

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2006**
- 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 No

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 Accelerated Filer Non-Accelerated Filer

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

As of November 2, 2006, 73,883,950 shares of the registrant's common stock were outstanding.

WIRELESS FACILITIES, INC.

FORM 10-Q

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 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	September 30, 2006
Assets		
Current assets:		
Cash and cash equivalents	\$ 12.9	\$ 12.9
Accounts receivable, net	109.6	107.8
Note receivable	—	9.6
Prepaid expenses	2.3	3.0
Employee loans and advances, net	0.4	0.3
Other current assets	4.6	7.8
Current assets of discontinued operations	46.7	0.6
Total current assets	176.5	142.0
Property and equipment, net	14.6	16.1
Goodwill	119.9	119.9
Other intangibles, net	7.4	6.1
Deferred tax assets	13.2	12.9
Investments in unconsolidated affiliates	2.1	2.1
Other assets	0.9	0.8
Non current assets of discontinued operations	1.7	—
Total assets	<u>\$ 336.3</u>	<u>\$ 299.9</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 22.9	\$ 18.8
Accrued expenses	18.0	13.3
Accrued compensation	13.0	15.5
Accounts payable—related party	0.8	—
Line of credit	—	8.0
Billings in excess of costs on completed contracts	4.3	4.0
Deferred tax liabilities	0.9	—
Tax contingencies	1.8	1.7
Accrual for contingent acquisition consideration	8.2	0.1
Accrual for unused office space	0.5	0.3
Income taxes payable	2.0	2.5
Capital lease obligations and other short-term debt	0.3	0.3
Current liabilities of discontinued operations	30.1	0.5
Total current liabilities	102.8	65.0
Capital lease obligations and debt, net of current portion	0.4	0.2
Accrual for unused office space, net of current portion	1.2	1.0
Other liabilities	1.3	1.2
Other long term liabilities of discontinued operations	0.3	0.2
Total liabilities	106.0	67.6
Commitments and contingencies (Notes 7 and 11)		
Stockholders' equity:		
Preferred stock, 5,000,000 shares authorized, Series B Convertible Preferred Stock, \$.001 par value; 25,483 and 10,000 shares outstanding at December 31, 2005 and September 30, 2006, respectively (liquidation preference \$12.7 and \$5.0, respectively)	—	—
Common Stock, \$.001 par value, 195,000,000 shares authorized; 72,188,449 and 73,883,950 shares issued and outstanding at December 31, 2005 and September 30, 2006, respectively	—	—
Additional paid-in capital	324.9	327.8
Accumulated deficit	(91.7)	(94.0)
Accumulated other comprehensive loss	(2.9)	(1.5)
Total stockholders' equity	<u>230.3</u>	<u>232.3</u>
Total liabilities and stockholders' equity	<u>\$ 336.3</u>	<u>\$ 299.9</u>

See accompanying notes to unaudited consolidated financial statements.

WIRELESS FACILITIES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share amounts)
(Unaudited)

Three months ended September 30, 2005	2006	Nine months ended September 30, 2005	2006
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Revenues	\$ 94.5	\$ 84.3	\$ 280.5	\$ 254.4
Cost of revenues	74.3	69.0	217.7	209.3
Gross profit	20.2	15.3	62.8	45.1
Selling, general and administrative expenses	17.2	16.1	51.2	47.2
Contingent acquisition consideration	(2.5)	—	(2.5)	0.1
Operating income (loss)	5.5	(0.8)	14.1	(2.2)
Other income (expense), net:				
Interest income, net	—	0.1	0.2	0.5
Foreign currency loss	(0.1)	—	(0.2)	(0.2)
Other expenses, net	—	—	(0.3)	—
Other income (expense), net	(0.1)	0.1	(0.3)	0.3
Income (loss) before provision for income taxes	5.4	(0.7)	13.8	(1.9)
Provision for income taxes	0.7	0.4	3.9	0.6
Income (loss) from continuing operations	4.7	(1.1)	9.9	(2.5)
Income from discontinued operations	0.5	0.2	2.2	0.2
Net income (loss)	\$ 5.2	\$ (0.9)	\$ 12.1	\$ (2.3)
Basic earnings (loss) per common share:				
Income (loss) from continuing operations	\$ 0.06	\$ (0.01)	\$ 0.13	\$ (0.03)
Income from discontinued operations	0.01	0.00	0.03	0.00
Net income (loss)	\$ 0.07	\$ (0.01)	\$ 0.16	\$ (0.03)
Diluted earnings (loss) per common share:				
Income (loss) from continuing operations	\$ 0.06	\$ (0.01)	\$ 0.13	\$ (0.03)
Income from discontinued operations	0.01	0.00	0.03	0.00
Net income (loss)	\$ 0.07	\$ (0.01)	\$ 0.16	\$ (0.03)
Weighted average common shares outstanding:				
Basic	74.2	73.9	74.0	73.3
Diluted	75.3	73.9	75.4	73.3

See accompanying notes to unaudited consolidated financial statements.

WIRELESS FACILITIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)
(Unaudited)

	Nine months ended September 30,	
	2005	2006
Operating activities:		
Net income (loss) from continuing operations	\$ 9.9	\$ (2.5)
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	5.9	6.1
Deferred income taxes	4.3	(0.6)
Net loss on disposition of fixed assets	0.6	0.3
Stock-based compensation	0.1	2.4
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	(3.7)	1.8
Prepaid expenses	(1.3)	(0.7)
Other assets	(2.5)	(2.9)
Accounts payable	(1.7)	(4.9)
Accrued expenses	5.0	(4.7)
Accrued compensation	5.5	2.5
Tax contingencies	0.1	(0.1)
Accrued contingent acquisition consideration	(2.5)	0.3
Billings in excess of costs on completed contracts	(1.2)	(0.3)
Accrual for unused office space	(0.7)	(0.4)
Income tax payable	(1.7)	0.5
Other liabilities	(0.1)	(0.1)
Net cash provided by (used in) continuing operations	<u>16.0</u>	<u>(3.3)</u>
Investing activities:		
Sale/maturity of short-term investments	7.6	—
Cash paid for contingent acquisition consideration	(16.0)	(8.4)
Proceeds from the disposition of discontinued operations	—	9.3
Cash paid for acquisitions, net of cash acquired	(33.4)	—
Capital expenditures	(5.7)	(6.5)
Net cash used in investing activities from continuing operations	<u>(47.5)</u>	<u>(5.6)</u>
Financing activities:		
Proceeds from issuance of common stock	1.7	0.5
Proceeds from issuance of common stock under employee stock purchase plan	1.8	—
Borrowings under line of credit	—	12.0
Repayment under line of credit	—	(4.0)
Repayment of capital lease obligations	(0.3)	(0.2)
Net cash provided by financing activities from continuing operations	<u>3.2</u>	<u>8.3</u>

Cash flows of discontinued operations (Revised see Note 1(l))		
Operating cash flows	(8.0)	(0.7)
Investing cash flows	(0.8)	—
Net cash flows of discontinued operations	(8.8)	(0.7)
Effect of exchange rate on cash and cash equivalents	0.4	1.3
Net decrease in cash and cash equivalents	(36.7)	0.0
Cash and cash equivalents at beginning of period	52.0	12.9
Cash and cash equivalents at end of period	\$ 15.3	\$ 12.9

See accompanying notes to unaudited consolidated financial statements.

