

GLENAYRE TECHNOLOGIES INC

Form 10-Q

November 09, 2005

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**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 8<sup>TH</sup> AVENUE, 23<sup>RD</sup> 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.

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**Glenayre Technologies, Inc. and Subsidiaries**

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**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

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

	<b>9/30/05</b>	<b>12/31/04</b>
	<b>(Unaudited)</b>	
<b>ASSETS</b>		
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
<b>Total Current Assets</b>	<b>161,240</b>	<b>111,622</b>
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
<b>TOTAL ASSETS</b>	<b>\$ 329,238</b>	<b>\$ 121,282</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
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	
<b>Total Current Liabilities</b>	<b>119,200</b>	<b>22,502</b>
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
<b>Total Liabilities</b>	<b>231,127</b>	<b>26,097</b>
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

	1,345	1,336
Contributed capital	363,385	362,698
Accumulated deficit	(266,606)	(268,849)
Cumulative translation adjustment	(785)	
 Total Stockholders Equity	 97,339	 95,185
 <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	 <b>\$ 329,238</b>	 <b>\$ 121,282</b>

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)**

	<b>Three months ended September 30,</b>	
	<b>2005</b>	<b>2004</b>
<b>REVENUES:</b>		
Product sales	\$ 67,720	\$ 9,320
Service revenues	29,193	5,533
Total Revenues	96,913	14,853
<b>COST OF REVENUES:</b>		
Cost of sales	51,849	4,954
Cost of services	19,470	2,618
Total Cost of Revenues	71,319	7,572
<b>GROSS MARGIN:</b>	25,594	7,281
<b>OPERATING EXPENSES:</b>		
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
<b>OPERATING INCOME (LOSS)</b>	3,776	(1,770)
<b>OTHER INCOME (EXPENSES):</b>		
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

<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES</b>	2,995	(1,363)
Provision (benefit) for income taxes	404	(121)
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>	2,591	(1,242)
<b>INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX</b>	(48)	4,742
<b>NET INCOME</b>	\$ 2,543	\$ 3,500
<b>INCOME (LOSS) PER WEIGHTED AVERAGE COMMON SHARE:</b>		
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
<b>INCOME (LOSS) PER COMMON SHARE ASSUMING DILUTION:</b>		
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.



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

(In thousands, except per share amounts)

	<b>Nine months ended September</b>	
	<b>30,</b>	
	<b>2005</b>	<b>2004</b>
<b>REVENUES:</b>		
Product sales	\$ 111,807	\$ 22,358
Service revenues	45,782	14,915
Total Revenues	157,589	37,273
<b>COST OF REVENUES:</b>		
Cost of sales	75,671	13,550
Cost of services	29,794	7,072
Total Cost of Revenues	105,465	20,622
<b>GROSS MARGIN:</b>	52,124	16,651
<b>OPERATING EXPENSES:</b>		
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
<b>OPERATING INCOME (LOSS)</b>	3,658	(9,097)
<b>OTHER INCOME (EXPENSES):</b>		
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
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES</b>	2,460	(8,452)

Provision (benefit) for income taxes	567	(68)
<b>INCOME (LOSS) FROM CONTINUING OPERATIONS</b>	1,893	(8,384)
<b>INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX</b>	350	10,235
<b>NET INCOME</b>	\$ 2,243	\$ 1,851
<b>INCOME (LOSS) PER WEIGHTED AVERAGE COMMON SHARE</b>		
<b>(1):</b>		
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)
<b>INCOME (LOSS) PER COMMON SHARE ASSUMING DILUTION</b>		
<b>(1)</b>		
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)**

	<b>Common Stock</b>		<b>Contributed</b>	<b>Accumulated</b>		<b>Comprehensive</b>
	<b>Shares</b>	<b>Amount</b>	<b>Capital</b>	<b>Deficit</b>	<b>Other Comprehensive Loss</b>	<b>Income (Loss)</b>
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.

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

	<b>Nine months ended September</b>	
	<b>30,</b>	
	<b>2005</b>	<b>2004</b>
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	\$ 27,860	\$ (7,223)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
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)	
<b>NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>	(78,386)	2,241
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
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
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	46,912	373
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>	(751)	
<b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>	(4,365)	(4,609)
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>	82,691	65,853
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	\$ 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:**

	<b>Nine months ended September</b>	
	<b>30,</b>	
	<b>2005</b>	<b>2004</b>
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.



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**Glenayre Technologies, Inc. and Subsidiaries**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Tabular amounts in thousands, except per share data)**

**(Unaudited)**

**1. Business and Basis of Presentation**

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

	<b>Estimated Fair Value at Acquisition Date</b>
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.

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**Glenayre Technologies, Inc. and Subsidiaries**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued**

**(Tabular amounts in thousands, except per share data)**

**(Unaudited)**

***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.

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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.

	<b>Three months Ended September 30,</b>		<b>Nine months Ended September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
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

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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.





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**Glenayre Technologies, Inc. and Subsidiaries**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued**

**(Tabular amounts in thousands, except per share data)**

**(Unaudited)**

***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.

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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.

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
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.

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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.



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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:

<b>(in millions)</b>	<b>Carrying Amount</b>	<b>Fair Value</b>
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:

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
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).

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

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

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:

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
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)
	<b>\$ 43,408</b>	<b>\$ 8,812</b>

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

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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.



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

	<b>Severance and Benefits</b>	<b>Lease Cancellation and Other Exit Costs</b>	<b>Total</b>
<b>Messaging</b>			
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:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	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.

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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:

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
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
	<b>\$ 52,379</b>	<b>\$ 11,912</b>

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

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

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
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
	<b>\$ 14,932</b>	<b>\$ 3,497</b>

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:

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
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	<b>\$ 61,996</b>	<b>\$</b>

In May 2005, to fund the balance of the purchase price for the North American and Central European DC and DVD manufacturing and distribution operations from Universal Music Group 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, 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. Substantially all of EDC's assets, with a carrying value of \$171.8 million at September 30, 2005, are pledged as collateral to secure obligations under the Credit Facility. The term loan requires scheduled principal payments as shown in the table below.

The Credit Facility bears interest, at the Company's option, at either:

The higher of (i) the Prime Rate in effect and (ii) the Federal Funds Effective Rate in effect plus 1/2 of 1% plus a 0.25% margin on the cash collateralized portion of the term loan and a 2% margin on the non-cash collateralized portion; or

The LIBOR rate plus a 1.25% margin on the cash collateralized portion of the term loan and a 3% margin on the non-cash collateralized portion.

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The applicable LIBOR rate is determined periodically based on the length of the interest term selected by the Company. The weighted average interest rate of outstanding debt under the Credit Facility was 5.90% at September 30, 2005.

The Credit Facility contains usual and customary restrictive covenants that, among other things, place limitations on (i) EDC's ability to incur additional indebtedness; (ii) EDC's or Glenayre's ability to enter into mergers and acquisitions outside either the industries of either the Messaging Business or EDC; and (iii) asset dispositions by EDC. The Credit Facility also contains financial covenants relating to maximum consolidated leverage, minimum interest coverage and maximum senior secured leverage as defined therein.

The unused amount of the revolving credit facility was \$10.0 million at September 30, 2005. In addition to interest, the Credit Facility imposes a commitment fee of 0.5% per annum on the average daily unused amount of the Credit Facility. The fee for the three and nine months ended September 30, 2005 was \$13,000 and \$17,000 respectively. Additionally, under the terms of the manufacturing and distribution agreements entered into as part of the acquisition, EDC is obligated to pay Universal deferred acquisition payments with a net present value of approximately \$39.8 million at acquisition. At September 30, 2005 the obligation to Universal increased to \$40.0 million due to accretion for imputed interest and change in exchange rates. See Note 2 for description of the acquisition. Total scheduled principal payments including unamortized discount for all long-term debt are as follows:

<b>(in millions)</b>	<b>Principal Payment</b>	<b>Third Party</b>	<b>Total</b>
2005	\$ 5.0	\$ 5.5	\$ 10.5
2006	6.5	8.3	14.8
2007	8.0	13.6	21.6
2008	9.0	14.1	23.1
2009	9.0	1.8	10.8
Thereafter	9.0	2.0	11.0
Total	\$ 46.5	\$ 45.3	\$ 91.8

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The Company's consolidated income tax provision from continuing operations was different from the amount computed using the U.S. federal statutory income tax rate for the following reasons:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Income tax provision (benefit) U.S. statutory rate	\$ 1,049	\$ (477)	\$ 861	\$ (2,958)
State income tax (benefit) net of federal benefit and related valuation allowance	(68)	(118)	(240)	(435)
Increase (Decrease) in valuation allowance	(1,026)	583	(1,084)	3,359
Foreign taxes, net of federal benefit and related valuation allowance	477	(121)	615	(68)
Profits interest awards	49		331	
Deductible amortization	(99)			
Other non deductibles	25	12	65	34
Minority interest from partnership	(3)		19	
Income tax provision	\$ 404	\$ (121)	\$ 567	\$ (68)

The Company accounts for income taxes under the liability method in accordance with SFAS 109. At September 30, 2005, the Company's U.S. net deferred tax asset was fully reserved by a valuation allowance. Pursuant to SFAS 109, a valuation allowance should be recognized to reduce the deferred tax asset to the amount that is more likely than not to be realized as offsets to the Company's future taxable income. The Company assessed whether the net deferred asset at September 30, 2005 was realizable and determined due to significant net operating losses and its inability to project future taxable income that the entire amount should be reserved. The foreign pretax income from operations for the nine months ended September 30, 2005 was \$682,000.

As of September 30, 2005, the Company recorded a deferred tax liability resulting from differences in assigned values of EDC supply contracts for income tax and financial reporting purposes. See Note 6.

The Company has realized U.S. Federal net operating losses (NOLs) of \$275.8 million and Foreign NOLs of \$33.8 million. At December 31, 2004, of the \$275.8 million realized U.S. Federal NOLs, \$242.4 million will begin to expire in 2019. The remaining \$33.4 million of U.S. NOLs were related to the 1997 acquisitions of Open Development Corporation and Wireless Access, Inc., which start expiring in 2006. However, the Company's ability to offset future income with these acquired NOLs is subject to restrictions in the United States Internal Revenue Code of 1986 as amended (the Code).

