex production-type projects. Revenue is recognized on our standard satellite ground segment systems upon shipment and acceptance of factory performance testing which is when title transfers to the customer. The amount of revenues recorded on each standard production-type contract is reduced by the customer's contractual holdback amount, which typically requires 10% to 30% of the contract value to be retained by the customer until installation and final acceptance is complete. The customer generally becomes obligated to pay 70% to 90% of the contract value upon shipment and acceptance of factory performance testing. Installation is not deemed to be essential to the functionality of the system since installation does not require significant changes to the features or capabilities of the equipment, does not require complex software integration and interfacing and we have not experienced any difficulties installing such equipment. In addition, the customer or other third party vendors can install the equipment. The estimated relative fair value of the installation services is determined by management, which is typically less than the customer's contractual holdback percentage. If the holdback is less than the fair value of installation, we will defer recognition of revenues, determined on a contract-by-contract basis equal to the fair value of the installation services. Payments received in advance by customers are deferred until shipment and are presented as deferred revenues.

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

Costs from Ground Segment Systems, Networks and Enterprise Solutions

Costs related to our production-type contracts and our non-standard, complex production-type contracts rely on estimates based on total expected contract costs. We use estimates of the costs applicable to various elements which we believe are reasonable. Since these contract costs depend on estimates, which are assessed continually during the

term of these contracts, costs are subject to revisions as the contract progresses to completion. Revision in cost estimates are reflected in the period in which they become known. In the event an estimate indicates that a loss will be incurred at completion, we record the costs in the period identified.

Goodwill

Goodwill represents the excess of the purchase price of businesses over the fair value of the identifiable net assets acquired. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and other indefinite life intangible assets are no longer amortized, but instead tested for impairment at least annually. The impairment test for goodwill uses a two-step approach, which is performed at the reporting unit level. Step one compares the fair value of the reporting unit (calculated using a discounted cash flow method) to its carrying value. If the carrying value exceeds the fair value, there is a potential impairment and step two must be performed. Step two compares the carrying value of the reporting unit's goodwill to its implied fair value (i.e., fair value of the reporting unit less the fair value of the unit's assets and liabilities, including identifiable intangible assets). If the carrying value of goodwill exceeds its implied fair value, the excess is required to be recorded as an impairment charge. There have been no events during the nine months ended March 31, 2005 that would result in any goodwill impairment.

Allowances for Doubtful Accounts

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

The allowance for doubtful accounts at March 31, 2005 and June 30, 2004 was \$0.8 million and \$2.6 million, respectively. The decrease in the allowance primarily related to a bad debt recovery of approximately \$1.5 million under a settlement reached with a major customer in July 2004.

Inventories

Inventories consist primarily of work-in-progress from costs incurred in connection with specific customer contracts, which are stated at the lower of cost or market value. In assessing the realizability of inventories, we are required to make estimates of the total contract costs based on the various

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elements of the work-in-progress. It is possible that changes to these estimates could cause a reduction in the net realizable value of our inventories.

Results of Operations

Three and Nine Months Ended March 31, 2005 and 2004

Revenues from Ground Segment Systems, Networks and Enterprise Solutions. Revenues increased by \$4.5 million, or 23.7%, to \$23.4 million for the three months ended March 31, 2005 and increased by \$13.8 million, or 24.8%, to \$69.7 million for the nine months ended March 31, 2005, compared to \$19.0 million and \$55.9 million for the three and nine months ended March 31, 2004, respectively. The increases in revenue were primarily the result of increased infrastructure sales in the U.S. Government and government related entities marketplace, primarily driven by sales to Ministry of Communication of the Islamic Transitional State of Afghanistan, coupled with increased sales due to an overall improvement in the telecommunications industry segments we serve and the achievement of shipment milestones associated with projects currently in progress offset by a decrease in sales at Globecom Systems Europe Limited.

Revenues from Data Communication Services. Revenues increased by \$1.4 million, or 43.4%, to \$4.7 million for the three months ended March 31, 2005 and increased by \$2.6 million, or 24.7%, to \$13.1 million for the nine months ended March 31, 2005, compared to \$3.3 million and \$10.5 million for the three and nine months ended March 31, 2004, respectively. The increase was due to the increase in Video Broadcast service offerings and the Voice Over Internet Protocol (VOIP) service.

Costs from Ground Segment Systems, Networks and Enterprise Solutions. Costs from ground segment systems, networks and enterprise solutions increased by \$3.3 million, or 20.6%, to \$19.5 million for the three months ended March 31, 2005 and increased by \$9.3 million, or 18.9% to \$58.6 million for the nine months ended March 31, 2005, compared to \$16.2 million and \$49.3 million for the three and nine months ended March 31, 2004, respectively. Costs as a percentage of related revenues decreased to 83.3% and 84.0% for the three and nine months ended March 31, 2005, respectively, compared to 85.4% and 88.2% for the three and nine months ended March 31, 2004, respectively. The decrease was mainly attributable to a non-recurring cost recovery related to a settlement with a large customer of \$0.9 million for the nine months ended March 31, 2005 and increased margin on revenues related to the U.S. Government and government related entities projects in the three and nine months ended March 31, 2005.

