WIRELESS FACILITIES INC
Form 10-Q
May 10, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006**

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

Commission file number 0-27231

WIRELESS FACILITIES, INC.

(Exact name of Registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**13-3818604** (I.R.S. Employer Identification No.)

4810 Eastgate Mall
San Diego, CA 92121
(858) 228-2000

(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)

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 ý No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b-2 of the Exchange Act): Large Accelerated Filer o Accelerated Filer ý Non-Accelerated Filer o

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

As of May 4, 2006, 73,881,260 shares of the registrant s common stock were outstanding.

WIRELESS FACILITIES, INC.

FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

WIRELESS FACILITIES, INC.
CONSOLIDATED BALANCE SHEETS

(in millions, except par value and number of shares)

(Unaudited)

	December 31, 2005	March 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 12.9	$ 10.0
Accounts receivable, net	109.6	107.0
Note receivable		17.5
Prepaid expenses	2.3	2.9
Employee loans and advances, net	0.4	0.4
Other current assets	4.6	6.1
Current assets of discontinued operations	46.7	0.7
Total current assets	176.5	144.6
Property and equipment, net	14.6	14.8
Goodwill	119.9	119.9
Other intangibles, net	7.4	7.0
Deferred tax assets	13.2	13.2
Investments in unconsolidated affiliates	2.1	2.1
Other assets	0.9	0.9
Non current assets of discontinued operations	1.7	
Total assets	$ 336.3	$ 302.5
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 22.9	$ 19.2
Accrued expenses	18.0	15.2
Accrued compensation	13.0	14.5
Accounts payable related party	0.8	0.8
Line of credit		7.0
Billings in excess of costs on completed contracts	4.3	4.0
Deferred tax liabilities	0.9	0.4
Tax contingencies	1.8	1.7
Accrual for contingent acquisition consideration	8.2	1.1
Accrual for unused office space	0.5	0.4
Income taxes payable	2.0	1.8
Capital lease obligations and other short-term debt	0.3	0.3
Current liabilities of discontinued operations	30.1	1.2
Total current liabilities	102.8	67.6
Capital lease obligations and debt, net of current portion	0.4	0.4

Accrual for unused office space, net of current portion		1.2		1.1
Other liabilities		1.3		1.2
Other long term liabilities of discontinued operations		0.3		0.2
Total liabilities		106.0		70.5
Commitments and contingencies (Notes 1 and 7)				
Stockholders equity:				
Preferred stock, 5,000,000 shares authorized, Series B Convertible Preferred Stock, $.001 par value; 25,483 shares outstanding at December 31, 2005 and March 31, 2006, (liquidation preference $12.7)				
Common Stock, $.001 par value, 195,000,000 shares authorized; 72,188,449 and 72,332,360 shares issued and outstanding at December 31, 2005 and March 31, 2006, respectively				
Additional paid-in capital		324.9		326.3
Accumulated deficit		(91.7)		(92.5)
Accumulated other comprehensive loss		(2.9)		(1.8)
Total stockholders equity		230.3		232.0
Total liabilities and stockholders equity	$	336.3	$	302.5

See accompanying notes to unaudited consolidated financial statements.

WIRELESS FACILITIES, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in millions, except per share amounts)

	Three months ended March 31, 2005		Three months ended March 31, 2006	
Revenues	$	90.7	$	83.9
Cost of revenues		70.0		69.7
Gross profit		20.7		14.2
Selling, general and administrative expenses		16.4		15.6
Contingent acquisition consideration				0.1
Operating income (loss)		4.3		(1.5)
Other income (expense), net:				
Interest income, net		0.2		0.1
Foreign exchange gain				
Other income (expense), net		(0.1)		
Other income, net		0.1		0.1
Income (loss) before provision for income taxes		4.4		(1.4)
Provision (benefit) for income taxes		1.7		(0.4)
Income (loss) from continuing operations		2.7		(1.0)
Income from discontinued operations		0.9		0.2
Net income (loss)	$	3.6	$	(0.8)
Basic earnings (loss) per common share:				
Income (loss) from continuing operations	$	0.04	$	(0.01)
Income from discontinued operations, net of taxes		0.01		0.00
Net income (loss)	$	0.05	$	(0.01)
Diluted earnings (loss) per common share:				
Income (loss) from continuing operations	$	0.04	$	(0.01)
Income from discontinued operations, net of taxes		0.01		0.00
Net income (loss)	$	0.05	$	(0.01)
Weighted average common shares outstanding:				
Basic		73.7		72.3
Diluted		75.9		72.3

See accompanying notes to unaudited consolidated financial statements.

WIRELESS FACILITIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in millions)

	Three months ended March 31, 2005	2006
Operating activities:		
Net income (loss) from continuing operations	$ 2.7	$ (1.0)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1.7	2.1
Deferred income taxes	1.1	(0.5)
Net loss on disposition of fixed assets	0.3	
Stock-based compensation	0.1	0.9
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	11.6	2.6
Accounts receivable related party	(0.1)	
Prepaid expenses	(0.8)	(0.6)
Other assets	(1.2)	(1.4)
Accounts payable	(2.6)	(3.7)
Accrued expenses	(2.2)	(2.8)
Accrued compensation	1.9	1.5
Tax contingencies	0.1	
Accrued contingent acquisition consideration		0.1
Billings in excess of costs on completed contracts	(2.1)	(0.3)
Accrual for unused office space	(0.3)	(0.2)
Income tax payable	0.2	(0.1)
Other liabilities		(0.1)
Net cash provided by (used in) continuing operations	10.4	(3.5)
Investing activities:		
Sale/maturity of short-term investments	5.7	
Cash paid for contingent acquisition consideration	(1.0)	(7.3)
Proceeds from the disposition of discontinued operations		1.5
Cash paid for acquisitions, net of cash acquired	(33.4)	
Capital expenditures	(1.6)	(1.4)
Net cash used in investing activities from continuing operations	(30.3)	(7.2)
Financing activities:		
Proceeds from issuance of common stock	0.6	0.5
Proceeds from issuance of common stock under employee stock purchase plan	0.5	
Borrowings under line of credit		7.0
Repayment of capital lease obligations	(0.1)	(0.1)
Net cash provided by financing activities from continuing operations	1.0	7.4
Cash flows of discontinued operations (Revised see Note 1(o))		
Operating cash flows	2.2	(0.2)
Investing cash flows		(0.4)
Net cash flows of discontinued operations	2.2	(0.6)
Effect of exchange rate on cash and cash equivalents		1.0

Net decrease in cash and cash equivalents		(16.7)		(2.9)
Cash and cash equivalents at beginning of period		52.0		12.9
Cash and cash equivalents at end of period	$	35.3	$	10.0

See accompanying notes to unaudited consolidated financial statements.

	Three months ended March 31, 2005		Three months ended March 31, 2006	
Supplemental disclosure of cash flow information:				
Cash received during the period for interest	$	0.2	$	
Net cash paid during the period for income taxes	$	(0.1)	$	
Supplemental disclosures of non-cash investing and financing transactions:				
Fair value of assets acquired in acquisitions	$	40.0	$	
Cash paid for acquisitions	$	(33.6)	$	
Liabilities assumed in acquisitions	$	6.4	$	
Note receivable on disposition of discontinued operations	$		$	17.5

WIRELESS FACILITIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Organization and Summary of Significant Accounting Policies

(a) Description of Business

Wireless Facilities, Inc. (WFI) was initially incorporated in the state of New York on December 19, 1994, commenced operations in March 1995 and was reincorporated in Delaware in 1998. WFI conducts business in three segments: Wireless Network Services, Government Network Services and Enterprise Network Services. WFI is an independent, global provider of outsourced communications and security systems engineering and integration services for the wireless communications industry through its Wireless Network Services division (WNS), the U.S. government through its Government Network Services division (GNS) (which is operated through WFI s wholly-owned subsidiary, WFI Government Services, Inc.), and enterprise customers through its Enterprise Network Services division (ENS).

