

GLENAYRE TECHNOLOGIES INC

Form 10-Q

November 09, 2005

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

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

For the quarterly period ended September 30, 2005

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

For the transition period from _____ to _____

Commission File Number 0-15761

GLENAYRE TECHNOLOGIES, INC.

(Exact Name of Registrant as Specified in Its Charter)

DELAWARE

(State or Other Jurisdiction of
Incorporation or Organization)

98-0085742

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

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

(Address of principal executive offices)

10019

(Zip Code)

(770) 283-1000

(Registrant's telephone number, including area code)

NOT APPLICABLE

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

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

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

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

The number of shares outstanding of the Registrant's common stock, par value \$.02 per share, at October 31, 2005 was 67,275,832 shares.

Glenayre Technologies, Inc. and Subsidiaries

INDEX

Page

Part I Financial Information:

<u>Item 1. Financial Statements</u>	
<u>Report of Independent Registered Public Accounting Firm</u>	3
<u>Condensed Consolidated Balance Sheets as of September 30, 2005 (Unaudited) and December 31, 2004</u>	4
<u>Condensed Consolidated Statements of Operations for the three months ended September 30, 2005 and 2004 (Unaudited)</u>	5
<u>Condensed Consolidated Statements of Operations for the nine months ended September 30, 2005 and 2004 (Unaudited)</u>	6
<u>Condensed Consolidated Statement of Stockholders' Equity for the nine months ended September 30, 2005 (Unaudited)</u>	7
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2005 and 2004 (Unaudited)</u>	8
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	34
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	50
<u>Item 4. Controls and Procedures</u>	51
<u>Part II - Other Information:</u>	
<u>Item 1. Legal Proceedings</u>	52
<u>Item 6. Exhibits</u>	53
<u>EX-15.1 LETTER REGARDING UNAUDITED FINANCIAL INFORMATION</u>	
<u>EX-31.1 SECTION 302, CERTIFICATION OF THE CEO</u>	
<u>EX-31.2 SECTION 302, CERTIFICATION OF THE CFO</u>	
<u>EX-32.1 SECTION 906, CERTIFICATION OF THE CEO</u>	
<u>EX-32.2 SECTION 906, CERTIFICATION OF THE CFO</u>	

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders

Glenayre Technologies, Inc.

We have reviewed the Condensed Consolidated Balance Sheet of Glenayre Technologies, Inc. and Subsidiaries as of September 30, 2005, and the related Condensed Consolidated Statements of Operations for the three month and nine month periods ended September 30, 2005 and 2004, the Condensed Consolidated Statement of Stockholders' Equity for the nine months ended September 30, 2005, and the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2005 and 2004. These financial statements are the responsibility of the Company's management.

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

Based on our review, we are not aware of any material modifications that should be made to the Condensed Consolidated Financial Statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the Consolidated Balance Sheet of Glenayre Technologies, Inc. and Subsidiaries as of December 31, 2004, and the related Consolidated Statements of Operations, Stockholders' Equity, and Cash Flows for the year then ended not presented herein, and in our report dated March 7, 2005 we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying Condensed Consolidated Balance Sheet as of December 31, 2004, is fairly stated, in all material respects, in relation to the Consolidated Balance Sheet from which it has been derived.

/s/ Ernst & Young LLP

Atlanta, Georgia
November 7, 2005

Table of Contents

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

	9/30/05	12/31/04
	(Unaudited)	
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 78,326	\$ 82,691
Short-term investments		12,180
Restricted cash	10,474	30
Accounts receivable, net	37,648	7,695
Current portion of long-term receivable	3,592	
Inventories, net	20,770	6,163
Prepaid expenses and other current assets	10,430	2,863
Total Current Assets	161,240	111,622
Restricted cash	30,189	
Property, plant and equipment, net	43,408	8,812
Long-term receivable	10,485	
Intangible assets	67,960	
Goodwill	13,532	
Other assets	2,424	848
TOTAL ASSETS	\$ 329,238	\$ 121,282
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	\$ 30,932	\$ 3,552
Deferred revenue	8,967	3,754
Accrued liabilities	52,379	11,912
Accrued liabilities, discontinued operations	2,414	3,284
Current portion of long-term debt	24,508	
Total Current Liabilities	119,200	22,502
Other liabilities	14,932	3,497
Deferred income taxes, long-term	13,099	
Pension obligation	21,842	
Long-term debt	61,996	
Accrued liabilities, discontinued operations - noncurrent	58	98
Total Liabilities	231,127	26,097
Minority Interest in Subsidiary Company	772	

Stockholders Equity

Preferred stock, \$.01 par value; authorized: 5,000,000 shares, no shares issued and outstanding

Common stock, \$.02 par value; authorized: 200,000,000 shares outstanding: 2005 67,273,338 shares; 2004 66,820,124 shares