Costs from Data Communications Services. Costs from data communications services increased by \$1.0 million, or 33.4%, to \$4.2 million for the three months ended March 31, 2005 and increased by \$1.5 million, or 15.4%, to \$11.1 million for the nine months ended March 31, 2005, compared to \$3.1 million and \$9.6 million for the three and nine months ended March 31, 2004, respectively. The increase is a result of additional space segment costs required for the Video Broadcast service offerings and the minutes cost for the Voice Over Internet Protocol (VOIP) service.

Selling and Marketing. Selling and marketing expenses increased by \$0.3 million, or 21.1%, to \$1.5 million for the three months ended March 31, 2005 and increased by \$0.6 million, or 16.4%, to \$4.0 million for the nine months ended March 31, 2005, compared to \$1.2 million and \$3.5 million for the three and nine months ended March 31, 2004, respectively. The increase in selling and marketing costs is a result of increased salary and salary related expenses for additional marketing personnel.

Research and Development. Research and development expenses remained constant at \$0.2 million for the three months ended March 31, 2005 and March 31, 2004 and decreased by \$0.3 million, or 26.2%, to \$0.7 million for the nine months ended March 31, 2005, compared to \$1.0 million for the nine months ended March 31, 2004. The decrease was principally due to non-recurrence of costs associated with product research and development associated with projects in process in the nine months ended March 31, 2004.

General and Administrative. General and administrative expenses increased by \$0.3 million, or 21.1%, to \$2.5 million for the three months ended March 31, 2005 and increased by \$0.1 million, or

1.0%, to \$5.2 million for the nine months ended March 31, 2005, compared to \$2.1 million and \$5.1 million for the three and nine months ended March 31, 2004, respectively. The increase in general and administrative expenses for the three months ended March 31, 2005 was primarily due to an increase in the accounts receivable allowance at our data communication services business, an increase in accounting fees related to the implementation of Section 404 of the Sarbanes-Oxley Act of 2002, and termination costs collectively. Although, general and administrative expenses were consistent for the nine months ended March 31, 2005 and 2004, general and administrative expenses included a bad debt recovery of \$1.5 million as a result of a settlement reached with a customer offset by an increase of \$0.5 million in the accounts receivable allowance at our data communication services business, an increase in accounting fees related to the implementation of Section 404 of the Sarbanes-Oxley Act of 2002, and termination costs collectively as compared to the \$1.0 million recovery in the nine months ended March 31, 2004.

Gain on Sale of Available-for-Sale Securities. The gain on sale of available-for-sale securities of \$0.1 million for the three and nine months ended March 31, 2005, related to the sale of an investment that resulted in proceeds of \$0.3 million in the nine months ended March 31, 2005.

Interest Income. Interest income increased for the three and nine months ended March 31, 2005 as compared to March 31, 2004 due to increased interest rates coupled with an increase in the balance of cash and cash equivalents.

Liquidity and Capital Resources

At March 31, 2005, we had working capital of \$35.7 million, including cash and cash equivalents of \$22.4 million, restricted cash of \$3.9 million, net accounts receivable of \$23.4 million, inventories of \$9.2 million, prepaid expenses and other current assets of \$0.9 million, offset by \$18.0 million in accounts payable, \$2.4 million in deferred revenues and \$3.8 million in accrued expenses and other current liabilities.

Net cash used in operating activities during the nine months ended March 31, 2005 was \$4.0 million, which primarily related to an increase in accounts receivable of \$7.7 million relating to the increase in revenues, an increase in inventory of \$5.5 million due to timing of shipments of certain jobs, a decrease in the provision for doubtful accounts, due to a bad debt recovery of \$1.4 million, offset in part by net income of \$3.7 million, an increase in accounts payable of \$2.5 million relating to the increase in revenues and the timing of vendor payments, an increase in deferred revenue of \$1.3 million due to timing differences between project billings and revenue recognition milestones resulting from specific customer contracts, and a non-cash item representing depreciation and amortization expense of \$2.3 million primarily related to the network operations center and satellite earth station equipment.

Net cash used in investing activities during the nine months ended March 31, 2005 was \$3.9 million, which related to the purchase of \$2.3 million of fixed assets primarily for our network operations center, specifically related to the Video Broadcast and VOIP platforms, an increase in restricted cash of \$2.0 million based on certificates of deposit issued as collateral for performance and payment guarantees offset by proceeds received of \$0.3 million from the sale of available-for-sale securities.

Net cash provided by financing activities during the nine months ended March 31, 2005 was \$2.1 million which primarily related to \$1.3 million of proceeds from the exercise of warrants issued in connection with our private placement in December 2003 and \$0.7 million of proceeds from the exercise of stock options.