(b) Principles of Consolidation

The consolidated financial statements include the accounts of WFI and its wholly-owned and majority-owned subsidiaries. WFI and its subsidiaries are collectively referred to herein as the Company.

In 2003, the Company acquired three privately-held companies as part of its Enterprise Network Solutions segment (now Enterprise Network Services) which provides voice, data, security, system design, deployment, integration and monitoring for enterprise networks. In 2004, the Company acquired two privately-held companies as part of its Government Network Services segment which provides systems engineering, systems integration and the outsourcing of technical services such as operational test and evaluation and program management. In 2005, the Company acquired one privately-held company as part of its Government Network Services segment which provides services including network engineering, network infrastructure support, information assurance, application development, and managed services, including network maintenance and monitoring, to government agencies. See Note 6 for additional details regarding these acquisitions.

All inter-company transactions have been eliminated in consolidation. Investments in unconsolidated affiliates are accounted for using the cost method and equity method. The cost method is used for companies in which the Company owns less than 20% and for which the Company has no significant influence.

(c) Fiscal Calendar

The Company operates and reports using a 52-53 week fiscal year ending the last Friday in December. As a result, a fifty-third week is added every five or six years. Our 52 week fiscal year consists of four equal quarters of 13 weeks each, and our 53 week fiscal year consists of three 13 week quarters and one 14 week quarter. The financial results for our 53 week fiscal years and our 14 week fiscal quarters will not be exactly comparable to our 52 week fiscal years and our 13 week fiscal quarters. However, the 2005 and 2006 quarters presented in this report on Form 10-Q have the same number of weeks. For presentation purposes, all fiscal periods presented or discussed in this report have been presented as ending on the last day of the nearest calendar month. For example, our first quarter in 2005 ended on April 1, 2005, but we present our quarter as ending on March 31, 2005.

The information as of March 31, 2006, and for the three months ended March 31, 2005 and 2006 is unaudited. In the opinion of management, these unaudited consolidated financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of our financial position, results of operations and cash flows for the interim periods presented. Interim operating results are not necessarily indicative of operating results expected in subsequent periods or for the year as a whole. These unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and the related notes included in WFI s annual consolidated financial statements for the year ended December 31, 2005, filed on Form 10-K on April 3, 2006 with the United States Securities and Exchange Commission.

The unaudited consolidated financial statements include the accounts of WFI and its wholly-owned and majority-owned subsidiaries.

(d) Cash and Cash Equivalents and Short-Term Investments

The Company s cash equivalents consist of highly liquid investments with original maturities of three months or less when purchased by the Company.

In the event the Company has investments, it evaluates such investments in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities. Based on the Company s intent, investment policies and ability to liquidate debt securities maturing after one year during the one-year operating cycle, the Company classifies such short-term investment securities within current assets. Available-for-sale securities are carried at fair value, with unrealized gains and losses reported as a separate component of Stockholders Equity under the caption Accumulated Other Comprehensive Income or Loss. The amortized cost basis of debt securities is periodically adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization is included as a component of interest income (expense). The amortized cost basis of securities sold is based on the specific identification method and all such realized gains and losses are recorded as a component within other income (expense), net. Interest and dividends on securities classified as available-for-sale are included in interest income. The cash and cash equivalents at March 31, 2006 were as follows (in millions):

	March 31, 2006	
	Amortized Cost Basis	**Fair Value Basis**
Cash and cash equivalents:		
Cash	$ 4.7	$ 4.7
Money market	5.3	5.3
Cash and cash equivalents	10.0	10.0
Cash and cash equivalents	$ 10.0	$ 10.0

There were no net unrealized gains on short-term investments included as a component of stockholders equity at March 31, 2006. There were also no realized gains or losses recorded for the three months ended March 31, 2006.

(e) Inventory

Inventories are stated at the lower of cost or market and are included in other current assets in the accompanying balance sheets. Cost typically includes materials. The Company regularly reviews inventory quantities on hand, future purchase commitments with its suppliers, and the estimated utility of its inventory. If the Company review indicates a reduction in utility below carrying value, it reduces its inventory to a new cost basis. As of March 31, 2006 and December 31, 2005, the Company had $1.4 million and $1.1 million, respectively, of inventories which were reflected in Other Current Assets on the Consolidated Balance Sheet.

(f) Property and Equipment, Net

Property and equipment consists primarily of computer, field testing and office-related equipment and is recorded at cost. Equipment acquired under capital leases is recorded at the present value of the future minimum lease payments. Depreciation is calculated using the straight-line method over the estimated useful life of each asset, which is one to three years for computer equipment, five years for furniture and office equipment, ten years for purchased software for the Company s enterprise system and fifteen years for the Company s Local Area Network infrastructure. Equipment acquired under capital leases is amortized over the shorter of the lease term or the estimated useful life of the asset. Improvements which significantly improve and extend the useful life of an asset are capitalized. Expenditures for maintenance and repairs are charged to operations as incurred.

(g) Goodwill and Other Intangible Assets, Net

Goodwill represents the excess of the purchase price over the fair value of net assets from acquired companies.

The Company typically engages a valuation consultant to assist in the determination of the carrying value and amortizable life of its intangible assets related to its acquisitions. The estimated useful life for its intangible assets is approximately two to eight years depending on the nature of the asset.

The Company adopted SFAS No. 142, Goodwill and Other Intangible Assets, on January 1, 2002. SFAS No. 142 superseded Accounting Principles Board Opinion No. 17, Intangible Assets, and discontinued the amortization of goodwill and intangible assets with indefinite useful lives associated with purchase business combinations. In addition, SFAS No. 142 includes provisions regarding the reclassification between goodwill and identifiable intangible assets in accordance with the new definition of intangible assets set forth in SFAS No. 141, Business Combinations, the reassessment of the useful lives of existing finite-life intangible assets, and the annual testing for impairment of existing goodwill and other intangible assets with indefinite lives. In accordance with the adoption of SFAS No. 142 on January 1, 2002, the Company ceased the amortization of goodwill, and completed the required transitional impairment test. The Company also re-evaluated the classifications of its existing intangible assets and goodwill in accordance with SFAS No. 141. In accordance with SFAS No. 142, the Company conducts, at a minimum, an annual impairment test of goodwill in the fourth quarter of each fiscal year, or earlier if triggering events or circumstances warrant an accelerated review for potential impairment.

(h) Revenue Recognition

The Company provides services to customers under three primary types of contracts: fixed-price long-term turnkey; time and materials; and contract management and out of pocket reimbursables. The Company realizes a significant portion of its revenue from long-term contracts and accounts for these contracts under the provisions of Statement of Position (SOP) 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. Revenue on fixed-price contracts is recognized using the percentage-of-completion method of accounting based on the ratio of total costs incurred to date compared to estimated total costs to complete the contract. Estimates of costs to complete include materials, direct labor, overhead, and allowable general and administrative expenses (for government contracts). While the Company generally does not incur a material amount of set-up fees for its projects, such costs, if any, are excluded from the estimated total costs to complete the contract. Cost estimates are reviewed monthly on an individual contract basis, and are revised periodically throughout the life of the contract such that adjustments to profit resulting from revisions are made cumulative to the date of the revision. In certain instances in which it is impractical to estimate the final outcome of the project margin, but it is certain that the Company will not incur a loss on the project, the Company may record revenue equal to cost incurred, at a zero profit margin. Once the estimate of the final outcome of the project margin is determined, the Company will record revenue using the percentage-of-completion method of accounting based on the ratio of total costs incurred to date compared to the estimated total costs to complete the project. The full amount of an estimated loss associated with a contract is accrued and charged to operations in the period it is determined that it is probable a loss will be realized from the performance of the contract. Significant management judgments and estimates, including the estimated costs to complete projects, which determine the project s percent of completion and profit margin must be made and used in connection with the revenue recognized in any accounting period. In the future, the Company may realize actual results that differ from current estimates.

