AETHER SYSTEMS INC
Form 10-Q
August 09, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the Period Ended June 30, 2004

Or

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

Commission File Number: 000-27707

AETHER SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**52-2186634**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
11500 Cronridge Dr., Suite 110, Owings Mills, MD	**21117**
(Address of principal executive offices)	(Zip Code)

(Registrant s telephone number, including area code): **(410) 654-6400**

Securities registered Pursuant to Section 12(b) of the Act: **NONE.**

Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, Par Value $.01
Convertible Subordinated Notes Due 2005

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 an accelerated filer (as defined in Rule 12b-2 of the Act) Yes ý No o

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date:

As of August 3, 2004, 43,826,836 shares of the Registrant s common stock, $.01 par value per share, were outstanding.

AETHER SYSTEMS, INC.

QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2004

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PART I FINANCIAL INFORMATION

ITEM I: FINANCIAL STATEMENTS

AETHER SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	June 30, 2004 (Unaudited)	December 31, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 252,562	$ 26,242
Trade accounts receivable, net	13,634	15,014
Inventory, net	12,058	10,162
Assets from discontinued operations		14,219
Net investment in sales-type leases (current)	3,068	2,636
Prepaid expenses and other current assets (current)	14,969	16,338
Total current assets	296,291	84,611
Restricted cash	11,490	13,460
Investments available for sale (non-current)		220,849
Property and equipment, net	7,439	9,335
Investments not readily available for sale	211	2,273
Goodwill	4,249	25,369
Intangibles, net	5,981	12,171
Net investment in sales-type leases (non-current)	8,651	8,765
Other assets (non-current), net	8,700	21,272
	$ 343,012	$ 398,105
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Convertible subordinated notes payable	$ 154,912	$
Accounts payable	137	388
Accrued expenses	11,223	12,220
Accrued employee compensation and benefits	2,203	2,796
Deferred revenue	14,528	15,373
Liabilities from discontinued operations		9,687
Restructuring reserve (current portion)	419	1,407
Accrued interest payable	2,529	2,529
Total current liabilities	185,951	44,400

Convertible subordinated notes payable				154,912
Deferred revenue (less current portion)		18,335		18,799
Restructuring reserve (less current portion)				70
Other long term liabilities		580		623
Total liabilities		204,866		218,804
Stockholders equity:				
Preferred stock, $0.01 par value; 1,000,000 shares authorized; 0 shares issued and outstanding at June 30, 2004 and December 31, 2003				
Common stock, $0.01 par value; 1,000,000,000 shares authorized; 43,821,481 and 42,918,408 shares issued and outstanding at June 30, 2004 and December 31, 2003, respectively		438		429
Additional paid-in capital		2,592,776		2,589,608
Accumulated deficit		(2,454,974)		(2,414,283)
Foreign currency translation adjustment		(56)		3,830
Unrealized gain on investments available for sale		(38)		(283)
Total stockholders equity		138,146		179,301
Commitments and contingencies				
Total liabilities and stockholders equity	$	343,012	$	398,105

See accompanying notes to Condensed Consolidated Financial Statements.

AETHER SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Subscriber revenue	$ 4,768	$ 7,267	$ 10,044	$ 14,578
Software and related services revenue	4,136	4,912	8,366	10,169
Device sales	3,517	2,286	6,480	4,573
Total revenue	12,421	14,465	24,890	29,320
Cost of subscriber revenue	1,772	3,183	3,777	6,632
Cost of software and related services revenue	1,228	1,059	2,390	2,240
Cost of device sales	3,846	2,088	7,373	4,824
Total cost of revenue	6,846	6,330	13,540	13,696
Gross profit	5,575	8,135	11,350	15,624
Operating expenses:				
Research and development (exclusive of option and warrant expense)	2,578	2,691	5,126	5,342
General and administrative (exclusive of option and warrant expense)	7,151	7,593	13,616	15,749
Selling and marketing (exclusive of option and warrant expense)	1,517	2,043	3,388	4,343
Depreciation and amortization	2,147	2,375	4,441	4,653
Option and warrant expense:				
Research and development	62	62	125	119
General and administrative	172	249	615	540
Selling and marketing	5	43	25	89
Impairment of intangibles and other long-lived assets	35,550	1,588	35,550	2,035
(Gain) loss on disposal of assets	(22)	843	(52)	838
Restructuring charge	275	59	774	163
Total operating expenses	49,435	17,546	63,608	33,871
Operating loss	(43,860)	(9,411)	(52,258)	(18,247)
Other income (expense):				
Interest income	1,534	1,813	3,210	4,154
Interest expense	(2,604)	(2,609)	(5,208)	(5,211)
Equity in losses of investments		(33)		(92)
Unrealized gains on future purchase commitments	866		866	
Investment gains (losses), including impairments, net	(5,528)	43	(4,971)	(124)
	(49,592)	(10,197)	(58,361)	(19,520)

Loss from continuing operations before discontinued operations								
Loss from discontinued operations				(4,520)				(7,637)
Gain (loss) on sale of discontinued operations		(245)				17,670		
Net loss	$	(49,837)	$	(14,717)	$	(40,691)	$	(27,157)
Other comprehensive income (loss):								
Foreign currency translation adjustment		(3)		(1,905)		(3,886)		(1,449)
Unrealized holding gains (losses) on investments available for sale		(424)		508		245		(294)
Comprehensive loss	$	(50,264)	$	(16,114)	$	(44,332)	$	(28,900)
Net loss per share (basic and diluted) from continuing operations before discontinued operations	$	(1.13)	$	(0.24)	$	(1.34)	$	(0.46)
Net loss per share (basic and diluted) from discontinued operations				(0.11)				(0.18)
Gain (loss) on sale of discontinued operations		(0.01)				0.41		
Net loss per share (basic and diluted)	$	(1.14)	$	(0.35)	$	(0.93)	$	(0.64)
Weighted average shares outstanding (basic and diluted)		43,802		42,538		43,538		42,406

See accompanying notes to Condensed Consolidated Financial Statements.