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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) Basis of Presentation

The information as of September 30, 2006, and for the three months and nine months ended September 30, 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. The results have been prepared in accordance with the instructions to Form 10-Q and do not necessarily include all information and footnotes necessary for presentation in accordance with accounting principles generally accepted in the United States. 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. Interim operating results are not necessarily indicative of operating results expected in subsequent periods or for the year as a whole.

(c) 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.

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(d) Fiscal Calendar

On November 7, 2006, the Board of Directors (the “Board”) of the Company approved a change in the fiscal year end from the last Friday in December to December 31. Concurrently, the Board approved a change in the interim fiscal periods to provide that the last day of the fiscal quarter shall be the last day of the calendar month of each quarter. As a result, the third fiscal quarter of fiscal 2006, which would have ended on September 29, 2006, ended as of September 30, 2006. Prior to this change in fiscal year, the Company operated and reported using a 52-53 week fiscal year ending the last Friday in December. As a result, a fifty-third week was added every five or six years. Under the prior reporting system, each 52 week fiscal year consisted of four equal quarters of 13 weeks each, and each 53 week fiscal year consists of three 13 week quarters and one 14 week quarter. The change in fiscal year and interim fiscal periods will not be applied to periods prior to the quarter ended September 30, 2006, and, consistent with prior reports, all prior fiscal periods presented or discussed in this report have been presented as ending on the last day of the nearest calendar month. In reliance on Exchange Act Release No. 26589, the Company will not file a transition report covering the transition period from December 30, 2006 to December 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. 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 September 30, 2006 and December 31, 2005, the Company had \$2.2 million and \$1.1 million, respectively, of inventories which were reflected in Other Current Assets on the Consolidated Balance Sheet.

(f) Revenue Recognition

The Company provides services to customers under three primary types of contracts: fixed-price; time and materials; and cost reimbursement. 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 the Company is awarded work on a phase by phase basis rather than on a total project basis such as the Company's large deployment program, 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. In the event that the cost incurred to date may be in excess of the funded contract value, the Company may defer those costs until the associated contract value has been funded by the customer. As of September 30, 2006, the Company deferred costs of \$1.0 million in excess of funded contract value and has recorded this amount in other current assets. There was no comparable balance as of December 31, 2005. 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.

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Significant management judgments and estimates, including the estimated costs to complete projects, which determine the project's percentage 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 and the differences could be material.

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 and nine months ended September 30, 2006 and September 30, 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 recognized on multiple projects to account for revenue under the combination or segmentation 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 September 30, 2006 were \$51.0 million and \$50.4 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 September 30, 2006, approximately \$7.6 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 December 31, 2005 and September 30, 2006 will be billed within one year as billing and performance milestones are achieved.

Revenue from certain time and materials and fixed-price 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

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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.

(g) *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 September 30, 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 September 30, 2006.

(h) *Comprehensive Income (Loss)*

Comprehensive income (loss) consists of net income and other gains and losses affecting shareholders' investment that, under accounting principles generally accepted in the United States of America are excluded from net income (loss).

The components of other comprehensive income (loss) are as follows:

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2005	2006	2005	2006
Net income (loss)	\$5.2	\$(0.9)	\$12.1	\$(2.3)
Foreign currency translation adjustment	0.7	0.2	0.7	1.4
Other comprehensive income	0.7	0.2	0.7	1.4
Comprehensive income (loss)	<u>\$5.9</u>	<u>\$(0.7)</u>	<u>\$12.8</u>	<u>\$(0.9)</u>

The following table summarizes the components of accumulated other comprehensive income (loss):

	December 31, 2005	September 30, 2006
Cumulative foreign currency translation adjustment	(2.9)	(1.5)
Accumulated other comprehensive (loss)	<u>\$(2.9)</u>	<u>\$(1.5)</u>

(i) *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 nine months ended September 30, 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 \$0.7 million and \$2.4 million related to non-vested equity awards that was expensed during the three and nine months ended September 30, 2006, respectively.

The Company had the following three stock option plans under which shares were available for grant at September 30, 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. All stock options granted under these plans are granted at the fair market value on the date of grant and historically options have been granted with vesting over a 4 year period. 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 reduce 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 and the weighted average assumptions (annualized percentages) included in the following table. Awards with graded vesting are recognized using the straight-line method. The weighted-average estimated fair value of employee stock options granted during the three and nine months ended September 30, 2006 was \$1.23 and \$2.47 per share, respectively.

	Three months ended September 30,		Nine months ended September 30,	
	2005	2006	2005	2006
Expected life:(1)				
Stock options	4 years	3.8 years	4 years	3.7 years
Purchase plan	6 months	—	6 months	—
Risk-free interest rate(2)	4.0%	5.0%	4.0%	4.6%
Volatility(3)	73%	58.9%	73%	61.6%
Forfeiture rate(4)	—	23.7%	—	23.7%
Dividend yield(5)	—	—	—	—

- (1) The expected life of stock options granted under the Plans is based upon historical exercise patterns which the Company believes are representative of future behavior. The expected life of shares under the Purchase Plan represents the amount of time remaining in the offering period.
- (2) The risk-free interest rate is based on U.S. Treasury yields in effect at the time of grant with a term equal to the expected term of the options.
- (3) The Company estimates the implied volatility of its common stock at the date of grant based on an equally weighted average of trailing volatility and market based implied volatility for the computation.

- (4) Forfeitures are estimated at the time of grant based upon historical information. Forfeitures will be revised, if necessary, in subsequent periods if actual forfeitures differ from estimates. Previously, under APB25, the Company recognized forfeitures as they were incurred.
- (5) The Company has no history or expectation of paying dividends on its common stock.

The following table shows the amounts recognized in the financial statements for the three and nine months ended September 30, 2006 for share-based compensation related to employees (in millions, except per share data). In addition, for the nine months ended September 30, 2006, there was no incremental tax benefit from stock options exercised in the period.

	Three months ended September 30, 2006	Nine months ended September 30, 2006
Cost of revenues	\$ 0.2	\$ 0.9
Selling, general and administrative	0.5	1.5
Total cost of employee share-based compensation included in operating loss, before income tax	0.7	2.4
Amount of income tax recognized in earnings	—	—
Amount charged against income	<u>\$ 0.7</u>	<u>\$ 2.4</u>
Impact on net income (loss) per common share:		
Basic	\$ (0.01)	\$ (0.03)
Diluted	\$ (0.01)	\$ (0.03)

A summary of the status of the Company's stock option plan as of September 30, 2006 and of changes in options outstanding under the plan during the nine months ended September 30, 2006 is as follows:

	Number of Shares (000's)	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (000's)
Options outstanding at December 31, 2005	13,193	\$ 6.17		
Options granted	512	5.00		
Options exercised	(147)	3.84		
Options forfeited or expired	(1,672)	6.49		
Options outstanding at September 30, 2006	<u>11,886</u>	<u>\$ 6.10</u>	<u>6.9</u>	<u>\$ 36.4</u>
Options vested and exercisable at September 30, 2006	<u>9,281</u>	<u>\$ 6.18</u>	<u>6.4</u>	<u>\$ 36.4</u>

As of September 30, 2006, there was \$7.5 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 2.6 years.