**20. Employee Benefit Plans, Postretirement Health Care Benefits**

*(a) Net postretirement benefit costs consist of the following components:*

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Service Cost	\$ 15	\$ 9	\$ 44	\$ 36
Interest cost on APBO	32	28	95	82
Amortization of prior service costs	(64)	(64)	(191)	(191)
Amortization of actuarial loss	22	14	67	44

\$ 5      \$ (13)      \$ 15      \$ (29)

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The unrecognized prior service cost decreases the postretirement benefit costs due to amortization of the plan amendment effective September 1, 2003 that reduced the number of participants by changing eligibility provisions. The Company reported in its financial statements for the year ended December 31, 2004, that it expects to contribute \$82,000 to its postretirement health care plan in 2005.

***(b) Pension Plans***

As a result of the acquisition described in Note 2, the Company assumed the obligations of four defined benefit plans. Employees and managing directors of EDC's operations in Germany participate in these various defined benefit pension plans. These benefits are based on pay, years of service and age. The plans are not funded and therefore have no plan assets. The Company is meeting its obligation for these pension benefits using funds in escrow included in restricted cash in the Condensed Consolidated Balance Sheet. See Note 8. All pension plans are accounted for pursuant to SFAS No 87, *Accounting for Pensions*.

The Company obtained December 31, 2004 actuarial valuations updated for the activity to May 31, 2005. The rates assumed in the actuarial calculations for the pension plans of the Company as of their respective measurement dates were as follows:

Discount rate	4.4%
Rate of compensation increase	3.5%
Rate of post-retirement pension increase	1.5%

The Company recorded the May 31, 2005 projected benefit obligation of 17.8 million (\$21.5 million) in the opening balance sheet.

Net periodic costs recognized in the period after acquisition include \$303,000 for service costs and \$328,000 for interest 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)****21. Stockholders Equity****(a) Income (Loss) from Continuing Operations per Common Share**

The following table sets forth the computation of income (loss) from continuing operations per share:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Numerator:				
Net income (loss) from continuing operations	\$ 2,591	\$ (1,242)	\$ 1,893	\$ (8,384)
Denominator:				
Denominator for basic income from continuing operations per share weighted average shares	67,210	66,711	67,031	66,593
Effect of dilutive securities: Stock options *	3,044		2,199	
Denominator for diluted income (loss) from continuing operations per share	70,254	66,711	69,230	66,593
Income (loss) from continuing operations per weighted average common share	\$ 0.04	\$ (0.02)	\$ 0.03	\$ (0.13)
Income (loss) from continuing operations per common share-assuming dilution	\$ 0.04	\$ (0.02)	\$ 0.03	\$ (0.13)

\* There were no shares of potential common stock included in the calculation of diluted loss per share for the three and nine month periods ended September 30, 2004, as their effect would be anti-dilutive.

**(b) Incentive Stock Plans**

The Company maintains two stock option plans (the 1996 Plan and the 1991 Plan ) and an employee stock purchase plan that were approved by the stockholders. These plans are administered by the Compensation and Plan Administration Committee of the Board of Directors (the Compensation Committee ) and are utilized to promote the long-term financial interests and growth of the Company. The 1996 and 1991 Plans, as amended, authorize the grant of up to 9,650,000 and 11,475,000 shares, respectively, of the Company's common stock for issuance in connection

with the grant of stock options, stock appreciation rights, restricted stock and performance shares.

Options granted have an option price equal to the fair market value of the Company's common stock on the date of grant. Options under the plans expire no later than ten years from the grant date.

The Company has elected to follow APB 25 and related interpretations in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under FASB Statement No. 123, *Accounting for Stock-Based Compensation*, ( FAS 123 ) requires the use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recognized. Pro forma information regarding net income and earnings per share is required by FAS 123, which also requires that the information be determined as if the Company had accounted for its employee stock options granted subsequent to December 31, 1994 under the fair value method of that statement. See Note 3, *Stock-Based Compensation* for these disclosures.

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The fair value for these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	<b>September 30, 2005</b>	<b>September 30, 2004</b>
Expected Life in Years	1 to 4	1 to 4
Risk Free Interest Rate	3.9% to 4.2%	2.1% to 4.1%
Volatility	0.66	0.78
Dividend Yield		

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

**22. Commitments and Contingencies*****Litigation***

The EDC division is not currently party to any material legal proceedings. In connection with the licensing of the Company's software products related to the Messaging division, the Company's standard purchase and license agreements typically require the Company to defend and indemnify its customers against claims that the Company's licensed programs infringe or misappropriate the intellectual property rights of third parties. Under these agreements, the Company agrees to indemnify, defend and hold harmless the customer in connection with patent, copyright, trade secret or mask works infringement claims made by third parties with respect to the customer's authorized use of our licensed programs. The indemnity provisions generally provide, subject to various exclusions and conditions, for our control of defense and settlement and cover costs and damages actually finally awarded against the customer. The Company retains the right in its discretion or after issuance of a final adverse judgment to obtain a license for the licensed program in question from the third party, to modify the licensed program so it is no longer infringing, or to terminate the customer's license for the licensed program with a pro-rata refund of license fees paid based on a 5-year straight-line amortization schedule.

*Phillip Jackson* Beginning in late 2001, Phillip Jackson ( Jackson ) filed lawsuits against several of the Company's customers claiming that products sold by the Company and used by these customers infringed a patent held by Jackson. The Company agreed to indemnify its customers for the claims in these lawsuits and assumed primary responsibility for defending the claims with respect to the Company's products. Following completion of the trial and post-trial reduction of damages by the court, the court entered judgment in the total amount of approximately \$2.7 million, plus interest and costs. During the first quarter of 2004, the Company recorded a charge consisting of \$2.7 million of royalty fee expense (recorded in cost of revenues) and \$200,000 of interest expense, and recorded a reduction of the estimated liability for accrued legal cost associated with this case of \$770,000. The Company paid the \$2.7 million award plus interest and costs during the second quarter of 2004.

On May 14, 2004, Jackson filed a motion with the trial court to set trial on remaining issues of contributory infringement and inducement to infringe Jackson's patent. On June 29, 2004, the trial court ruled that there were no issues remaining between the parties and denied Jackson's motion to set trial on remaining issues. Jackson is currently appealing this ruling and the appeal was argued before the United States Court of

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**Glenayre Technologies, Inc. and Subsidiaries**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Continued**

**(Tabular amounts in thousands, except per share data)**

**(Unaudited)**

Appeals for the Federal Circuit on March 11, 2005. As of November 7, 2005, the appellate court has not yet ruled on the appeal. The Company believes that it is unlikely that the appellate court will reverse the trial court's ruling of June 29, 2004.

*Lynnview Ridge, Alberta* In November 2002 and April 2003, a total of twenty lawsuits seeking approximately \$22.3 million (Canadian) in damages were filed in the Court of Queen's Bench, Judicial Centre of Calgary, in Alberta, Canada, against the Company and several other defendants, including Imperial Oil, a major Canadian petroleum company. These lawsuits asserted that the defendants, including the Company, are liable for negligence, nuisance, and negligent misrepresentation arising out of the development and sale of homes located in a Calgary, Canada residential development, Lynnview Ridge, that was jointly developed in the early 1980's by a corporate predecessor of the Company and a wholly owned subsidiary of Imperial Oil.

The Company understands that the land on which some of this residential development was located at one time contained a petroleum storage tank farm and is adjacent to land on which Imperial Oil operated a refinery for many years. In June 2001, Alberta Environment, a department of the Government of Alberta, issued an Environmental Protection Order requiring Imperial Oil to remediate significant petroleum-based contamination discovered on Lynnview Ridge. In July 2002, following an appeal to the Environmental Appeal Board, the Alberta Minister of the Environment issued a Ministerial Order confirming this Environmental Protection Order. Imperial Oil initiated a judicial proceeding to reverse this Ministerial Order, which was unsuccessful. The Company is not a party to these proceedings. The Company understands that Imperial Oil has purchased from the homeowners 137 of the 160 homes located in the Lynnview Ridge development. To date, the Company has conducted preliminary investigations and some limited discovery regarding these lawsuits.

In March 2004, one of the lawsuits was discontinued by one of the plaintiffs. In April 2004, the Company made an application for grant of summary judgment in one action that was chosen to be a representative case for this matter, but the plaintiffs in this representative case discontinued their lawsuit in October 2004. In April 2005, the Company was notified that Imperial Oil had filed a notice with the Court that it has settled nine of the lawsuits involving approximately \$11.8 million (Canadian) in total damages and that the releases to be made by the plaintiffs in connection with those settlements will include the Company. Since that time consent judgments and dismissals covering the Company have been entered in eight of the remaining nine lawsuits, which had been requesting approximately \$6.5 million (Canadian) in total damages. The Company has paid no damages with respect to any of the foregoing settlements or judgments. The one remaining lawsuit seeks approximately \$145,000 (Canadian) in total damages. A provision for legal fees associated with this matter of \$12,000 is included in Accrued Liabilities, discontinued operations of the Company's June 30, 2005 unaudited Condensed Consolidated Balance Sheet.

In addition to the legal proceedings discussed above, the Company is from time to time, involved in various disputes and legal actions related to its business operations. While no assurance can be given regarding the outcome of the matters discussed above, based on information currently available, the Company believes that the resolution of these matters will not have a material adverse effect on the financial position or results of future operations of the Company. However, because of the nature and inherent uncertainties of litigation, should the outcome of these actions be unfavorable, the Company's business, financial condition, results of operations and cash flows could be materially adversely affected.

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

The Company leases facilities and various equipment under non-cancelable operating leases. Future minimum lease payments under non-cancelable operating leases (with initial or remaining lease terms in excess of one year), net of sublease income related to its continuing operations for calendar years subsequent to September 30, 2005 are as follows:

2005	\$ 1,978
2006	7,553
2007	6,759
2008	6,817
2009	6,853
Thereafter	27,850
Subtotal	57,810
Sublease income	(30)
Total	\$ 57,780

The office and manufacturing facility leases include provisions for annual rent escalation of 5% or less and hold over options to continue occupancy without renewal. Contingent rentals are estimated based on provisions in the lease and historical trends.

***Letters of Credit and Cash Collateral***

The collateral for the credit facility described in Note 18 is included in restricted cash in the Condensed Consolidated Balance Sheet. Total collateral is \$16.5 million, of which half will be released in June 2006. A portion of restricted cash in the current asset section of the Condensed Consolidated Balance Sheet also includes \$0.7 million customer performance bonds and \$0.1 million for letters of credit for leased space and a tax bond. None of these letters of credit were drawn upon as of September 30, 2005.

