GLOBECOMM SYSTEMS INC
Form 10-Q
November 09, 2006

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 September 30, 2006

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________

Commission file number: 000-22839

Globecomm Systems Inc.

(Exact name of Registrant as specified in its charter)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of ''accelerated filer and large accelerated filer'' in Rule 12b-2 of the Exchange Act. Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

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

As of November 6, 2006, there were 15,540,000 shares of the registrant's Common Stock outstanding.

GLOBECOMM SYSTEMS INC.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

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

	September 30, 2006 (Unaudited)	June 30, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 25,773	$ 24,512
Accounts receivable, net	25,182	30,837
Inventories	14,982	13,058
Prepaid expenses and other current assets	1,012	1,131
Deferred income taxes	22	22
Total current assets	66,971	69,560
Fixed assets, net	16,410	15,510
Goodwill	7,204	7,204
Other assets	961	960
Total assets	$ 91,546	$ 93,234
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$ 13,322	$ 19,020
Deferred revenues	4,072	1,691
Accrued payroll and related fringe benefits	2,276	2,872
Other accrued expenses	1,603	1,966
Deferred liabilities	316	316
Total current liabilities	21,589	25,865
Other liabilities	1,027	353
Commitments and contingencies		
Stockholders’ equity:		
Series A Junior Participating, shares authorized, issued and outstanding: none at September 30, 2006 and June 30, 2006	—	—
Common stock, $.001 par value, 50,000,000 shares authorized, shares issued: 15,819,903 at September 30, 2006 and 15,660,524 at June 30, 2006	16	16
Additional paid-in capital	136,671	135,673
Accumulated deficit	(64,976)	(65,892)
Treasury stock, at cost, 465,351 shares at September 30, 2006 and June 30, 2006	(2,781)	(2,781)
Total stockholders’ equity	68,930	67,016
Total liabilities and stockholders’ equity	$ 91,546	$ 93,234

See accompanying notes.

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

	Three Months Ended	
	September 30, 2006	September 30, 2005
Revenues from ground segment systems, networks and enterprise solutions	$ 17,461	$ 23,019
Revenues from data communications services	8,258	6,557
Total revenues	25,719	29,576
Costs and operating expenses:		
Costs from ground segment systems, networks and enterprise solutions	14,075	19,525
Costs from data communications services	6,587	5,568
Selling and marketing	1,775	1,514
Research and development	200	109
General and administrative	2,414	2,256
Total costs and operating expenses	25,051	28,972
Income from operations	668	604
Interest income	268	229
Income before income taxes	936	833
Provision for income taxes	20	20
Net income	$ 916	$ 813
Basic net income per common share	$ 0.06	$ 0.06
Diluted net income per common share	$ 0.06	$ 0.05
Weighted-average shares used in the calculation of basic net income per common share	15,219	14,719
Weighted-average shares used in the calculation of diluted net income per common share	15,834	15,336

See accompanying notes.

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GLOBECOMM SYSTEMS INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006
(In thousands)

(Unaudited)

	Common Stock		Additional Paid-in	Accumulated	Treasury Stock		Total Stockholders'
	Shares	Amount	Capital	Deficit	Shares	Amount	Equity
Balance at June 30, 2006	15,661	$ 16	$135,673	$(65,892)	465	$(2,781)	$67,016
Proceeds from exercise of stock options	159		979				979
Stock compensation expense			12				12
Tax benefit from exercise of stock options			7				7
Net income				916			916
Balance at September 30, 2006	15,820	$ 16	$136,671	$(64,976)	465	$(2,781)	$68,930

See accompanying notes.