Contributed capital

Accumulated deficit

Cumulative translation adjustment

Total Stockholders Equity

TOTAL LIABILITIES AND STOCKHOLDERS EQUITY

	1,345	1,336
	363,385	362,698
	(266,606)	(268,849)
	(785)	
	97,339	95,185
	\$ 329,238	\$ 121,282

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)****(In thousands, except per share amounts)**

	Three months ended September 30,	
	2005	2004
REVENUES:		
Product sales	\$ 67,720	\$ 9,320
Service revenues	29,193	5,533
Total Revenues	96,913	14,853
COST OF REVENUES:		
Cost of sales	51,849	4,954
Cost of services	19,470	2,618
Total Cost of Revenues	71,319	7,572
GROSS MARGIN:	25,594	7,281
OPERATING EXPENSES:		
Selling, general and administrative expense	16,631	5,570
Provision for doubtful receivables, net of recoveries	15	81
Research and development expense	3,462	3,390
Restructuring expense		10
Amortization of intangible assets	1,710	
Total Operating Expenses	21,818	9,051
OPERATING INCOME (LOSS)	3,776	(1,770)
OTHER INCOME (EXPENSES):		
Interest income	729	289
Interest expense	(1,549)	(6)
Gain on disposal of assets	1	65
Gain on currency swaps, net	125	
Translation loss, net	(109)	
Other gain, net	22	59
Total Other Income (Expenses)	(781)	407

INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES	2,995	(1,363)
Provision (benefit) for income taxes	404	(121)
INCOME (LOSS) FROM CONTINUING OPERATIONS	2,591	(1,242)
INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX	(48)	4,742
NET INCOME	\$ 2,543	\$ 3,500
INCOME (LOSS) PER WEIGHTED AVERAGE COMMON SHARE:		
Income (loss) from continuing operations	\$ 0.04	\$ (0.02)
Income (loss) from discontinued operations	(0.00)	0.07
Net income per weighted average common share	\$ 0.04	\$ 0.05
INCOME (LOSS) PER COMMON SHARE ASSUMING DILUTION:		
Income (loss) from continuing operations	\$ 0.04	\$ (0.02)
Income (loss) from discontinued operations	(0.00)	0.07
Net income per weighted average common share	\$ 0.04	\$ 0.05

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

(In thousands, except per share amounts)

	Nine months ended September	
	30,	
	2005	2004
REVENUES:		
Product sales	\$ 111,807	\$ 22,358
Service revenues	45,782	14,915
Total Revenues	157,589	37,273
COST OF REVENUES:		
Cost of sales	75,671	13,550
Cost of services	29,794	7,072
Total Cost of Revenues	105,465	20,622
GROSS MARGIN:	52,124	16,651
OPERATING EXPENSES:		
Selling, general and administrative expense	35,717	15,060
Provision for doubtful receivables, net of recoveries	41	17
Research and development expense	10,444	10,549
Restructuring expense	(12)	122
Amortization of intangible assets	2,276	
Total Operating Expenses	48,466	25,748
OPERATING INCOME (LOSS)	3,658	(9,097)
OTHER INCOME (EXPENSES):		
Interest income	1,830	813
Interest expense	(2,061)	(220)
Gain on disposal of assets, net		59
Gain on currency swaps, net	387	
Translation loss, net	(1,409)	
Other gain (loss), net	55	(7)
Total Other Income (Expenses)	(1,198)	645
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES	2,460	(8,452)

Provision (benefit) for income taxes	567	(68)
INCOME (LOSS) FROM CONTINUING OPERATIONS	1,893	(8,384)
INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX	350	10,235
NET INCOME	\$ 2,243	\$ 1,851
INCOME (LOSS) PER WEIGHTED AVERAGE COMMON SHARE		
(1):		
Income (loss) from continuing operations	\$ 0.03	\$ (0.13)
Income from discontinued operations	0.01	0.15
Net income (loss) per weighted average common share	\$ 0.03	\$ (0.03)
INCOME (LOSS) PER COMMON SHARE ASSUMING DILUTION		
(1)		
Income (loss) from continuing operations	\$ 0.03	\$ (0.13)
Income from discontinued operations	0.01	0.15
Net income (loss) per weighted average common share	\$ 0.03	\$ (0.03)

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

See Notes to Condensed Consolidated Financial Statements.

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

	Common Stock		Contributed	Accumulated		Comprehensive
	Shares	Amount	Capital	Deficit	Other Comprehensive Loss	Income (Loss)
Balances, January 1, 2005	66,820	\$ 1,336	\$ 362,698	\$ (268,849)	\$	
Net income				2,243		\$ 2,243
Foreign currency translation					(785)	(785)
Comprehensive income						\$ 1,458
Shares issued for ESP Plan and option exercises	453	9	687			
Balances, September 30, 2005	67,273	\$ 1,345	\$ 363,385	\$ (266,606)	\$ (785)	

See Notes to Condensed Consolidated Financial Statements.