***Minority Shareholder Put Options***

EDC's limited liability company agreement grants minority members put option rights such that they can require EDC or Glenayre Electronics, Inc. to purchase the minority member interest in EDC. The put options, which cover both the 2.2% of EDC's outstanding Common Units acquired by two key employees and EDC's outstanding profits interests, can be exercised during a 5 year period beginning on the Put Trigger Date (as defined in the agreement) in the event EDC shall not have consummated an initial public offering prior to the Put Trigger Date. The Put Trigger Date is the earlier of May 31, 2015 or the date on or after May 31, 2013 on which the terms of all EDC's manufacturing and distributions agreements with Universal Music Group, are extended to a term ending on or after May 31, 2018. The purchase price for any member interest purchased as a result of the put option is the Fair Market Value (as defined in the agreement) on the date of the put notice. The Company has not completed the allocation of purchase price relating to the EDC transaction and has not included an allocation for the minority shareholder put options in its preliminary purchase price allocation.

***Employee Contracts***

Certain executives of the Company have contracts that generally provide benefits in the event of termination or involuntary termination for "good reason" accompanied by a change in control of Glenayre or certain subsidiaries.

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

Under the terms of the share purchase agreement described in Notes 2 and 6, EDC must pay to Universal, 75% of the profit earned on the revenue derived from services provided to certain third parties, Vivendi Universal Games (VUG) and Universal Pictures Group (UPG), during the initial term of the agreements, and 50% during the first renewal term. The initial term of the agreement with VUG expired July 31, 2005 and was renewed for one annual term. The initial term of the agreement with UPG expires December 31, 2005. The profit is defined as earnings before interest and taxes (EBIT). 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 estimated earnings for the three months ended December 31, 2005.

Western Multiplex Corporation merged with Proxim Corporation in March 2002. The Company is contingently liable for Proxim's building lease payments through September 2006. The maximum contingent liability as of September 30, 2005 for this obligation was approximately \$476,000.

**23. Segment Reporting**

The Company has two reportable segments: Glenayre Messaging, and EDC. The Glenayre Messaging segment consists of the Company's software development operation, producing network-based messaging and communication systems and software that enable applications including voice messaging, multimedia messaging and other enhanced services. The EDC segment consists of the Company's CD and DVD manufacturing and distribution operations. The Company's segments operate in different industries and are managed separately.

**Business Segments**

	<b>Three Months Ended September 30,</b>					
	<b>Consolidated</b>		<b>EDC</b>		<b>Messaging</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Revenues	\$ 96,913	\$ 14,853	\$ 75,910	\$	\$ 21,003	\$ 14,853
Gross margin	25,594	7,281	14,162		11,432	7,281
Income (loss) from operations before income taxes	2,995	(1,363)	1,984		1,011	(1,363)
Depreciation and amortization	5,316	470	4,781		535	470
Interest income	729	289	258		471	289
Interest expense	1,549	6	1,561		(12)	6
Income tax expense (benefit)	404	(121)	313		91	(121)
Total assets	\$ 329,238	\$ 122,270	\$ 227,666	\$	\$ 101,572	\$ 122,270

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	<b>Nine Months Ended September 30,</b>					
	<b>Consolidated</b>		<b>EDC</b>		<b>Messaging</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Revenues	\$ 157,589	\$ 37,273	\$ 95,917	\$	\$ 61,672	\$ 37,273
Gross margin	52,124	16,651	16,891		35,233	16,651
Income (loss) from operations before income taxes	2,460	(8,452)	(2,031)		4,491	(8,452)
Depreciation and amortization	7,903	1,286	6,389		1,514	1,286
Interest income	1,830	813	310		1,520	813
Interest expense	2,061	220	2,066		(5)	220
Income tax expense (benefit)	567	(68)	313		254	(68)
Total assets	\$ 329,238	\$ 122,270	\$ 227,666	\$	\$ 101,572	\$ 122,270
<i>Geographic Area</i>						

	<b>Three Months Ended September 30,</b>							
	<b>Consolidated</b>		<b>United States</b>		<b>Germany</b>		<b>Other International</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Revenues	\$ 96,913	\$ 14,853	\$ 52,535	\$ 12,703	\$ 36,961	\$	\$ 7,417	\$ 2,150
Long-lived assets	\$ 124,900	\$ 8,822	\$ 61,239	\$ 8,802	\$ 63,508	\$	\$ 153	\$ 20

	<b>Nine Months Ended September 30,</b>							
	<b>Consolidated</b>		<b>United States</b>		<b>Germany</b>		<b>Other International</b>	
	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>	<b>2005</b>	<b>2004</b>
Revenues	\$ 157,589	\$ 37,273	\$ 91,371	\$ 31,117	\$ 46,440	\$	\$ 19,778	\$ 6,156
Long-lived assets	\$ 124,900	\$ 8,822	\$ 61,239	\$ 8,802	\$ 63,508	\$	\$ 153	\$ 20

Long-lived assets include property, plant and equipment goodwill and intangible assets.

The only customer accounting for in excess of 10% of total revenues is Universal, which accounted for \$70.1 million and \$88.7 million of revenues for the three and nine months ended September 30, 2005 respectively.



**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The Company, from time to time, makes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements reflect the expectations of management of the Company at the time such statements are made. The reader can identify such forward-looking statements by the use of words such as may, will, should, expects, plans, anticipates, believes, estimates, predicts, intend(s), potential, such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements.

These forward-looking statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors including those set forth under *Risk Factors That May Affect Future Results* below. All forward-looking statements included in this Quarterly Report on Form 10-Q are based on information available to the Company on the date hereof. The Company assumes no obligation to update any forward-looking statements and does not intend to do so.

***Overview******Glenayre Messaging***

The Company's enhanced messaging business segment provides Communications Service Providers (CSPs) with a complete messaging solution, consisting of hardware, software, and services that enable a range of related applications that provide significant value in both wireless, wireline and cable networks. Messaging applications available in the product group include voice mail, fax mail, video solutions, short message service, multimedia message service, missed-call notification, and others. The Company's services relate primarily to the installation or maintenance of the Company's messaging products. These products and services each form a single group that together form one business segment.

In 2004 Glenayre Messaging launched the Versera Intelligent Communications Environment (Versera ICE) product line, a next generation messaging solution. Versera ICE allows CSPs to migrate from existing legacy systems to a next-generation system that supports not only traditional telephony functions and interfaces, but also IP-based telephony interfaces for voice and video, integrated Internet web portals, increased scalability and reliability, and a growing range of advanced messaging applications. Versera ICE systems are now installed in North America, Europe, Africa, Asia, and the Middle East.

Quarterly and year-to-date revenues through September 30, 2005 for the Messaging segment increased significantly over 2004 levels primarily due to an increase in product sales associated with expansions and upgrades by the Company's North American customer base due to subscriber growth, significant sales growth in other regions due to both large and small new customer wins (including a large contract with MTN in South Africa), and increased services revenue associated with a growing amount of deployed equipment and increased installation activities. During 2005, Glenayre Messaging introduced several new products based on the Versera ICE platform. A new suite of Video Solutions, including Video Mail, Video Portal, and Video Storefront, have been announced, demonstrated and made commercially available. A major new release of the Short Message Service and Multimedia Message Service products has been introduced that utilizes the power of the Versera ICE platform. These products have been deployed in several customer networks. Additionally, a smaller version of the Versera ICE platform has been developed and successfully trialed and is now ready for commercial deployment. The ability for Versera ICE to scale down to a smaller, lower cost size will enable many more CSPs to adopt a next generation messaging platform for a range of important applications.

In the coming quarters, the Messaging division plans to continue to focus on aggressively selling and marketing Versera ICE, defining and developing new and enhanced applications, and building a larger and stronger team to meet the needs of its expanding customer base. The Company is also actively evaluating potential acquisitions in the Messaging space that would further strengthen the business and broaden the range of products it is able to offer to Communications Service Providers.

**Table of Contents***EDC*

On May 31, 2005 the Company, through the newly formed Entertainment Distribution Company ( EDC ) division, acquired the North American and Central European CD and DVD manufacturing and distribution operations from Universal Music Group ( Universal ). 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 immediately became exclusive manufacturer and distributor for approximately 80% of Universal s CD and DVD requirements for North America and Central Europe. 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 results of EDC s operations of the acquired operations have been included in the consolidated financial statements of the Company since the acquisition on May 31, 2005. Revenue for the third quarter of 2005, which represents the first full quarter of operations for EDC, was \$75.9 million. On a pro forma basis this represented an increase of approximately 16.8% over the same period in the prior and was primarily due to increased demand from Universal for CD and DVD manufacturing and distribution services.

During the remainder of 2005 EDC plans to focus on maintaining its high service level commitment to Universal and to implementing various strategic operational initiatives to increase EDC s capacity and to reduce costs over time. EDC continues to pursue several opportunities to increase revenue by providing a wide range of manufacturing, distribution and value added services to entertainment content owners and their customers. These opportunities consist of manufacturing or distribution services agreements with new parties, partnerships or additional acquisitions. In evaluating acquisition opportunities and expansion of existing operations, EDC will consider the continued downward pressure on DVD pricing and the strong interest from the third party market for DVD production and distribution services.

***Critical Accounting Policies and Estimates***

The Company s discussion and analysis of its financial condition and results of operations are based upon the Company s unaudited Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

The Company believes that there have been no significant changes for the Messaging division during the nine months ended September 30, 2005 to the items that were disclosed as critical accounting policies and estimates in Management s Discussion and Analysis of Financial Condition and Results of Operations in the Company s Annual Report on Form 10-K, as amended, for the fiscal year ended December 31, 2004.