AETHER SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(DOLLARS IN THOUSANDS)
(unaudited)

	Six Months Ended June 30, 2004	Six Months Ended June 30, 2003
Cash flows from operating activities:		
Net loss from continuing operations	$ (58,361)	$ (19,520)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:		
Depreciation and amortization	4,441	4,653
Amortization of deferred financing fees	560	560
Provision for doubtful accounts	527	607
Provision for inventory obsolescence	57	
Depreciation on leased devices	765	356
Equity in losses of investments		92
Option and warrant expense	765	748
Impairment of intangibles and other long-lived assets	35,550	2,035
(Gain) loss on disposal of assets	(52)	838
Investment losses (gains), including impairments	4,971	124
Unrealized gains on future purchase commitments	(866)	
Changes in assets and liabilities:		
(Increase) decrease in trade accounts receivable	853	(4,598)
(Increase) decrease in inventory	(2,137)	4,259
(Increase) decrease in prepaid expenses and other assets	4,356	(5,004)
Increase in investment in sales-type leases	(317)	(1,980)
Decrease in accounts payable	(251)	(371)
Decrease in accrued expenses, accrued employee compensation and benefits and interest payable	(1,590)	(3,223)
Increase (decrease) in deferred revenue	(1,309)	6,500
Decrease in restructuring reserve and other long term liabilities	(1,105)	(5,307)
Net cash used in operating activities from continuing operations	(13,143)	(19,231)
Net cash provided by (used in) discontinued operations	481	(4,250)
Net cash used in operating activities	(12,662)	(23,481)
Cash flows from investing activities:		
Sales and maturities of investments available for sale	331,440	321,858
Purchases of investments available for sale	(114,686)	(256,363)
Proceeds from sale of EMS segment, net of transaction costs	16,249	
Purchases of property and equipment	(96)	(793)
Sales of property and equipment	13	4,412
Sales of long-term investments	2,163	340
Increase in intangible and other assets	(3)	(2,296)

Net cash provided by investing activities		235,080		67,158
Cash flows from financing activities:				
Decrease in restricted cash		1,970		6,923
Exercise of options and warrants		1,932		597
Net cash provided by financing activities		3,902		7,520
Net increase in cash and cash equivalents		226,320		51,197
Cash and cash equivalents, at beginning of period		26,242		56,227
Cash and cash equivalents, at end of period	$	252,562	$	107,424
Supplemental disclosure of cash flow information:				
Cash paid during the period for interest	$	4,647	$	4,647

Supplemental disclosure of non-cash investing and financing activities:

In January 2004, in connection with the sale of the Enterprise Mobility Solutions segment, the Company received common stock of TeleCommunication Systems, Inc. and a note receivable with an estimated fair value of $1.1 million and $1.0 million, respectively.

For the six months ended June 30, 2004 and 2003, the Company recorded unrealized holding gains and (losses) of approximately $245,000 and ($294,000), respectively, associated with its investments available for sale. These amounts have been reported through changes in stockholders equity.

During the six months ended June 30, 2004 and 2003, the Company transferred approximately $184,000 and $5.0 million, respectively, of equipment under an operating lease from inventory to property and equipment.

See accompanying notes to Condensed Consolidated Financial Statements.

AETHER SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE (1) ORGANIZATION, DESCRIPTION OF THE BUSINESS AND BASIS OF PRESENTATION

(a) ORGANIZATION AND DESCRIPTION OF THE BUSINESS

Aether Systems, Inc. (the Company or Aether) was originally formed in January 1996. The Company operates in two business segments: Mobile Government and Transportation. The Mobile Government segment provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations. The Transportation segment provides mobile and wireless solutions to the transportation industry. Its customers are primarily the owners and operators of truck and other vehicle fleets.

Effective January 2004, the Company sold the operations of its discontinued Enterprise Mobility Solutions (EMS) segment. The financial statements for all periods presented have been restated to present the results of operations of the Company s EMS segment as discontinued operations, as discussed in Note 3. The Company has a definitive agreement to sell its Transportation segment, as discussed in Note 4 below and is in negotiations to sell its Mobile Government segment. Each transaction will require stockholder approval. The Company will reflect the segments as discontinued in the period in which stockholder approval is obtained. Upon exiting the Transportation and Mobile Government businesses, management intends to focus the Company s cash resources on investments in residential mortgaged-backed securities, as discussed in Note 6 below.

If the sale of the Transportation segment is completed, the Company intends to offer to repay at par, together with accrued but unpaid interest through the date of repayment, up to 100% of its $154.9 million of outstanding 6% convertible subordinated notes due March 2005. Consistent with the terms of the notes, the Company will make this offer to each noteholder promptly after completion of the sale transaction, and each noteholder will have 45 days to accept or reject the offer. To the extent that some or all of the Company s noteholders accept this offer, the Company will use a portion of its available cash to repay those notes that are delivered for early repayment in connection with the offer. In the event the notes are retired early, the Company will write-off the portion of the unamortized deferred financing costs related to the notes that are retired, which could be up to $840,000 if all the notes are retired.

(b) BASIS OF PRESENTATION

The condensed Consolidated Financial Statements include the accounts of Aether Systems, Inc. and its subsidiaries. The Condensed Consolidated Balance Sheet as of June 30, 2004 and the condensed consolidated statements of operations and other comprehensive loss for the three and six months ended June 30, 2004 and 2003, and the condensed consolidated statements of cash flows for the six months ended June 30, 2004 and 2003, have been prepared by the Company, without audit. In the opinion of management, all adjustments have been made, which include normal recurring adjustments necessary to present fairly the Condensed Consolidated Financial Statements. Operating results for the three and six month periods ended June 30, 2004 are not necessarily indicative of the operating results for the full year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The Company believes that the disclosures provided are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

NOTE (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) INVESTMENTS AVAILABLE FOR SALE

Investments available for sale consisted of highly liquid investments in United States Government Agency-sponsored securities with original maturities of less than four years. As of December 31, 2003, investments available for sale totaling approximately $220.8 million had been classified as non-current assets. The Company carries such investments at fair value. Unrealized gains (losses) are excluded from earnings (loss) and are reported as a separate component of other comprehensive income (loss) until realized. Realized gains and losses from the sale of these investments are determined on a specific identification basis.

During the second quarter of 2004, as the potential for a sale of the Transportation segment became more certain, the Company anticipated that it would need to have a substantial amount of cash available in the late third quarter or early fourth quarter of this year to meet potential repurchase obligations on its outstanding 6% convertible subordinated notes due March 2005. In addition, as the Company began to implement its residential mortgage-backed securities strategy, it needed to have cash available to purchase mortgage-backed securities. In light of recent and anticipated future increases in interest rates, management decided that it would be prudent to liquidate its holdings of United States Government Agency-sponsored securities with an average maturity of just over two years during the second quarter. The market value of these securities had begun to decline in response to current and anticipated increases in interest rates, after an extended period of increasing market value in a declining interest rate environment. In view of management s expectations that the Company would need to have significant cash available in the near term and its belief, in light of market conditions and with the advice of the Company s outside financial advisors, management concluded that liquidating these investments sooner, rather than later, was likely to avoid the Company experiencing an additional loss as a result of further market value declines. The Company experienced a $5.5 million loss in liquidating these securities before their maturity.

(b) USE OF ESTIMATES

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Estimates are used in accounting for, among other things, long-term contracts, allowances for uncollectible receivables, inventory obsolescence, recoverability of goodwill, long-lived assets and investments, depreciation and amortization, employee benefits, restructuring accruals, taxes and contingencies. Estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary.