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For purposes of pro forma disclosures under SFAS 123 for the three and nine months ended September 30, 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 and nine months ended September 30, 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 September 30, 2005	Nine months ended September 30, 2005
Net income	\$ 5.2	\$ 12.1
Add back: Actual stock-based compensation expense included in net earnings	0.0	0.1
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(7.3)	(13.9)
Pro forma net (loss)	<u>\$ (2.1)</u>	<u>\$ (1.7)</u>
Earnings (loss) per common share:		
Basic—as reported	\$ 0.07	\$ 0.16
Basic—pro forma	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>
Diluted—as reported	\$ 0.07	\$ 0.16
Diluted—pro forma	<u>\$ (0.03)</u>	<u>\$ (0.02)</u>
Weighted average shares:		
Basic—as reported and pro forma	74.2	74.0
Diluted—as reported and pro forma	75.3	75.4

(j) *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.

(k) *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,

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"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. We do not expect this statement to have a material impact on the Company.

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. We do not expect this statement to have a material impact on the Company.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) "Accounting for Uncertainty in Income Taxes" which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for the Company beginning December 30, 2006. The Company is in the process of determining the effect, if any, the adoption of FIN 48 will have on its financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Guidance re: the Use of a Cumulative Effect Adjustment to Correct Immaterial Misstatements" ("SAB 108"). SAB 108 expresses the SEC Staff's views regarding the process of quantifying financial statement misstatements. SAB 108 addresses the diversity in practice in quantifying financial statement misstatements and the potential under current practice for the build up of improper amounts on the balance sheet. SAB 108 will be effective for the Company for the year ending December 31, 2006. The cumulative effect of the initial application of SAB 108 will be reported in the carrying amounts of assets and liabilities as of the beginning of the fiscal year, with the offsetting balance to retained earnings. The Company is in the process of determining the impact, if any, the adoption of SAB 108 will have on its financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). This new standard provides guidance for using fair value to measure assets and liabilities and information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS 157 also expands financial statement disclosure requirements about a company's use of fair value measurements, including the effect of such measures on earnings. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007. While the Company is currently evaluating the provisions of SFAS 157, the adoption is not expected to have a material impact on its financial statements.

(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 September 30,		For the Nine Months Ended September 30,	
	2005	2006	2005	2006
Net income (loss)	\$ 5.2	\$ (0.9)	\$ 12.1	\$ (2.3)
Shares used in basic per share amounts:				
Weighted average common shares outstanding	74.2	73.9	74.0	73.3
Shares used in diluted per share amounts:				
Dilutive effect of stock options	1.1	—	1.4	—
Dilutive weighted average shares	75.3	73.9	75.4	73.3
Basic net income (loss) per share	\$ 0.07	\$ (0.01)	\$ 0.16	\$ (0.03)
Diluted net income (loss) per share	\$ 0.07	\$ (0.01)	\$ 0.16	\$ (0.03)
Anti-dilutive weighted shares from stock options excluded from calculation	9.3	11.9	6.2	12.4
Average per share market value of common stock	\$ 5.87	\$ 2.32	\$ 6.45	\$ 3.62
Average outstanding stock option price per share	\$ 8.38	\$ 6.21	\$ 8.38	\$ 6.21

(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 September 30, 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 September 30, 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 Administracion, 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 Administracion, 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 \$18.0 million, subject to adjustment for the closing net asset calculation, 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 final closing balance sheet as of February 17, 2006 resulted in net asset adjustments aggregating to a total approximate \$18.9 million consideration, \$1.5 million which was paid on February 17, 2006, with the remaining \$17.4 million payable by means of the promissory note in installments through December 31, 2006 with an interest rate of 7.5% per annum. On June 26, 2006, the Company entered into an Addendum with the buyer to finalize the closing net asset calculations, pursuant to which the parties agreed that the resulting total purchase price was \$18.9 million. The Addendum also provided for a conditional waiver that permits the purchaser to make the payment due on August 17, 2006 by September 29, 2006, and for the installments due on November 17, 2006 and December 31, 2006 to be made on or before December 29, 2006. Failure to make the payments on such later dates will result in a restoration of the original terms of the note. The first scheduled note payment of \$3.3 million was received from the buyer on May 19, 2006, and the second scheduled note payment of \$5.5 million was received in installments of \$5.2 million on September 29, 2006 and \$0.3 million on October 10, 2006. The remaining

note receivable balance of \$9.6 million which includes accrued interest through September 30, 2006, and includes the \$0.3 million payment received on October 10, 2006, is reflected on the Company's Consolidated Balance Sheet as of September 30, 2006. The unpaid principal will continue to accrue interest at the rate of 7.5% per annum.

The impact of the divestiture has been reflected in the consolidated balance sheets as of September 30, 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 September 30, 2006, our other discontinued operations in Latin America had revenues of \$0.6 million and a net income of \$0.2 million. For the nine months ended September 30, 2006, these operations had revenues of \$6.5 million and net income of \$0.2 million.

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 (in millions):

	December 31, 2005	September 30, 2006
Cash	\$ 3.2	\$ 0.4
Restricted cash	0.6	0.2
Accounts receivable, net	34.5	—
Prepaid expenses	0.2	—
Income tax receivable	2.3	—
Other current assets	5.9	—
Current assets of discontinued operations	<u>\$ 46.7</u>	<u>\$ 0.6</u>
Property, plant and equipment	\$ 1.5	\$ —
Other assets	0.2	—
Non-current assets of discontinued operations	<u>\$ 1.7</u>	<u>\$ —</u>
Accounts payable	\$ (3.9)	\$ (0.2)
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)	(0.2)
Current liabilities of discontinued operations	<u>\$ (30.0)</u>	<u>\$ (0.4)</u>
Non-current liabilities of discontinued operations	\$ (0.3)	\$ (0.2)

The restricted cash of \$0.2 million, is a result of a 2005 regulation in Argentina that requires a percentage of each loan advanced by the Company to the Argentinean Subsidiary be held in a one-year fixed account at zero interest.

(5) Investments in Unconsolidated Affiliates

Tactical Survey Group, Inc. ("TSG")

On February 23, 2004, the Company paid an additional \$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 was 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.