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

	Nine months ended September 30,	
	2005	2004
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	\$ 27,860	\$ (7,223)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(4,118)	(1,684)
Maturities of short-term securities	12,180	3,925
Asset and share purchase of EDC, net of cash acquired	(69,948)	
Increase in restricted cash related to acquisition	(16,500)	
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(78,386)	2,241
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from long-term borrowing, net of costs	45,444	
Proceeds from sale of LLC interest in subsidiary	772	
Issuance of common stock	696	373
NET CASH PROVIDED BY FINANCING ACTIVITIES	46,912	373
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(751)	
NET DECREASE IN CASH AND CASH EQUIVALENTS	(4,365)	(4,609)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	82,691	65,853
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 78,326	\$ 61,244

SUPPLEMENTAL INFORMATION OF NON-CASH INVESTING AND FINANCING ACTIVITIES

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

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

	Nine months ended September 30,	
	2005	2004
Depreciation included in cost of sales	\$ 3,879	\$ 285
Depreciation included in selling, general and administrative expense	775	187
Depreciation included in research and development expense	973	814
Amortization of intangible assets	2,276	

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts in thousands, except per share data)

(Unaudited)

1. Business and Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of Glenayre Technologies, Inc. and Subsidiaries (Glenayre or the Company) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation for the periods presented have been included. All significant inter-company accounts and transactions have been eliminated in consolidation. Operating results for the three and nine months ended September 30, 2005 are not necessarily indicative of the results that may be expected for the year ending December 31, 2005.

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

2. Acquisition of EDC

On May 31, 2005, the Company completed the acquisition of the North American and Central European CD and DVD manufacturing and distribution operations from Universal Music Group (Universal) for a purchase price of approximately \$125.0 million. The results of operations of the acquired operations have been included in the consolidated financial statements of the Company since the acquisition date. The acquisition was made through EDC, a newly formed division of Glenayre. The acquisition was a strategic opportunity for the Company to become an industry leader in providing pre-recorded products and distribution services to the entertainment industry. As part of the transaction, EDC entered into 10-year supply agreements with Universal under which it became the exclusive manufacturer and distributor for approximately 80% of Universal's CD and DVD requirements for North America and Central Europe (see Note 6). Under these contracts, EDC will have the opportunity to assume responsibility for fulfilling the remaining portion of Universal's requirements that are currently outsourced as Universal's commitments to third party suppliers expire over the next three years.

The North American CD and DVD manufacturing and distribution operations were acquired under an Asset Purchase Agreement. The Central European CD and DVD manufacturing and distribution operations were acquired under a Share Purchase Agreement. The acquired assets include Universal's manufacturing and distribution operations in Hanover, Germany, its manufacturing operations in Grover, North Carolina, and its distribution operations in Fishers, Indiana, Reno, Nevada and Wilkes-Barre, Pennsylvania. EDC is leasing all of the facilities with the exception of the manufacturing facility in Grover, North Carolina, which it acquired from Universal.

The purchase price consists of \$82.9 million cash paid, at closing \$39.8 million deferred payments to Universal and \$2.3 million for various contingent payments and transaction costs, using the May 2005 Euro to US dollar exchange rate of 1.2474. The purchase price is subject to post-closing adjustments. Of the purchase price paid at closing, \$30.5 million was for the U.S. operations, \$35.2 million (\$43.9 million) was for the Central European operations, and the balance constituted transaction expenses. Under the terms of the supply contracts entered into as part of the transaction, EDC is obligated to pay to Universal deferred acquisition payments with a net present value totaling approximately \$39.8 million and \$40.0 million at May 31, 2005 and September 30, 2005 respectively. This long-term obligation is scheduled to be paid as follows: approximately \$5.5 million is payable on December 15, 2005, approximately \$7.9, \$13.3, \$13.7 and \$1.4 million is payable on each of May 31, 2006 through 2009, respectively, and

approximately \$400,000 is payable on each of December 15, 2006 through 2014, respectively. Approximately 45% of the total obligation is payable in Euros.

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(Tabular amounts in thousands, except per share data)****(Unaudited)**

Under the terms of the share purchase agreement, EDC must pay to Universal 75% of the profit earned during the first term, and 50% of the profit earned during the first renewal term on the revenue derived from two third party distribution services agreements assumed as part of the acquisition. The initial term of the agreement with the first third party expired July 31, 2005 and was renewed for one annual term. The initial term of the agreement with the second third party expires December 31, 2005. The profit is defined as earnings before interest and taxes. The contingent consideration included in the purchase price totals 1,918,000 (\$2.3 million) at September 30, 2005 consisting of 1,040,000 (\$1.25 million) for actual consideration for the four months ended September 30, 2005 and 878,000 (\$1.05 million) for estimated consideration due for the three months ended December 31, 2005. Additional adjustments to the purchase price will be recorded in future periods when the amounts become probable and determinable. Included in accrued liabilities in the Company's Condensed Consolidated Balance Sheet at September 30, 2005 is \$1.25 million for consideration earned, but not yet paid as of September 30, 2005, and \$1.05 million for the estimated amount payable for the three months ended December 31, 2005.