The following is a clarification of the Company s critical accounting policies for revenue recognition related to the Messaging division. The Company recognizes revenues in accordance with the guidance of Staff Accounting Bulletin ( SAB ) No. 101, *Revenue Recognition in Financial Statements*, as amended by SAB No. 104, *Revenue Recognition*; Emerging Issues Task Force (EITF) Issue No. 00-21: *Revenue Arrangements with Multiple Deliverables*; EITF Issue No. 01-9: *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*; Statement of Position (SOP) 97-2, *Software Revenue Recognition*; EITF Issue No. 03-5, *Applicability of AICPA Statement of Position 97-2 ( EITF 01-9 ), Software Revenue Recognition, to Non-Software Deliverable in an Arrangement Containing More-Than Incidental Software*; and related interpretations. The Company recognizes revenue for products sold at the time delivery occurs and acceptance is determinable, collection of the resulting receivable is deemed probable, the price is fixed and determinable and evidence of an arrangement exists. Certain products sold by the Company have operating software embedded in the configuration of the system. Existing customers may purchase product enhancements and upgrades after such enhancements or upgrades are developed by the Company based on a standard price list in effect at the time such product enhancements and upgrades are purchased. The Company generally has no significant performance obligations to customers after the date products,

product enhancements and upgrades are delivered, except for product warranties.

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The Company allocates revenue on arrangements involving multiple deliverables based on the relative fair value of each element. The Company's determination of fair value of each deliverable in multiple-element arrangements is based on vendor-specific objective evidence (VSOE). The Company limits its assessment of VSOE for each element to the price charged when the same element is sold separately or to that price set by the Company's pricing authority for new products. The Company has analyzed all of the elements included in its multiple-element arrangements and determined that it has sufficient VSOE to allocate revenue to each of the multiple-elements.

The Company recognizes service revenues from installation and repair services based on a standard price list in effect when such services are provided to customers. In instances where installation is essential to the functionality of the product sold, recognition of the product related revenue is deferred until installation is completed. In instances where installation is not essential to the functionality of the products sold and is inconsequential or perfunctory to the sale of the products, revenue recognition typically occurs at time of delivery. Revenues derived from contractual post installation support services are recognized ratably over the contract support period based on the relative fair value amount to these services.

The Company offers discounts off the established price list as sales incentives to customers during contract negotiations. Once terms are agreed upon, the Company does not provide subsequent sales incentives. The Company accounts for the discounts as reductions to the selling prices of the Company's products and services. Therefore the discounts are recognized in the income statement as a reduction to revenue in accordance with EITF 01-9. If market conditions were to decline, the Company may take actions to increase customer incentive offerings possibly resulting in an incremental reduction of revenue at the time the incentive is offered.

EDC's revenue is comprised of pre-recorded entertainment product sales and distribution service revenue earned from the fulfillment of services. Revenue from sales of product 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. Shipping and handling costs that are reimbursed by customers for invoice charges such as postage, freight packing and small order surcharges are recorded as revenue. The Company's revenue recognition policies are significant because its revenue is a key component of the Company's results of operations. In addition, the recognition of revenue determines the timing of certain expenses, such as commissions and royalties. Although the Company follows specific and detailed guidelines in measuring revenue, certain judgments, such as determination of VSOE, affect the application of its revenue policy. Revenue results are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause the Company's operating results to vary significantly from quarter to quarter and could result in future operating losses.

**Recent Accounting Pronouncements**

The FASB issued FASB Staff Position 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* 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.

See Note 3 of the unaudited Condensed Consolidated Financial Statements for a description of other recent accounting pronouncements, including the expected date of adoption and estimated effects on results of operations and financial condition.

**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 of 2001 in accordance with APB Opinion No. 30, *Reporting the Results of Operations*.



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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 values in the Company's unaudited Condensed Consolidated Balance Sheet as of September 30, 2005 and audited Consolidated Balance Sheet as of December 31, 2004. 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. See Note 15 to the Company's unaudited Condensed Consolidated Financial Statements.

During 2001, the Company recorded a loss from discontinued operations of approximately \$232.5 million related to the discontinuance of the Paging segment. This loss consisted of (a) operating losses of approximately \$46.8 million incurred in the Paging segment and (b) an estimated loss on disposal of the segment of approximately \$185.7 million which includes charges for the following: (i) the write-off of goodwill and other intangibles, (ii) reserves on property, plant and equipment, (iii) customer accounts and notes receivable settlement costs, (iv) employee termination costs, (v) inventory and non-inventory purchase commitments, (vi) anticipated losses from operations during the twelve month transition period, (vii) facility exit and lease termination costs, (viii) expenses to be incurred to fulfill contractual obligations existing prior to the formal disposal date and (ix) related net tax expense, primarily related to a valuation allowance for related deferred tax assets

The Company believes all business transactions related to the Paging segment, with the exception of existing contractual obligations, were completed by May 2002. As of September 30, 2005, the Company reported current liabilities and non-current liabilities of \$2.5 million and \$58,000, respectively related to the discontinued Paging segment. Approximately \$2.1 million of these liabilities relate to international franchise tax obligations arising prior to the discontinuance of the segment. Approximately \$382,000 of these liabilities relate to one-time charges recorded in the second quarter of 2001 and consist of (i) lease commitment costs and (ii) estimated operating costs during the wind-down period and other estimated business exit costs related to meeting customer contractual commitments.

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 increase in the loss on disposal of \$63,000 was recorded. The adjustments to the original estimates totaling \$11,000 related primarily to international office closures. The Company also recorded income of \$74,000 primarily due to the settlement received from Pilot Pacific Properties, Inc. and its associated companies of \$68,000.

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 adjustments to the original estimates totaling \$389,000 related primarily to the release of a reserve for the Lynnview Ridge litigation.

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.

During 2004, the Company recorded income from discontinued operations of \$12.7 million, primarily as a result of entering into a favorable settlement agreement with Pilot Pacific relating to the Company's former Vancouver facility. As part of this settlement, the Company received \$6.0 million and recorded a \$1.5 million reduction to the liability for legal and other costs related to the pending litigation. In addition, the Company liquidated its remaining paging operations inventory for approximately \$714,000 that was previously fully reserved. The Company also recorded income of \$1.6 million primarily due to a reduction to its tax liability after receiving a favorable assessment for several prior tax years relating to one of the Company's foreign subsidiaries. The remaining income from discontinued operations was primarily due to collection of previously reserved accounts receivable and 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.

Related to the settlement agreement with Pilot Pacific discussed above was the release of \$3.4 million held as security by the court. In order to clear a lien filed against the Vancouver facility related to the Pilot Pacific litigation, the proceeds from the sale in 2003 were placed with the court until the conclusion of the litigation. This \$3.4 million was included in Other Current Assets - discontinued operations on the Company's balance sheet until it was released to the

Company in August 2004.

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The Company estimates that approximately \$0.2 million of the remaining liabilities associated with the discontinued operations will be disbursed during the remaining quarter of 2005 and the remainder in 2006 and beyond. Numerous estimates and assumptions were made in determining the net realizable value of the Company's discontinued assets and various obligations noted above. Management will continue to monitor the Company's future obligations associated with its pre-existing contractual commitments in order to assess the current carrying values of the liabilities associated with the discontinued operations. These original estimates have been and are subject to further recalculation as a result of future changes in estimates related to the Company's future obligations associated with its pre-existing contractual commitments. See Note 15 to the Company's unaudited Condensed Consolidated Financial Statements.



**Table of Contents****Results of Continuing Operations**

The following table and discussion present the material changes in the consolidated results of operations of the Company for the periods indicated:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2005	2004	Yr. to Yr. \$ Change	2005	2004	Yr. to Yr. \$ Change
<b>Revenue</b>						
Entertainment	\$ 75,910	\$	\$ 75,910	\$ 95,917	\$	\$ 95,917
Messaging	21,003	14,853	6,150	61,672	37,273	24,399
<b>Consolidated</b>	<b>\$ 96,913</b>	<b>\$ 14,853</b>	<b>\$ 82,060</b>	<b>\$ 157,589</b>	<b>\$ 37,273</b>	<b>\$ 120,316</b>
<b>Gross Margin</b>						
Entertainment	\$ 14,162	\$	\$ 14,162	\$ 16,891	\$	\$ 16,891
Messaging	11,432	7,281	4,151	35,233	16,651	18,582
<b>Consolidated</b>	<b>\$ 25,594</b>	<b>\$ 7,281</b>	<b>\$ 18,313</b>	<b>\$ 52,124</b>	<b>\$ 16,651</b>	<b>\$ 35,473</b>
<b>Operating Income (Loss)</b>						
Entertainment	\$ 3,216	\$	\$ 3,216	\$ 696	\$	\$ 696
Messaging	560	(1,770)	2,330	2,962	(9,097)	12,059
<b>Consolidated</b>	<b>\$ 3,776</b>	<b>\$ (1,770)</b>	<b>\$ 5,546</b>	<b>\$ 3,658</b>	<b>\$ (9,097)</b>	<b>\$ 12,755</b>
<b>Income (Loss) From Continuing Operations, Before Tax</b>						
Entertainment	\$ 1,984	\$	\$ 1,984	\$ (2,031)	\$	\$ (2,031)
Messaging	1,011	(1,363)	2,374	4,491	(8,452)	12,943
<b>Consolidated</b>	<b>\$ 2,995</b>	<b>\$ (1,363)</b>	<b>\$ 4,358</b>	<b>\$ 2,460</b>	<b>\$ (8,452)</b>	<b>\$ 10,912</b>
<b>Income (Loss) From Continuing Operations</b>						
Entertainment	\$ 1,671	\$	\$ 1,671	\$ (2,344)	\$	\$ (2,344)
Messaging	920	(1,242)	2,162	4,237	(8,384)	12,621
<b>Consolidated</b>	<b>\$ 2,591</b>	<b>\$ (1,242)</b>	<b>\$ 3,833</b>	<b>\$ 1,893</b>	<b>\$ (8,384)</b>	<b>\$ 10,277</b>

**Three months Ended September 30, 2005 and 2004**

On a consolidated basis, the increase in revenues is primarily due to revenue for the three months ended September 30, 2005 from the Company's new EDC division that was acquired on May 31, 2005. The increase in gross margins is due to \$14.2 million additional margin from EDC and to the Messaging business' higher margin services to expand customer systems and improved product marketing. Operating income (loss) improvement resulted from the addition of \$2.0 million from EDC and increased margin from the Messaging business partially offset by higher

operating expenses.

**EDC**

*Revenues.* Total revenue for the three months ended September 30, 2005 from the Company's newly formed Entertainment division was \$75.9 million, of which 49% was international. The EDC division was formed on May 31, 2005 with the acquisition of Universal Music Group's U.S. and Central European CD and DVD manufacturing and distribution operations. During the three months ended September 30, 2005, Universal accounted for approximately 92% of EDC's revenue. EDC's revenue of \$75.9 million compares to revenue on a pro forma basis of \$65.0 million for the third quarter of 2004. The Company attributed the increase in revenue for the third quarter of 2005 over the third quarter of 2004 to a higher proportion of the total second half of year volume occurring in the third quarter in 2005 as compared to 2004.