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During the third quarter of 2006, TSG was awarded a prime contract from a government customer and the Company has entered into a subcontract agreement with TSG to support them on this government contract. As such, TSG is no longer considered a significant subcontractor to the Company. This factor, combined with the lack of current representation on TSG's board of directors resulted in the Company concluding effective September 29, 2006 that significant influence no longer existed. Accordingly, the investment in TSG no longer met the conditions for the use of the equity method of accounting and has been accounted for under the cost method effective September 29, 2006. There were no equity earnings related to this investment during the period this investment was accounted for under the equity method of accounting. The balance of the Company's investment in TSG at December 31, 2005 and September 30, 2006 totaled \$1.2 million and has been classified on the consolidated balance sheet under the caption "Investments in unconsolidated affiliates."

The Company evaluates the realizability of its investment in TSG according to the provisions of APB Opinion No. 18 and EITF Issue 03-1. The Company periodically obtains and reviews the financial statements of TSG. Based on this review, and the facts listed above, there is no indication that a decrease in value of the TSG investment has occurred which is other than temporary and the Company has concluded that the carrying value of its investment in TSG has not been impaired as of September 29, 2006.

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 September 30, 2006 totals \$0.9 million. This investment is accounted for under the cost method and has been classified on the consolidated balance sheet under the caption "Investments in unconsolidated affiliates." One of the Company's directors is also a director of CommVerge Solutions, Inc.

Management periodically obtains and reviews the most recent financial performance and financial forecasts available from CommVerge which may include information regarding project status and current progress of the business. Based on this review, there is no indication that a decrease in value of the CommVerge investment has occurred which is other than temporary and the Company has concluded that the carrying value of its investment in CommVerge has not been impaired as of September 30, 2006.

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(6) Acquisitions

The following table summarizes the changes in the carrying amounts of goodwill and other indefinite and finite-life intangible assets for the nine months ended September 30, 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 September 30, 2006	<u>25.5</u>	<u>18.3</u>	<u>76.1</u>	<u>119.9</u>
Other intangibles, net				
Balance as of December 31, 2005	—	1.1	6.3	7.4
Acquisition	—	—	—	—
Amortization expense	—	(0.2)	(1.1)	(1.3)
Balance as of September, 2006	<u>—</u>	<u>0.9</u>	<u>5.2</u>	<u>6.1</u>
Total goodwill and other intangibles, net	<u>\$ 25.5</u>	<u>\$ 19.2</u>	<u>\$ 81.3</u>	<u>\$ 126.0</u>

(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 September 30, 2006 is summarized in the following table.

Summary of Contingent Acquisition Consideration

	<u>Suntech</u>	<u>Enco</u>	<u>DSI</u>	<u>Total</u>
Balance as of December 31, 2005	6.9	0.8	0.5	8.2
(Release) accrual for contingent consideration	(0.1)	0.2	0.2	0.3
Payments	<u>(6.8)</u>	<u>(0.9)</u>	<u>(0.7)</u>	<u>(8.4)</u>
Balance as of September 30, 2006	<u>—</u>	<u>0.1</u>	<u>—</u>	<u>0.1</u>

Enterprise Network Services

During the three and nine months ended September 30, 2006, \$0.0 million and \$7.7 million, respectively, was paid to certain shareholders of the companies acquired in ENS. 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. The remaining balance of \$0.1 million as of September 30, 2006 is expected to be paid to the ENS shareholders in the fourth quarter of 2006.

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 could be earned by the former major stockholders of DSI over an 18 month period, based upon performance milestones related to certain

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specified contracts. As of September 30, 2006, approximately \$2.8 million additional consideration had been earned and paid related to the contract milestones achieved by DSI. As of March 31, 2006, the performance period had ended and no further contingent consideration was due.

Madison Research Corporation

On October 2, 2006 the Company acquired Huntsville, Alabama based Madison Research Technology Corporation ("MRC") as part of the Company's Government Network Services business. MRC offers a broad range of technical, engineering and IT solutions, and has developed core competencies in weapons system lifecycle support, integrated logistics, test and evaluation, commercial-off-the-shelf software and hardware selection and implementation, software development and systems lifecycle maintenance.

The purchase price was approximately \$69 million, subject to certain post-closing adjustments. The Company paid \$62.1 million at closing. The working capital adjustment due in December 2006 and the remaining \$6.9 million was held back to secure the Company's indemnity rights and will be released, subject to indemnity rights, in installments following 6, 12 and 18 months from the date of close. The Company entered into a new \$85 million credit facility with KeyBank National Association ("KeyBank") to fund the acquisition, which replaced the Company's existing credit facility of \$15 million. Refer to Note 8 for further discussion. The results of operations of MRC will be included in the Company's consolidated statement of operations for the period from the acquisition date of October 2, 2006 in the Company's fourth quarter.

(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 was designated as the sole arranger and sole book manager. The facility had a 3-year term which could be expanded to a \$60.0 million credit facility. The Company intended to use the facility for general corporate purposes and to fund future acquisitions. As of September 30, 2006, \$8.0 million had been drawn to pay the contingent acquisition consideration payments due in the first two quarters of 2006. Interest on amounts outstanding under the credit facility accrued at the applicable margin over LIBOR or KeyBank's Prime Rate as determined by the credit agreement.

The terms of the original credit agreement required the Company to provide certain customary covenants for a credit agreement, including certain financial covenants. These financial covenants are computed as defined by the terms of the agreement. These financial covenants include a maximum senior leverage ratio of 1.5 to 1.0, a maximum total leverage ratio of 3.0 to 1.0, a minimum liquidity ratio of 1.35 to 1.0, and a minimum fixed charge coverage ratio of 1.25 to 1.0. As of September 30, 2006, the Company was in compliance with all covenants under this agreement.

On October 2, 2006, the Company entered into a new credit agreement with Key Bank to provide an \$85 million senior credit facility, which replaced the Company's existing \$15 million senior credit facility. The facility has a 5 year term with principal due in 2011 and interest payable on a monthly basis, and the facility can be expanded to a \$125 million credit facility to fund acquisitions. The capability to expand the facility to \$125 million is through December 31, 2006. The facility is collateralized by the assets of the Company. The Company has used the facility to fund its acquisition of Madison Research Corporation (MRC) and intends to use the facility for general corporate purposes and to fund future acquisitions. As of November 1, 2006, the Company has \$63 million drawn principally to fund the MRC acquisition and to extinguish the balance outstanding on the original facility.

The terms of the new credit agreement require the Company to provide certain customary covenants for a credit agreement, including certain financial covenants. These financial covenants are computed as defined by the terms of the agreement. These financial covenants include a maximum senior net debt

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leverage ratio of 4.0 to 1.0, a minimum liquidity ratio of 1.35 to 1.0, and a minimum fixed charge coverage ratio of 1.10 to 1.0.

(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 and nine months ended September 30, 2005 and September 30, 2006 are as follows (in millions).