(c) ACCOUNTS RECEIVABLE

Accounts receivable consists of the following:

(IN THOUSANDS)		**June 30, 2004**		**December 31, 2003**
Billed	$	8,565	$	12,668
Unbilled		6,809		4,998
Allowance for doubtful accounts		(1,740)		(2,652)
Total Accounts Receivable	$	13,634	$	15,014

The Company believes all unbilled accounts receivable included above will be billed within the next twelve months. In addition, the Company has unbilled accounts receivable of approximately $593,000 as of June 30, 2004 relating to a long-term contract that will not be billed in the next twelve months and is included in other non-current assets.

(d) IMPAIRMENTS

Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values. Long-lived assets, such as property and equipment, and purchased intangibles subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

During 2003, the Company assessed the fair value of certain of its long-lived assets, including software, computer equipment, other tangible assets and identifiable intangible assets obtained in connection with acquisitions. This assessment resulted in impairment charges of $1.6 million and $2.0 million for the three and six months ended June 30, 2003, respectively. These charges are recorded in impairment of intangibles and other long-lived assets in the accompanying consolidated statements of operations. The Company, with the assistance of third party appraisers, determined the fair value of these assets based on a combination of quoted market prices and a cost approach methodology.

During the first quarter of 2004, the Company assessed the recoverability of the carrying amount of the assets of the Transportation and Mobile Government segments and, at that time, concluded there was no impairment.

In connection with the announced sale of our Transportation segment, the Company has recorded a non-cash impairment charge to reduce the carrying value of long-lived assets of the Transportation segment to the value implied by the negotiated sale price for that business. The charge was $26.6 million for the three and six months ended June 30, 2004. This amount has reduced the carrying value of certain long-lived assets, including goodwill, intangibles and deferred costs.

Additionally, with the potential future sale of the Mobile Government segment, the Company reassessed the value of the Mobile Government goodwill and recorded an $8.9 million non-cash impairment charge during the second quarter of 2004.

(IN THOUSANDS)		Transportation		Mobile Government		Total
Goodwill	$	12,191	$	8,928	$	21,119
Other intangible assets		3,138				3,138
Other assets		11,293				11,293
Total impairment charge	$	26,622	$	8,928	$	35,550

(e) STOCK OPTIONS AND WARRANTS

The Company accounts for equity-based employee compensation arrangements in accordance with the provisions of Accounting Principle Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees , and related interpretations including FIN 44. Under APB No. 25, compensation expense is based upon the difference, if any, on the date of grant, between the fair value of the Company s stock and the exercise price. All equity-based awards to non-employees are accounted for at their fair value in accordance with SFAS No. 123. SFAS No. 123 established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net loss if the fair-value-based method had been applied to all outstanding and unvested awards in each period:

(IN THOUSANDS, EXCEPT PER SHARE DATA)	Three Months Ended June 30,				Six Months Ended June 30,			
		2004		2003		2004		2003
Net loss from continuing operations, as reported	$	(49,592)	$	(10,197)	$	(58,361)	$	(19,520)
Add stock-based employee compensation expense included in reported net loss		239		354		765		748
Deduct total stock-based employee compensation expense determined under fair-value-based method for all awards		(713)		(4,265)		(1,506)		(8,014)
Pro forma net loss from continuing operations	$	(50,066)	$	(14,108)	$	(59,102)	$	(26,786)
Pro forma net loss from continuing operations per share	$	(1.14)	$	(0.33)	$	(1.36)	$	(0.63)

(f) EARNINGS PER SHARE

The Company computes net income (loss) per share in accordance with SFAS No. 128, Earnings Per Share, and SEC Staff Accounting Bulletin No. 98 (SAB 98). Under the provisions of SFAS No. 128 and SAB 98, basic net income (loss) per share is computed by dividing net income (loss) available to common stockholders for the period by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing the net income (loss) for the period by the weighted average number of common and dilutive common equivalent shares outstanding during the period. As the Company has had a net loss from continuing operations in each of the periods presented, basic and diluted net income (loss) per share are the same. As of June 30, 2004 and June 30, 2003, options and warrants to purchase 3.4 million and 5.9 million shares of the Company s common stock, have been excluded from the calculation of diluted net income (loss) per share because their inclusion would be anti-dilutive.

(g) GUARANTEES AND WARRANTY RESERVE

The Company has certain guarantees requiring disclosure under FASB Interpretation No. 45, Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others as follows:

The Company has guaranteed the payment of sublease rentals to our landlord on several properties the Company sublets. The maximum aggregate guarantee on these properties is $967,000.

In the Mobile Government segment, the Company may have to pay liquidated damages in some cases if the Company s sub-contractors do not perform on time. In addition, the Company sometimes indemnifies certain of its customers against damages, if any, they might incur as a result of a claim brought against them related to third party software imbedded in the Company s products. The Company is unable to estimate the maximum exposure of such indemnifications due to the inherent uncertainty and the varying nature of the contractual terms.

As of June 30, 2004, approximately $7.9 million of the Company s certificates of deposit were secured by an outstanding letter of credit established to secure the Mobile Government segment s contract with Hamilton County, Ohio. Additionally,

$2.0 million was in an escrow available to Lockheed Martin in the event of non-payment of liabilities for work performed by the Mobile Government segment on its Pennsylvania State Police contract. Both the letter of credit and the escrow have been included as restricted cash in the accompanying consolidated balance sheets.

In the Transportation segment, the Company has experienced warranty repair costs associated with its MobileMax product. The Company has reserved approximately $346,000 for these repairs.

The following table provides the changes in the Company s product warranties during the first and second quarter of 2004 and 2003:

(IN THOUSANDS)		2004		2003
Warranty liability balance at beginning of period	$	847	$	788
Liabilities accrued for warranties issued during the first quarter		58		634
Changes in liability for warranties during the first quarter, including claims paid and expirations		(58)		(134)
Warranty liability balance at end first quarter		847		1,288
Liabilities accrued for warranties issued during the second quarter		69		298
Changes in liability for warranties during the second quarter, including claims paid and expirations		(175)		(326)
Warranty liability balance at end second quarter	$	741	$	1,260

NOTE (3) SALE OF DISCONTINUED OPERATIONS

On January 13, 2004, Aether completed the sale of its EMS segment to TeleCommunication Systems, Inc. (TCS). Pursuant to the purchase agreement, as amended, Aether received $19 million for the EMS segment, consisting of $18 million in cash and a note in the principal amount of $1 million due in August 2004. Aether also received 204,020 shares of TCS Class A common stock valued as of closing at approximately $1.1 million. In April 2004 the Company sold these securities and received approximately $1.4 million in cash. The total consideration is subject to adjustment following a post closing review of the working capital of the EMS segment. The Company expects to complete the post closing review shortly and does not anticipate a material adjustment to the purchase price.