Accordingly, the revenue the Company recognizes in a given financial reporting period depends on (1) the costs the Company has incurred for individual projects, (2) the Company s then current estimate of the total remaining costs to complete the individual projects and (3) current estimated contract value associated with the projects. In the Company s wireless network services business, the estimated contract value and costs are impacted by the estimated number and mix of site types that we may be assigned. If, in any period, we significantly increase or decrease our estimate of the total costs to complete a project, and/or reduce or increase the associated contract value, revenue for that period would be impacted. To the extent that the Company s estimates fluctuate over time or differ from actual results, gross margins in subsequent periods may vary significantly from previous estimates. Material differences may result in the amount and timing of the Company s revenue for any period if management made different judgments or utilized different estimates. In the event the Company is unable to provide reliable cost estimates on a given project, the Company records revenue using the completed contract method. There are no contracts for which the Company utilized the completed contract method for the quarter ended March 31, 2006 and year ended December 31, 2005.

Many of the Company s contracts are master service agreements under which the Company is contracted to provide services to deploy a pre-determined and specific number of sites in specific geographic markets. These agreements are typically segmented into multiple projects to account for revenue under the guidelines of SOP 81-1. These contractual arrangements with the Company s customers typically include milestone billings. The milestone billing clauses relate specifically to the timing of customer billings and payment schedules, and are independent of the Company s right to payment and the timing of when revenue is recognized. Under the terms of substantially all of the Company s contracts, if a contract is terminated without proper cause by the customer, if the customer creates unplanned/unreasonable time delays, or if the customer modifies the contract tasks/scope, the Company has contractual rights to reimbursement in accordance with the terms and conditions regarding payment for work performed, but not yet billed (i.e., unbilled trade accounts receivable) at a gross profit margin that is consistent with the overall project margin. Furthermore, certain additional provisions compensate the Company for additional or excess costs incurred, whereby any scope reductions (i.e., reduction in original number of sites awarded) or other modifications are subject to reimbursement of costs incurred to date with a reasonable profit margin based on the contract value and completed work at that time. The inherent aforementioned risks associated with the presence of potential partial milestone billings or reductions in scope are reflected in the Company s ongoing periodic assessment of the total contract value and the associated revenue recognized. Total net unbilled accounts receivable at December 31, 2005 and March 31, 2006 were $51.0 million and $54.5 million, respectively. The Company periodically performs work under authorizations to proceed or work orders from its customers for which a formal purchase order may not be received until after the work has commenced. As of March 31, 2006, approximately $6.5 million of the Company s unbilled accounts receivable balance were under unapproved change orders or claims. The Company expects that substantially all of the unbilled balances as of March 31, 2006 will be billed within one year as billing and performance milestones are achieved.

Revenue from certain time and materials and fixed priced contracts are recognized when realized or realizable and earned, in accordance with Staff Accounting Bulletin (SAB) 101, as revised by SAB 104 (recognized when services are rendered at contracted labor rates, when materials are delivered and when other direct costs are incurred). Additionally, based on management s periodic assessment of the collectibility of its accounts receivable, credit worthiness and financial condition of customers, the Company determines if collection is reasonably assured prior to the recognition of revenue.

The Company s government network services business with the U.S. government and prime contractors to the U.S. government is generally performed under cost reimbursable plus fixed fee, fixed price or time and material contracts. Cost reimbursable contracts for the government provide for reimbursement of costs plus the payment of a fee. The Company records the fee as costs are incurred. Under fixed-price contracts, the Company agrees to perform certain work for a fixed price. Under time and materials contracts, the Company is reimbursed for labor hours at negotiated hourly billing rates and is reimbursed for travel and other direct expenses at actual costs plus applied general and administrative expenses. Under certain of the Company s contractual arrangements, the Company may also recognize revenue for out-of-pocket expenses in accordance with EITF 01-14 Income Statement Characterization of Reimbursements Received for Out-of-Pocket Expenses Incurred. Depending on the contractual arrangement, these expenses may be reimbursed with or without a fee.

Under certain of its contracts, the Company provides supplier procurement services and materials for its customers. The Company records revenue on these arrangements on a gross or net basis in accordance with EITF 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, depending on the specific circumstances of the arrangement. The Company considers the following criteria, among others, for recording revenue on a gross or net basis:

(1) Whether the Company acts as a principal in the transaction;

(2) Whether the Company takes title to the products;

(3) Whether the Company assumes risks and rewards of ownership, such as risk of loss for collection, delivery or returns;

(4) Whether the Company serves as an agent or broker, with compensation on a commission or fee basis; and

(5) Whether the Company assumes the credit risk for the amount billed to the customer subsequent to delivery.

(i) Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments, which results in bad debt expense. Management periodically determines the adequacy of this allowance by evaluating the comprehensive risk profiles of all individual customer receivable balances including, but not limited to, the customer s financial condition and overall current economic conditions. Additionally, on certain contracts whereby the Company performs services for a prime/general contractor, a specified percentage of the invoiced trade accounts receivable may be retained by the customer until the project is completed. The Company periodically reviews all retainages for collectibility and records allowances for doubtful accounts when deemed appropriate, based on its assessment of the associated credit risks. Total retainages included in accounts receivable were $1.7 million and $1.2 million at December 31, 2005 and March 31, 2006, respectively. Changes to estimates of contract value are recorded as adjustments to revenue and not as a component of the allowance of doubtful accounts. Allowance for doubtful accounts was $1.5 million as of December 31, 2005 and March 31, 2006.

(j) Income Taxes

The Company records deferred tax assets and liabilities for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company maintains a valuation allowance on the portion of the deferred tax assets for which it is more likely than not that the Company will not realize the benefits of these tax assets in future tax periods. The valuation allowance is based on estimates of future taxable income by tax jurisdiction in which the Company operates, the number of years over which the deferred tax assets will be recoverable, and scheduled reversals of deferred tax liabilities.

In assessing the realizability of deferred tax assets, management considers, on a periodic basis, whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. For U.S. purposes, the Company is in a cumulative book tax profit position as of March 31, 2006 and consideration is given to future taxable income, including the reversal of temporary differences, in evaluating the recoverability of its U.S. deferred tax assets and the corresponding valuation allowance related to the assets. Unlike the Company s U.S. tax position, its foreign operations are in a cumulative book loss position. Pursuant to the provisions of SFAS No. 109, Accounting for Income Taxes, limited consideration is given to the Company s future foreign income in determining the recoverability of its foreign deferred tax assets and the related valuation allowance. Accordingly, management believes the current valuation allowance on deferred tax assets is sufficient and properly stated at March 31, 2006.

(k) Stock-based Compensation

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R (SFAS 123R), Share-Based Payments, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. SFAS 123R supersedes the Company s previous accounting methodology using the intrinsic value method under Accounting Principles Board Opinion APB No. 25, Accounting for Stock Issued to Employees. Under the intrinsic value method, no share-based compensation expense related to stock option awards granted to employees had been recognized in the Company s Consolidated Statements of Operations, as all stock option awards granted under the plans had an exercise price equal to or greater than the market value of the common stock on the date of grant. The Company has no awards with market or performance conditions.

The Company adopted SFAS 123R using the modified prospective transition method. Under this transition method, compensation expense recognized during the three months ended March 31, 2006 included: (a) compensation expense for all share-based awards granted prior to, but not yet vested, as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all share-based awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In accordance with the modified prospective transition method, the Company s consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123R. The Company adopted SFAS 123R as of January 1, 2006 and had $0.9 million related to non-vested equity awards that was expensed during the quarter ended March 31, 2006.

The Company had the following three stock option plans under which shares were available for grant at March 31, 2006: the 1999 Equity Incentive Plan (the 1999 Plan), the 2000 Non-Statutory Stock Option Plan (the 2000 Plan) and the 2005 Equity Incentive Plan (the 2005 Plan).

The 1999 Plan permits the granting of incentive stock options or non-statutory stock options which are exercisable for up to ten years after the grant date. The 2000 Plan permits the granting of non-statutory stock options, which are exercisable for a period following the date of grant as determined by the Board of Directors (generally ten years). The 2005 Plan permits the granting of incentive stock options, non-statutory stock options and other types of grants or awards, which are exercisable for up to ten years after the grant date. A cumulative total of 15.9 million, 6.5 million and 3.5 million of common stock have been authorized for issuance under the 1999 Plan, 2000 Plan and 2005 Plan, respectively.