EDC was capitalized with a \$35.0 million equity capital contribution from Glenayre. Following the closing, members of EDC management purchased \$772,000 of Glenayre's equity interest. In addition, certain profits interests were issued at closing to EDC management, Universal and the Company's financial advisor that will entitle these parties to up to 30% of EDC's distributed profits, after Glenayre has received a return of its equity capital contribution and certain internal rate of return hurdles and other conditions have been met. See Note 7. The profit interests valuation is not complete. Consequently, adjustments to the purchase price will be recorded in future periods.

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

The acquisition was accounted for as a purchase business combination in accordance with SFAS 141, *Business Combinations*. The purchase price is being allocated to the related tangible and identifiable intangible assets acquired and liabilities assumed based on their respective estimated fair values on the acquisition date. Identifiable intangible assets acquired include 10-year manufacturing and distribution services supply agreements between EDC and Universal Music Group (see Note 6). In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, the fair values of the identifiable intangible assets are being amortized over their estimated useful lives in a manner that best reflects the economic benefits derived from such assets. The purchase price is being allocated to the assets and liabilities based upon their estimated fair value at the date of the acquisition as noted below. Included in the assets purchased was \$38.4 million (30.8 million) of cash contributed by the seller including \$30.6 million (24.5 million) to fund certain net liabilities assumed by EDC as described below and the remaining \$7.8 million (6.2 million) to meet certain German regulatory requirements. The preliminary allocation of the purchase price was based on real estate appraisals obtained for land and buildings, on net book values for furniture and equipment, and on preliminary calculations of the present value of the cash flows of the supply agreements. These estimated values are subject to change upon the finalization of the valuations. Valuations for the profits interests granted to the investment banker, Universal and certain EDC management, and for management members

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)**

granted to the investment banker, Universal and certain EDC management, and for management members right to force sell (put) their ownership to EDC or the Company have not been finalized, and therefore allocations for these items have not yet been assigned.

	Estimated Fair Value at Acquisition Date
Cash	\$ 38,374
Accounts Receivable	5,702
Other Receivables	2,294
Inventories	10,071
Prepaid Assets	1,782
Property, Plant & Equipment	36,782
Long-term Receivable from Universal**	21,878
Deferred Financing Fees	1,056
Intangible Assets	71,472
Goodwill	13,532
Accounts Payable and Accrued Expenses	(28,622)
Deferred Tax Liability	(13,532)
Long-Term Liabilities	(35,747)
 Total	 \$ 125,042

** Under the terms of the share purchase agreement relating to the acquisition of Universal's Central European operations, the seller is required to reimburse EDC for \$52.5 million relating to the liabilities net of accounts receivable and other

receivables assumed by EDC at the acquisition date. Amounts not paid or received in future periods for these assumed liabilities and receivables, with the exception of the pension obligation, will be adjusted through the seller receivable. To fund the payment of these obligations, Universal contributed 24.5 million (\$30.6 million) of cash at the closing of the acquisition and will contribute the remaining 17.5 million (\$21.9 million) as future obligations become due. 19.3 million (\$24.1 million) of the cash contributed at the closing of the acquisition will be held in escrow until May 31, 2010 to fund various long-term pension and other employee related

obligations,
many of which
extend beyond
2010.

Conversions to
US\$ are based
on the May 31,
2005 exchange
rate of 1.2474.

3. Summary of Significant Accounting Policies

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

Use of Estimates

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

Table of Contents

Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued

(Tabular amounts in thousands, except per share data)

(Unaudited)

Consolidation

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

Foreign Currency Translation

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

For international operations for which the functional currency is the United States dollar, transactions denominated in currencies other than the United States dollar are translated into United States dollars. The resulting gains or losses on currency translation are included in earnings amounted to losses of \$51,000 and \$19,000 for the nine months ended September 30, 2005 and 2004, respectively.

Fair Value of Financial Instruments

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

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

Deferred Financing Costs

Certain costs associated with debt financing are capitalized and included in other non-current assets on the consolidated balance sheet. These costs are amortized to interest expense over the term of the debt agreement. Amortization of deferred financing costs included in interest expense was \$90,000 and \$119,000 for the three and nine months ended September 30, 2005, respectively.

Stock-Based Compensation

The Company grants stock options and issues shares under option plans and an employee stock purchase plan as described in Note 21(b). The Company accounts for stock option grants and shares sold under the employee stock purchase plan in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25); and, accordingly, records compensation expense for options granted and sales made at prices that are less than fair market value at the date of grant or sale. No compensation expense is recognized for options granted to employees with an exercise price equal to the fair value of the shares at the date of grant.

Compensation cost for profits interests granted to key employees of EDC are measured as the fair value of those profits interests at the date of grant and are amortized over the respective vesting period.

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)**

The following table compares the Company's results of continuing operations as reported to the pro forma results of continuing operations whereby stock-based compensation is computed under the fair value method required by Statement of Financial Accounting Standards No. 123 (Revised 2004). For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense on a straight-line basis over the options' vesting period for each of the three and nine month periods ended September 30 for each of the years presented.