The following table provides the detail of the gain recognized on the sale of the EMS segment:

(IN THOUSANDS)		Three Months Ended June 30, 2004		Six Months Ended June 30, 2004
Proceeds	$		$	20,143
Expenses		(217)		(1,751)
Net assets		(28)		(722)
Gain on sale of EMS segment	$	(245)	$	17,670

The summary of 2003 operating results from discontinued operations is as follows:

(IN THOUSANDS)	Three Months Ended June 30, 2003	Six Months Ended June 30,

			2003
Net sales	$	13,292	$ 27,674
Restructuring charges		(2,320)	(2,741)
Net loss from discontinued operations	$	(4,520)	$ (7,637)

The Company did not allocate any interest income or expense to its segments.

The EMS segment generated approximately $260,000 and $416,000 of revenue from related parties for the three and six months ended June 30, 2003. The related parties consisted of companies in which Aether had made an equity investment.

Assets and liabilities of discontinued operations consisted of the following:

(IN THOUSANDS)		December 31, 2003
Cash and cash equivalents	$	1,882
Accounts receivable, net		7,947
Inventory, net		886
Property and equipment, net		1,652
Other assets		1,852
Assets from discontinued operations	$	14,219
Accounts payable and accrued expenses	$	6,756
Deferred revenue		2,914
Other liabilities		17
Liabilities of discontinued operations	$	9,687

NOTE (4) PROPOSED SALE OF TRANSPORTATION SEGMENT

On July 20, 2004, the Company announced that it has signed a definitive agreement to sell its Transportation segment to an affiliate of Platinum Equity Capital Partners L.P., Slingshot Acquisition Corporation (Slingshot) for $25.0 million in cash. Completion of the sale is subject to customary closing conditions, including the approval of Aether s stockholders. The purchase price is subject to a post-closing adjustment (up or down) to the extent the Transportation segment s net working capital (as defined in the asset purchase agreement) is less than approximately $27.6 million (in which case the price will be adjusted down) or greater than approximately $28.2 million (in which case the price will be adjusted up).

The transaction is structured as a sale of assets and assumption of certain liabilities. The assets being sold consist of all of the assets used primarily in the Transportation segment. Slingshot will assume responsibility for substantially all post-closing liabilities, and certain historical liabilities, of the Transportation segment, all as specified in the definitive asset purchase agreement. Slingshot and Aether also plan to enter into a transition services agreement to provide for the orderly transition of the business to Slingshot.

In connection with the announced sale of the Transportation segment, the Company has recorded a non-cash impairment charge in the second quarter of 2004 of $26.6 million, as discussed in Note 2(d) above.

After impairment, assets and liabilities of the Transportation segment as of June 30, 2004 consisted of the following:

(IN THOUSANDS)		**June 30, 2004**
Accounts receivable, net	$	4,705
Inventory, net		12,000
Property and equipment, net		5,223
Net investment in sales-type leases		11,719
Intangibles, net		3,945
Other assets		17,208
Total assets	$	54,800
Accounts payable and accrued expenses	$	4,677
Deferred revenue		27,199
Total liabilities	$	31,876

NOTE (5) RESTRUCTURING CHARGES

On January 1, 2003, the Company adopted SFAS No. 146, which requires that a liability for a cost associated with an exit or disposal activity be recognized when incurred at fair value. The Company recorded charges to earnings for the three and six months ended June 30, 2003 of approximately $59,000 and $163,000, respectively, related to workforce reductions. Employee separation benefits under the restructuring plan include severance, medical, and other benefits.

The Company recorded charges to earnings for the three and six months ended June 30, 2004 of approximately $275,000 and $774,000, respectively. Employee separation benefits of approximately $348,000 under the restructuring plan include severance, medical and other benefits. Facility closure and other costs of approximately $426,000 include expected losses on subleases, brokerage commissions, asset impairment charges, contract termination costs and other costs.

A rollforward of the restructuring accrual is as follows:

(IN THOUSANDS)	Employee Separation Benefits	Facility Closure Costs and Other	Total
2003 Restructuring:			
Restructuring liability as of December 31, 2002	$ 423	$ 32,029	$ 32,452
Charges	468	175	643
Adjustments		(271)	(271)
Net charge and adjustments to discontinued operations	967	4,818	5,785
Total restructuring charge for period ending December 31, 2003	$ 1,435	$ 4,722	$ 6,157
Cash payments	(1,458)	(35,674)	(37,132)
Restructuring liability as of December 31, 2003	$ 400	$ 1,077	$ 1,477
2004 Restructuring:			
Charges	$ 348	$ 426	$ 774
Cash payments	(739)	(1,093)	(1,832)
Restructuring liability as of June 30, 2004	$ 9	$ 410	$ 419

NOTE (6) RESIDENTIAL MORTGAGE-BACKED SECURITIES (RMBS) STRATEGY

The main focus of the Company s future strategy will be the management of a leveraged portfolio of residential mortgage-backed securities. During the second quarter of 2004, the Company took its first steps toward implementing this strategy. In late June 2004, the Company purchased six forward option contracts representing commitments to make future purchases of mortgage-backed securities with a face value of $264.3 million. These securities were intended to settle in August and September of 2004, for $266.4 million, which represents a premium of $2.1 million at the time of settlement.

During July 2004, the purchase commitments increased in value and the Company sold its position and realized a cash gain of approximately $1.8 million. As of June 30, 2004, the Company s purchase commitments had an unrealized gain of $866,000. As of June 30, 2004, the Company recorded the $866,000 increase in market value as an asset in Prepaid and Other Current Assets in the condensed consolidated balance sheet and Unrealized Gain on Future Purchase Commitments in the condensed consolidated statement of operations. The additional gain of approximately $1 million will be recorded in the third quarter of 2004.

In the future, the Company expects to enter into similar purchase commitments. At the time of entering into these commitments, management will designate these as derivatives and account for them as cash flow hedges in accordance with the requirements of FAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended. This accounting should enable the Company to defer recognition in the statement of operations of gains and losses on the commitments until the securities are sold or otherwise liquidated.

NOTE (7) RELATED PARTY TRANSACTIONS

The Company receives benefit coordination services from Huber Oros, which is considered a related party because an owner of Huber Oros is related to a member of the Company s senior management. For the three and six months ended June 30, 2004, the Company recorded expenses related to Huber Oros of approximately $31,000 and $69,000, respectively. For the three and six months ended June 30, 2003, the Company recorded expenses related to Huber Oros of approximately $27,000 and $57,000, respectively. As of June 30, 2004 and December 31, 2003 there were no outstanding payables due to Huber Oros.