In 2005, the Company accelerated options to avoid recognition of future compensation expense that the Company would have otherwise recognized in its Consolidated Statement of Operations with respect to these options upon the adoption of SFAS 123R. The future expense that was eliminated as a result of the acceleration of vesting of these options was approximately $18.4 million. At the end of December 2005, vesting was accelerated for all options which had an exercise price per share equal to or greater than $6.50. In addition, in December 2005, the Company repriced options to eliminate future expense for those options with an exercise price per share greater than 120% of the closing market price of the Company s common stock on December 29, 2005.

The Company records compensation expense for employee stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model with the assumptions included in the table below. The Company uses historical and intrinsic data, among other factors, to estimate the expected price volatility, the expected option life and the expected forfeiture rate. The risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. The weighted-average estimated fair value of employee stock options granted during the three months ended March 31, 2006 was $2.71 per share using the Black-Scholes option-pricing model with the following weighted-average assumptions used for valuation of options under SFAS 123 and SFAS 123R granted during the period (annualized percentages):

	Three months ended March 31,	
	2005	**2006**
Expected-term (Hold Period):		
Stock options	4 years	4.28 years
Purchase plan	6 months	
Risk-free interest rate	3.88%	3.96%

Volatility	82%	62%
Forfeiture rate		23.7%
Dividend yield		

There was no forfeiture rate prior to the adoption of SFAS 123R as forfeitures were recognized as incurred.

The table below shows the amounts recognized in the financial statements for the three months ended March 31, 2006 for share-based compensation related to employees (in millions, except per share data).

		Three months ended March 31, 2006
Cost of revenues	$	0.4
Selling, general and administrative		0.5
Total cost of employee share-based compensation Included in operating loss, before income tax		0.9
Amount of income tax recognized in earnings		(0.3)
Amount charged against income	$	0.6
Impact on net income per common share:		
Basic	$	(0.01)
Diluted	$	(0.01)

A summary of the status of the Company s stock option plan as of March 31, 2006 and of changes in options outstanding under the plan during the three months ended March 31, 2006 is as follows:

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2005	13,192,578	$ 6.17		
Options granted	450,511	$ 5.22		
Options exercised	(143,911)	$ 3.90		
Options forfeited or expired	(709,964)	$ 7.21		
Options outstanding at March 31, 2006	12,789,214	$ 6.10	7.39	$ 359,394.15
Options vested and exercisable at March 31, 2006	9,331,813	$ 6.19	6.77	$ 359,394.15

As of March 31, 2006, there was $8.9 million of unamortized compensation cost related to non-vested stock option awards, which is expected to be recognized over a remaining weighted-average vesting period of 3.1 years.

For purposes of pro forma disclosures under SFAS 123 for the three months ended March 31, 2005, the estimated fair value of share-based awards was assumed to be amortized to expense over the vesting period of the award. There is no pro forma presentation for the three months ended March 31, 2006 as the Company adopted SFAS 123R as of January 1, 2006, as discussed above. The pro forma effects of recognizing estimated compensation expense under the fair value method on net income and earnings per common share were as follows (in millions, except per share data):

	Three months ended March 31, 2005
Net income	$ 3.6
Actual stock-based compensation expense included in net earnings	
Total stock-based employee compensation expense determined under fair value based method for all awards	(3.5)
Pro forma net income	$ 0.1
Earnings per common share:	
Basic as reported	$ 0.05
Basic pro forma	$ 0.00
Diluted as reported	$ 0.05
Diluted pro forma	$ 0.00
Weighted average shares:	
Basic as reported	73.7
Basic pro forma	73.7
Diluted as reported	75.9
Diluted pro forma	75.9

(l) Accrual for Unused Office Space

As a result of the Company s operating results and the economic environment in the telecommunications industry, during 2002, the Company recorded a charge for unused office space. The accrual for loss on unused office space as of December 31, 2005 and March 31, 2006 was $1.7 million and $1.5 million, respectively. The Company estimates that the remaining accrual will be utilized through 2010, the term of the Company s lease agreement.

(m) Tax Contingencies

The Company assesses tax uncertainties and exposure items after taking into consideration the probability of the tax contingencies being incurred. Accordingly, based upon the Company s assessment of the probability of these tax contingencies, it was determined that accruals of $0.8 million and $0.8 million were accrued for VAT tax contingencies and $1.0 million and $0.9 million were required for sales and use tax contingencies as of December 31, 2005 and March 31, 2006, respectively, related to contingencies for fiscal years 1998 through 2005 and through quarter ending March 31, 2006.

(n) Use of Estimates

The preparation of financial statements in conformity with Generally Accepted Accounting Principles in the United States (US GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates include revenue recognition, allowance for doubtful accounts, valuation of long-lived assets including identifiable intangibles and goodwill, accounting for income taxes including the related valuation allowance on the deferred tax asset, accruals for partial self-insurance, contingencies and litigation and contingent acquisition consideration. In the future, the Company may realize actual results that differ from the current reported estimates and if the estimates that we have used change in the future, such changes could have a material impact.

(o) Reclassifications

The accompanying statements of cash flows separately reflect the operating and investing portions of the cash flows attributable to the Company s discontinued operations for each of the periods presented. These amounts were reported on a combined basis as a single amount in prior statements of cash flows. In addition, the balance sheets and statements of operations have been reclassified to present the discontinued operations.

(2) Recent Accounting Pronouncements

In November 2005, the FASB issued Staff Position (FSP) FAS123R-3, Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards. This FSP requires an entity to follow either the transition guidance for the additional-paid-in-capital pool as prescribed in SFAS No. 123R, Share-Based Payment, or the alternative transition method as described in the FSP. An entity that adopts SFAS No. 123R using the modified prospective application may make a one-time election to adopt the transition method described in this FSP. An entity may take up to one year from the later of its initial adoption of SFAS No. 123R or the effective date of this FSP to evaluate its available transition alternatives and make its one-time election. This FSP became effective in November 2005. We continue to evaluate the impact that the adoption of this FSP could have on our financial statements.

In November 2005, the FASB issued FSP FAS115-1/124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, which addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. This FSP also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. The guidance in this FSP amends FASB Statements No. 115, Accounting for Certain Investments in Debt and Equity Securities, and No. 124, Accounting for Certain Investments Held by Not-for-Profit Organizations, and APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. We adopted this FSP during the three months ended March 31, 2006 and it did not have a material impact on our financial statements.

In February 2006, the FASB issued FASB Statement No. 155, Accounting for Certain Hybrid Financial Instruments. This Statement amends FASB Statements No. 133, Accounting for Derivative Instruments and Hedging Activities, and No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This statement resolves issues addressed in Statement No. 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial Interests in Securitized Financial Assets. This statement: (a) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (b) clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement No. 133, (c) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, (e) amends Statement 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006.

In March 2006, the FASB issued FASB Statement No. 156, Accounting for Servicing of Financial Assets. Statement 156 amends FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, and requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable, and permits an entity to subsequently measure those servicing assets and servicing liabilities at fair value. This statement is effective for fiscal years beginning after September 15, 2006. This statement does not have a material impact on the Company.