We have a credit agreement in place which provides for a working capital credit facility of up to \$16.5 million, which expires in October 2005. We may be advanced up to 80% of eligible accounts receivable and 100% of unrestricted cash and cash equivalents at the bank. The line of credit bears interest at the greater of 6.0% per annum or the prime rate plus 1.5% per annum, and is collateralized by a first security interest on all of our personal property. The credit agreement allows us to borrow and apply letters of credit against the availability under the line of credit. In addition,

the credit

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agreement contains certain financial and other covenants, deposit requirements, monthly reporting provisions and other requirements, as defined in the credit agreement, with which we were in compliance at March 31, 2005. As of March 31, 2005, no borrowings were outstanding under this credit facility, however, there were standby letters of credit of approximately \$15.3 million, which were applied against and reduced the amounts available under this credit facility.

We lease satellite space segment services and other equipment under various operating lease agreements, which expire in various years through 2009. Future minimum lease payments due on these leases through March 31, 2006 are approximately \$9.5 million.

At March 31, 2005 we had contractual obligations and commercial commitments as follows (in thousands):

	Total	Payments Due by Period			
		Less than 1 year	1-3 years	4-5 years	After 5 years
<u>Contractual Obligations</u>					
Operating leases	\$ 18,970	\$ 9,524	\$ 8,455	\$ 991	\$ —
Total contractual obligations	\$ 18,970	\$ 9,524	\$ 8,455	\$ 991	\$ —
<u>Other Commercial Commitments</u>					
Standby letters of credit	\$ 15,338	\$ 10,865	\$ 4,473	\$ —	\$ —
Total commercial commitments	\$ 15,338	\$ 10,865	\$ 4,473	\$ —	\$ —

On November 7, 2001, the Board of Directors authorized a stock repurchase program whereby we can repurchase up to \$2.0 million of our outstanding stock, representing approximately 3.7% of the total shares outstanding on that date. Since November 2001, we have repurchased an aggregate of 317,606 shares for approximately \$1.7 million. The timing, price, quantity and manner of future purchases will be at the discretion of management, depending on market conditions and other factors, subject to compliance with the applicable securities laws.

We expect that our cash and working capital requirements for operating activities will continue to increase as we continue to implement our business strategy. Management anticipates additional working capital requirements for work in progress for orders as obtained and that we may experience negative cash flows due to quarter-to-quarter operating performance.

Globecomm Network Services Corporation has had, and we expect it will continue to have, working capital and additional capital expenditure requirements, which have, and may continue to put increased pressure on our capital resources.

Our future capital requirements will depend upon many factors, including the success of our marketing efforts in the ground segment systems, networks and data communications services business, the nature and timing of customer orders and the level of capital requirements related to the expansion of our service offerings. Based on current plans, we believe that our existing capital resources will be sufficient to meet working capital requirements at least through

March 31, 2006. However, we cannot assure you that there will be no unforeseen events or circumstances that would consume available resources significantly before that time. For example, future events occurring in response to the hostilities in Iraq and Afghanistan, or in connection with any armed conflict, including, without limitation, future terrorist attacks against the United States or its allies or military or trade or travel disruptions impacting our ability to sell and market our products and services in the United States and internationally may impact our results of operations. In particular, we currently have two significant contracts with the Ministry of Communication of the Islamic Transitional State of Afghanistan. Unexpected events negatively impacting international commerce, including additional conflicts in the Middle East, could defer our ability to close contracts with international customers. Additional funds may not be available when needed and, even if available, additional funds may be raised through financing arrangements and/or the issuance of preferred or common stock or convertible securities on terms and prices significantly more favorable than those of the currently outstanding common stock, which could have the effect of diluting or adversely affecting the holdings or rights of our existing stockholders. If adequate funds are unavailable, we may be required to delay,

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scale back or eliminate some of our operating activities, including, without limitation, the timing and extent of our marketing programs, capital expenditures, research and development activities and we may be required to reduce headcount. We cannot assure you that additional financing will be available to us on acceptable terms, or at all.

Risk Factors

We have had a history of operating losses and negative cash flow. Our negative cash flows may increase as we pursue our business plan and our losses may reoccur, which may strain our capital resources.

Although, recently we have had profitable quarters, we have incurred significant net losses since we began operating in August 1994. We incurred net losses of \$1.3 million during the fiscal year ended June 30, 2004, \$19.6 million during the fiscal year ended June 30, 2003, and \$17.3 million during the fiscal year ended June 30, 2002. As of March 31, 2005 our accumulated deficit was \$71.5 million. Our ability to achieve and maintain profitability will depend upon our ability to generate significant revenues through new profitable customer contracts and the expansion of our existing products and services, including our data communications services. We cannot assure you that we will be able to obtain new profitable customer contracts or generate significant additional revenues from those contracts or any new products or services that we introduce. We may not be able to sustain or increase our profits on a quarterly or annual basis in the future, which will negatively impact our operating cash flows.

Since sales of satellite communications equipment are dependent on the growth of communications networks, if market demand for these networks declines, our revenue and profitability are likely to decline.