The Company also receives legal services from Kirkland & Ellis LLP, which is considered a related party because a partner at that firm is a member of the Company s Board of Directors. For the three and six months ended June 30, 2004, the Company recorded expenses related to Kirkland & Ellis LLP of approximately $371,000 and $945,000, respectively. We first retained Kirkland & Ellis LLP during the first half of 2003, and during that period, expenses related to Kirkland & Ellis LLP were approximately $50,000. As of June 30, 2004 and December 31, 2003, the Company had outstanding payables of approximately $329,000 and $805,000, respectively, due to Kirkland & Ellis LLP.

NOTE (8) LEGAL PROCEEDINGS

Aether is among the hundreds of defendants that are named in the putative class action lawsuits filed in the United States District Court for the Southern District of New York relating to allegedly fraudulent initial public offering practices, which are being coordinated before Judge Shira A. Scheindlin under the caption In Re Initial Public Offering Securities Litigation, 21 MC 92 (S.D.N.Y.) (SAS). The court has consolidated the actions by issuer, and, accordingly, there are approximately 310 consolidated actions before Judge Scheindlin, including the consolidated action against Aether.

These actions were filed on behalf of persons and entities that acquired Aether common stock after the initial public offering on October 20, 1999. Among other things, the complaints claim that prospectuses, dated October 20, 1999, March 17, 2000, and September 27, 2000 and issued by Aether in connection with the public offerings of common stock, allegedly contained untrue statements of material fact or omissions of material fact in violation of securities laws because, inter alia, the prospectuses allegedly failed to disclose that the offerings underwriters had solicited and received additional and excessive fees, commissions and benefits beyond those listed in the arrangements with certain of their customers which were designed to maintain, distort and/or inflate the market price of the Company s common stock in the aftermarket. The actions seek unspecified monetary damages and rescission. Aether believes the claims are without merit and is vigorously contesting these actions.

Initial motions to dismiss the case were filed and the court held oral argument on the motions to dismiss on November 1, 2002. On February 19, 2003, the court issued an Opinion and Order on defendants motions to dismiss, which granted the motions in part and denied the motions in part. As to Aether Systems, the motion to dismiss the claims against it was denied in its entirety. Discovery is now commencing against the underwriter defendants. The plaintiffs voluntarily dismissed without prejudice the officer and director defendants of Aether. On June 26, 2003, the Plaintiffs Executive Committee in this case announced a proposed settlement with the issuers. The proposed settlement provides that the cases against the more than 300 issuers who had IPO s between 1998 and 2000 will end. Aether has agreed to support the settlement. Under the terms of the proposed settlement, Aether would not incur any material financial or other liability. The proposed settlement would not involve the cases against the 55 investment bank underwriter defendants, which would continue.

On June 14, 2004, the plaintiffs and issuer defendants presented the executed settlement agreement to Judge Scheindlin during a court conference. Subsequently, plaintiffs made a motion for preliminary approval of the settlement agreement. On July 14, 2004, the underwriter defendants filed a memorandum of law in opposition to plaintiffs motion for preliminary approval of the settlement agreement. Reply briefs are due to be filed on August 4, 2004. The settlement agreement is subject to the approval of the district court.

Aether is also a party to other legal proceedings in the normal course of business. Based on our evaluation of these matters and discussions with counsel, the Company believes that liabilities arising from these matters will not have a material adverse effect on the consolidated results of its operations or financial position.

NOTE (9) SEGMENT INFORMATION

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* established standards for reporting information about the operating segments in interim and annual financial reports issued to stockholders. It also established standards for related disclosures about products and services and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and assess performance. The Company s chief operating decision-making group is Executive Management, which comprises the Chief Executive Officer and the senior vice presidents of the Company. The operating segments are managed separately because each operating segment represents a strategic business unit that offers distinct services.

The Company s business consists of two operating segments: Transportation and Mobile Government.

Transportation

The Transportation segment provides mobile and wireless solutions to the transportation and fleet management industries. The Company s customers are primarily the owners and operators of truck and other vehicle fleets, including US Xpress Enterprises, Inc., TRL Inc. and Contract Freighters, Inc. The Company s products offer wireless data and asset tracking and vehicle positioning features. The Company s customers use these products to monitor the location, movement and status of their vehicles. The Company s products enable their customers to reduce trailer to tractor ratios and improve their operational efficiency.

Mobile Government

In the Mobile Government segment, the Company provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations. The Company s public safety solutions are integrated into 50 different state databases, as well as local and federal databases. The Company s products deliver real-time information in seconds, without the need for human dispatchers or other resources.

(IN THOUSANDS) Three Months Ended June 30, 2003	Mobile Government	Transportation	Corporate & Other	Total
Revenue	$ 5,263	$ 9,202	$	$ 14,465
Gross profit	4,042	4,093		8,135
Depreciation and amortization	755	802	818	2,375
Net income (loss) from continuing operations	$ 116	$ (1,829)	$ (8,484)	$ (10,197)

(IN THOUSANDS) Three Months Ended June 30, 2004	Mobile Government	Transportation	Corporate & Other	Total
Revenue	$ 4,692	$ 7,729	$	$ 12,421
Gross profit	2,953	2,622		5,575
Depreciation and amortization	693	979	475	2,147
Net loss from continuing operations	$ (9,915)	$ (29,114)	$ (10,563)	$ (49,592)

(IN THOUSANDS) Six Months Ended June 30, 2003	Mobile Government	Transportation	Corporate & Other	Total
Revenue	$ 10,794	$ 18,526	$	$ 29,320
Gross profit	8,146	7,478		15,624
Depreciation and amortization	1,514	1,487	1,652	4,653
Net income (loss) from continuing operations	$ 454	$ (4,182)	$ (15,792)	$ (19,520)
Total assets from continuing operations	$ 29,500	$ 82,500	$ 309,811	$ 421,811

(IN THOUSANDS) Six Months Ended June 30, 2004	Mobile Government	Transportation	Corporate & Other	Total
Revenue	$ 9,454	$ 15,436	$	$ 24,890
Gross profit	6,064	5,286		11,350
Depreciation and amortization	1,380	1,958	1,103	4,441
Net loss from continuing operations	$ (10,639)	$ (31,745)	$ (15,977)	$ (58,361)
Total assets from continuing operations	$ 16,904	$ 54,800	$ 271,308	$ 343,012

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following description of our financial condition and results of operations in conjunction with our Consolidated Financial Statements and Notes thereto included in Item 1 of Part I of this Quarterly Report on Form 10-Q, as well as the Audited Financial Statements and Notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 2003 contained in our 2003 Annual Report on Form 10-K.

INTRODUCTION

Anticipated Effects of Strategic Decisions on Our Company

As a result of our strategic evaluation process (and consistent with our previously reported expectations), we expect that our business and our financial results will change significantly during the second half of this year.