(3) Net Income (loss) Per Common Share

The Company calculates net income (loss) per share in accordance with the provisions of SFAS No. 128, Earnings Per Share . Under SFAS No. 128, basic net income (loss) per common share is calculated by dividing net income (loss) by the weighted-average number of common shares outstanding during the reporting period. The Company adopted EITF No. 03-6 Participating Securities and the Two-Class Method Under FASB Statement No. 128 on January 1, 2005. In accordance with EITF No. 03-6, the Company determined that its Series B Convertible Preferred Stock were participating securities and therefore were required to be included in the weighted average basic shares if dilutive. Diluted net income (loss) per common share reflects the effects of potentially dilutive securities. Weighted average shares used to compute basic and diluted net income (loss) per share are presented below (in millions):

	For the Three Months Ended March 2005		For the Three Months Ended March 2006	
Net income (loss)	$	3.6	$	(0.8)
Shares used in basic per share amounts:				
Weighted average common shares outstanding		73.7		72.3
Shares used in diluted per share amounts:				
Dilutive effect of stock options		2.2		
Dilutive weighted average shares		75.9		72.3
Basic net income (loss) per share	$	0.05	$	(0.01)
Diluted net income (loss) per share	$	0.05	$	(0.01)
Anti-dilutive weighted shares from stock options excluded from calculation		6.1		13.5
Average per share market value of common stock	$	7.77	$	4.90
Average outstanding stock option price per share	$	9.23	$	6.20

(4) Significant Transactions

(a) Discontinued Operations - Scandinavia

During the second quarter of 2004, the Company made the decision to sell or otherwise divest its Network Management business in Scandinavia, which had previously been reported in its Wireless Network Services segment. WFI determined that this entity met the criteria to classify it as held for sale. Accordingly, WFI has reflected this operation as discontinued in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. After actively marketing to sell this business for one quarter, the Company made the decision to wind-down this operation in the third quarter of 2004.

As of December 31, 2005 and March 31, 2006, there were zero assets of discontinued operations and $0.1 million and $0.05 million of liabilities of discontinued operations for December 31, 2005 and March 31, 2006, respectively.

(b) Discontinued Operations Latin American Operations

In December 2005, the Company s Board of Directors made the decision to exit the Company s Mexican operations and certain of its other deployment businesses in South America. Prior to this decision, these operations had been reported in its Wireless Network Services segment. The Company determined that these operations meet the criteria to be classified as held for sale. Accordingly, WFI has reflected these operations as discontinued in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The South American operations were substantially shut down as of the end of December 2005.

On February 17, 2006, the Company entered into an Equity Purchase Agreement to sell all of the stock of its wholly owned subsidiaries (i) WFI de Mexico, S. de R.L. de C.V., (ii) WFI de Mexico, Servicios de Adminstracion, S. de R.L. de C.V., (iii) WFI de Mexico, Servicios de

Ingenieria, S. de R.L. de C.V., (iv) WFI Services de Mexico S.A. de C.V., (v) WFI Asesoria en Adminstracion, S.C; and (vi) WFI Asesoria en Telecomunicaciones, S.C. (the Mexico Operations) to Sakoki LLC. The transaction closed on March 10, 2006. Refer to Note 10 Related Party Transactions for further discussion of the purchaser, Sakoki, LLC.

The Equity Purchase Agreement provides that the Company will receive total approximate cash consideration of $18 million, subject to adjustment, with $1.5 million payable in cash on signing of the equity Purchase Agreement and $16.5 payable by means of a secured promissory note payable in installments through December 31, 2006, subject to adjustments. The note is secured by pledges of assets and a personal guaranty. The total consideration approximates the net book value of operations, including $13.2 million of contingent liabilities.

The closing balance sheet as of February 17, 2006 resulted in net asset adjustments aggregating to a total approximate $19.0 million consideration, $1.5 million which was paid on February 17, 2006, with the remaining $17.5 million payable by means of the promissory note in installments through December 31, 2006 with an interest rate of 7.5% per annum. The note receivable is reflected on the Company s Consolidated Balance Sheet as of March 31, 2006. In April 2006, the Company presented the final net asset computation to the buyer, Sakoki, LLC, and the buyer is still in the review process of the computation, as provided in the Equity Purchase Agreement. The Company expects that the parties will reach final resolution of the net asset computation in the second quarter of 2006.

The impact of the divestiture has been reflected in the consolidated balance sheets as of March 31, 2006. There was no gain or loss realized on the sale since the business was sold at its net carrying value.

For the quarter ended March 31, 2006, these operations had revenues of $5.9 million and net income of $0.2 million through the effective date of February 17, 2006. Included in the income from discontinued operations for the quarter ended March 31, 2006 is a pre-tax gain of approximately $0.1 million of accumulated foreign currency translation gain written off in the first quarter of 2006 in accordance with EITF Issue 01-05 Application of FASB Statement No. 52 to an Investment Being Evaluated for Impairment that will be Disposed Of (EITF 01-05).

The components of the current and non-current assets and liabilities for the Latin American operations are included in the accompanying balance sheet as discontinued operations as of December 31, 2005 and March 31, 2006 (in millions):

		12/31/05		**3/31/06**
Cash	$	3.2	$	0.1
Restricted cash		0.6		0.6
Accounts receivable, net		34.5		
Prepaid expenses		0.2		
Income tax receivable		2.3		
Other current assets		5.9		
Current assets of discontinued operations	$	46.7	$	0.7
Property, plant and equipment	$	1.5	$	
Other assets		0.2		
Non-current assets of discontinued operations	$	1.7	$	
Accounts payable	$	(3.9)	$	(0.5)
Accrued expenses		(6.6)		
Tax contingencies		(13.2)		
Billings in excess of cost		(0.6)		
Deferred tax liability		(0.1)		
Other current liabilities		(5.6)		(0.6)
Current liabilities of discontinued operations	$	(30.0)	$	(1.1)
Non-current liabilities of discontinued operations	$	(0.3)	$	(0.2)

The restricted cash of $0.6 million, is a one-year fixed account at zero interest as a result of a 2005 regulation in Argentina which requires the maintenance of cash balances as a percentage of foreign loans advanced by the Company to its foreign subsidiary.

(5) Investments in Unconsolidated Affiliates

Tactical Survey Group, Inc. (TSG)

On February 23, 2004, the Company paid $1.0 million in cash to acquire an 11% interest in Tactical Survey Group, Inc. (TSG), a privately-held company that provides expertise in developing, deploying and integrating tactical survey systems for use in government and commercial applications. Pursuant to the provisions of APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock , this investment is accounted for under the equity method of accounting due to the presence of significant influence deemed to exist based on the significant number of contracts that the Company has entered into with TSG and the presence of a WFI employee on TSG s board of directors. The equity in earnings from this investment is classified within Other income (expense) in the Company s consolidated statements of operations. As of March 31, 2006, the Company has recorded zero equity earnings related to this investment. The balance of the Company s investment in TSG at December 31, 2005 and March 31, 2006 totaled $1.2 million and has been classified on the consolidated balance sheet under the caption Investments in unconsolidated affiliates.

CommVerge Solutions, Inc.

The Company has an investment in CommVerge Solutions, Inc., a privately-held wireless network planning and deployment company. The balance of the Company s investment in CommVerge Solutions, Inc. at December 31, 2005 and March 31, 2006 totals $0.9 million and has been classified on the consolidated balance sheet under the caption Investment in unconsolidated affiliates. One of the Company s directors is also a director of CommVerge Solutions, Inc.

(6) Acquisitions

TLA Associates

On January 27, 2005, the Company acquired all of the issued and outstanding shares of capital stock of JMA Associates, Inc d/b/a TLA Associates (TLA) for $37.3 million in cash. TLA provides services including network engineering, network infrastructure support, information assurance, application development, and managed services, including network maintenance and monitoring, to government agencies. The acquisition was a continuation of the Company s strategy to expand its government services business. The intangible assets consist of backlog of $1.3 million amortized over a 3 year period, customer relationships of $0.8 million amortized over a 10 year period and non-competion agreements executed by the sellers of TLA of $0.6 million amortized over a 3 year period.