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*Gross Margins on Product Sales and Services.* Gross margins were \$14.2 million for the three months ended September 30, 2005, or 19% of revenues.

*Operating Income.* Operating income was \$3.2 million for the three months ended September 30, 2005 and included \$1.7 million of amortization expense on intangible assets. The intangible assets consist primarily of 10 year manufacturing and distribution services agreements that EDC entered into with Universal as part of the acquisition.

*Income from Operations before Tax.* Income from operations before tax was \$2.0 million for the three months ended September 30, 2005. EDC's income included interest expense and debt issuance cost amortization of \$1.0 million relating to the \$46.5 million term loan with Wachovia Bank, \$0.6 million imputed interest relating to the deferred acquisition payments due to Universal, and interest income of \$0.3 million on its cash and long-term restricted cash.

*Income from Operations.* Income from operations for EDC's first full quarter of operations was \$1.7 million. Included in income from operations was \$0.3 million of income tax expense relating to the international operations.

**Messaging**

*Revenues.* Total revenue from continuing operations for the three months ended September 30, 2005 increased to \$21.0 million as compared to \$14.9 million for the three months ended September 30, 2004. The increase in Messaging revenue was primarily due to an increase in sales of new products to international customers. International revenue increased to \$7.4 million for the three months ended September 30, 2005 as compared to \$2.1 million for the three months ended September 30, 2004 and accounted for 35% and 14% of total revenue respectively. During the three months ended September 30, 2005, five customers individually accounted for approximately 15%, 13%, 12%, 10% and 10% of Messaging's total revenue from continuing operations. During the three months ended September 30, 2004, three customers individually accounted for 22%, 12% and 10% of Messaging's total revenue from continuing operations.

*Gross Margins on Product Sales and Services.* Gross margins increased to \$11.4 million for the three months ended September 30, 2005 compared to \$7.3 million for the three months ended September 30, 2004. Messaging's gross margin was 54% for the three months ended September 30, 2005 compared to 49% for the three months ended September 30, 2004. The increase in margin dollars for the Messaging business was due to higher margin services to expand customer systems and improved product marketing. During the three months ended September 30, 2005, Messaging's product mix included higher volumes of system expansions, which contributed to the increase in the gross margin percentage. Messaging's gross margins may be affected by several factors including, but not limited to: (i) the mix of products sold and services provided, (ii) the price of products sold and services provided and (iii) changes in material costs and other components of cost of sales.

*Operating Income (loss).* Operating income (loss) was \$0.6 million during the three months ended September 30, 2005 compared to (\$1.8) million for the three months ended September 30, 2004. The increase in Messaging operating income was primarily a result of the increase in revenue and gross margin dollars partially offset by higher operating expenses including incentive plan costs and commission increases. Beginning in June of 2005, corporate overhead costs were allocated to each division leaving approximately 20% of these costs for the last four months in the Messaging segment. Operating expenses for the Messaging business were 52% of revenue for the three months ended September 30, 2005 compared to 61% for the three months ended September 30, 2004.

*Income (Loss) from Continuing Operations before Tax.* Income (loss) from continuing operations before tax was \$1.0 million during the three months ended September 30, 2005 compared to (\$1.4) million during the three months ended September 30, 2004. The improvement was primarily due to Messaging's increased gross margin and an increase in interest income related to increased yields on cash, cash equivalents and restricted cash.

*Income (Loss) from Continuing Operations.* Income (loss) from continuing operations was \$0.9 million during the three months ended September 30, 2005 compared to (\$1.2) million during the three months ended September 30, 2004. Included in income from operations was \$0.1 million of income tax expense relating to the international operations.

**Table of Contents*****Nine months Ended September 30, 2005 and 2004***

On a consolidated basis, the increase in revenues is primarily due to \$95.9 million of revenue for the four months ended September 30, 2005 from the Company's new EDC division that was acquired on May 31, 2005. The increase in Messaging revenue was primarily due to revenue from Messaging's North American customers to accommodate their subscriber growth, product sales to South African wireless carrier MTN and other strong international business. The increase in gross margins is due to \$16.9 million from EDC, Messaging business' increased revenue for 2005 and increased volume of higher margin services, and a \$2.7 million charge the Company recorded in the first quarter of 2004 as a result of a patent infringement judgment awarded to Philip Jackson. The improvement in operating income was primarily due to the Messaging business' improvement resulting from increased revenue and gross margin dollars partially offset by higher operating expenses.

**EDC**

*Revenues.* Total revenue for the four months ended September 30, 2005 from the Company's newly formed Entertainment division was \$95.9 million, of which 48% was international. The EDC division was formed on May 31, 2005 with the acquisition of Universal's U.S. and Central European CD and DVD manufacturing and distribution operations. During the four months ended September 30, 2005, one customer individually accounted for approximately 93% of EDC's revenue.

*Gross Margins on Product Sales and Services.* Gross margins were \$16.9 million for the four months ended September 30, 2005, or 18% of revenues.

*Operating Income.* Operating income was \$0.7 million for the four months ended September 30, 2005 and included \$1.6 million of non-recurring charges for indirect acquisition costs and one-time employment related costs relating to the acquisition of the Universal operations and \$2.3 million of amortization expense on intangible assets. The intangible assets consist primarily of 10 year manufacturing and distribution services agreements that EDC entered into with Universal as part of the acquisition.

*Loss from Operations before Tax.* Loss from operations before tax was (\$2.0) million for the four months ended September 30, 2005. EDC's loss included \$1.4 million translation loss and \$0.4 million foreign currency swap gain primarily related to the acquisition of EDC. Interest expense of \$2.1 million included \$1.2 million interest and debt issuance cost amortization relating to the \$46.5 million term loan with Wachovia Bank and \$0.9 million imputed interest relating to the deferred acquisition payments due to Universal and was offset by interest income of \$0.3 on its cash and long-term restricted cash.

*Loss from Operations.* Loss from operations for EDC's first four months of operations was (\$2.3) million. Included in loss from operations was \$0.3 million of income tax expense relating to the international operations.

**Messaging**

*Revenues.* Revenue increased to \$61.7 million for the nine months ended September 30, 2005 as compared to \$37.3 million for the nine months ended September 30, 2004. The increase in revenue was primarily due to sales to North American customers to accommodate their subscriber growth, product sales to South African wireless carrier MTN and other strong international business. International revenues increased to \$19.8 million for the nine months ended September 30, 2005 as compared to \$6.2 million for the nine months ended September 30, 2004 and accounted for 32% and 17% of total net sales for the nine months ended September 30, 2005 and 2004, respectively. During the nine months ended September 30, 2005, four customers individually accounted for approximately 17%, 16%, 15% and 13% of total revenue from continuing operations. During the nine months ended September 30, 2004, four customers individually accounted for 17%, 15%, 12% and 12% of total revenue from continuing operations.

*Gross Margins on Product Sales and Services.* Gross margins increased to \$35.2 million during the nine months ended September 30, 2005 compared to \$16.7 million for the nine months ended September 30, 2004. Gross margin was 57% of revenue for the nine months ended September 30, 2005 compared to 45% for the nine months ended September 30, 2004. The increase in margin dollars and margin percentage was due to primarily increased revenue for 2005 and increased volume of higher margin services. Additionally, the gross margins in 2004 were unfavorably impacted by a \$2.7 million charge the Company as a result of a patent infringement judgment awarded to Philip Jackson.

*Operating Income (loss).* Operating income (loss) for the nine months ended September 30, 2005 was \$3.0 million compared to (\$9.1) million for the nine months ended September 30, 2004. The increase in operating income was primarily a result of increased revenue and gross margin dollars partially offset by higher operating expenses including incentive plan costs and commission increases. Beginning in June of 2005, corporate overhead costs were allocated to each division leaving approximately 20% of these costs for the last four months in the Messaging segment. Operating expenses for the Messaging business were 52% of revenue for the nine months ended September 30, 2005 compared to 69% for the nine months ended September 30, 2004.

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*Income (Loss) from Continuing Operations before Tax.* The Messaging income (loss) from continuing operations before tax increased to \$4.5 million for the nine months ended September 30, 2005 as compared to (\$8.5) million for the nine months ended September 30, 2004. The increase was primarily due to the increase in Messaging's operating income and an increase in interest income related to increased yields on the division's cash, cash equivalents, restricted cash, and short-term investments.

*Income (Loss) from Continuing Operations.* The Messaging income (loss) from operations was \$4.2 million for the nine months ended September 30, 2005 compared to (\$8.4) million for the nine months ended September 30, 2004. Included in income from operations was \$0.3 million of income tax expense relating to the international operations.

**Contractual Obligation**

The following table summarizes the Company's contractual obligations, as discussed in the Notes to Condensed Consolidated Financial Statements, as of September 30, 2005 (in thousands):

**Contractual Obligations**

	<b>Total</b>	<b>Payments due by period</b>			<b>Thereafter</b>
		<b>2005</b>	<b>2006 2007</b>	<b>2008 2009</b>	
Long-Term Debt (1)	\$ 91,742	\$ 10,501	\$ 36,458	\$ 33,825	\$ 10,958
Operating Leases (2)	57,810	1,978	14,312	13,670	27,850
Purchase obligations (3)	8,561	8,561			
Guarantee of lease obligation (4)	476	161	315		
<b>Total</b>	<b>\$ 158,589</b>	<b>\$ 21,201</b>	<b>\$ 51,085</b>	<b>\$ 47,495</b>	<b>\$ 38,808</b>

(1) Long-Term Debt includes a commercial bank loan and third party obligations. See Note 18 to the Condensed Consolidated Financial Statements.

(2) The Company leases manufacturing and office facilities and equipment under non-cancelable operating leases.

(3) The amount represents

cancelable and non-cancelable purchase agreements for inventory for continuing operations.

- (4) The Company is contingently liable for a building lease of a former subsidiary.