We derive, and expect to continue to derive, a significant amount of revenues from the sale of satellite ground segment systems and networks. If the long-term growth in demand for communications networks does not continue to return from recent depressed levels, the demand for our satellite ground segment systems and networks may decline or grow more slowly than we expect. As a result, we may not be able to grow our business, our revenues may decline from current levels and our results of operations may be harmed. The demand for communications networks and the products used in these networks is affected by various factors, many of which are beyond our control. For example, the uncertain general economic conditions have affected the overall rate of capital spending by many of our customers. Also, many companies have found it difficult to raise capital to finish building their communications networks and, therefore, have placed fewer orders. The economic slowdown resulted in a softening of demand from

our customers. We cannot predict the extent to which demand will increase. Further, increased competition among satellite ground segment systems and networks manufacturers has increased pricing pressures. Recently, we have seen improvement in the segments we serve, in particular within the U.S. Government and government related entities marketplace. A future reduction in opportunities from U.S. Government and government related agencies will negatively impact our results of operations.

We derive a substantial portion of our revenues from fixed-price projects, under which we assume greater financial risk if we fail to accurately estimate the costs of the projects.

We derive a substantial portion of our revenues from fixed-price projects. We assume greater financial risks on a fixed-price project than on a time-and-expense based project. If we miscalculate the resources or time we need for these fixed-price projects, the costs of completing these projects may exceed our original estimates, which would negatively impact our results of operations.

Risks associated with operating in international markets could restrict our ability to expand globally and harm our business and prospects.

We market and sell our products and services in the United States and internationally. We anticipate that international sales will continue to account for a significant portion of our total

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revenues for the foreseeable future with a significant portion of the international revenue coming from developing countries, including countries in areas of conflict like Afghanistan. There are a number of risks inherent in conducting our business internationally, including:

- general political and economic instability in international markets, including the hostilities in Iraq and Afghanistan, could impede our ability to deliver our products and services to customers and harm our results of operations;
- changes in regulatory requirements could restrict our ability to deliver services to our international customers;
- export restrictions, tariffs, licenses and other trade barriers could prevent us from adequately equipping our network facilities;
- differing technology standards across countries may impede our ability to integrate our products and services across international borders;
- protectionist laws and business practices favoring local competition may give unequal bargaining leverage to key vendors in countries where competition is scarce, significantly increasing our operating costs;
- increased expenses associated with marketing services in foreign countries could affect our ability to compete;
- relying on local subcontractors for installation of our products and services could adversely impact the quality of our products and services;
- difficulties in staffing and managing foreign operations could affect our ability to compete;
- potentially adverse taxes could affect our results of operations;
- complex foreign laws and treaties could affect our ability to compete; and
- difficulties in collecting accounts receivable could adversely affect our results of operations.

These and other risks could impede our ability to manage our international operations effectively, limit the future growth of our business, increase our costs and require significant management attention.

If Globecomm Network Services Corporation does not execute its business strategy or if the market for its services fails to develop or develops more slowly than it expects, our results of operations will be harmed.

Globecomm Network Services Corporation's future revenues and results of operations are dependent on its execution of its business strategy and development of the market for its current and future services. Despite the settlement agreements which modified and reduced our satellite bandwidth obligations, we cannot assure you that the transponder space will be efficiently and substantially utilized or that an increase in orders will be realized. Globecomm Network Services Corporation has had, and we expect will continue to have, cash requirements, which have and will decrease our cash resources. If Globecomm Network Services Corporation does not efficiently and substantially utilize its transponder space capacity and increase its level of orders, its cash requirements may increase and our results of operations will be harmed. In addition, significant capital expenditures have been required as we have built our VOIP and Video Broadcast service offerings. If our VOIP and Video Broadcast service offerings are not accepted, or if the market fails to grow, we cannot assure you that we will be able to realize an appropriate return on these capital expenditures.

You should not rely on our quarterly operating results as an indication of our future results because they are subject to significant fluctuations, and if we fail to meet the expectations of public market analysts or investors, our stock price could decline significantly.

Our future revenues and results of operations may significantly fluctuate due to a combination of factors, including:

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- delays and/or a decrease in the booking of new contracts;
 - general political and economic conditions in the United States and abroad, including hostilities in Iraq and Afghanistan;
 - the length of time needed to initiate and complete customer contracts;
 - the demand for and acceptance of our existing products and services;
 - the cost of providing our products and services, including the ability to ship and install our products and services in hostile areas;
 - the cost of performance on fixed price contracts;
 - market acceptance of new products and services;
 - the mix of revenue between our standard products, custom-built products and our communications services;
 - the timing of significant marketing programs;
 - our ability to hire and retain additional personnel;
 - the competition in our markets; and
 - difficult global economic conditions and the currency devaluations in international markets, which have adversely impacted and may continue to adversely impact our quarterly results.

Accordingly, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance. It is possible that in future periods our results of operations may be below market expectations, which could cause the trading price of our common stock to decline.

Our markets are highly competitive and we have many established competitors, and we may lose market share as a result.

