

GLOBECOMM SYSTEMS INC

Form 10-Q

May 11, 2009

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**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, 2009

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
(State or other jurisdiction of
incorporation or organization)**

**11-3225567
(I.R.S. Employer
Identification No.)**

**45 Oser Avenue,
Hauppauge, NY
(Address of principal executive offices)**

**11788
(Zip Code)**

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller Reporting Company
(Do not check if a smaller reporting company)

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

As of May 7, 2009, there were 20,840,398 shares of the registrant's Common Stock outstanding.

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

	March 31, 2009 (Unaudited)	June 30, 2008
Assets		
Current assets:		
Cash and cash equivalents	\$ 44,142	\$ 51,399
Accounts receivable, net	43,695	52,106
Inventories	21,259	16,444
Prepaid expenses and other current assets	2,009	1,402
Deferred income taxes	860	1,017
Total current assets	111,965	122,368
Fixed assets, net	32,662	33,379
Goodwill	25,725	22,197
Intangibles, net	4,613	2,599
Deferred income taxes	10,532	11,496
Other assets	1,332	1,053
Total assets	\$ 186,829	\$ 193,092
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 19,293	\$ 25,650
Deferred revenues	6,858	10,004
Accrued payroll and related fringe benefits	3,154	5,848
Other accrued expenses	2,689	1,759
Deferred liabilities		98
Total current liabilities	31,994	43,359
Other liabilities	1,024	957
Deferred income taxes	675	
Commitments and contingencies		
Stockholders equity:		
Series A Junior Participating, shares authorized, issued and outstanding: none at March 31, 2009 and June 30, 2008		
Common stock, \$.001 par value, 50,000,000 shares authorized, shares issued: 21,264,307 at March 31, 2009 and 20,695,466 at June 30, 2008		
	21	21

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Additional paid-in capital	184,084	182,083
Accumulated deficit	(28,229)	(30,547)
Accumulated other comprehensive income	41	
Treasury stock, at cost, 465,351 shares at March 31, 2009 and June 30, 2008	(2,781)	(2,781)
Total stockholders' equity	153,136	148,776
Total liabilities and stockholders' equity	\$186,829	\$193,092

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,	March 31,	March 31,	March 31,
	2009	2008	2009	2008
Revenues from infrastructure solutions	\$ 19,396	\$ 27,483	\$ 64,269	\$ 93,206
Revenues from services	19,198	15,809	56,657	46,875
Total revenues	38,594	43,292	120,926	140,081
Costs and operating expenses:				
Costs from infrastructure solutions	15,938	21,388	53,124	74,007
Costs from services	14,386	12,178	42,899	35,311
Selling and marketing	2,891	2,457	9,220	7,710
Research and development	636	507	1,456	1,660
General and administrative	3,892	3,533	11,256	11,837
Total costs and operating expenses	37,743	40,063	117,955	130,525
Income from operations	851	3,229	2,971	9,556
Interest income	33	387	511	1,463
Interest expense				(285)
Income before income taxes	884	3,616	3,482	10,734
Provision for income taxes	342	193	1,164	568
Net income	\$ 542	\$ 3,423	\$ 2,318	\$ 10,166
Basic net income per common share	\$ 0.03	\$ 0.17	\$ 0.11	\$ 0.53
Diluted net income per common share	\$ 0.03	\$ 0.17	\$ 0.11	\$ 0.51
Weighted-average shares used in the calculation of basic net income per common share	20,210	20,036	20,184	19,281
Weighted-average shares used in the calculation of diluted net income per common share	20,357	20,610	20,479	20,086

See accompanying notes.

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GLOBECOMM SYSTEMS INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY
FOR THE NINE MONTHS ENDED MARCH 31, 2009
(In thousands)
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock Shares	Treasury Stock Amount	Total Stockholders Equity
Balance at June 30, 2008	20,695	\$ 21	\$ 182,083	\$ (30,547)	\$	465	\$ (2,781)	\$ 148,776
Proceeds from exercise of stock options	28		110					110
Stock compensation expense			1,889					1,889
Grant of restricted shares, net	541							
Tax benefit from stock compensation plan			2					2
Comprehensive income:								
Net income				2,318				2,318
Gain from foreign currency translation					41			41
Total comprehensive income								2,359
Balance at March 31, 2009	21,264	\$ 21	\$ 184,084	\$ (28,229)	\$ 41	465	\$ (2,781)	\$ 153,136

See accompanying notes.