***Financial Condition and Liquidity***

*Overview.* At September 30, 2005, the Company had cash and cash equivalents and restricted cash totaling \$119.0 million. The restricted cash of \$40.7 million at September 30, 2005 consisted primarily of cash and cash equivalents to fund the payment of certain pension liabilities of EDC's European operations. At September 30, 2005, the Company's principal source of liquidity was its \$78.3 million of cash and cash equivalents. The Company's cash generally consists of money market demand deposits and the Company's cash equivalents generally consist of high-grade commercial paper, bank certificates of deposit, treasury bills, notes or agency securities guaranteed by the U.S. government, and repurchase agreements backed by U.S. government securities with original maturities of three months or less. There were no short-term investments at September 30, 2005. The Company's EDC division has a \$56.5 million credit facility with Wachovia Bank, which consists of a \$46.5 million five year term loan and a \$10.0 million revolving line of credit. At September 30, 2005, no drawings had been made against the \$10.0 million line of credit and it is available as a source of liquidity, if required.

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The Company expects to use its cash and cash equivalents for working capital and other general corporate purposes, including the expansion and development of its existing products and markets within both the Messaging and EDC divisions, liabilities related to discontinued operations, and potential further acquisitions.

At September 30, 2005 approximately \$2.5 million in discontinued operations liabilities remained outstanding of which the Company anticipates approximately \$0.2 million will be disbursed during the remainder of 2005 with the remainder in 2006 and beyond.

*Operating Activities.* Cash provided by (used in) operating activities, including both continuing and discontinued operations, was \$27.9 million and (\$7.2) million for the nine months ended September 30, 2005 and 2004, respectively. In the nine months ended September 30, 2005, the increases in income, accounts payable, deferred revenue and other accrued expenses were the primary sources of cash, but were partially offset by increases in accounts receivable and inventory.

Accounts receivable related to continuing operations increased \$29.9 million to \$37.6 million at September 30, 2005 from \$7.7 million at December 31, 2004. The increase in accounts receivable from continuing operations was due primarily to revenues from the Company's new EDC division that was acquired on May 31, 2005 and to receivables acquired as part of the EDC acquisition. At September 30, 2005 EDC's accounts receivable totaled \$22.8 million. In addition, increased revenues from the Messaging division contributed to the increase in accounts receivable.

Messaging's international sales have longer terms than domestic sales and consequently, the increase in international sales lengthened the accounts receivable turnover. EDC has fifteen day terms with Universal.

Inventories related to continuing operations increased \$14.6 million to \$20.8 million at September 30, 2005 from \$6.2 million at December 31, 2004. The increase in inventories was primarily due to the \$10.1 million of inventory acquired from Universal on May 31, 2005, and to new Messaging products shipped to customers during the three months ended September 30, 2005, where installation that is essential to the functionality of the product was not completed. At September 30, 2005 EDC's inventory totaled \$11.2 million.

Accounts payable increased \$27.3 million to \$30.9 million at September 30, 2005 from \$3.6 million at December 31, 2004 primarily due to the Company's new EDC division that was acquired on May 31, 2005 and the timing of inventory purchases related to the Messaging business. At September 30, 2005 EDC's accounts payable totaled \$25.9 million.

Total current and non-current accrued liabilities related to continuing operations increased approximately \$92.0 million to \$111.2 million at September 30, 2005 from \$19.2 million at December 31, 2004. The increase was primarily due to assumption of liabilities and activity from the Company's new EDC division that was acquired on May 31, 2005. At September 30, 2005 EDC's current and non-current accrued liabilities totaled \$81.9 million and includes \$52.8 million assumed liabilities and \$13.1 million deferred tax liabilities from purchase price allocation. The remaining increase of \$10.1 million in accrued liabilities was due primarily to:

A \$5.2 million increase to deferred revenue primarily related to the delivery of a significant amount of equipment for which the related revenue is not recognized until installation is complete, as well as to the deferral of revenue for annual extended maintenance contracts that were renewed during the first quarter of 2005,

A \$5.2 million increase to accrued payroll related costs including bonus provision,

A (\$0.3) million net reduction to other accrued liabilities.

In addition, during the first nine months of 2005 the Company's liability relating to restructuring costs decreased by \$247,000 primarily due to rental payments. As of September 30, 2005, the Company's remaining restructuring obligations were approximately \$13,000 related to lease termination costs and employee termination benefits. The Company anticipates all of the remaining cash payments for this restructuring charge will be made in 2005.

*Investing Activities.* On May 31, 2005, the Company acquired the manufacturing and distribution operations from Universal for a purchase price of approximately \$125.0 million. See detail information in Note 2 to the Condensed Consolidated Financial Statements. The Company spent \$1.8 million and \$1.7 million during the nine months ended September 30, 2005 and 2004, respectively, on equipment used in its Messaging operations, and \$2.3 million during the four months ended September 30, 2005 for equipment used in its EDC operations. The Company anticipates that



property, plant and equipment purchases related to its Messaging and EDC operations for the remainder of 2005 will approximate \$0.9 and \$7.2 million respectively.

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*Financing Activities.* The Company entered into a Credit Facility with a commercial bank to partially fund the purchase of the EDC division for an aggregate principal amount of \$56.5 million consisting of a term facility of \$46.5 million and a revolving credit facility of \$10.0 million. The \$10.0 million of credit facility was unused as of September 30, 2005. See detailed information in Note 18 to the Condensed Consolidated Financial Statements. During the nine months ended September 30, 2005 and 2004, the Company issued Company common stock in connection with purchases under the Company's Employee Stock Purchase Plan and as a result of the exercise of options and other awards totaling \$696,000 and \$373,000 respectively.

*Income Tax Matters.* Glenayre's recent cash outlays for income taxes have been limited primarily to foreign income taxes.

At December 31, 2004, the Company had U.S. net operating loss carryforwards ( NOLs ) aggregating approximately \$309.6 million, which may be used to offset future taxable income and reduce federal income taxes. These NOLs begin to expire in 2006 as noted in the table below.

	Expiration of NOLS (In millions)			
	UNRESTRICTED U.S.	RESTRICTED U.S.	INT L*	TOTAL
2006	\$	\$ 0.2	\$	\$ 0.2
2007		1.8		1.8
2008		3.3		3.3
2009		3.8	0.8	4.6
2010		5.9	33.0	38.9
2011		9.0		9.0
2012		9.4		9.4
2019	44.3			44.3
2020	50.6			50.6
2021	65.0			65.0
2022	13.4			13.4
2023	20.7			20.7
2024	48.4			48.4
TOTAL	\$ 242.4	\$ 33.4	\$ 33.8	\$ 309.6

\* International NOLs are primarily related to Canada.

*Summary.* The Company believes that its current cash reserves together with its ability to establish borrowing arrangements will be sufficient to (i) support the short-term and long-term liquidity requirements for current operations (including annual capital expenditures) and its discontinued operations and (ii) make potential acquisitions and strategic investments.

**Outlook***Glenayre Messaging*

Purchasing activity by communication service providers will continue to be somewhat variable. Key growth drivers for the remainder of 2005 and 2006 include:

Replacement of aging legacy systems with next generation platforms;

Continued wireless subscriber growth worldwide;

Increased penetration and acceptance of enhanced services;

New market build-outs as service providers consolidate or increase coverage;

Deployment of new services across existing network base; and

The necessity for service providers to deploy new revenue generating services that reduce customer churn.

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The Company expects that service providers will continue to seek to differentiate themselves in increasingly competitive markets by offering high-demand solutions. Glenayre continues to invest aggressively in applications and services to help wireless, wireline, cable and broadband operators enhance their competitive positions.

The Company also expects that reducing the total cost of ownership of communications systems will remain a primary concern for communication service providers. By providing open, standards-based platforms, Glenayre believes it is well positioned to help service providers offer competitive services with a lower total cost of ownership.

*EDC*

During the remainder of 2005 EDC plans to focus on implementing various strategic initiatives to increase EDC's capacity to allow for additional third party business and to drive costs down over time. The Company expects to achieve results from these initiatives during the first half of 2006. In addition EDC is pursuing several opportunities to increase revenue by providing a wide range of manufacturing, distribution and value added services to entertainment content owners and their customers.

Under its manufacturing and distribution agreements with Universal, EDC will also 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.

*Strategic Initiatives*

The Company expects to continue its search for additional acquisition targets in both the Messaging and EDC segments.

This Outlook section contains forward-looking statements that are subject to the risks described under the *Risk Factors That May Affect Future Results* immediately below

***Risk Factors That May Affect Future Results***

The Company's prospects are subject to certain risks and uncertainties as follows:

***Potential Intellectual-Property Infringement Claims from Third Parties***

Substantial litigation regarding intellectual property rights continues in the technology industry. If the Company was to discover that its products violated a third party's proprietary rights and was unable to obtain licenses on terms acceptable to the Company, the Company might not be able to continue offering those products without substantial reengineering. Reengineering efforts might result in substantial costs and product delays, and might not be successful. The industry in which EDC competes has many participants who own, or who claim to own, intellectual property for certain of the manufacturing processes EDC employs, the products EDC produces or the content produced by EDC's customers. EDC pays licensing fees to certain third parties that claim to own the rights to intellectual property that EDC employs in its manufacturing processes or products. It is not possible to determine with certainty whether these or any other existing third party patents or the issuance of any new third party patents may require EDC to alter, or obtain licenses relating to its processes or products. There is no assurance that EDC would be able to obtain any such licenses on favorable terms, if at all, and obtaining and paying royalties on new licenses might materially increase EDC's costs. Additionally, the fees EDC pays for existing licenses could increase materially in the future when these licenses are renewed. New multimedia formats will likely require EDC to obtain additional licenses.

Any intellectual property infringement claims asserted by a third party against the Company could be time-consuming and costly to defend, divert management's attention and resources, cause product and service delays, or require the Company to pay damages to or enter into licensing agreements with third party claimants. An adverse decision in an infringement claim asserted against the Company could result in the Company being prohibited from using such technology, as licensing arrangements may not be available on commercially reasonable terms.

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The Company's inability to license the infringed or similar technology on commercially reasonable terms could have a material adverse effect on its business, financial condition and results of operations.

Although the Company believes its technology does not infringe any third party rights, the Company is currently subject to certain infringement claims. The Company expects that its products may continue to be subject to third-party infringement claims. See Note 22 to the unaudited Condensed Consolidated Financial Statements and Part II, Item 1. Legal Proceedings.