	Three months Ended September 30,		Nine months Ended September 30,	
	2005	2004	2005	2004
Income (loss) from continuing operations-as reported	\$ 2,591	\$ (1,242)	\$ 1,893	\$ (8,384)
Pro forma stock option expense	(401)	(420)	(1,186)	(967)
Income (loss) from continuing operations-pro forma	\$ 2,190	\$ (1,662)	\$ 707	\$ (9,351)
Income (loss) from continuing operations per common share as reported	\$ 0.04	\$ (0.02)	\$ 0.03	\$ (0.13)
Pro forma stock option expense	(0.01)	(0.01)	(0.02)	(0.01)
Income (loss) from continuing operations per common share pro forma (1)	\$ 0.03	\$ (0.02)	\$ 0.01	\$ (0.14)
Income (loss) from continuing operations, assuming dilution as reported	\$ 0.04	\$ (0.02)	\$ 0.03	\$ (0.13)
Pro forma stock option expense	(0.01)	(0.01)	(0.02)	(0.01)
Income (loss) from continuing operations, assuming dilution pro forma (1)	\$ 0.03	\$ (0.02)	\$ 0.01	\$ (0.14)

(1) Income (loss) per share amounts are rounded to the nearest \$0.01; therefore, such rounding may impact individual amounts presented.

Impact of Recently Issued Accounting Standards

In response to the December 8, 2003 enactment of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the "Act"), the FASB issued Financial Staff Position ("FSP ") No. FAS 106-1. The Act introduced a prescription drug benefit under Medicare ("Medicare Part D") as well as a federal subsidy to sponsors of retiree health care benefit plans that provides a benefit that is at least actuarially equivalent to Medicare Part D. The Company

elected to defer recognition of the effects of the Act on its post-retirement benefit plan until authoritative guidance on the accounting for the federal subsidy was issued in accordance with alternatives prescribed by FSP No. FAS 106-1 which was effective for the Company beginning with the year ended December 31, 2003. FSP No. FAS 106-1 was superseded by FSP No. FAS 106-2 on May 19, 2004 and is effective for the first interim or annual period beginning after June 15, 2004. The Company has two alternative methods of transition: retroactive application to the date of enactment or prospective application from the date of adoption. The Company is pursuing the subsidy and will prospectively apply the provision of the various FSPs. The actuarial valuations are not finalized to determine if benefits provided by the Company's plan are actuarially equivalent to Medicare Part D. Therefore, the Company is unable to determine if its plan qualifies for the subsidy under the Act. Consequently, the measure of the Accumulated Post-retirement Benefit Obligation (APBO) and net periodic post-retirement benefit cost do not reflect any amount associated with the subsidy.

In November of 2004, FASB issued Statement No. 151, *Inventory Costs*, an amendment of Accounting Research Bulletin No. 43, Chapter 4 (SFAS 151). The amendments made by SFAS 151 clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current period charges and require the allocation of fixed production overheads to inventory

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)**

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

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

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

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

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

1. A modified prospective method in which compensation cost is recognized beginning with the effective date
 - (a) based on the requirements of SFAS 123R all share-based payments granted after the effective date and
 - (b) based on the requirements of SFAS 123 for all awards granted to employees prior to the effective date of SFAS 123R that remain unvested on the effective date.

2. A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

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

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

Table of Contents

Glenayre Technologies, Inc. and Subsidiaries

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued

(Tabular amounts in thousands, except per share data)

(Unaudited)

Reclassifications

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

3a. Significant Accounting Policies (EDC only)

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

Revenues

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

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

Services revenue is recognized as services are performed.

Cost of Sales, Selling General and Administrative Costs

Cost of sales includes direct and indirect manufacturing and distribution costs. Selling, general and administrative costs include indirect overhead costs.

Shipping Costs

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

Inventories

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

Property, Plant and Equipment

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

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

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)****4. Risks and Uncertainties*****Concentrations of Credit Risk***

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

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

Concentrations of Suppliers

EDC has a limited number of suppliers who are able to provide it with its raw materials. In Germany all polystyrene (accounting for approximately 11% of total cost of sales) is purchased from one supplier and all polycarbonate (accounting for approximately 13% of total cost of sales) is purchased from two suppliers. In the U.S. all polycarbonate (accounting for approximately 11% of total cost of sales) is purchased from two suppliers. Jewel boxes and trays (accounting for approximately 23% of total cost of sales) that are not manufactured by EDC are purchased from two suppliers. These inputs are crucial to the production of CDs and DVDs and while there are alternative suppliers of these products, it would be disruptive to EDC's production if any of these companies were unable to deliver its product to EDC.