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

	Nine Months Ended	
	March 31, 2009	March 31, 2008
Operating Activities:		
Net income	\$ 2,318	\$ 10,166
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	4,198	4,417
Provision for doubtful accounts	656	332
Deferred income taxes	1,121	296
Stock compensation expense	1,889	558
Tax benefit from stock compensation plan	2	19
Changes in operating assets and liabilities, excluding the effect of acquisition:		
Accounts receivable	9,121	(6,154)
Inventories	(4,315)	(5,391)
Prepaid expenses and other current assets	(348)	978
Other assets	(203)	(42)
Accounts payable	(7,254)	(5,155)
Deferred revenue	(3,146)	1,775
Accrued payroll and related fringe benefits	(2,782)	(1,793)
Other accrued expenses	80	(586)
Other liabilities	(30)	(197)
Net cash provided by (used in) operating activities	1,307	(777)
Investing Activities:		
Purchases of fixed assets	(2,510)	(3,619)
Acquisition of business, net of cash received	(6,170)	
Net cash used in investing activities	(8,680)	(3,619)
Financing Activities:		
Proceeds from exercise of stock options	110	824
Proceeds from exercise of warrants		110
Proceeds from offering, net		36,400
Repayments of debt		(15,845)
Net cash provided by financing activities	110	21,489

Effect of foreign currency translation on cash	6	
Net (decrease) increase in cash and cash equivalents	(7,257)	17,093
Cash and cash equivalents at beginning of period	51,399	25,558
Cash and cash equivalents at end of period	\$44,142	\$ 42,651
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	\$	\$ 385
Cash paid for income taxes	185	144

See accompanying notes.

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**GLOBECOMM SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2009
(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, 2008 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 or nine months ended March 31, 2009, are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2009, 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, 2008 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 15, 2008.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Globecomm Network Services Corporation (GNSC), Globecomm Services Maryland LLC (GSM), Cachendo LLC (Cachendo), and B.V. Mach 6 (Mach 6).

Accounting Estimates

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

Revenue Recognition

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

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Company will defer recognition of revenues, determined on a contract-by-contract basis equal to the fair value of the installation services. Payments received in advance by customers are deferred until shipment and are presented as deferred revenues in the accompanying consolidated balance sheets.

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

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

Revenues from services consist of managed network services and lifecycle support services for a broad variety of communications applications. Service revenues are recognized ratably over the period in which services are provided. Payments received in advance of services are deferred until the period such services are provided and are presented as deferred revenues in the accompanying consolidated balance sheets.

Costs from Infrastructure Solutions

Costs from infrastructure 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 Services

Costs from services relating to Internet-based services consist primarily of satellite space segment charges, Internet connectivity fees, voice termination costs and network operations expenses. Satellite space segment charges consist of the costs associated with obtaining satellite bandwidth (the measure of capacity) used in the transmission of services to and from the satellites leased from operators. Network operations expenses consist primarily of costs associated with the operation of the network operation centers, 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 based compensation in accordance with SFAS No. 123 (revised 2004), Share-Based Payment, which is a revision of SFAS 123 (SFAS 123R). Stock compensation expense was approximately \$670,000 and \$1,889,000 for the three and nine months ended March 31, 2009, respectively. Stock compensation expense was approximately \$151,000 and \$558,000 for the three and nine months ended March 31, 2008, respectively. As of March 31, 2009, there was approximately \$271,000 of unrecognized compensation cost related to non-vested outstanding stock options. The cost is expected to be recognized over a weighted-average period of 2.2 years. As of March 31, 2009, there was approximately \$3,241,000 of unrecognized compensation cost related to non-vested stock-based compensation related to restricted shares and restricted share units. The cost is expected to be recognized over a weighted-average period of 2.2 years.

Table of Contents*Goodwill and Other Intangible Assets*

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

The carrying value of goodwill was approximately \$25,725,000 and \$22,197,000 at March 31, 2009 and June 30, 2008, respectively, which related to the services reporting unit. The Company performs the goodwill impairment test annually in the fourth quarter. There have been no events during the nine months ended March 31, 2009 that would indicate that goodwill was impaired.

Intangibles subject to amortization consist of the following:

	March 31, 2009	June 30, 2008
	(Unaudited)	
	(In thousands)	
Customer relationships	\$5,066	\$3,000
Contracts backlog	897	640
Trademark	25	
Covenant not to compete	81	60
	6,069	3,700
Less accumulated amortization	1,456	1,101
Intangibles, net	\$4,613	\$2,599

Amortization is calculated using the straight-line method over the estimated useful lives of the assets. The useful lives were estimated as 8-11 years, 6-8 months, 5 years and 3-4 years for customer relationships, contracts backlog, trademark and covenants not to compete, respectively. Amortization expense of \$158,000 and \$356,000 was included in general and administrative expenses in the three and nine months ended March 31, 2009, respectively. Amortization expense of \$99,000 and \$776,000 was included in general and administrative expenses in the three and nine months ended March 31, 2008, respectively.

Total amortization expense for the following fiscal years related to these intangible assets is expected to be as follows (in thousands):

2009	\$277
2010	676
2011	573
2012	573
2013	571

Comprehensive Income

Comprehensive income for the three and nine months ended March 31, 2009 of approximately \$41,000 represents an unrealized foreign currency translation gain.