Three months ended
September 30,

Nine months ended
September 30,

	2005	2006	2005	2006
Revenues:				
Wireless Network Services	\$ 57.0	\$ 47.4	\$ 168.3	\$ 150.4
Enterprise Network Services	16.1	16.8	49.5	42.9
Government Network Services	21.4	20.1	62.7	61.1
Total revenues	<u>\$ 94.5</u>	<u>\$ 84.3</u>	<u>\$ 280.5</u>	<u>\$ 254.4</u>
Operating income (loss):				
Wireless Network Services	\$ (0.3)	\$ (2.4)	\$ 3.3	\$ (5.3)
Enterprise Network Services	3.7	(0.1)	4.8	(2.5)
Government Network Services	2.1	1.7	6.0	5.6
Total operating income (loss)	<u>\$ 5.5</u>	<u>\$ (0.8)</u>	<u>\$ 14.1</u>	<u>\$ (2.2)</u>

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

	Three months ended September 30,		Nine months ended September 30,	
	2005	2006	2005	2006
Revenues:				
U.S.	\$ 86.7	\$ 78.0	\$ 251.5	\$ 233.9
Latin America	1.6	1.8	7.2	7.5
EMEA	6.2	4.5	21.8	13.0
Total revenues	<u>\$ 94.5</u>	<u>\$ 84.3</u>	<u>\$ 280.5</u>	<u>\$ 254.4</u>

The Company had sales to one customer totaling \$19.9 million (23.6%) and \$73.6 million (28.9%) of the Company's total revenues for the three and nine months ended September 30, 2006, respectively. Sales to this customer were \$27.5 million (29.1%) and \$72.5 million (25.8%) of the Company's total revenues for the three months and nine months ended September 30, 2005, respectively. The Company had sales to another customer totaling \$8.7 million (10.3%) and \$18.1 million (7.1%) of the Company's total revenues for the three and nine months ended September 30, 2006, respectively. Sales to this customer were \$4.6 million (4.9%) and \$9.4 million (3.4%) of the Company's total revenues for the three months and nine months ended September 30, 2005, respectively. Revenues for both customers are recorded in the Wireless Network Services operating unit.

(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. On April 5, 2006, 15,483 shares of Series B Convertible Preferred Stock were converted into 1,548,300 shares of the Company's Common Stock.

Through September 30, 2006, the Company has received notices from the holders to convert an aggregate number of 80,000 shares of Series B Convertible Preferred Stock into an aggregate 8,000,000 shares of the Company's Common Stock. On December 31, 2005 and September 30, 2006, the total liquidated preference equaled \$12.7 million and \$5.0 million, respectively.

In 2003, in connection with the Company's acquisition of a company in its Enterprise Network Services business, the Company assumed certain facility lease obligations relating to facilities that were owned by the previous shareholders. The lease expense, which approximates \$0.2 million and \$0.2 million for the nine months ended September 30, 2005 and 2006, respectively, is reflected in the statement of operations.

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 \$18.0 million subject to adjustments for the closing net asset calculations, 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, 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 an independent valuation analysis.

The final closing balance sheet as of February 17, 2006 resulted in net asset adjustments aggregating to a total approximate \$18.9 million consideration, \$1.5 million which was paid on February 17, 2006, with the remaining \$17.4 million payable by means of the promissory note in installments through December 31, 2006 with an interest rate of 7.5% per annum. On June 26, 2006, the Company entered into an Addendum with the buyer to finalize the closing net asset calculations, pursuant to which the parties agreed that the resulting total purchase price was \$18.9 million. The Addendum also provided for a conditional waiver that permits the purchaser to make the payment due on August 17, 2006 by September 30, 2006, and for the installments due on November 17, 2006 and December 31, 2006 to be made on or before December 29, 2006. Failure to make the payments on such later dates will result in a restoration of the original terms of the note. The first scheduled note payment of \$3.3 million was received from the buyer on May 19, 2006, and the second scheduled note payment of \$5.5 million was received in installments of \$5.2 million on September 29, 2006 and \$0.3 million on October 10, 2006. The remaining note receivable balance of \$9.6 million which includes accrued interest through September 30, 2006, and includes the \$0.3 million payment received on October 10, 2006 is reflected on the Company's Consolidated Balance Sheet as of September 30, 2006. The unpaid principal will continue to accrue interest at the rate of 7.5% per annum.

(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 in the fourth quarter of 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. Defendants filed a motion to dismiss this complaint on June 8, 2006. Plaintiffs’ opposition was filed on July 12, 2006, and Defendants’ reply was filed on August 2, 2006. The motion and responsive briefs were taken under submission by the court in August 2006, and the judge has not made a decision on the motion. 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 was completed on June 14, 2006. Defendants’ motion to dismiss the complaint against the non-California resident defendants was filed on July 14, 2006. In October 2006, with the personal jurisdiction motion body briefed by both sides, the court took the motion under submission. 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 on October 27, 2006, the court continued the stay pending the decisions on the federal derivative lawsuit. The parties will appear before the judge in April 2007 to apprise the court of the status of the federal 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 January 2005 a former independent contractor of the Company filed a lawsuit in Brazil against the Company's subsidiary, WFI do Brazil, to which he had been assigned for a period of time. He sought to be designated an employee of WFI do Brazil and entitled to severance and related compensation pursuant to Brazilian labor law. The individual sought back wages, vacation pay, stock option compensation and related benefits in excess of \$0.5 million. This matter was argued before the appropriate labor court in July 2005 and in July, 2006, the labor court awarded the individual the Brazilian currency equivalent of approximately \$0.3 million for his back wages, vacation pay and certain other benefits. The Company filed an appeal in the matter on July 20, 2006 and is challenging the basis for the award on several theories. The Company has accrued approximately \$0.3 million as of September 30, 2006 related to this matter. The Company intends to pursue the appeal of this award and is unable to determine the ultimate outcome of this matter.

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," "predict," "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.

Certain of the information set forth herein, including costs and expenses that exclude the impact of stock compensation expense in 2006, may be considered non-GAAP financial measures. We believe this information is useful to investors because it provides a basis for measuring the operating performance of our business and our cash flow, excluding the effect of stock compensation expense that would normally be included in the most directly comparable measures calculated and presented in accordance with Generally Accepted Accounting Principles. Our management uses these non-GAAP financial measures along with the most directly comparable GAAP financial measures in evaluating our operating performance, capital resources and cash flow. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP, and non-financial measures as reported by WFI may not be comparable to similarly titled amounts reported by other companies.

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 as 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 approximate cash consideration of \$18.0 million, 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 final closing balance sheet as of February 17, 2006 resulted in net asset adjustments aggregating to a total approximate \$18.9 million consideration, \$1.5 million which was paid on February 17, 2006, with the remaining \$17.4 million payable by means of the promissory note in installments through December 31, 2006 with an interest rate of 7.5% per annum. On June 26, 2006, the Company entered into an Addendum with the buyer to finalize the closing net asset calculations, pursuant to which the parties agreed that the resulting total purchase price was \$18.9 million. The Addendum also provided for a conditional waiver that permits the purchaser to make the payment due on August 17, 2006 by September 30, 2006, and for the installments due on November 17, 2006 and December 31, 2006 to be made on or before December 29, 2006. Failure to make the payments on such later dates will result in a restoration of the original terms of the note. The first scheduled note payment of \$3.3 million was received from the buyer on May 19, 2006, and the second scheduled note payment of \$5.5 million was received in installments of \$5.2 million on September 29, 2006 and \$0.3 million on October 10, 2006. The remaining note receivable balance of \$9.6 million which includes accrued interest through September 30, 2006, and includes the \$0.3 million payment received on October 10, 2006. The unpaid principal will continue to accrue interest at the rate of 7.5% per annum.