Workforce Subject to Collective Bargaining Agreements

In Germany, approximately 42% of EDC's workforce of 917 employees is unionized. However, collective bargaining agreements negotiated by the unions cover all non-exempt staff. Exempt staff is approximately 4% of the total. In the United States, approximately 27% of EDC's workforce of 944 employees is unionized and subject to collective bargaining. None of these collective bargaining agreements expire within one year.

5. Pro Forma Financial Information

The unaudited financial information in the table below summarizes the combined results of operations of Glenayre and EDC, on a pro forma basis, as though the companies had been combined as of the first day of the earliest period presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition (see Note 2) had taken place on the first day of the earliest period presented. The pro forma financial information for the three and nine months ended September 30, 2005 includes the business combination accounting effect on historical EDC revenues, adjustments to depreciation on acquired property, and acquisition costs reflected in Glenayre's and EDC's historical statements of operations for periods prior to the acquisition.

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)**

The unaudited pro forma financial information for the three and nine months ended September 30, 2004 and 2005 combines the historical results for Glenayre and EDC for those periods.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2005	2004	2005	2004
Total revenues	\$ 96,913	\$ 79,842	\$ 273,636	\$ 214,094
Net income (loss) from continuing operations	\$ 2,591	\$ (1,929)	\$ (126)	\$ (15,093)
Net income (loss) from discontinued operations	\$ (48)	\$ 4,742	\$ 350	\$ 10,235
Net income (loss)	\$ 2,543	\$ 2,813	\$ 224	\$ (4,858)
Basic net income (loss) per share	\$ 0.04	\$ 0.04	\$ (0.00)	\$ (0.07)
Diluted net income (loss) per share	\$ 0.04	\$ 0.04	\$ 0.00	\$ (0.07)

6. Intangible Assets and Goodwill

As a result of the EDC acquisition, certain long-term intangible assets were identified and are recorded at their estimated fair value of \$70.2 million at September 30, 2005, less accumulated amortization of \$2.3 million for a net of \$67.9 million. Amortization expense was \$1.7 million and \$2.3 million for the three months and nine months ended September 30, 2005 respectively.

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

As a result of the EDC acquisition, the Company recorded goodwill of \$13.5 million under the preliminary purchase price allocation. SFAS 141, *Business Combinations*, requires the purchase price be allocated to the individual assets acquired and liabilities assumed based on the estimated fair values of the acquired assets and assumed liabilities at the acquisition date. For income tax purposes, the amounts assigned to the supply contracts as intangible assets are different than amounts used for financial reporting. This difference in assigned values is a temporary difference as a result of which SFAS 109, *Accounting for Income Taxes*, requires the Company to recognize the tax effect as a deferred tax liability. The resulting impact on the purchase price allocation is to increase the allocation to goodwill. The Company has not yet completed the final allocation of the purchase price for the EDC acquisition. Additional information could come to our attention that may require a revision to the preliminary allocation of the purchase price to the intangible assets and goodwill.

7. EDC LLC Agreement Profits Interests and Minority Interest**EDC Profits Interests**

Upon the completion of the acquisition of the North American and Central European CD and DVD manufacturing and distribution operations from Universal, EDC, a majority-owned subsidiary of the Company, issued profits interests to certain key employees, Universal, and the Company's financial advisor, that will entitle these parties to up to 30% of EDC's distributed profits after the Company has received a return of its equity capital contribution and certain internal rate of return hurdles and other profitability conditions have been met. No payments were required from these parties to acquire the profits interests. These profits interests do not carry any voting rights.

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)**

The estimated fair value of the profits interests at the date of grant is currently being independently appraised and will represent the probability-weighted present value of estimated future cash flows to those profits interests. The fair value of the profits interests granted to Universal and the financial advisor will be included in the acquisition costs of EDC. The profits interests issued to members of management will be accounted for as compensation expense and will be amortized over the vesting schedule of one-third immediately upon grant and two-thirds ratably in each of the two years after grant. Included in EDC's results for the four months ended September 30, 2005 is a preliminary charge of \$710,000 for the estimated vested portion of the profits interests that were granted to key employees and \$236,000 for the amortization of the unvested portion.

Minority interest

As part of the EDC acquisition described in Note 2, the Company sold 772 Class A units of EDC it owned (representing 2.2% of EDC's outstanding units) to two key employees at the fair value of \$1,000 per unit upon which such Class A units were automatically converted into Class B units. The Class A and Class B units carry equivalent economic rights. The Company has 97.8% of the voting rights. If EDC does not undergo an initial public offering prior to the earlier of (1) May 31, 2015 and (2) the date on or after May 31, 2013 on which the terms of all EDC's manufacturing and distribution agreements with Universal Music Group shall have been extended to a term ending on or after May 31, 2018, holders of Class B units and profits interests would have the right for a five-year period beginning on such date to sell their interests to the Company at fair value.