The markets in which we operate are highly competitive and this competition could harm our ability to sell our products and services on prices and terms favorable to us. Our primary competitors in the satellite ground segment systems and networks market generally fall into two groups: (1) system integrators, like Spacelink, ITT, Data Path, and Global Communication Solutions, and (2) equipment manufacturers which also provide integrated systems, like Andrew Corporation, General Dynamics, Alcatel and ND Satcom AG.

In the end-to-end satellite-based communication solutions and communications services markets, we compete with other satellite communication companies who provide similar services, like Globecast, Americom Government Services and Convergent Media Systems. In addition, we may compete with other communications service providers like Echostar and MCI, and satellite owners like Panamsat, Loral Skynet, New Skies Satellites N.V. and Intelsat. We anticipate that our competitors may develop or acquire services that provide functionality that is similar to that provided by our services and that those services may be offered at significantly lower prices or bundled with other services. These competitors may have the financial resources to withstand substantial price competition, may be in a better position to endure difficult economic conditions in international markets and may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Moreover, many of our competitors have more extensive customer bases, broader customer relationships and broader industry alliances than we do that they could use to their advantage in competitive situations.

The markets in which we operate have limited barriers to entry, and we expect that we will face additional competition from existing competitors and new market entrants in the future. Moreover, our current and potential competitors have established or may establish strategic relationships among themselves or with third parties to increase the ability of their products and services to address the needs of our current and prospective customers. The potential strategic relationships of existing and new competitors may rapidly acquire significant market share, which would harm our business and financial condition.

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If the satellite communications industry fails to continue to develop or new technology makes it obsolete, our business and financial condition will be harmed.

Our business is dependent on the continued success and development of satellite communications technology, which competes with terrestrial communications transport technologies like terrestrial microwave, coaxial cable and fiber optic communications systems. Fiber optic communications systems have penetrated areas in which we have traditionally provided services. If the satellite communications industry fails to continue to develop, or if any technological development significantly improves the cost or efficiency of competing terrestrial systems relative to satellite systems, then our business and financial condition would be materially harmed.

We may be unable to raise additional funds to meet our capital requirements in the future.

We believe that our available cash resources will be sufficient to meet our working capital and capital expenditure requirements through at least March 31, 2006. However, our future liquidity and capital requirements are difficult to predict, as they depend on numerous factors, including the success of our existing product and service offerings, as well as competing technological and market developments. We may need to raise additional funds in order to meet additional working capital requirements and to support additional capital expenditures. Should this need arise,

additional funds may not be available when needed and, even if additional funds are available, we may not find the terms favorable or commercially reasonable. If adequate funds are unavailable, we may be required to delay, reduce or eliminate some of our operating activities, including marketing programs and research and development programs. If we raise additional funds by issuing equity securities, our existing stockholders will own a smaller percentage of our capital stock and new investors may pay less on average for their securities than, and could have rights superior to, existing stockholders.

A limited number of customer contracts account for a significant portion of our revenues, and the inability to replace a key customer contract would adversely affect our results of operations, business and financial condition.

We rely on a small number of customer contracts for a large portion of our revenue. Specifically, we have agreements with four customers to provide equipment and services, from which we expect to generate a significant portion of our revenues. We derived 34% and 10% of our revenues in the three months ended March 31, 2005 from the Ministry of Communication of the Islamic Transitional State of Afghanistan and the United Nations, respectively. If any of these customers is unable to implement its business plan, the market for these customers' services declines, or if all or any of the customers modifies or terminates its agreement with us, and we are unable to replace these contracts, our results of operations, business and financial condition would be materially harmed.

If our products and services are not accepted in developing countries with emerging markets, our revenues will be impaired.

We anticipate that a substantial portion of the growth in the demand for our products and services will come from customers in developing countries due to a lack of basic communications infrastructure in these countries. However, we cannot guarantee an increase in the demand for our products and services in developing countries or that customers in these countries will accept our products and services at all. Our ability to penetrate emerging markets in developing countries is dependent upon various factors including:

- the speed at which communications infrastructure, including terrestrial microwave, coaxial cable and fiber optic communications systems, which compete with satellite-based services, is built;
- the effectiveness of our local resellers and sales representatives in marketing and selling our products and services; and
- the acceptance of our products and services by customers.

If our products and services are not accepted, or the market potential we anticipate does not develop, our revenues will be impaired.

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We depend upon certain key personnel and may not be able to retain these employees. If we lose the services of these individuals or cannot hire additional qualified personnel, our business will be harmed.

Our success also depends to a substantial degree on our ability to attract, motivate and retain other highly-qualified personnel. There is considerable competition for the services of highly-qualified technical and engineering personnel. We may not be able either to retain our current personnel or hire additional qualified personnel if and when needed.

Our future performance depends on the continued service of our key technical, managerial and marketing personnel; in particular, David Hershberg, Kenneth Miller, Stephen Yablonski and Donald Woodring. The employment of any of

our key personnel could cease at any time.

Unauthorized use of our intellectual property by third parties may damage our business.