The following table summarizes the changes in the carrying amounts of goodwill and other indefinite and finite-life intangible assets for the three months ended March 31, 2006, are as follows (in millions):

	Wireless Network Services	Enterprise Network Services	Government Network Services	Total
Goodwill				
Balance as of December 31, 2005	$ 25.5	$ 18.3	$ 76.1	$ 119.9
Acquisition				
Accrual for contingent consideration				
Adjustment				
Balance as of March 31, 2006	25.5	18.3	76.1	119.9
Other intangibles, net				
Balance as of December 31, 2005		1.1	6.3	7.4
Acquisition				
Amortization expense		(0.1)	(0.3)	(0.4)
Balance as of March 31, 2006		1.0	6.0	7.0
Total goodwill and other intangibles, net	$ 25.5	$ 19.3	$ 82.1	$ 126.9

(7) Contingent Acquisition Consideration

In connection with certain business acquisitions, the Company may agree to make additional future payments to sellers contingent upon achievement of specific performance-based milestones by the acquired entities. Pursuant to the provisions of SFAS No. 141, such amounts are accrued, and therefore, recorded by the Company when the contingency is resolved beyond a reasonable doubt and, hence, the additional consideration becomes payable. A summary of the contingent acquisition consideration as of December 31, 2005 and March 31, 2006 is summarized in the table below.

Summary of Contingent Acquisition Consideration

	Suntech	Enco	DSI	Total
Balance as of December 31, 2005	6.9	0.8	0.5	8.2
Accrual for contingent consideration	(0.1)	0.2	0.1	0.2
Payments	(6.8)		(0.5)	(7.3)
Balance as of March 31, 2006		1.0	0.1	1.1

Enterprise Network Services

During the quarter ended March 31, 2006, approximately $6.8 million was paid to certain shareholders of the companies acquired in ENS. This amount was accrued at December 31, 2005. The contingent acquisition accrual related to the Enterprise Network Services (ENS) acquisitions as of March 31, 2006 is $1.0 million. As of March 31, 2006, all earn-out performance periods have ended and there was no additional contingent consideration earned related to the ENS shareholders.

Defense Systems, Incorporated

In connection with the Company s acquisition of Defense Systems, Incorporated (DSI) in August 2004, additional consideration of up to $3.2 million can be earned by the former major stockholders of DSI over an 18 month period, based upon performance milestones related to certain specified contracts. As of March 31, 2006, approximately $2.8 million additional consideration has been earned related to the contract milestones achieved by DSI, of which $2.7 million has been paid and $0.1 million has been accrued as additional consideration based on the attainment of certain milestones as of March 31, 2006. The Company expects to pay this amount during the second quarter of 2006. As of March 31, 2006, the performance period has ended and no further contingent consideration can be earned.

(8) Credit Agreement

On March 16, 2005, the Company entered into a credit agreement with KeyBank National Association (KeyBank) to provide a $15.0 million senior credit facility. KeyBank is designated as the sole arranger and sole book manager. The facility has a 3-year term and can be expanded to a $60.0 million credit facility. The Company intends to use the facility for general corporate purposes and to fund future acquisitions. As of March 31, 2006, $7.0 million had been drawn to pay the contingent acquisition consideration payments due in the first quarter of 2006. Interest on amounts outstanding under the credit facility accrues at the applicable margin over LIBOR or KeyBank s Prime Rate as determined by the credit agreement, 6.16% at the most recent borrowing date of April 18, 2006.

(9) Segment Information

The Company organized its business along service lines to include three reportable segments: Wireless Network Services, Enterprise Network Services and Government Network Services. Revenues and operating income generated by the Company s reporting segments for the three months ended March 31, 2005 and 2006 are as follows (in millions).

	Three months ended March 31, 2005	Three months ended March 31, 2006
Revenues:		
Wireless Network Services	$ 53.7	$ 51.0
Enterprise Network Services	17.1	12.6
Government Network Services	19.9	20.3
Total revenues	$ 90.7	$ 83.9
Operating income (loss):		
Wireless Network Services	$ 1.6	$ (2.0)
Enterprise Network Services	0.7	(1.7)
Government Network Services	2.0	2.2
Total operating income (loss)	$ 4.3	$ (1.5)

Revenues derived by geographic region are as follows (in millions):

	Three months ended March 31, 2005	Three months ended March 31, 2006
Revenues:		
U.S.	$ 81.2	$ 76.3
Latin America	1.3	3.0
EMEA	8.2	4.6
Total revenues	$ 90.7	$ 83.9

The Company had sales to one customer, which comprised $26.1 million (31.1%) of the Company s total revenues for the quarter ended March 31, 2006. The Company had sales to one customer, which comprised $21.6 million (23.8%) of the Company s total revenues for the quarter ended March 31, 2005. Revenues for this customer are recorded in the wireless network services operating segment.

(10) Related Party Transactions

On May 30, 2002, the Company issued an aggregate of 90,000 shares of Series B Convertible Preferred Stock, at an aggregate purchase price of $45.0 million, in a private placement to entities affiliated with one of the directors of the Company (40,000 shares), to a brother of the Chairman and Chief Executive Officer of the Company (10,000 shares) and to an unrelated third-party investor (40,000 shares). The Company received $44.9 million of net proceeds. Each share of Series B Convertible Preferred Stock is initially convertible into 100 shares of Common Stock for a conversion price of $5.00 per share, which was the fair market value of the common stock at the closing, at the option of the holder at any time, subject to certain provisions in the Series B Preferred Stock Purchase Agreement. The Series B Preferred Stock Purchase Agreement had a lock-up provision, which has expired prior to March 5, 2004, on which date 40,000 shares of Series B Convertible Preferred Stock were converted into 4,000,000 shares of the Company s Common Stock.

Through March 31, 2006, the Company has received notices from the holders to convert an aggregate number of 64,517 shares of Series B Convertible Preferred Stock into an aggregate 6,451,700 shares of the Company s Common Stock. On March 31, 2006, the total liquidated preference equaled $12.7 million.

In 2003, in connection with two companies that the Company acquired in its ENS segment, the Company assumed certain facility lease obligations relating to facilities owned by the previous shareholders. The lease expense, which approximates $0.1 million for the quarters ended March 31, 2005 and 2006, is reflected in the statement of operations.

In connection with the Company s acquisition of TLA in January 2005, the Company assumed certain facility lease obligations relating to facilities by the previous shareholders. The lease expense, which approximates $0.1 million for the quarter ended March 31, 2006, is reflected in the statement of operations.

On March 28, 2005, the Company entered into Change in Control Agreements with the following employees: Deanna Lund, the Company s Senior Vice President and Chief Financial Officer and James R. Edwards, the Company s Senior Vice President and General Counsel. The Agreements provide that, among other things, upon a change of control each employee is entitled to (i) the immediate vesting of fifty percent (50%) of all stock options and stock appreciation rights granted to such employee as of the date of the change in control and (ii) the vesting of the remaining stock options and stock appreciation rights on the earlier of the one year anniversary date of the change of control or the resignation by such employee as a result of certain triggering events following the change in control. On March 28, 2006, these agreements were amended and restated to provide (i) a severance payment of two years of such employee s base salary plus the employee s maximum bonus amount for that period in the event of termination or resignation as a result of certain triggering events and (ii) a severance payment of one year of such employee s base salary in the event the employee is terminated without cause, plus a vesting of all unvested stock options and stock appreciation rights.

On February 17, 2006, the Company entered into a definitive agreement to divest all of its operations in Mexico for total approximate cash consideration of $18 million, with $1.5 million payable in cash on signing of the Equity Purchase Agreement and $16.5 million by means of a secured promissory note payable in installments through December 2006, subject to adjustment, which approximates the net book value of the operations. The purchaser, Sakoki LLC, is a newly-formed entity controlled by Massih Tayebi. Although Massih Tayebi has no current role with the Company, he was a co-founder of the Company, having served as Chief Executive Officer from inception in 1994 through September 2000 and as a director from inception through April 2002. In addition, Massih Tayebi owns or controls approximately 11% of the total voting power of the Company s capital stock. He is also the brother of Masood Tayebi, the Company s current Chairman of the Board of Directors. Masood Tayebi has no personal financial interest in the transaction and will have no role with the entity that has purchased the Mexico Operations. The transaction was approved by the disinterested members of the Company s Board of Directors after consideration of other expressions of interest and a valuation analysis by an independent audit firm.