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 material 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 adjust these standard costs periodically to ensure they are comparable to actual costs.

Selling, general and administrative expenses include compensation and benefits for corporate service employees and similar costs for billable employees whose time and expenses cannot be assigned to a project (underutilization costs), expendable computer software and equipment, facilities expenses and other operating expenses not directly related and/or allocated to projects. General and administrative costs include all corporate and administrative functions that support existing operations and provide infrastructure to facilitate our future growth. Additionally, our sales personnel and senior corporate executives have, as part of their compensation packages, periodic and annual bonus/commission incentives based on the attainment of specified performance goals.

We consider the following factors when determining if collection of a receivable is reasonably assured: comprehensive collection history; results of our communications with customers; the current financial position of the customer; and the relevant economic conditions in the customer's country. If we have had no prior experience with the customer, we review reports from various credit organizations to ensure that the customer has a history of paying its creditors in a reliable and effective manner. If the financial condition of our customers were to deteriorate, and adversely affect their financial ability to make payments, additional allowances would be required. Additionally, on certain contracts whereby we perform services for a prime/general contractor, a specified percentage of the invoiced trade accounts receivable may be retained by the customer until we complete the project. We periodically review all retainages for collectibility and record allowances for doubtful accounts when deemed appropriate, based on our assessment of the associated risks. Total retainages included in accounts receivable were \$0.8 million at September 30, 2006.

Management currently considers the following events, trends and uncertainties to be important to understanding its financial condition and operating performance:

- We believe there remain opportunities for us to grow our domestic Wireless Network Services business in Land Mobile Radio (LMR), IP Fixed and Core Networks and in-building networks. We also see opportunities in spectrum clearing and frequency realignment activities related to the Federal Communication Commission's recent action on the reallocation of licenses in the 800 megahertz frequencies. We believe that we may continue to experience pressure on our operating margins in our Wireless Network Services legacy Radio Frequency (RF) engineering business as a result of aggressive pricing by our competitors. Within the WNS business, we are continuing our efforts to reduce the amount of high risk, turn key, firm fixed price contracting that we do in higher risk markets by being extremely selective with these projects, while focusing on lower risk market areas and modular work.

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- We believe that our Government Network Services segment will build and expand our customer relationships within the U.S. Departments of Defense and Homeland Security by taking advantage of the significant opportunities for companies with substantial expertise in wireless technology. We believe we will experience continued growth in revenues and operating income from this operating segment. On October 2, 2006, we acquired Huntsville, Alabama-based Madison Research Corporation ("MRC") as part of our GNS business. MRC offers a broad range of technical, engineering and IT solutions, and has developed core competencies in weapons system lifecycle support, integrated logistics, test and evaluation, commercial-off-the-shelf software and hardware selection and implementation, software development and systems lifecycle maintenance. The results of operations of MRC will be consolidated beginning from the closing date of October 2, 2006.
 - We also believe that despite project delays and set backs in the first quarter and second quarter of this year that our Enterprise Network Services segment will grow. We continue to be optimistic about the opportunity to integrate wireless technology into municipality and enterprise networks, especially physical and electronic security systems, and voice and data networks.
 - As of September 30, 2006, we have estimated our annual effective tax rate to be a negative 31% for the year ending December 31, 2006. The rate differs from the federal and state statutory rates primarily because of substantial losses of over \$3.2 million for the nine months ended September 30, 2006 incurred in our foreign operations for which we are not able to record any tax benefit. In addition, our effective tax rate is impacted by nondeductible permanent tax items, tax reserves, and a reduction to our valuation allowance for originating deductible differences. The provision recorded for the quarter of negative 63% is greater than our estimated annual effective tax rate because of discrete tax expense items relating to tax reserves and no tax benefit for losses in our international operations. To the extent our projections may change, which may impact our judgement regarding the realizability of our deferred tax assets and required valuation allowance, our annual effective tax rate for 2006 could change in future periods.

Critical Accounting Principles and Estimates

We have identified the following critical accounting policies that affect our more significant judgments and estimates used in the preparation of our consolidated financial statements. The preparation of our financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, stockholders' equity, revenues and expenses, and related disclosures of contingent assets and liabilities. On a periodic basis, as deemed necessary, we evaluate our estimates, including those related to 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, accruals for partial self-insurance, contingencies and litigation and contingent acquisition consideration. We explain these accounting policies in the notes to the unaudited consolidated financial statements and at relevant sections in this discussion and analysis. These estimates are based on the information that is currently available and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could vary from those estimates under different assumptions or conditions.

Revenue recognition. We derive a significant percentage of our revenue from long-term contracts and account for these contracts under the provisions of Statement of Position 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts". Revenue on time and materials contracts is recognized as services are rendered at contracted labor rates plus material and other direct costs incurred. The portion of our revenue derived from fixed-price contracts accounted for approximately 63.6% and 63.7% of our revenues for the three and nine months ended September 30, 2006, respectively. Revenue on fixed-price contracts is recognized using the percentage-of-completion method based on the ratio of total costs incurred to date compared to estimated total costs to complete the

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contract. Estimates of costs to complete include material, direct labor, overhead, and allowable general and administrative expenses for our government contracts. These cost estimates are reviewed and, if necessary, revised monthly on a contract-by-contract basis. If, as a result of this review, we determine that a loss on a contract is probable, then the full amount of estimated loss is charged to operations in the period it is determined that it is probable a loss will be realized from the full performance of the contract. In certain instances in which it is impractical to estimate the final outcome of the project margin, but it is certain that we will not incur a loss on the project, we may record revenue equal to cost incurred, at zero margin. In the event that our cost incurred to date may be in excess of our funded contract value, we may defer those costs until the associated contract value has been funded by the customer. Once the final estimate of the outcome of the project margin is determined, we 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. Significant management judgments and estimates, including but not limited to the estimated costs to complete projects, must be made and used in connection with the revenue recognized in any accounting period. The revenue we recognize in a given reporting period depends on: (1) the costs we have incurred for individual projects; (2) our then current estimate of the total remaining costs to complete individual projects; and (3) the current estimated contract value associated with the projects. If, in any period, we 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. As a result, our gross margin in such period and in future periods may be affected. To the extent that our estimates fluctuate over time or differ from actual results, gross margins in subsequent periods may vary significantly from our estimates. Material differences may result in the amount and timing of our revenue for any period if management made different judgments or utilized different estimates.

A cancellation, schedule delay, or modification of a fixed-price contract which is accounted for using the percentage-of-completion method may adversely affect our gross margins for the period in which the contract is modified or cancelled. Under certain circumstances, a cancellation or negative modification could result in us having to reverse revenue that we recognized in a prior period, thus significantly reducing the amount of revenues we recognize for the period in which the adjustment is made. Correspondingly, a positive modification may positively affect our gross margins. In addition, a schedule delay or modifications can result in an increase in estimated cost to complete the project, which would also result in an impact to our gross margin.