On July 20, 2004, we signed a definitive agreement to sell our Transportation segment to an affiliate of Platinum Equity Capital Partners L.P., for $25 million in cash. The purchase price is subject to a post-closing adjustment (up or down) to the extent the Transportation segment s net working capital (as defined in the asset purchase agreement) is less than $27.6 million (in which case the price will be adjusted down) or greater than $28.2 million (in which case the price will be adjusted up). The sale is subject to various closing conditions, including the approval of our stockholders. For additional information on this pending sale, see Note 4 of the notes to our Consolidated Financial Statements included in Item 1 of Part I of this Quarterly Report.

When we announced this transaction on July 21, 2004, we also announced our intention to complete a transformation of our Company by pursuing two additional strategic activities:

actively pursuing a sale of our Mobile Government business, and

expanding our activities in managing a leveraged portfolio of mortgage-backed securities so that it will become the focus of our ongoing business.

These actions and decisions reflect the culmination of our detailed strategic review process. As we have stated consistently in the past, in evaluating strategic options we have been pursuing two basic objectives:

become profitable as quickly as possible, and enhance the value of our assets for our stockholders.

We believe that the sale of our existing businesses and a focus on building and managing a leveraged portfolio of mortgage-backed securities are consistent with these objectives. Our existing businesses have not generated a profit and will require significant ongoing investment if they are to remain competitive and have the opportunity to achieve profitability (taking into account the corporate overhead expenses we incur to comply with our various obligations as a publicly traded company). Although we considered potential acquisitions and other strategic initiatives to seek to enhance these businesses, we ultimately concluded that their sale was most consistent with our stated key objectives and in the best interests of our stockholders.

As previously reported, in January 2004, we sold our Enterprise Mobility Solutions segment, which had been our largest business segment.

For a discussion of the leveraged mortgage-backed securities business, including a discussion of risks and uncertainties relevant to that business, see the Current Report on Form 8-K that we filed with the SEC on June 10, 2004. See also Note 6 of the notes to our Consolidated Financial Statements included in Item 1 of Part I of this Quarterly Report for a discussion of our initial activities in the mortgage-backed securities business.

These strategic decisions have had and are expected to have several notable effects on our reported financial results and financial condition:

In the second quarter of this year, we recorded a $26.6 million non-cash charge ($0.61 per share) to reflect a write-down of the fair value of the goodwill and long-lived assets on our balance sheet that are related to the Transportation segment. This write-down reduces the value of the net assets to an amount that is consistent with the negotiated $25 million purchase price for the Transportation segment.

When we receive stockholder approval of the sale of the Transportation segment, we will reclassify the results of the Transportation segment to discontinued operations. The Transportation segment accounts for a substantial majority of our operating revenues and expenses. Consequently, when the results of that segment are reclassified as discontinued operations, the operating revenues and expenses of our continuing operations will be significantly lower than they have been in the past. As required by Generally Accepted Accounting Principles, we also will restate prior periods to reflect the reclassification of the Transportation segment to discontinued operations so that period-to-period results will be comparable.

If we reach a definitive agreement to sell the Mobile Government segment, and we receive stockholder approval for such a sale, we also will reclassify the results of that business segment to discontinued operations. In addition, we will restate prior period results to reflect this additional reclassification. In this event, our operating revenues and expenses will reflect solely the results of our mortgage-backed securities business and the costs of running our business as a publicly traded company.

As the result of our plan to sell our Mobile Government segment, we reevaluated the carrying value of our Mobile Government goodwill and recorded a $8.9 million non-cash charge ($0.20 per share) in the second quarter of 2004.

As our business transitions from its current mobile and wireless data business activities to the management of a leveraged portfolio of residential mortgage-backed securities, our financial statements will change significantly. We will no longer have revenue, cost of revenue or gross profit to report. We are also likely to cease reporting research and development and selling and marketing expenses. Our future income statement under the residential mortgage-backed securities strategy will focus primarily on interest income and expense, realized and unrealized gains on transactions and general and administrative expenses. Our future balance sheet will be primarily comprised of cash, investments, repurchase liabilities (from reverse repurchase agreements which will be utilized to leverage our mortgage-backed securities portfolio), interest receivable and payable and other assets and liabilities. We expect that substantially all of our available cash will be invested in residential mortgage-backed securities, and that we will use leverage, through short-term reverse repurchase agreements, to purchase additional residential mortgage-backed securities. The reverse repurchase agreements will be collateralized by the mortgage-backed securities that we purchase, and we expect that once we have fully implemented our mortgage-backed securities strategy, we will leverage our cash investment between five and eight times.

As we have announced, if we complete the sale of the Transportation segment, we intend to offer to repay at par, together with accrued but unpaid interest through the date of repayment, up to 100% of our $154.9 million of outstanding 6% convertible subordinated notes due March 2005. Consistent with the terms of these notes, we will make this offer to noteholders promptly after completion of the sale transaction, and each noteholder will have 45 days to accept or reject the offer. To the extent that some or all of our noteholders accept this offer, we will use a portion of our available cash to repay those notes that are delivered to us for early repayment in connection with the offer. To the extent we repay notes early, the amount of our outstanding indebtedness will decline and we will cease to accrue interest on repaid notes. Notes that are not repaid will remain outstanding and due at maturity in March 2005, in accordance with their existing terms. Under the terms of these notes, we also have the right to redeem all or a portion of the notes at any time at a price of 101.2% of face value, plus accrued interest to the date of redemption. We are required to provide notice to the noteholders of any decision to redeem the notes. In the event the notes are retired early, we will write-off the portion of the unamortized deferred financing costs related to the notes that are retired, which could be up to $840,000 if all the notes are retired.

If we are able to sell our Transportation and Mobile Government segments, we expect that we will reduce our corporate overhead and staffing significantly, to a level consistent with the needs of our ongoing business operations (the residential mortgage-backed securities strategy). In this event, we would expect to eliminate research and development and sales and marketing expenditures. We also would expect a reduction in general and administrative expenses, although we will still incur costs required of a public company, including insurance, audit and other outside professional services, compliance and various regulatory fees. As the Company continues to implement its residential mortgage-backed securities strategy, it will rely on its investment advisor to recommend investments and funding and risk management strategies based upon its analysis of market conditions. Additionally, the Company has engaged an independent third-party oversight advisor to assist it in evaluating the appropriateness of our investment advisor s strategy recommendations and in monitoring the investment advisor s adherence to pre-established investment strategy guidelines.

An important aspect of our ongoing strategy will be our ability to realize value, in the form of tax savings, from our accumulated net losses. Under federal and state tax laws, we are permitted to use these losses to reduce the income taxes we otherwise would have to pay on future taxable income. As a result, we could have little or no income tax liability for a period of time. As of June 30, 2004, we have accumulated federal net operating losses totaling approximately $760.7 million that we can carry forward as potential tax deductions until they expire between 2012 and 2023. In addition, we have incurred capital losses of approximately $193.4 million that we can carry forward as potential tax deductions (but only against capital gains) until they expire between 2006 and 2008. We will only be able to realize value from the accumulated losses if we become profitable. In addition, our ability to realize value from these accumulated losses also is subject to various risks and uncertainties, including regulations that may limit our ability to use these net losses under certain circumstances to reduce future taxes that we might otherwise owe. For a discussion of these risks and uncertainties, as well as other important considerations relevant to our current and expected business activities, see the discussion under the heading Risk Factors below.