We regard our trademarks, trade secrets and other intellectual property as beneficial to our success. Unauthorized use of our intellectual property by third parties may damage our business. We rely on trademark, trade secret and patent protection and contracts, including confidentiality and license agreements with our employees, customers, strategic collaborators, consultants and others, to protect our intellectual property rights. Despite our precautions, it may be possible for third parties to obtain and use our intellectual property without our authorization.

We currently have been granted three patents in the United States, one for remote access to the Internet using satellites, one for satellite communication with automatic frequency control, and one for a monitor and control system for satellite communications networks and the like. We have two other patents pending in the United States, one for implementing facsimile and data communications using Internet Protocols and another for a distributed satellite-based cellular network. We currently have one Patent Cooperation Treaty patent application pending for implementing facsimile and data communications using Internet Protocols. We also intend to seek further patents on our technology, if appropriate. We cannot assure you that patents will be issued for any of our pending or future patent applications or that any claims allowed from such applications will be of sufficient scope, or be issued in all countries where our products and services can be sold, to provide meaningful protection or any commercial advantage to us. Also, our competitors may be able to design around our patents. The laws of some foreign countries in which our products and services are or may be developed, manufactured or sold may not protect our products and services or intellectual property rights to the same extent as do the laws of the United States and thus make the possibility of piracy of our technology and products and services more likely.

We have filed applications for trademark registration of Globecomm Systems Inc., Globecomm and GSI in the United States and various other countries, and have been granted registrations for some of these terms in the United States, Europe and Russia. We have various other trademarks and service marks registered or pending for registration in the United States and in other countries and may seek registration of other trademarks and service marks in the future. We cannot assure you that registrations will be granted from any of our pending or future applications, or that any registrations that are granted will prevent others from using similar trademarks in connection with related goods and services.

Defending against intellectual property infringement claims could be time consuming and expensive, and if we are not successful, could cause substantial expenses and disrupt our business.

We cannot be sure that the products, services, technologies and advertising we employ in our business do not or will not infringe valid patents, trademarks, copyrights or other intellectual property rights held by third parties. We may be subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business. Prosecuting infringers and defending against intellectual property infringement claims could be time consuming and expensive, and regardless of whether we are or are not successful, could cause substantial expenses and disrupt our business. We may incur substantial expenses in defending against these third

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party claims, regardless of their merit. Successful infringement claims against us may result in substantial monetary liability and/or may materially disrupt the conduct of, or necessitate the cessation of, segments of our business.

We may not be able to keep pace with technological changes, which would make our products and services become non-competitive and obsolete.

The telecommunications industry, including satellite-based communications services, is characterized by rapidly changing technologies, frequent new product and service introductions and evolving industry standards. If we are unable, for technological or other reasons, to develop and introduce new products and services or enhancements to existing products and services in a timely manner or in response to changing market conditions or customer requirements, our products and services would become non-competitive and obsolete, which would harm our business, results of operations and financial condition.

We depend on our suppliers, some of which are our sole or a limited source of supply, and the loss of these suppliers would materially adversely affect our business, results of operations and financial condition.

We currently obtain most of our critical components and services from single or limited sources and generally do not maintain significant inventories or have long-term or exclusive supply contracts with our vendors. We have from time to time experienced delays in receiving products from vendors due to lack of availability, quality control or manufacturing problems, shortages of materials or components or product design difficulties. We may experience delays in the future and replacement services or products may not be available when needed, or at all, or at commercially reasonable rates or prices. If we were to change some of our vendors, we would have to perform additional testing procedures on the service or product supplied by the new vendors, which would prevent or delay the availability of our products and services. Furthermore, our costs could increase significantly if we need to change vendors. If we do not receive timely deliveries of quality products and services, or if there are significant increases in the prices of these products or services, it could have a material adverse effect on our business, results of operations and financial condition.

Our network may experience security breaches, which could disrupt our services.

Our network infrastructure may be vulnerable to computer viruses, break-ins, denial of service attacks and similar disruptive problems caused by our customers or other Internet users. Computer viruses, break-ins, denial of service attacks or other problems caused by third parties could lead to interruptions, delays or cessation in service to our customers. There currently is no existing technology that provides absolute security, and the cost of minimizing these security breaches could be prohibitively expensive. We may face liability to customers for such security breaches. Furthermore, these incidents could deter potential customers and adversely affect existing customer relationships.

Satellites upon which we rely may malfunction or be damaged or lost.

The damage or loss of any of the satellites used by us, or the temporary or permanent malfunction of any of the satellites upon which we rely, would likely result in the interruption of our satellite-based communications services. This interruption could have a material adverse effect on our business, results of operations and financial condition.

Risks Related to the Securities Markets and Ownership of Our Common Stock

Our stock price is volatile.

From April 1, 2004 through March 31, 2005, our closing stock price ranged from a low of \$4.67 per share to a high of \$7.58 per share. The market price of our common stock, like that of the securities of many telecommunications and high technology industry companies, could be subject to significant fluctuations and is likely to remain volatile based on many factors, including the following:

- quarterly variations in operating results;
- announcements of new technology, products or services by us or any of our competitors;
- acceptance of satellite-based communication services and Internet access services in developing countries and emerging markets;
- changes in financial estimates or recommendations by securities analysts;
- general market conditions; or
- domestic and international economic factors unrelated to our performance.