In addition, many of our contracts include milestone billings. If a contract is terminated or if the scope of a contract changes prior to a milestone billing, the amount of revenue we recognize may change, based upon the specific termination clauses of the contract, which would affect our revenue and gross margin in the period in which the contract is terminated or the scope is changed.

During the reporting periods contained herein, we did experience revenue and margin adjustments of certain projects based on the aforementioned factors.

Allowance for doubtful accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from the potential inability of certain customers to make required future payments on amounts due to us. Management determines the adequacy of this allowance by periodically evaluating the aging and past due nature of individual customer accounts receivable balances and considering the customer's current financial situation as well as the existing industry economic conditions and other relevant factors that would be useful towards assessing the risk of collectibility. If the future financial condition of our customers were to deteriorate, resulting in their inability to make specific required payments, additions to the allowance for doubtful accounts may be required. In addition, if the financial condition of our customers improves and collections of amounts outstanding commence or are reasonably assured, then we may reverse previously established allowances for doubtful accounts. Changes to estimates of contract value are recorded as adjustments to revenue and not as a component of the

allowance for doubtful accounts. We write off accounts receivable when they become uncollectible and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

Valuation of long-lived assets including intangible assets and goodwill. We recorded goodwill and finite-life intangible assets resulting from the recently and previously completed acquisitions. Management assesses the impairment of identifiable finite-life intangibles, long-lived assets and related goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable, but at a minimum on an annual basis. Factors we consider relevant which could trigger an accelerated impairment review include, but are not limited to, the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of our use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and
- our market capitalization relative to net book value.

When we determine that the carrying value of intangibles, long-lived assets and related goodwill may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure any impairment based substantially on a projected discounted future cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model combined with other readily available and other relevant information. Net intangible assets, long-lived assets (including investments in unconsolidated affiliates), and goodwill was \$144.2 million as of September 30, 2006.

In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, we do not amortize goodwill and indefinite lived intangible assets. In lieu of amortization, we are required to perform, at a minimum, an annual impairment review unless specific evidence identified as a triggering event would warrant an accelerated review of our goodwill and intangible assets with indefinite lives. The first step of the goodwill impairment test requires the Company to determine and compare the fair value of its defined reporting units to their carrying values as of the evaluation date. The fair value for each reporting unit is determined using an undiscounted cash flow valuation analysis. The carrying values of each reporting unit are determined by specifically identifying and allocating the assets and liabilities of the Company to each reporting unit based on headcount, relative revenues or costs, or other methods as deemed appropriate by management. If the estimated fair values exceed the carrying values for each reporting unit, there is no indication of impairment. Consequently, the second step of the impairment test will not be required.

Since the last annual impairment test as of December 31, 2005, there has been no indication of a triggering event that would warrant an accelerated review of our goodwill and intangible assets with indefinite lives.

Accounting for income taxes and tax contingencies. As part of the process of preparing our consolidated financial statements we are required to estimate our provision for income taxes in each of the tax jurisdictions in which we conduct business. This process involves estimating our actual current tax expense in conjunction with the evaluation and measurement of temporary differences resulting from differing treatment of certain items for tax and accounting purposes. These temporary timing differences result in the establishment of deferred tax assets and liabilities, which are recorded on a net basis and included in our consolidated balance sheet. We then assess on a periodic basis the probability that our net deferred tax assets will be recovered and, therefore realized from future taxable income and to the extent we believe that recovery is not more likely than not, a valuation allowance is established to mitigate such risk resulting in an additional related provision for income taxes during the period. If we are required to

further increase the valuation allowance in the future, it could have an adverse impact on our results of operations.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, tax contingencies and any required valuation allowance, including taking into consideration the probability of the tax contingencies being incurred. Management assesses this probability based upon information provided to us by our tax advisors, our legal advisors and similar tax cases. If at a later time our assessment of the probability of these tax contingencies changes, our accrual for such tax uncertainties may increase or decrease.

We have a valuation allowance at September 30, 2006, due to management's overall assessment of risks and uncertainties related to our future ability to realize and, hence, utilize certain deferred tax assets, primarily consisting of net operating losses, carryforward temporary differences and future tax deductions resulting from certain types of stock option exercises, before they expire. The assessed adequacy of valuation allowance is based on our current estimates of adjusted taxable income by each tax jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adversely adjust these estimates in future periods, our financial position and results of operations could be materially impacted. Management believes the valuation allowance recorded at September 30, 2006 is properly stated.

The 2006 effective tax rate for annual and interim reporting periods could be impacted if certain tax items that are reserved for at September 30, 2006 are resolved at an amount which differs from our estimate. Finally, during 2006, if we are impacted by a change in the valuation allowance as of September 30, 2006 resulting from a change in judgment regarding the realizability of deferred tax assets beyond December 31, 2006, such effect will be recognized in the interim period in which the change occurs.

Accrual for partial self-insurance. We maintain an accrual for our health and workers compensation partial self-insurance, which is a component of total accrued expenses in the consolidated balance sheets. Management determines the adequacy of these accruals based on a monthly evaluation of our historical experience and trends related to both medical and workers compensation claims and payments, information provided to us by our insurance broker, industry experience and average lag period in which claims are paid. If such information indicates that our accruals require adjustment, we will, correspondingly, revise the assumptions utilized in our methodologies and reduce or provide for additional accruals as deemed appropriate. As of September 30, 2006, the accrual for our partial self-insurance programs approximated \$2.1 million. We also carry stop-loss insurance that provides coverage limiting our total exposure related to each medical and workers compensation claim incurred, as defined in the applicable insurance policies. The medical and workers compensation limits per claim are \$150,000 and \$250,000, respectively.

Contingencies and litigation. We are currently involved in certain legal proceedings. We estimate a range of liability related to pending litigation where the amount and range of loss can be estimated. We record our estimate of a loss when the loss is considered probable and estimable. Where a liability is probable and there is a range of estimated loss and no amount in the range is more likely than any other number in the range, we record the minimum estimated liability related to the claim in accordance with SFAS No. 5, "Accounting for Contingencies." As additional information becomes available, we assess the potential liability related to our pending litigation and revise our estimates. Revisions in our estimates of potential liability could materially impact our results of operations. See Part II, Item 1 "Legal Proceedings" for additional information.

Share-Based Payments. Beginning in fiscal year 2006, we account for share-based compensation arrangements in accordance with 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. Prior to adoption of SFAS 123R, we accounted for share-based compensation using the intrinsic value-based method in accordance with Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." Under the intrinsic method, no share-based compensation expense related to stock option awards granted to employees had been recognized in our Consolidated Statement of Operations. We adopted SFAS 123R using the modified prospective transition method.

The valuation provisions of SFAS 123R apply to new awards and to awards that are outstanding on the effective date and subsequently modified or cancelled. Under the modified prospective application, which we used, prior periods are not revised for comparative purposes. We use the Black-Scholes option valuation model to estimate the fair value of our stock options at the grant date. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. Our employee stock options are generally subject to vesting restrictions and are generally not transferable.