Risk Factors

Our current activities are subject to various important risks and uncertainties, including the following:

We may not be able to complete the sale of the Transportation segment on the announced terms or at all, and in such event we might continue to operate this business.

Under the terms of the asset purchase agreement for the sale of the Transportation segment, we may receive less than $25 million (as a result of our obligations under the post-closing net working capital adjustment provisions and our indemnity obligations). In addition, we will be subject to contingent liabilities that could result in future costs relating to the sold business.

We may not be able to sell the Mobile Government segment on terms that are acceptable to us, which would require us to consider other alternatives for that business. One alternative would be continuing to operate this business.

We have only recently begun our mortgage-backed securities activities, and there is no assurance that we will be able to manage this new business successfully or realize our objectives.

If we do not sell one or both of our existing wireless and mobile data businesses, we may have to make additional changes to our planned business strategy, such as reducing the expected scope of our mortgage-backed securities activities, or pursuing other or additional strategic alternatives.

Our existing business activities and our planned strategic activities are subject to additional risks and uncertainties that are discussed under the heading Risk Factors in Part II of our 2003 Annual Report on Form 10-K. In addition, our new mortgage-backed securities activities are subject to numerous risks and uncertainties that are discussed under the heading Risk Factors in the Current Report on Form 8-K that we filed with the SEC on June 10, 2004. We also have set out below several additional tax and regulatory risks, uncertainties and other considerations that we believe would be relevant if we complete the planned transformation of our business to focus our activities on building and managing a leveraged portfolio of mortgage-backed securities. We encourage you to carefully review all of these risk factors and considerations. If any of them actually occur, our business, financial condition or results of operations could be materially adversely affected.

If building and managing a leveraged portfolio of mortgage-backed securities becomes our primary business activity, we may be subject to the following additional tax and regulatory risks and considerations:

The Internal Revenue Service may seek to impose the accumulated earnings tax on some or all of the taxable income we retain.

As a component of our mortgage-backed securities investment strategy, we may find it necessary to retain all or a substantial portion of future earnings to finance the development and growth of our business at least for several years. Among other things, if the size of our mortgage-backed securities business grows significantly over time, we may seek to add to our employee base so that our staff will have additional industry-specific capabilities and expertise to help manage our portfolio. In this event, we likely would reduce our reliance on outside professionals for such advice and assistance. In addition, we may expand our corporate staff over time to enhance other corporate functions, such as financial, legal and other administrative and compliance activities, to the extent our business grows and makes such additions cost-effective. As a result, we may not declare or pay any significant dividends on shares of our common stock for an extended period to conserve cash for our business needs. If the IRS were to believe we were accumulating earnings beyond our reasonable business needs, the IRS could seek to impose an accumulated earnings tax, or AET, of 15% on our accumulated taxable income. We do not believe that we will be subject to the AET due to various reasons, including the existence of our large deficit in accumulated earnings and profits. However, the IRS may disagree with us on this point, and the IRS may attempt to impose the AET on all or a portion of our taxable income. In such event, we would expect to challenge any attempt by the IRS to impose the AET on our business, but the outcome of such a challenge is uncertain.

If we were to distribute our accumulated taxable income for each year to our stockholders as dividends, we would not be subject to the AET for the amounts so distributed, but would only be subject to the AET for the amounts of earnings retained. If we were to pay dividends to stockholders, these dividends would, generally speaking, be eligible to be treated as qualified dividends for federal income tax purposes, taxed at a maximum federal rate of 15%, assuming that the recipient stockholder meets the various requirements under the Internal Revenue Code for such treatment. The maximum rate for qualified dividends is currently projected to increase to the maximum federal income tax rate applicable to ordinary income (currently at 35%) for tax years beginning after December 31, 2008 in accordance with the Jobs and Growth Tax Relief Reconciliation Act of 2003.

We expect to be subject to the alternative minimum tax, and our net loss carryforwards would not offset that tax in its entirety.

We do not plan to seek to qualify as a real estate investment trust. We will continue to be subject to federal income tax, but as a result of our capital loss carryforwards and net operating loss carryforwards, we do not anticipate having any regular federal income tax obligation for the current fiscal year as well as for several years into the future. We expect to incur alternative minimum tax obligations under our planned new business strategy because of the provisions of the alternative minimum tax that allow only 90% of our alternative minimum taxable income to be offset by alternative tax net operating loss carryforwards. These provisions would result, in effect, in 10% of our alternative minimum taxable income being subject to the 20% alternative minimum tax assessed on corporations. This amounts to a 2% effective tax rate on our alternative minimum taxable income.

If we were required to register as an investment company under the Investment Company Act of 1940, our business strategy would be materially and adversely affected.

If we are successful in selling the Transportation segment, and if we become primarily engaged in building and managing a leveraged portfolio of mortgage-backed securities, we expect to rely on an exemption from the Investment Company Act of 1940 for companies that are engaged primarily in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate. Under the current interpretation of the staff of the SEC, in order to meet the criteria for this exemption, we plan to maintain at least 55% of our assets in qualifying real estate interests, such as whole pool mortgage interests issued by Federal Home Loan Mortgage Corporation, Federal National Mortgage Association or Government National Mortgage Association, and at least 25% of our assets in other real estate related assets, such as non-whole pool mortgage-backed securities. This 25% minimum is reduced to the extent we invest more than 55% of our assets in qualifying real estate interests. These requirements may limit our ability to purchase certain types of mortgage-backed securities that might otherwise be attractive and these restrictions could result in a lower level of income from our portfolio. Changes in the Investment Company Act or the rules thereunder, or in the SEC staff s interpretation of the statute and rules, could force us to sell a substantial portion of our portfolio under potentially adverse market conditions. Were we to fail to qualify for this exemption from registration under the Investment Company Act of 1940, or if we were for any other reason required to register as an investment company, our ability to use leverage would be reduced substantially and we would not be able to pursue our mortgage-backed securities strategy as discussed herein.

Results of Continuing Operations. In reviewing the discussion and analysis of the results of our continuing operations that follows, you should consider the following:

Our revenue comes from three sources: (1) payments from our subscribers for the wireless services we provide; (2) payments for licensing or selling software to our customers that they need to use our services, together with related payments for maintenance, support, training, and consulting services; and (3) payments for hardware needed to use our services, which we sell or lease to our customers.