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

	Three Months Ended	
	September 30, 2006	September 30, 2005
Operating activities:		
Net income	$ 916	$ 813
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	761	767
Provision for doubtful accounts	52	118
Stock compensation expense	12	—
Tax benefit from stock compensation plan	7	—
Changes in operating assets and liabilities:		
Accounts receivable	5,603	1,294
Inventories	(1,924)	(2,928)
Prepaid expenses and other current assets	119	105
Other assets	(1)	(1)
Accounts payable	(5,698)	1,429
Deferred revenue	2,381	(2,435)

Accrued payroll and related fringe benefits	(596)	(110)
Other accrued expenses	(363)	(585)
Other liabilities	674	(79)
Net cash provided by (used in) operating activities	1,943	(1,612)
Investing activities:		
Purchases of fixed assets	(1,661)	(649)
Net cash used in investing activities	(1,661)	(649)
Financing activities:		
Proceeds from exercise of stock options	979	1,015
Proceeds from exercise of warrants	—	440
Net cash provided by financing activities	979	1,455
Effect of foreign currency translation on cash	—	(13)
Net increase (decrease) in cash and cash equivalents	1,261	(819)
Cash and cash equivalents at beginning of period	24,512	25,609
Cash and cash equivalents at end of period	25,773	24,790

See accompanying notes.

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GLOBECOMM SYSTEMS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
SEPTEMBER 30, 2006
(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, 2006 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 months ended September 30, 2006, are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2007, 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, 2006 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 13, 2006.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Globecomm Network Services Corporation (‘‘GNSC’’), and Globecomm Systems Europe Limited (collectively, the ‘‘Company’’). On June 30, 2006, the Company liquidated the Globecomm Systems Europe Limited entity. All significant intercompany balances and transactions have been eliminated in consolidation.

Accounting Estimates

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

Revenue Recognition

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

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

Costs from Ground Segment Systems, Networks and Enterprise Solutions

Costs from ground segment systems, networks and enterprise solutions consist primarily of the costs of purchased materials (including shipping and handling costs), direct labor and related overhead expenses, project-related travel and living costs and subcontractor salaries.

Costs from Data Communications Services

Costs from data communications 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 Center, on a twenty-four hour a day, seven-day a week basis, including personnel and related costs and depreciation.

Research and Development

Research and development expenditures are expensed as incurred.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), Share-Based Payment, which is a revision of SFAS 123 (''SFAS 123R''). SFAS 123R

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eliminates the ability to account for share-based compensation under the intrinsic value method permitted by APB 25. This requires the Company to adopt the fair value model for recognizing compensation expense for employee stock options, and would have the effect of reducing the Company's reported net income and net income per share.

On July 1, 2005, the Company adopted SFAS 123R using a modified prospective application, as permitted under SFAS 123R. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption.

Stock compensation expense was approximately $12,000 and $0 for the three months ended September 30, 2006 and 2005, respectively. As of September 30, 2006, there was approximately $174,000 of unrecognized compensation cost related to non-vested stock-based compensation. The cost is expected to be recognized over a weighted-average period of 3.5 years.

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. There have been no events during the three months ended September 30, 2006 that would result in any goodwill impairment.

Other Liabilities

Other liabilities consist primarily of security deposits received from customers for long term projects which are due to the customer beyond one year from the balance sheet date.

Income Taxes

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of the net deferred tax assets is dependent upon the generation of future taxable income prior to the expiration of any net operating loss carryforwards. For the three months ended September 30, 2006 and the year ended June 30, 2006, due to the uncertainty regarding the Company's ability to utilize its net operating losses in the future, the Company provided a valuation allowance against its previously recorded deferred tax assets except for approximately $22,000, representing state investment tax credit carryforwards that will be utilized to offset state capital taxes on the Company's combined state tax return. The tax provision was approximately $20,000 for the three months ended September 30, 2006 and 2005. The tax provision represents the estimated federal alternative minimum tax for the period.

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.

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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 and warrants (using the treasury stock method). The incremental common shares for stock options and warrants 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 months ended September 30, 2006 and 2005, excludes the effect of approximately 872,000 and 2,395,000 stock options and warrants in the calculation of the incremental common shares, respectively, as their effect would have been anti-dilutive.

3. Inventories

Inventories consist of the following:

	September 30, 2006 (Unaudited)	June 30, 2006
	(In thousands)	
Raw materials and component parts	$ 121	$ 110
Work-in-progress	16,595	14,564
	16,716	14,674
Less progress payments	1,734	1,616