8. Restricted Cash

Long-term restricted cash at September 30, 2005 includes \$8.2 million of cash deposited with Wachovia to collateralize a portion of EDC's credit facility and \$21.9 million (18.2 million Euros) being held in escrow to fund various pension and other employee related obligations of EDC's German operation. As part of the acquisition of the Universal manufacturing and distribution operation (see Note 2), one of Universal's subsidiaries deposited these escrowed funds into an account controlled by an Escrow Agreement restricting the disbursement of the funds. Universal and the Company participate in determining and approving disbursement. The earnings on the funds are paid to EDC monthly. On June 1, 2010, the restrictions expire, and any remaining funds in escrow will be released to EDC.

Included in the current portion of restricted cash is \$8.3 million of cash deposited with Wachovia to collateralize a portion of EDC's credit facility (see Note 18), \$1.3 million (1.1 million Euros) being held in escrow to fund various pension and other employee related obligations of EDC's German operations, \$0.7 million of customer performance bonds, and letters of credit for leased space and a tax bond totaling \$0.1 million.

9. Financial Instruments

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

Currency Rate Swap

The Company entered into a cross currency rate swap agreement with a commercial bank on May 31, 2005. The Company's objective is to manage foreign currency exposure arising from its loan to its German subsidiary, acquired in May of 2005 and is therefore for purposes other than trading. The loan is denominated in Euros and repayment is due on demand, or by May 31, 2010. According to Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation*, the Company will report the foreign currency exchange gains or losses attributable to changes in the US\$/Euro exchange rate on the currency swap in earnings. In accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, the derivatives held by the Company do not qualify as hedges and accordingly the Company records the gains and losses from the derivative instruments in earnings.

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)**

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

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

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

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

As of September 30, 2005, the swap is carried at its fair value of approximately \$387,000. The fair value of the currency rate swap was calculated based on mathematical approximations of market values derived from the commercial banks' proprietary models as of a given date. These valuations are calculated on a mid-market basis and do not include a bid/offered spread that would be reflected in an actual price quotation. Therefore, the actual price quotations for unwinding these transactions would be different. These valuations and models rely on certain assumptions regarding past, present and future market conditions and are subject to change at any time. Valuations based on other models or assumptions may yield different results.

Long-Term Debt and Payable to Universal Music Group

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

(in millions)	Carrying Amount	Fair Value
Commercial bank term loan	\$ 46.5	\$ 45.6
Payable to Universal	\$ 40.0	\$ 39.5

10. Accounts Receivable

Accounts receivable related to continuing operations consisted of:

	September 30, 2005	December 31, 2004
Trade receivables	\$ 38,335	\$ 8,139
Less: allowance for doubtful accounts	(687)	(444)
	\$ 37,648	\$ 7,695

The increase is primarily due to the acquisition of the Universal manufacturing and distribution operations by the Company's EDC division (See Note 2).

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)****11. Inventories**

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

	September 30, 2005	December 31, 2004
Raw materials	\$ 14,916	\$ 2,745
Work-in-process	1,896	586
Finished goods	3,958	2,832
	\$ 20,770	\$ 6,163

At September 30, 2005 and December 31, 2004, reserves were approximately \$2.9 million and \$2.7 million, respectively.

In connection with the introduction of new products and services as well as in an effort to demonstrate its products to new and existing customers, the Messaging division, from time to time, delivers new product test systems for demonstration and test to customer third-party locations. The Company expenses the cost associated with new product test equipment upon shipment from the Company's facilities.

The increase is primarily due to the acquisition of the Universal manufacturing and distribution operations by the Company's EDC division (See Note 2).

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

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

	September 30, 2005	December 31, 2004
Land	\$ 1,676	\$ 676
Buildings and improvements	13,858	5,039
Equipment	36,263	5,988
	51,797	11,703
Less: Accumulated depreciation	(8,389)	(2,891)
	\$ 43,408	\$ 8,812

The increase is primarily due to the acquisition of the Universal manufacturing and distribution operations by the Company's EDC division (See Note 2).

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)****13. Estimated Warranty Costs**

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

Balance at January 1, 2005	\$ 573
Provision for warranty obligations	46
Settlements of warranty obligations	(45)
Balance at March 31, 2005	\$ 574
Provision for warranty obligations	82
Settlements of warranty obligations	(74)
Balance at June 30, 2005	\$ 582
Provision for warranty obligations	223
Settlements of warranty obligations	(168)
Balance at September 30, 2005	\$ 637

The Company also offers post-installation extended warranty and support services, known as Glenayre Care, for its Messaging products and services to customers. One year of Glenayre Care is generally included in the price of the Company's product. A portion of the product revenue equal to the fair value of the Glenayre Care is deferred at the time the sale of the product is recorded and recognized ratably over the support period. Once this service period expires, the Company's customers generally enter into Glenayre Care agreements of varying terms, which typically require payment in advance of the performance of the extended warranty service. Revenue derived from post-installation support services is recognized ratably over the contracted support period. Deferred revenue at September 30, 2005 related to product sales and to the sale of post-installation support services was approximately \$4.0 million of the \$9.0 million of deferred revenue.