To generate that revenue, we incur various direct costs, which we report as our cost of revenue. These costs include primarily (1) the amounts we pay to purchase airtime, software, and hardware that we resell, license, or lease to our customers; and (2) certain personnel expenses for employees who provide specific services to our customers or develop products that we sell or license (such as engineers). We exclude certain costs of customer fulfillment and customer care from our cost of revenue and report these costs as operating expenses. Our gross profit is the difference between our revenue and the cost of our revenue. Our gross margin is the percentage of our revenue that is left as gross profit, after deducting the cost of our revenue.

The other costs of operating our businesses are our operating and our non-operating expenses. Most of these expenses require us to spend cash to pay them. These include salaries, bonuses and benefits for our employees, rental payments for our offices, legal, accounting and other professional fees and expenses, and other similar costs required in operating our businesses.

We also report our non-operating income. Historically, this is interest income from our cash balances and our investments in United States Government Agency-sponsored securities. However, during the second quarter of 2004 we liquidated our investment in these securities. See Note 2(a) of the notes to our Consolidated Financial Statements included in Item 1 of Part I of this Quarterly Report.

Our critical accounting policies affect the amount of revenue and expense we record in each period. In applying these critical accounting policies to the results of our business operations, we must make judgments that, if made differently, would have a positive or negative effect on our financial results. We believe that our judgments are both reasonable and appropriate, in light of the relevant accounting rules.

As a result of acquisitions, dispositions and restructuring activities, our business has changed significantly from year to year. In addition, in certain periods we have been required to take significant charges to reflect declines in the value of our investments in other businesses and the value of some of our business assets. As a result, our financial results have changed significantly from one year to the next and can sometimes be difficult to compare.

As was the case in the latter part of 2003 and the first half of 2004, the strategic evaluation process and the uncertainty about our future direction has negatively affected the operating results of our existing businesses in the near term. We expect that the results of our two mobile and wireless data businesses will continue to be negatively affected while the sale processes remain pending. In addition, we will continue to incur additional expenses for the fees of our professional advisers, including our financial advisor and our legal counsel, while these sale processes continue.

Financial Condition. In reviewing the discussion and analysis of the financial condition of our continuing operations that follows, you should consider the following:

Our business has never generated an operating profit. Consequently, we have required funding from sources other than our business operations to run our business. This funding has come principally from selling securities. In October 1999, we completed our initial public offering, in which we sold stock and received net proceeds for us of $101.1 million (after paying underwriting discounts, commissions and other expenses of the offering). In March 2000, we completed an additional sale of our stock that generated net proceeds for us of approximately $1.06 billion. In 2001, we sold $310.5 million of 6% convertible subordinated notes due March 2005 and received net proceeds of $300.6 million. We have not borrowed money from banks, and we currently do not have any agreements with banks that would allow us to borrow money.

In 2000, 2001 and 2002, we used cash from our sales of stock and our convertible subordinated notes, and we also issued additional shares of stock, to pay for the purchase of assets and businesses that allowed us to significantly expand the products and the services we offered in all of our segments. We also used cash to fund our operating losses and to repurchase approximately 50% of the convertible subordinated notes at a discount during 2001 and 2002.

We now have cash balances of approximately $252.8 million (excluding restricted cash), and we have $154.9 million of outstanding convertible subordinated notes, which we will be required to repay on March 22, 2005 (unless we repay them earlier, as discussed above). We also have various other obligations that we are required to pay over time under various contracts and agreements, as discussed in more detail below.

As discussed above, since our inception in 1996, we have accumulated substantial net operating losses that would be a valuable asset if we become profitable in the future and start to generate income that would be subject to income tax.

CRITICAL ACCOUNTING POLICIES

As we begin to execute our strategy to invest in residential mortgaged-backed securities (RMBS) our critical accounting policies will change. In particular, we expect to become party to derivative instruments to hedge our exposure to changes in variable interest rates as well as hedges to manage our cash flow risk with respect to the purchase of various RMBS pools.

Our hedging activities will be accounted for in accordance with FAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended, which requires that all derivatives are recognized as either assets or liabilities and measured at fair value in the statement of financial position. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment (fair value hedge), or (b) a hedge of the exposure to variable cash flows of a forecasted transaction (cash flow hedge).

The accounting for changes in the fair value of a derivative depends on the intended use of the derivative and the resulting designation. For a fair value hedge , the gain or loss is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributable to the risk being hedged. The effect of that accounting is to reflect in earnings the extent to which the hedge is not effective in achieving offsetting changes in fair value. For a cash flow hedge , the effective portion of the derivative s gain or loss is initially reported as a component of other comprehensive income and subsequently reclassified into earnings when the forecasted transaction affects earnings. The ineffective portion of the gain or loss is reported in earnings immediately.

Our RMBS investments will likely be treated as available-for-sale and carried at fair market value. Gains and losses will not be realized through our statements of operations until such time that securities are sold, unless a loss on a security is deemed to be other than temporary, in which case it will be recognized in the statement of operations immediately. RMBS purchases will generally result in premiums or discounts, which we will amortize through interest income using the interest method over the expected life of the securities, in accordance with FAS 91 Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Lease.

For a discussion of all other critical accounting policies please see our 2003 Annual Report on Form 10-K.

COMPARISON OF RESULTS FOR THREE AND SIX MONTHS ENDED JUNE 30, 2004 AND 2003

RESULTS OF CONTINUING OPERATIONS

In this section, when we discuss the results of our operations, we will be talking about our Mobile Government and Transportation segments, which we refer to as continuing operations.

During the second quarter and first six months of 2004 compared to the second quarter and first six months of 2003, our business experienced a decline in revenue and gross profit. Our gross margin percentage also decreased from 2003 to 2004, and this, together with the decline in our revenue, caused our gross profit to decline. Operating expenses were unfavorably impacted by impairment charges recorded to the Transportation and Mobile Government segments, causing a significant increase in our operating loss. See Note 2(d) of the notes to our Consolidated Financial Statements included in Item 1 of Part I of the Quarterly Report for a discussion of the impairment charges.

A summary of our revenue, by business segment, follows:

Revenue:

	Mobile Government		Transportation		Total	
	Three Months ended June 30		Three Months ended June 30		Three Months ended June 30	
(IN THOUSANDS)	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**
Subscriber	$ 197	$ 33	$ 7,070	$ 4,735	$ 7,267	$ 4,768
Software and Related Services	4,912	4,136			4,912	4,136
Hardware	154	523	2,132	2,994	2,286	3,517
Total	$ 5,263	$ 4,692	$ 9,202	$ 7,729	$ 14,465	$ 12,421

	Mobile Government		Transportation		Total
	Six Months ended June 30		Six Months ended June 30		Six Months ended June 30
(IN THOUSANDS)	**2003**	**2004**	**2003**	**2004**	