Additionally, numerous factors relating to our business may cause fluctuations or declines in our stock price.

The stock markets in general and the markets for telecommunications stocks in particular have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

We have not paid dividends in the past and do not expect to pay dividends in the future, and any return on investment may be limited to the value of our stock.

We have never paid cash dividends on our common stock and do not anticipate paying cash dividends on our common stock in the foreseeable future. The payment of dividends on our common stock will depend on our future earnings, capital requirements, financial condition, future prospects and other factors as the board of directors might deem relevant. If we do not pay dividends our stock may be less valuable because a return on your investment will only occur if our stock price appreciates

Because our common stock is thinly traded, it may be difficult to sell shares of our common stock into the markets without experiencing significant price volatility.

Our common stock is currently traded on the NASDAQ National Market. Because of the relatively small number of shares that are traded, it may be difficult for you to find a purchaser for shares of our common stock without experiencing significant price volatility. We cannot guarantee that an active trading market will develop, that our common stock will have a higher trading volume than it has historically had or that it will maintain its current market price. This illiquidity could have a material adverse effect on the market price of our stock.

A third party could be prevented from acquiring shares of our stock at a premium to the market price because of our anti-takeover provisions.

Various provisions with respect to votes in the election of directors, special meetings of stockholders, and advance notice requirements for stockholder proposals and director nominations of our amended and restated certificate of incorporation, bylaws and Section 203 of the General Corporation Law of the State of Delaware could make it more difficult for a third party to acquire us, even if doing so might be beneficial to our stockholders. In addition, we have a poison pill in place and employment provisions with our senior executives that have change of control provisions that could make an acquisition of us by a third party more difficult.

Risks Related to Government Approvals

We are subject to many government regulations, and failure to comply with them will harm our business.

Operations and Use of Satellites

We are subject to various federal laws and regulations, which may have negative effects on our business. We operate FCC licensed earth stations in Hauppauge, New York, subject to the

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Communications Act of 1934, as amended (the "FCC Act"), and the rules and regulations of FCC. Pursuant to the FCC Act and rules, we have obtained and are required to maintain radio transmission licenses from the FCC for both domestic and foreign operations of our earth stations. We have also obtained and are required to maintain authorization issued under Section 214 of the FCC Act to act as a telecommunications carrier, which authorization also extends to Globecomm Network Services Corporation. These licenses should be renewed by the FCC in the normal course as long as we remain in compliance with FCC rules and regulations. However, we cannot guarantee that the FCC will grant additional licenses when our existing licenses expire, nor are we assured that the FCC will not adopt new or modified technical requirements that will require us to incur expenditures to modify or upgrade our equipment as a condition of retaining our licenses. We are also required to comply with FCC regulations regarding the exposure of humans to radio frequency radiation from our earth stations. These regulations, as well as local land use regulations, restrict our freedom to choose where to locate our earth stations. In addition, prior to a third party acquisition of us, we would need to seek approval from the FCC to transfer the radio transmission licenses we have obtained to the third party upon the consummation of the acquisition. However, we cannot assure you that the FCC will permit the transfer of these licenses. These approvals may make it more difficult for a third party to acquire us.

Foreign Ownership

We may, in the future, be required to seek FCC approval if foreign ownership of our stock exceeds the specified criteria. Failure to comply with these policies could result in an order to divest the offending foreign ownership, fines, denial of license renewal and/or license revocation proceedings against the licensee by the FCC.

Foreign Regulations

Regulatory schemes in countries in which we may seek to provide our satellite-delivered data communications services may impose impediments on our operations. Some countries in which we intend to operate have telecommunications laws and regulations that do not currently contemplate technical advances in telecommunications technology like Internet/intranet transmission by satellite. We cannot assure you that the present regulatory environment in any of those countries will not be changed in a manner, which may have a material adverse impact on our business. Either we or our local partners typically must obtain authorization from each country in which we provide our satellite-delivered data communications services. The regulatory schemes in each country are different, and thus there may be instances of noncompliance of which we are not aware. We cannot assure you that our licenses and approvals are or will remain sufficient in the view of foreign regulatory authorities, or that necessary licenses and approvals will be granted on a timely basis in all jurisdictions in which we wish to offer our products and services or that restrictions applicable thereto will not be unduly burdensome.