***Litigation***

The Company is party to certain legal proceedings as described in Note 22 to the unaudited Condensed Consolidated Financial Statements and Part II, Item 1, Legal Proceedings. In addition to such legal proceedings, the Company is from time to time, involved in various disputes and legal actions related to its business operations. While no assurance can be given regarding the outcome of such matters, based on information currently available, the Company believes that the resolution of these matters will not have a material adverse effect on the financial position or results of future operations of the Company. However, because of the nature and inherent uncertainties of litigation, should the outcome of such actions be unfavorable, the Company's business, financial condition, results of operations and cash flows could be materially adversely affected.

***Potential Acquisitions and Strategic Investments***

The Company intends to continue to make significant investments in its business, and to examine opportunities for growth through both complementary and diversified acquisitions and strategic investments. These activities may involve significant expenditures and obligations that cannot readily be curtailed or reduced if anticipated demand for the associated products does not materialize or is delayed. The impact of these decisions on future financial results cannot be predicted with certainty, and the Company's commitment to growth may increase its vulnerability to downturns in its markets, technology changes and shifts in competitive conditions.

The Company has made, and in the future, may continue to make, strategic investments in other companies. These investments have been made in, and future investments will likely be made in, immature businesses with unproven track records and technologies. Such investments have a high degree of risk, with the possibility that the Company may lose its entire investment. The Company may not be able to identify suitable investment candidates, and, even if it does, the Company may not be able to make those investments on acceptable terms. In addition, even if the Company makes investments, it may not gain strategic benefits from those investments.

***Volatility of Stock Price***

The market price of the Company's common stock is volatile. The market price of its common stock could be subject to significant fluctuations in response to variations in quarterly operating results and other factors such as announcements of technological developments or new products by the Company, developments in relationships with its customers, strategic alliances and partnerships, potential acquisitions and strategic investments, technological advances by existing and new competitors, general market conditions in the Company's industries and changes in government regulations. In addition, in recent years, conditions in the stock market in general and shares of technology companies in particular have experienced significant price and volume fluctuations that have often been unrelated to the operating performance of these specific companies.

***Ability to Attract and Retain Key Personnel***

The Company's continued growth and success depends to a significant extent on the continued service of senior management and other key employees, the development of additional management personnel and the hiring of new qualified employees. There can be no assurance that the Company will be successful in continuously recruiting new personnel or in retaining existing personnel. The loss of one or more key or other employees or Glenayre's inability to attract additional qualified employees or retain other employees could have a material adverse effect on Glenayre's business, results of operations or financial condition.

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***Risk Factors Related to the Messaging Business***

**Competition**

The majority of the competitors in the Company's messaging business are seasoned communications providers like Glenayre. These companies include Comverse Technologies, Inc., SS8's Centigram, Unisys Corporation, the Octel Messaging division of Lucent Technologies, Inc., InterVoice, LogicaCMG, Tecnomen and Schlumberger-Sema. As with Glenayre, some of these competitors also have the financial stability, aggressive research and development programs and long-term customer relationships required to compete in the current environment. The competition among these firms is intense and is primarily based on a combination of price, product architecture, features, system capacity, reliability, selection of applications, services and support.

Some of the messaging business's competitors have substantially greater financial, technical, marketing and distribution resources than Glenayre and Glenayre may be unable to successfully compete with these companies. In addition, competitive pricing pressures exist which may have an adverse effect on the messaging business's profit margins in the future.

**Variability of Quarterly Results and Dependence on Key Customers**

The messaging business's financial results in any single quarter are highly dependent upon the timing and size of customer orders and the shipment of products for large orders. Large orders from customers can account for a significant portion of products shipped in any quarter. During the nine months ended September 30, 2005, Nextel, Alltel, MTN and US Cellular individually accounted for approximately 17%, 16%, 15% and 13%, respectively, of the messaging business's total revenue from continuing operations. There can be no assurance that these significant customers will continue to purchase systems and services from the Company at current levels in the future, and the loss of one or more of these significant customers could have a material adverse effect on the Company's business, financial condition or results of operations. In the future, the customers with whom the messaging business does the largest amount of business are expected to vary from quarter to quarter and year to year as a result of the timing for development and expansion of customers' communications networks and systems, the continued expansion into international markets and changes in the proportion of revenues generated by the messaging business's newly developed products and services. Furthermore, if a customer delays or accelerates its delivery requirements or a product's completion is delayed or accelerated, revenues expected in a given quarter may be deferred or accelerated into subsequent or earlier quarters. The messaging business has also historically experienced reduced revenues in its fourth quarter resulting from reduced system expansions as many CSPs halt system upgrades during their busiest retail season. Therefore, annual financial results are more indicative of the messaging business's performance than quarterly results, and results of operations in any quarterly period may not be indicative of results likely to be realized in the subsequent quarterly periods.

**Potential Market Changes Resulting from Rapid Technological Advances**

The Company's messaging business is primarily focused on offering communications solutions to wireless and fixed network carriers, as well as broadband and cable operators worldwide. These industries are characterized by rapid technological change and are likely to experience consolidation in the next 12 to 18 months. Carrier consolidation could result in redeployment of existing capital equipment that could reduce new capital spending and in delays in capital spending decisions. The messaging business has been focused on building next-generation messaging platforms such as its Versera's ICE platforms and communications solutions that leverage speech-driven, multimedia messaging and presence and availability technologies. Demand for these products and services may be affected by changes in technology and the development of substitute products and services by competitors. If changing technology negatively affects demand for Glenayre's Versera solutions, it could have a material adverse effect on Glenayre's business.

The messaging business is dependent on the continued growth of its markets as well as the effective and successful convergence of technologies for its systems and related applications and solutions. The markets for these technologies are still developing and market acceptance of some of these services is uncertain. If the commercial market for these services is lower than Glenayre anticipates, or grows more slowly than Glenayre anticipates, it could have a material adverse effect on the Company's business. There can be no assurance that these technologies will be successfully integrated or that a significant commercial market for the integrated services will develop.



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**Proprietary Technology**

The Company owns or licenses numerous patents used in the operations of the messaging business. Glenayre believes that while these patents are useful to the Company, they are not critical or valuable on an individual basis. The collective value of the intellectual property of Glenayre is comprised of its patents, blueprints, specifications, technical processes and cumulative employee knowledge. Although Glenayre attempts to protect its proprietary technology through a combination of trade secrets, patent, trademark and copyright law, nondisclosure agreements and technical measures, such protection may not preclude competitors from developing products with features similar to Glenayre's products. The laws of certain foreign countries in which Glenayre sells or may sell its products, including the Republic of Korea, the People's Republic of China, Saudi Arabia, Thailand, India and Brazil, do not protect Glenayre's proprietary rights in its intellectual property to the same extent as do the laws of the United States.

**Potential Changes in Government Regulation**

Many of the messaging business's products connect to public telecommunications networks. While many of Glenayre's current products are not directly subject to regulation, national, regional and local governments regulate public telecommunications networks, as well as the operations of telecommunication service providers in most domestic and international markets. As a result, Glenayre must obtain regulatory approvals in connection with the manufacture and sale of certain of its products, and the Company's service provider customers may need regulatory approvals to operate the systems that utilize certain of the Company's products. When introducing a product to a market, there is no assurance that the Company's customers will obtain necessary regulatory approvals. In addition, the enactment by federal, state, local or international governments of new laws or regulations or a change in the interpretation of existing regulations could adversely affect the market for the messaging business's products.

**International Business Risks**

Approximately 32% and 17% of the messaging business's revenues from continuing operations for the nine months ended September 30, 2005 and 2004, respectively, were generated in markets outside of the United States. International sales are subject to the customary risks associated with international transactions, including political risks, local laws and taxes, the potential imposition of trade or currency exchange restrictions, tariff increases, transportation delays, difficulties or delays in collecting accounts receivable, exchange rate fluctuations and the effects of prolonged currency destabilization in major international markets. Although a substantial portion of the messaging business's international sales for the nine months ended September 30, 2005 were negotiated in U.S. dollars, the messaging business may not be able to maintain such a high percentage of U.S. dollar denominated international sales. Should the amount of sales denominated in local currencies of foreign countries increase, the Company may seek to mitigate its currency exchange fluctuation risk by entering into currency hedging transactions. The Company also acts to mitigate certain risks associated with international transactions through the purchase of political risk insurance and the use of letters of credit. However, there can be no assurance that these efforts will successfully limit the risks associated with these international transactions.

**Continuation and Expansion of Third Party Agreements**

The messaging business has entered into initiatives with third parties that provide development services, products and channels-to-market that are used to enhance the Company's business and additional third party arrangements are continuing to be explored. Additionally, Glenayre has entered into several Original Equipment Manufacturer agreements with companies that market and distribute the messaging business's products and intends to enter into service reseller arrangements. Glenayre is dependent upon these third parties to augment its research and development efforts as well as to distribute its products and services and increase its product offerings. If these third parties are not successful or the agreements are terminated, a material adverse effect on Glenayre's business could result. Glenayre intends to continue entering into agreements and initiatives with third parties; however, there can be no assurance that additional arrangements with suitable vendors and distributors on acceptable terms will be available. The inability of Glenayre to enter into agreements with third parties on acceptable terms could have a material adverse effect on Glenayre's business.



**Table of Contents****Restructuring Activities**

The Company continues to assess its business to align resources and achieve its desired cost structure. Past restructuring efforts related to the messaging business have been based on certain assumptions regarding the cost structure of the Company's business, which may not be correct. These restructuring efforts may not be sufficient for the messaging business to achieve sustained profitability and meet the changes in industry and market conditions. The Company will continue to make judgments as to whether further reductions in its workforce may be required. These workforce reductions may impair the Company's ability to achieve its current or future business objectives. Costs incurred in connection with restructuring efforts may be higher than estimated. Any decision by the Company to further limit investment or exit, or dispose of, businesses may result in the recording of additional charges. As a result, the costs actually incurred in connection with the restructuring efforts may be higher than originally planned and may not lead to the anticipated cost savings.

As part of the Company's review of its restructured business, it must also review long-lived assets for recoverability under FAS 144. Future market conditions may trigger further write downs of these assets due to uncertainties in the estimates and assumptions used in asset valuations, which are based on the Company's forecasts of future business performance and accounting estimates relating to the useful life and recoverability of the net book value of these assets.