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

14. Business Restructuring of Continuing Operations

The Company accounts for restructuring activities in conformity with Statement of Financial Accounting Standard No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

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

For the nine months ending September 30, 2004, the Company recorded a restructuring charge of \$148,000 for severance and outplacement services related to the reduction of the Company's workforce from prior years.

Additionally, in 2004 the Company recorded net favorable adjustments to its original estimates associated with the Company's prior years restructuring activities of \$34,000, primarily related to a reduction in accrued severance benefits; as well as \$8,000 related to an increase in lease cancellation and other costs.

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)**

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

	Severance and Benefits	Lease Cancellation and Other Exit Costs	Total
Messaging			
Balance at January 1, 2005	\$ 27	\$ 233	\$ 260
Expense accrued			
Credits and changes in estimates		(12)	(12)
Payments		(93)	(93)
Balance at March 31, 2005	\$ 27	\$ 128	\$ 155
Expense accrued			
Credits and changes in estimates	(16)	16	
Payments	(11)	(59)	(70)
Balance at June 30, 2005	\$	\$ 85	\$ 85
Expense accrued			
Credits and changes in estimates			
Payments		(72)	(72)
Balance at September 30, 2005	\$	\$ 13	\$ 13

15. Discontinued Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Gain on disposal before income taxes	\$	\$ 4,806	\$ 491	\$ 9,007
Income Tax Benefit (Provision)	(48)	(64)	(141)	1,228
Gain (loss) on disposal of discontinued operations	(48)	4,742	350	10,235

Income (loss) from discontinued operations	\$ (48)	\$ 4,742	\$ 350	\$ 10,235
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In the first quarter of 2005, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, a net decrease in the loss on disposal of \$63,000 was recorded. The Company recorded income of \$74,000 primarily due to a settlement received from Pilot Pacific Properties, Inc. and its associated companies. This income was offset by the adjustments to the original estimates, related primarily to international office closures, of \$11,000.

In the second quarter of 2005, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, a net decrease in the loss on disposal of \$428,000 was recorded. The Company recorded income of \$53,000 primarily due to a settlement and previously reserved accounts receivable receipts. Additional reductions of \$375,000 were recorded primarily related to the release of a reserve for the Lynnview Ridge litigation. The one remaining lawsuit seeks approximately \$145,000 (Canadian) in total damages. A provision for legal fees associated with this matter remains.

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)**

In the third quarter of 2005, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, no change was recorded in the loss on disposal except for the recurring addition for accretion in contingent tax provisions.

In the first quarter of 2004, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, a net decrease in the loss on disposal of \$379,000 was recorded. The adjustments to the original estimates related primarily to better than anticipated recoveries received from paging customers and to asset and inventory liquidations. In addition, the Company recorded a \$1.3 million reduction in its tax liability relating to the discontinued operations primarily due to receiving a favorable assessment for several prior tax years relating to one of the Company's foreign subsidiaries.

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

During the third quarter of 2004, as a result of the Company's review of the estimated liabilities and future commitments related to the discontinued operations, the Company recorded a net decrease in the loss on disposal of \$4.7 million. \$4.3 million of this decrease related to funds the Company received during the third quarter of 2004 as a result of entering into a favorable settlement agreement with Pilot Pacific Properties Inc. and its associated companies relating to the Company's former Vancouver facility. The remaining \$0.4 million decrease was primarily due to (i) additional inventory liquidation and (ii) the expiration of a sales tax liability guarantee associated with the 1999 sale of the Company's Western Multiplex division.

16. Accrued Liabilities

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

	September 30, 2005	December 31, 2004
Accrued salaries and benefits	\$ 13,929	\$ 1,127
Accrued income taxes	6,766	4,993
Accrued refunds and rebates	3,934	
Accrued vacation	3,364	644
Accrued VAT	3,130	
Accrued royalty expense	2,735	236
Accrued audit, tax & professional services	1,194	857
Accrued contractual obligations	772	708
Other accruals	16,555	3,347
	\$ 52,379	\$ 11,912

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

Table of Contents**Glenayre Technologies, Inc. and Subsidiaries****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued****(Tabular amounts in thousands, except per share data)****(Unaudited)****17. Other Liabilities**

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

	September 30, 2005	December 31, 2004
Employee savings plan	\$ 3,912	\$
Employee long-term service provision	3,890	
Early retirement provision	2,734	
Post-retirement benefit accrual	2,157	2,204
Deferred compensation	1,803	847
Deferred officers compensation	436	446
	\$ 14,932	\$ 3,497

The increase in other liabilities is primarily due to the obligations assumed in the EDC acquisition.

18. Long-Term Debt

Long-term debt at September 30, 2005 and December 31, 2004 consisted of:

	September 30, 2005	December 31, 2004
Commercial Bank Term Loan	\$ 46,500	\$
Payable to Universal Principal Amount	45,242	
Less: Unamortized Discount	(5,238)	
Total Debt	86,504	
Less: Current Portion, at NPV	(24,508)	
Total Long-Term Debt, at NPV	\$ 61,996	\$