Table of Contents*Income Taxes*

Deferred Tax Assets

Consistent with the provisions of SFAS No. 109, Accounting for Income Taxes (SFAS 109), the Company regularly estimates the ability to recover deferred income taxes, and reports such deferred tax assets at the amount that is determined to be more-likely-than-not recoverable, and estimates income taxes in each of the taxing jurisdictions in which the Company operates. This process involves estimating current tax expense together with assessing any temporary differences resulting from the different treatment of certain items, such as the timing for recognizing revenue and expenses for tax and accounting purposes. These differences may result in deferred tax assets and liabilities, which are included in the consolidated balance sheets. The Company is required to assess the likelihood that the deferred tax assets, which include net operating loss carry forwards and temporary differences that are expected to be deductible in future years, will be recoverable from future taxable income or other tax planning strategies. If recovery is not likely, a valuation allowance must be provided based on estimates of future taxable income in the various taxing jurisdictions, and the amount of deferred taxes that are ultimately realizable. The provision for current and deferred taxes involves evaluations and judgments of uncertainties in the interpretation of complex tax regulations. This evaluation considers several factors, including an estimate of the likelihood of generating sufficient taxable income in future periods, the effect of temporary differences, the expected reversal of deferred tax liabilities, and available tax planning strategies.

Uncertainty in Tax Positions

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in income tax positions. FIN 48 requires that the Company recognize in its financial statements the benefits of tax return positions if that tax position is more likely than not of being sustained on audit, based on its technical merits. The adoption of this pronouncement on July 1, 2007 did not have an impact on the financial statements of the Company.

Unrecognized tax benefits at March 31, 2009 and June 30, 2008 which, if recognized in the future, would favorably impact the Company's effective tax rate were not material. The Company records both accrued interest and penalties related to income tax matters, if any, in the provision for income taxes in the accompanying consolidated statements of operations. At March 31, 2009 and June 30, 2008, the Company had not accrued any amounts for the potential payment of penalties and interest.

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.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS 157). SFAS 157 establishes a common definition for fair value under accounting principles generally accepted in the United States, establishes a framework for measuring fair value and expands disclosure requirements about such fair value measurements. SFAS 157 was effective for fiscal years beginning after November 15, 2007. The adoption of this pronouncement on July 1, 2008 did not have a material impact on the financial statements of the Company.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations revised (SFAS 141R). SFAS 141R provides additional guidance and standards for the acquisition method of accounting to be used for all business combinations. Changes for business combination transactions pursuant to SFAS 141R include, among others, expensing acquisition-related transaction costs as incurred, the recognition of contingent consideration arrangements at their acquisition date fair value and capitalization of in-process research and development assets

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acquired at their acquisition date fair value. SFAS141R will be effective for all business combinations consummated beginning July 1, 2009.

2. Basic and Diluted Net Income Per Common Share

The Company computes net income per share in accordance with the provisions of SFAS No. 128, Earnings Per Share. Basic net income per common share is computed by dividing the net income for the period by the weighted-average number of common shares outstanding for the period. For diluted earnings per share the weighted average shares include the incremental common shares issuable upon the exercise of stock options, warrants, and non-vested restricted shares (using the treasury stock method). The incremental common shares for stock options, warrants and non-vested restricted shares are excluded from the calculation of diluted net income per share, if their effect is anti-dilutive. Diluted net income per share for the three and nine months ended March 31, 2009 excludes the effect of approximately 1,364,000 and 1,024,000 stock options and restricted shares in the calculation of the incremental common shares, respectively, as their effect would have been anti-dilutive. Diluted net income per share for the three and nine months ended March 31, 2008 excludes the effect of approximately 565,000 and 358,000 stock options and restricted shares in the calculation of the incremental common shares, respectively, as their effect would have been anti-dilutive.

3. Inventories

Inventories consist of the following:

	March 31, 2009	June 30, 2008
	(Unaudited)	
	(In thousands)	
Raw materials and component parts	\$ 696	\$ 187
Work-in-progress	22,037	20,183
	22,733	20,370
Less progress payments	1,474	3,926
	\$21,259	\$16,444

4. Segment Information

The Company operates through two business segments. Its infrastructure solutions segment, through Globecomm Systems Inc., is engaged in the design, assembly and installation of ground segment systems and networks. Its services segment, through GNSC, GSM, Cachendo and Mach 6, 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.

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The following is the Company's business segment information for the three and nine months ended March 31, 2009 and 2008 and as of March 31, 2009 and June 30, 2008:

	Three Months Ended		Nine Months Ended	
	March	March	March	March 31,
	31,	31,	31,	2008
	2009	2008	2009	2008
	(Unaudited)			
	(In thousands)			
Revenues:				
Infrastructure solutions	\$ 19,589	\$ 27,513	\$ 64,585	\$ 93,296
Services	19,360	15,898	57,426	47,279
Intercompany eliminations	(355)	(119)	(1,085)	(494)
Total revenues	\$ 38,594	\$ 43,292	\$ 120,926	\$ 140,081
Income (loss) from operations:				
Infrastructure solutions		&nbs		