The closing balance sheet as of February 17, 2006 resulted in net asset adjustments aggregating to a total approximate $19.0 million consideration, $1.5 million which was paid on February 17, 2006, with the remaining $17.5 million payable by means of the promissory note in installments through December 31, 2006. The note receivable is reflected on the Company s Consolidated Balance Sheet as of March 31, 2006. In April 2006, the Company presented the final net asset computation to the buyer, Sakoki, LLC, and the buyer is still in the review process of the computation, as provided in the Equity Purchase Agreement. The Company expects that the parties will reach final resolution of the net asset computation in the second quarter of 2006.

(11) Legal Matters

Beginning in July 2001, the Company and certain of its former officers and directors (the Individuals) were named as defendants in a series of class action shareholder complaints filed in the U.S. District Court for the Southern District of New York, now consolidated into a single amended complaint captioned In re Buy.com, Inc. Initial Public Offering Securities Litigation, Case No. 01-CV-6323. In the amended complaint, filed in April 2002, the plaintiffs allege that the Company, the Individuals, and the underwriters of the Company s initial public offering (IPO) violated section 11 of the Securities Act of 1933 and section 10(b) of the Exchange Act of 1934 based on allegations that the Company s registration statement and prospectus failed to disclose material facts regarding the compensation to be received by, and the stock allocation practices of, the IPO underwriters. The complaint also contains claims against the Individuals for control person liability under Securities Act section 15 and Exchange Act section 20. The plaintiffs sought unspecified monetary damages and other relief. Similar complaints were filed in the same Court against hundreds of other public companies (Issuers) and the underwriters (Underwriters) that conducted IPOs of the Issuers common stock in the late 1990s or in the year 2000 (the IPO Cases).

In August 2001, all of the IPO Cases were consolidated for pretrial purposes before United States Judge Shira Scheindlin of the Southern

District of New York. In July 2002, the Company joined in a global motion to dismiss the IPO Cases filed by all of the Issuers (among others). In October 2002, the Court entered an order dismissing the Individuals from the IPO Cases without prejudice, pursuant to an agreement tolling the statute of limitations with respect to the Individuals. In February 2003, the Court issued a decision denying the motion to dismiss the Securities Act section 11 and Exchange Act section 10(b) claims against the Company.

In June 2003, the Issuers reached a tentative settlement agreement with the plaintiffs that would result in, among other things, (a) the dismissal with prejudice of all claims in the IPO Cases against the Issuers and their officers and directors and (b) a guarantee from the insurers of the Issuers to the plaintiffs that, if the plaintiffs recover less than $1 billion from the Underwriters in the IPO Cases, the insurers would pay the difference between the actual recovery and $1 billion. In June 2004, the Company executed a final settlement agreement with the plaintiffs. On February 15, 2005, the Court issued a decision certifying a class action for settlement purposes, and granting preliminary approval of the settlement subject to modification of certain bar orders contemplated by the settlement. . On August 31, 2005, the Court reaffirmed class certification and preliminary approval of the modified settlement in a comprehensive Order. In addition, the Court approved the form of Notice to be sent to members of the settlement classes, which was published and mailed beginning November 15, 2005. On February 24, 2006, the Court dismissed litigation filed against certain underwriters in connection with the claims to be assigned to the plaintiffs under the settlement. The Court held a Final Settlement Fairness Hearing on the settlement on April 24, 2006. The final ruling is expected mid-2006. The Company does not expect the settlement to have a material impact on its operations or cash flow. In addition, the settlement is still subject to statutory notice requirements as well as final judicial approval.

In August 2004, as a result of the Company s announcement on August 4, 2004 that it intended to restate its financial statements for the fiscal years ended December 31, 2000, 2001, 2002 and 2003, the Company and certain of its current and former officers and directors were named as defendants (Defendants) in several securities class action lawsuits filed in the United States District Court for the Southern District of California. These actions were filed on behalf of those who purchased, or otherwise acquired, the Company s common stock between April 26, 2000 and August 4, 2004. The lawsuits generally allege that, during that time period, Defendants made false and misleading statements to the investing public about the Company s business and financial results, causing its stock to trade at artificially inflated levels. Based on these allegations, the lawsuits allege that Defendants violated the Securities Exchange Act of 1934, and the plaintiffs seek unspecified damages. These actions have been consolidated into a single action in *In re Wireless Facilities, Inc. Securities Litigation,* Master File No. 04CV1589-JAH. The plaintiffs filed their consolidated complaint in January 2005 and did not name the Company a defendant in that complaint. After the individual defendants filed their motion to dismiss, the plaintiffs requested leave to amend their complaint to add the Company as a defendant. Plaintiffs filed the First Amended Consolidated Class Action Complaint on April 1, 2005. Defendants filed their motion to dismiss this first amended complaint on April 14, 2005. The plaintiffs then requested leave to amend their first amended complaint. The plaintiffs filed their second amended complaint on June 9, 2005, this time on behalf of those who purchased, or otherwise acquired, the Company s common stock between May 5, 2003 and August 4, 2004. Defendants filed their motion to dismiss this second amended complaint on July 14, 2005. The motion to dismiss was taken under submission on October 20, 2005 and on March 8, 2006, the Court granted the Defendants motion. However, plaintiffs were granted the right to amend their complaint within 45 days and subsequently filed their Third Amended Consolidated Class Action Complaint on April 24, 2006. Under the current proposed briefing schedule, Defendants anticipate filing a motion to dismiss this complaint on or before June 8, 2006. Plaintiffs opposition would be due on or before July 12, 2006, and Defendants reply would be due on or before August 2, 2006. The hearing on the motion to dismiss would take place no less than two weeks after the reply brief is filed. The Company believes that the allegations lack merit and intends to vigorously defend all claims asserted. It is impossible at this time to assess whether or not the outcome of these proceedings will or will not have a material adverse effect on the Company. We have not recorded any accrual for a contingent liability associated with this legal proceeding based on the Company s belief that a liability, while possible, is not probable and any range of potential future charge cannot be reasonably estimated at this time.

Two derivative lawsuits have been filed in the United States District Court for the Southern District of California against certain of the Company s current and former officers and directors: *Pedicini v. Wireless Facilities, Inc.,* Case No. 04CV1663; and *Roth v. Wireless Facilities, Inc.,* Case No. 04CV1810. These actions have been consolidated into a single action in *In re Wireless Facilities, Inc. Derivative Litigation*, Lead Case No 04CV1663-JAH. The factual allegations in these lawsuits are substantially similar to those in the class action lawsuits, but the plaintiffs in these lawsuits assert claims for breach of fiduciary duty, gross mismanagement, abuse of control, waste of corporate assets, violation of Sarbanes Oxley Act section 304, unjust enrichment and insider trading. The plaintiffs in these lawsuits seek unspecified damages and equitable and/or injunctive relief. The lead plaintiff filed a consolidated complaint on March 21, 2005. On May 3, 2005, the defendants filed motions to dismiss this action, to stay this action pending the resolution of the consolidated non-derivative securities case pending in the Southern District of California, and to dismiss the complaint against certain non-California resident defendants. Pursuant to a request by the Court, Defendants motions have been withdrawn without prejudice. The parties have agreed that Defendants may refile their motions to dismiss, and to stay this action, after limited discovery is completed regarding the motion to dismiss the action against certain individual defendants based on lack of personal jurisdiction. This discovery is scheduled to be completed by June 14, 2006. Defendants motion to dismiss the complaint against the non-California resident defendants will be due on or before July 14, 2006. After the court rules on this jurisdictional motion, the parties will stipulate to a briefing schedule for the remaining motions to dismiss or to stay the action. The Company believes that the allegations lack merit and intends to vigorously defend all claims asserted. It is impossible at this time to assess whether or not the outcome of these proceedings will or will not have a material adverse effect on the Company. We have not recorded any accrual for a contingent liability associated with this legal proceeding based on the Company s belief that a liability, while possible, is not probable and any range of potential future charge cannot be reasonably estimated at this time.