**Risk Factors Related to EDC****Sensitivity to Economic Trends and Consumer Preferences**

EDC's financial performance depends on consumer demand for its customers' products. Substantially all of the purchases of the pre-recorded media products sold by EDC's customers are discretionary. Accordingly, weak economic conditions or outlook or consumer confidence could significantly reduce consumption in any of EDC's customers major markets thereby causing material declines in EDC's sales and net earnings. In addition, because of the discretionary nature of their products, EDC's customers must continually compete for the public's leisure time and disposable income with other forms of entertainment, including sporting events, concerts, live theatre and restaurants. As a result of this competition, demand for EDC's customers' products could be reduced and EDC's sales volumes and gross profit margins could be adversely affected.

**Increased Costs or Shortages of Raw Materials or Energy**

Each year EDC purchases significant quantities of plastics, the key raw materials used in the production of DVDs, CDs, VHS video cassettes and audio cassettes. The availability and prices of these materials may be influenced by a number of different factors, many of which are beyond EDC's control, including weather, transportation, increased demand, production delays and the price of oil. Significant shortages of, and price increases for, the plastics EDC uses have occurred in the past. If EDC experiences raw material price increases and is unable to pass such increases through to its customers, EDC's gross margins would be adversely affected. Also, the processes at EDC's manufacturing, distribution and printing facilities are energy-intensive. Therefore, increases in energy costs would adversely affect EDC's gross margins and results of operations.

**Dependence on Universal Music Group: Potential Inability to Manage Successful Production**

EDC's manufacturing and distribution agreements with Universal Music Group account for approximately 93% of its revenues. Because EDC is so dependent on Universal Music Group for its revenues, if market or other factors cause Universal Music Group to cancel, reduce or postpone current or expected purchase commitments for EDC's products, EDC's operating results and financial condition may be adversely affected. EDC's efforts to expand the business it does with parties other than Universal may not succeed as a result of which EDC may not be able to significantly reduce its dependence on Universal.

Under EDC's agreements with Universal Music Group EDC is required to deliver substantial volumes of products meeting stringent requirements. EDC's failure to successfully manage the production or supply of its products, including the failure to meet scheduled production and delivery deadlines, or the failure of EDC's products to meet required quality standards, could materially adversely affect EDC's business, operating results and financial condition.

**Table of Contents****Advances in Technology, Efforts to Add Services and Changes in Customer Demands**

Changes in the technology employed by the pre-recorded media industry and the emergence of the future generations of multimedia products, such as Blu-ray discs or HD-DVD, may require EDC to extensively upgrade or alter its manufacturing processes and production facilities in order to offer the most up-to-date product variations. As the demands and requirements of EDC's customers shift, EDC will need to modify the products and services it offers to retain these customers. The costs associated with adapting EDC's operations to these requirements will likely be significant. The initiatives EDC is pursuing to increase revenue by providing a wide range of manufacturing distribution and value added services to entertainment content owners and their customers will also require EDC to incur costs which may be significant. However, there can be no assurance that these initiatives will succeed in significantly increasing EDC's revenues. If EDC is unable to obtain the resources necessary to fund product expansion and new technology development or to increase revenues by adding to the types of manufacturing, distribution and value added services it provides to its customers, EDC may not be able to successfully implement its business strategies and its market share, gross profit margins and results of operations could be adversely affected.

**Variability in Production Levels**

EDC's production levels and, in turn, revenue and cash flows are largely affected by the schedule according to which its major customers release their products, which, in turn, is dependent on a variety of factors such as consumer demand and the availability of marketable content. EDC's results of operations and cash flows in any period are materially affected by the timing of product releases by its customers, which may result in significant fluctuations from period to period. In addition, in the music and home video industries, a disproportionate amount of purchases are typically made in the last three months of the calendar year. Accordingly, a significant percentage of EDC's annual revenue and earnings is typically realized during the fourth quarter.

**Development of Digital Distribution Alternatives; Including Copying and Distribution of Music and Video Files**

EDC's business is dependent on the continued viability and growth of physical distribution of music and video through authorized pre-recorded media. Alternative distribution channels and methods, both authorized and unauthorized, for delivering music may erode EDC's volume of sales and the pricing of its products and services. The growth of these alternatives is driven by advances in technology that allow for the transfer and downloading of music and video files from the Internet. The proliferation of this copying, use and distribution of such files is supported by the increasing availability and decreasing price of new technologies, such as personal video recorders, CD and DVD burners, portable MP3 music and video players, widespread access to the Internet, and the increasing number of peer-to-peer digital distribution services that facilitate file transfers and downloading. EDC expects that file sharing and downloading, both legal and illegal, will continue to exert significant downward pressure on the demand for CDs. As current technologies improve, the digital transfer and downloading of video files will likely become more widespread. As the speed and quality with which video files can be transferred and downloaded improves, file sharing and downloading may in the future exert significant downward pressure on the demand for DVDs. In addition, EDC's business faces pressure from the emerging distribution alternatives, like video on demand, or VOD, and personal digital video recorders. As substantially all of EDC's revenues are derived from the sale of DVDs and CDs, continued file sharing, downloading and piracy or the growth of other alternative distribution channels and methods, could materially adversely affect its business, financial condition and results of operations.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company is subject to market risk arising from adverse changes in interest rates, foreign exchange rates and stock market volatility. The Company is also exposed to credit risks. The Company does not enter into financial investments for speculation or trading purposes and is not a party to any commodity derivatives. The Company entered into one derivative transaction as described below in the Foreign Currency Risk section.

***Interest Rate Risk***

The Company's exposure to market rate risk for a change in interest rates relates primarily to its investment portfolio. The Company's investment policy requires investment of surplus cash in high-grade commercial paper, bank certificates of deposits, treasury bills, notes or agency securities guaranteed by the U.S. Government and repurchase agreements backed by U.S. Government securities. The Company typically invests its surplus cash in these types of securities for periods of relatively short duration. Although the Company is exposed to market risk related to changes

in short-term interest rates on these investments, the Company manages these risks by closely monitoring market interest rates and the duration of its investments. Due to the short-term duration and the limited dollar amounts exposed to market interest rates, management believes that fluctuations in short-term interest rates will not have a material adverse effect on the Company's results of operations.

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The Company has variable rate debt that is not hedged by interest rate swaps. A 100 basis point change in the interest rate would affect earnings by approximately \$465,000 per year, based on variable rate balances outstanding at September 30, 2005.

***Foreign Currency Risk***

The Company operates internationally and is exposed to movements in foreign currency exchange rates primarily related to its German manufacturing and distribution facility and demand deposits denominated in non-functional currencies. The Company entered into a cross currency rate swap agreement with a commercial bank to offset the effect of exchange rate fluctuations on its loan to its German subsidiary.

At September 30, 2005, approximately U.S. \$48.5 million or 40.8% of the Company's cash and cash equivalent balances were denominated in foreign currencies. In the aggregate, if the value of the dollar against the foreign denominated currency strengthens by 10%, the Company would record an exchange loss of approximately \$4.9 million. Conversely, if the value of the dollar declines by 10%, the Company would record an exchange gain of approximately \$4.9 million. The Company seeks to mitigate the risk associated with foreign currency deposits by monitoring and limiting the total cash deposits held at each of its subsidiaries abroad. Additionally, the Company may seek to mitigate the risk by entering into currency hedging transactions. The Company was not a party to any hedge transactions as of September 30, 2005.

***Credit Risk***

Credit risk represents the loss that the Company would incur if counterparty fails to perform under its contractual obligations. The Company has established controls to determine and monitor the creditworthiness of customers. Credit concentration exists when a group of customers have similar business characteristics and/or are engaged in like activities that would cause their ability to meet their contractual commitments to be adversely affected, in a similar manner, by changes in the economy or other market conditions. The Company's customer base for the Messaging division is comprised primarily of communications service providers resulting in a concentration of credit risk for the division in the telecommunication industry. EDC's primary customer is Universal Music Group.

Other financial instruments potentially subjecting the Company to concentrations of credit risk consist of temporary cash investments and a currency swap. The Company places its temporary cash investments and currency swap with large diversified entities with operations through the U.S.

**ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934 (the Exchange Act)) pursuant to Rule 13a-15 of the Exchange Act. It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. The Company's disclosure controls and procedures were designed to reach a level of reasonable assurance of achieving their objectives and, based on the evaluation described above, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at reaching that level of reasonable assurance.

During the quarter ended September 30, 2005, there were no changes in internal controls that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. In accordance with guidance promulgated by the Office of the Chief Accountant of the Division of Corporate Finance of the Securities and Exchange Commission on June 24, 2004, the Company has excluded from its assessment of changes in internal controls the operations of Entertainment Distribution Company, LLC, a newly formed division which acquired Universal Music Group's North American and Central European CD and DVD manufacturing and distribution operations on May 31, 2005.

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**PART II OTHER INFORMATION**

**ITEMS 2, 3, 4 and 5 are inapplicable and have been omitted.**

**ITEM 1. LEGAL PROCEEDINGS**

Note 22 to the Condensed Consolidated Financial Statements in Part I, Item 1 which discusses material pending legal proceedings to which the Company is party is incorporated herein by reference.

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**ITEM 6. EXHIBITS**

The exhibits listed in the accompanying Exhibit Index are hereby incorporated by reference.

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**SIGNATURES**

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

Glenayre Technologies,  
Inc.

(Registrant)

/s/ Debra Ziola

Debra Ziola  
Executive Vice President  
and  
Chief Financial Officer  
(Principal Financial  
Officer)

Date: November 9, 2005

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**GLENAYRE TECHNOLOGIES, INC. AND SUBSIDIARIES  
EXHIBIT INDEX**

Exhibit Number	Description
3.1	Composite Certificate of Incorporation of Glenayre reflecting the Certificate of Amendment filed December 8, 1995 was filed as Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1995 and is incorporated herein by reference.
3.2	Restated by-laws of Glenayre effective June 7, 1990, as amended September 21, 1994 was filed as Exhibit 3.5 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1994 and is incorporated herein by reference.
10.1	Matthew K. Behrent Offer Letter was filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed September 6, 2005 and is incorporated herein by reference.*
10.2	Matthew K. Behrent Executive Severance Benefit Agreement was filed as Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed July 22, 2005 and is incorporated herein by reference*
10.3	Service Contract among Glenayre Electronics, Inc., Glenayre Electronics (UK) Ltd. and Roger Morgan was filed as Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed July 22, 2005 and is incorporated herein by reference.*



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Exhibit Number	Description
15.1	Letter regarding unaudited financial information.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a 14(a)/15d 14(a), Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Rule 13a 14(a)/15d 14(a), Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
*	Management Contract