Regulation of the Internet

Due to the increasing popularity and use of the Internet, it is possible that a number of laws and regulations may be adopted at the local, national or international levels with respect to the Internet, covering issues including user privacy and expression, pricing of products and services, taxation, advertising, intellectual property rights, information security or the convergence of traditional communication services with Internet communications. It is anticipated that a substantial portion of our Internet operations will be carried out in countries that may impose greater regulation of

the content of information coming into the country than that which is generally applicable in the United States, including but not limited to privacy regulations in numerous European countries and content restrictions in countries such as the People's Republic of China. To the extent that we provide content as a part of our Internet services, it will be subject to laws regulating content. Moreover, the adoption of laws or regulations may decrease the growth of the Internet, which could in turn decrease the demand for our Internet services or increase our cost of doing business or in some other manner have a material adverse effect on our business, operating results and financial condition. In addition, the

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applicability of existing laws governing issues including property ownership, copyrights and other intellectual property issues, taxation, libel, court jurisdiction and personal privacy to the Internet is uncertain. The vast majority of these laws were adopted prior to the advent of the Internet and related technologies and, as a result, do not contemplate or address the unique issues of the Internet and related technologies. Changes to these laws intended to address these issues, including some recently proposed changes, could create uncertainty in the marketplace which could reduce demand for our products and services, could increase our cost of doing business as a result of costs of litigation or increased product development costs, or could in some other manner have a material adverse effect on our business, financial condition and results of operations.

Telecommunications Taxation, Support Requirements, and Access Charges

All telecommunications carriers providing domestic services in the United States are required to contribute a portion of their gross revenues for the support of universal telecommunications services. Also, some telecommunications services are subject to special taxation and to contribution requirements to support services to special groups, like persons with disabilities. Our services may be subject to new or increased taxes and contribution requirements that could affect our profitability, particularly if we are not able to pass them through to customers for either competitive or regulatory reasons.

Internet services are currently exempt from charges that long distance telephone companies pay for access to the networks of local telephone companies in the United States. Efforts have been made from time to time, and may be made again in the future, to eliminate this exemption. If these access charges are imposed on telephone lines used to reach Internet service providers and/or if flat rate telephone services for Internet access are eliminated or curtailed, the cost to customers who access our satellite facilities using telephone company-provided facilities could increase to an extent that could discourage the demand for our services. Likewise, the demand for our services in other countries may be affected by the availability and cost of local telephone or other telecommunications facilities to reach our facilities.

Export of Telecommunications Equipment

The sale of our ground segment systems, networks, and communications services outside the United States is subject to compliance with the regulations of the United States Export Administration and, in certain circumstances, with International Traffic in Arms regulations. The absence of comparable restrictions on competitors in other countries may adversely affect our competitive position. In addition, in order to ship our products into and implement our services in some countries, the products must satisfy the technical requirements of that particular country. If we were unable to comply with such requirements with respect to a significant quantity of our products, our sales in those countries could be restricted, which could have a material adverse effect on our business, results of operations and financial condition.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are subject to a variety of risks, including foreign currency exchange rate fluctuations relating to certain purchases from foreign vendors and our wholly-owned subsidiary, Globecomm Systems Europe Limited, which primarily deals in British Pounds Sterling. In the normal course of business, we assess these risks and have established policies and procedures to manage our exposure to fluctuations in foreign currency values.

Our objective in managing our exposure to foreign currency exchange rate fluctuations is to reduce the impact of adverse fluctuations in earnings and cash flows associated with foreign currency exchange rates. Accordingly, we may utilize from time to time foreign currency forward contracts to hedge our exposure on firm commitments denominated in foreign currency. At March 31, 2005 and June 30, 2004 the Company had no outstanding foreign exchange contracts.

Our results of operations and cash flows are subject to fluctuations due to changes in interest rates primarily from our investment of available cash balances in money market funds with portfolios

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of investment grade corporate and government securities. Under our current positions, we do not use interest rate derivative instruments to manage exposure to interest rate changes.

Item 4. Controls and Procedures

Quarterly Evaluation of the Company's Disclosure Controls and Internal Controls.

- (a) As of the end of the period covered by this Quarterly Report on Form 10-Q, an evaluation was carried out under the supervision and with the participation of senior management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective (i) for gathering, analyzing and disclosing the information that the Company is required to disclose in reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act") and (ii) to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to the Company's management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.
- (b) There have been no significant changes in the Company's internal controls over financial reporting (as defined in Exchange Act Rule 13a-15(f) of the Securities Exchange Act of 1934, as amended) or in other factors during the fiscal quarter ended March 31, 2005 that materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

None

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Submission of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

Item 6. Exhibits

Index to Exhibits:

Exhibit No.

31.1 Chief Executive Officer Certification required by Rules 13a-14 and 15d-14 under the Securities Exchange Act of 1934, as amended (filed herewith).

31.2 Chief Financial Officer Certification required by Rules 13a- 14 and 15d- 14 under the Securities Exchange Act of 1934, as amended (filed herewith).

32 Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GLOBECOMM SYSTEMS INC.

(Registrant)

Date: May 16, 2005

/s/ DAVID E. HERSHBERG

David E. Hershberg
Chairman of the Board and
Chief Executive Officer
(Principal Executive Officer)

Date: May 16, 2005

/s/ ANDREW C. MELFI

Andrew C. Melfi
Vice President, Chief Financial
Officer and Treasurer (Principal
Financial and Accounting Officer)

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