In August and September 2004, two virtually identical derivative lawsuits were filed in California Superior Court for San Diego County against certain of the Company s current and former officers and directors. These actions contain factual allegations similar to those of the federal lawsuits, but the plaintiffs in these cases assert claims for violations of California s insider trading laws, breaches of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. The plaintiffs in these actions seek unspecified damages, equitable and/or injunctive relief and disgorgement of all profits, benefits and other compensation obtained by defendants. These lawsuits have been consolidated into one action and *In re Wireless Facilities, Inc. Derivative Litigation,* California Superior Court, San Diego County, Lead Case No. GIC 834253. The plaintiffs filed a Consolidated Shareholder Derivative Complaint on October 14, 2004. This action has been stayed pending a decision in federal court on a motion to dismiss the federal derivative lawsuits and there will be a hearing in October 2006 to evaluate the status of this case. The Company believes that the allegations lack merit and intends to vigorously defend all claims asserted. It is impossible at this time to assess whether or not the outcome of these proceedings will or will not have a material adverse effect on the Company. We have not recorded any accrual for a contingent liability associated with this legal proceeding based on the Company s belief that a liability, while possible, is not probable and any range of potential future charge cannot be reasonably estimated at this time.

On January 19, 2005, the Company and a selling shareholder in a Company subsidiary in the ENS division initiated an arbitration proceeding regarding the termination of employment of that individual from ENS. The amount in controversy was approximately $1.8 million. On April 20, 2005, the arbitrator, upon motion by the selling shareholder, permitted the arbitration proceeding to expand to allow the selling shareholder to seek early payment of the sums which may be due under the selling shareholder s earn-out agreement. In this arbitration proceeding, the selling shareholder was claiming he was entitled to approximately $5.0 million. The arbitration occurred in April 2006 and a decision was handed down on May 8, 2006, resulting in an award to the selling shareholder of $0.9 million, including contingent consideration, arbitration costs and attorney s fees. The Company has accrued approximately $0.9 million as of March 31, 2006 and, pursuant to the terms of the arbitration award, will pay the amount due during the second quarter of 2006. See Note 7 for discussion regarding contingent acquisition consideration.

In addition to the foregoing matters, from time to time, the Company may become involved in various lawsuits and legal proceedings that arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm the Company s business. The Company is currently not aware of any such legal proceedings or claims that we believe will have, individually or in the aggregate, a material adverse affect on our business, financial condition or operating results.

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

This report contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as may, will, should, expect, plan, anticipate, believe, estimate, potential or continue, the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. Factors that may cause our results to differ include, but are not limited to: changes in the scope or timing of our projects; changes or cutbacks in spending by the U.S. Department of Defense, which could cause delays or cancellations of key government contracts; slowdowns in telecommunications infrastructure spending in the United States and globally, which could delay network deployment and reduce demand for our services; the timing, rescheduling or cancellation of significant customer contracts and agreements, or consolidation by or the loss of key customers; failure to successfully consummate acquisitions or integrate acquired operations; the rate of adoption of telecom outsourcing by network carriers and equipment suppliers; the rate of growth of adoption of WLAN and wireless security systems by enterprises; and competition in the marketplace which could reduce revenues and profit margins.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, neither we, nor any other person, assume responsibility for the accuracy and completeness of the forward-looking statements. We are under no obligation to update any of the forward-looking statements after the filing of this Quarterly Report on Form 10-Q to conform such statements to actual results or to changes in our expectations.

The following discussion should be read in conjunction with our unaudited consolidated financial statements and the related notes and other financial information appearing elsewhere in this Form 10-Q. Readers are also urged to carefully review and consider the various disclosures made by us which attempt to advise interested parties of the factors which affect our business, including without limitation the disclosures made under the caption Management s Discussion and Analysis of Financial Condition and Results of Operations, under the caption Risks Related to Our Business, and the audited consolidated financial statements and related notes included in our Annual Report filed on Form 10-K, for the year ended December 31, 2005 and other reports and filings made with the Securities and Exchange Commission.

Overview

We are an independent provider of outsourced communications and security systems engineering and integration services for the wireless communications industry through our Wireless Network Services division (WNS), the U.S. government through our Government Network Services division (GNS), and enterprise customers through our Enterprise Network Services division (ENS). The principal services we provide include, but are not limited to, the design, deployment, integration, and the overall management of communications, information technology, and security networks. Our work for the wireless communications industry primarily involves radio frequency engineering, site development, project management and the installation of radio equipment networks. We also provide network management services, which involve day-to-day optimization and maintenance of wireless networks. Our work for the federal government primarily involves systems engineering, systems integration, and the outsourcing of technical services such as operational test and evaluation and program management. Our work for enterprise customers primarily involves the design, deployment and integration of security and other in-building systems including access control and intrusion detection and is focused on opportunities to integrate wireless technology into enterprise networks, especially physical and electronic security systems and voice and data networks.

In December 2005, our Board of Directors made the decision to exit our Mexican operations and certain of our other deployment businesses in South America. Prior to this decision, these operations had been reported in our Wireless Network Services segment. We determined that these operations meet the criteria to be classified s held for sale. Accordingly, we have reflected these operations as discontinued in accordance with SFAS No. 144, Accounting for the Impairment of Disposal of Long-Lived Assets. Our South American deployment operations were substantially shut down as of the end of 2005. Accordingly, all results for these operations for all periods presented have been reflected as discontinued operations. All operating results discussed in results of operations relate to our continuing operations.

On February 17, 2006, we entered into a definitive agreement to divest all of our operations in Mexico for total cash consideration, which approximates the net book value of the operations, including $13.2 million of liabilities associated with a loss contingency. The transaction closed on March 10, 2006. The transaction was structured as a sale of our subsidiaries in Mexico, and the purchase price consisted of $1.5 million in cash paid on February 17, 2006, plus a secured promissory note payable in installments through December 31, 2006. The note is secured by pledges of assets and a personal guaranty.

The closing balance sheet as of February 17, 2006 resulted in net asset adjustments aggregating to a total approximate $19.0 million consideration, $1.5 million of which was paid on February 17, 2006, with the remaining $17.5 million payable by means of the promissory note in installments through December 31, 2006. The note receivable is reflected on our Consolidated Balance Sheet as of March 31, 2006. In April 2006, we presented the final net asset computation to the buyer, Sakoki, LLC, and the buyer is still in the review process of the computation, as provided in the Equity Purchase Agreement. We expect that the parties will reach final resolution of the net asset computation in the second quarter of 2006.

The purchaser, Sakoki LLC, is a newly-formed entity controlled by Massih Tayebi. Although Massih Tayebi has no current role with us, he was one of our co-founders and served as our Chief Executive Officer from inception in 1994 through September 2000, and as a director from inception through April 2002. In addition, Massih Tayebi owns or controls approximately 11% of the total voting power of our capital stock. He is also the brother of Masood Tayebi, our Chairman of the Board of Directors. Masood Tayebi has no personal financial interest in the transaction and will have no role with the entity that is purchasing the Mexico operations.

Wireless Network Services contracts are primarily fixed price contracts whereby revenue is recognized using the percentage-of-completion method of accounting under the provisions of Statement of Position (SOP) 81-1, Accounting for Performance of Construction Type and Certain Production Type Contracts. For contracts offered on a time and expense basis, we recognize revenues as services are performed. We typically charge a fixed monthly fee for ongoing radio frequency optimization and network operations and maintenance services. With respect to these services, we recognize revenue as services are performed. Our Government Network Services business with the U.S. government and prime contractors is generally performed under cost reimbursable, fixed price or time and materials contracts. Cost reimbursable contracts for the government provide for reimbursement of costs plus the payment of a fee. Some cost-reimbursable contracts include incentive fees that are awarded based on performance on the contract. Under fixed-price contracts, we agree to perform certain work for a fixed price. Under time and materials contracts, we are reimbursed for labor hours at negotiated hourly billing rates and reimbursed for travel and other direct expenses at actual costs plus applied general and administrative expenses.

Cost of revenues includes direct compensation, living, travel and benefit expenses for project-related personnel, payments to third-party sub-contractors, project-related incentive compensation based upon the successful achievement of certain project performance goals, allocation of corporate overhead costs of expendable computer software and equipment, and other direct project-related expenses. Direct compensation and benefits are computed based on standard costs and actual hours billed. We review and adj