Option pricing models require the input of highly subjective assumptions including the expected stock price volatility, the expected life of an option and the number of awards ultimately expected to vest. Changes in these assumptions can materially affect the fair value estimates of an option. Furthermore, the estimated fair value of an option does not necessarily represent the value that will ultimately be realized by an employee. We used historical data to estimate the expected forfeiture rate, intrinsic and historical data to estimate the expected price volatility, and a weighted-average expected life formula to estimate the expected option life. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. If actual results are not consistent with our assumptions and judgments used in estimating the key assumptions, we may be required to increase or decrease compensation expense.

Comparison of Results for the Three Months Ended September 30, 2005 to the Three Months Ended September 30, 2006

Revenues. Revenues decreased \$10.2 million from \$94.5 million for the three months ended September 30, 2005 to \$84.3 million for the three months ended September 30, 2006. The \$10.2 million decrease was attributable to a decrease in domestic revenues of \$8.7 million and a decrease in international revenues of \$1.5 million.

Our domestic revenue decline is primarily attributed to a decline of \$8.1 million in our Wireless Network Services segment, primarily as a result of schedule delays resulting in part from our customer's delays of expenditures which was attributed to the capital requirements to support bids in anticipation of capital funding required for the AWS auction in September 2006, the impact of the merger of one of our carrier customers in 2005, as well as pricing pressures experienced in our legacy RF business in both the U.S. and Europe. The reduction in our domestic revenues was also impacted by a decline of \$1.3 million in our Government Network Services business resulting from program delays and program reductions from two of our DOD customers offset partially by an increase of \$0.7 million in our Enterprise Network Services segment.

Aggregate international revenues decreased by \$1.5 million from the prior year period, primarily due to the completion of a significant project in EMEA in 2005, as well as due to the impact of increased pricing pressures in the same international market.

	2005	2006	\$ change	% change
Wireless network services	\$57.0	\$47.4	\$ (9.6)	(16.8)%
Enterprise network services	16.1	16.8	0.7	4.3%
Government network services	21.4	20.1	(1.3)	(6.1)%
Total revenues	<u>\$94.5</u>	<u>\$84.3</u>	<u>\$ (10.2)</u>	<u>(10.8)%</u>

Revenues generated by geographic segment for the quarters ended September 30, 2005 and 2006 are as follows (in millions):

	2005	2006	\$ change	% change
United States	\$86.7	\$78.0	\$ (8.7)	(10.0)%
EMEA	6.2	4.5	(1.7)	(27.4)%
Latin America	1.6	1.8	0.8	12.5%
Total revenues	<u>\$94.5</u>	<u>\$84.3</u>	<u>\$ (10.2)</u>	<u>(10.8)%</u>

As described in the section “Critical Accounting Principles and Estimates” and in the footnotes to our unaudited consolidated financial statements, a significant portion of our revenue is derived from fixed-price contracts whereby revenue is calculated using the percentage-of-completion method based on the ratio of total costs incurred to date compared to estimated total costs to complete the contract. These estimates are reviewed monthly on a contract-by-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. Significant management judgments and estimates, including the estimated costs to complete project, which determine the project’s percent complete, must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of our revenue for any period if management makes different judgments or utilizes different estimates.

Cost of Revenues. Cost of revenues decreased from \$74.3 million for the three months ended September 30, 2005 to \$69.0 million for the three months ended September 30, 2006 primarily as a result of the reduction in revenues. The decrease in cost of revenues includes an increase of \$0.2 million of stock-based compensation in the third quarter of 2006 as a result of the adoption of SFAS 123R. There was no stock-based compensation expense recorded in 2005. Gross margin during the three months ended September 30, 2006 decreased from 21.4% in the third quarter of 2005 to 18.2%. The decrease in gross margin primarily resulted from the impact of competitive pricing pressures that we are experiencing in our legacy Radio Frequency engineering business in the U.S. and our EMEA business. In addition, gross margins have been negatively impacted by a large national deployment program under which the customer is issuing purchase orders for each separate phase of the project, rather than for the entire project, resulting in our recording zero profit margin or below the anticipated projected margin at completion on the projects. We will not record the anticipated profit margin on the project until we receive the requisite purchase orders from the customer.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased from \$17.2 million in the three months ended September 30, 2005 to \$16.1 million in the three months ended September 30, 2006. Included in the third quarter 2006 SG&A is \$0.5 million stock-based compensation expense resulting from our adoption of SFAS No. 123R. There was no stock-based compensation expense recorded in 2005. Excluding the effect of the stock compensation expense in 2006, SG&A decreased from \$17.2 million in the third quarter of 2005 to \$15.6 million in the same period for

2006. The reduction year over year is primarily a result of the reduced revenue volume discussed previously as well as the impact of cost reduction measures we have taken in 2006.

Contingent Acquisition Consideration. Included in the third quarter 2005 operating results is a credit of \$2.5 million resulting from the reduction of estimated earn-out consideration related to our acquisitions of certain of the ENS companies in 2003.

Other Income (Expense), Net. For the three months ended September 30, 2005, net other expense was \$0.1 million as compared to net other income of \$0.1 for the three months ended September 30, 2006. The change is primarily attributable to the interest income recorded in the three months ended September 30, 2006 on the Note Receivable relating to the sale of our Mexican subsidiary partially offset by interest expense for the borrowings on the Line of Credit.

Provision for Income Taxes. Our effective income tax rate for the three months ended September 30, 2005 was a provision of 13% compared to a provision of negative 63% for the three months ended September 30, 2006. The effective tax rate for the three months ended September 30, 2006 is negative due to the fact that the Company has recorded a net loss from operations before taxes, attributable solely to its foreign operations, for which no tax benefit has been realized on the financial statements. For US purposes, the Company has recognized income and recorded a tax expense.

Income from Discontinued Operations. Income from discontinued operations decreased from income of \$0.5 million for the three months ended September 30, 2005 to income of \$0.2 million for the three months ended September 30, 2006. The decrease of \$0.3 million resulted from the wind-down of operations in the Latin American operations at the end of 2005 and the sale of the Mexico operation effective on February 17, 2006.

Comparison of Results for the Nine months Ended September 30, 2005 to the Nine months Ended September 30, 2006

Revenues. Revenues decreased 9.3% from \$280.5 million for the nine months ended September 30, 2005 to \$254.4 million for the nine months ended September 30, 2006. The \$26.1 million decrease was attributable to reduced domestic revenues of \$17.6 million as a result of a carrier customer performing work internally rather than outsourcing this work after its merger with another carrier and a decrease in international revenues of \$8.5 million primarily attributable to a reduction in revenue in EMEA as a result of the completion of a large contract in 2005 and due to continued competitive pricing pressures. Total revenue decreased for the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005 by \$17.9 million in our Wireless Network Services segment, by \$6.6 million in our Enterprise Network Services segment and by \$1.6 million in our Government Network Services segment. Revenues in our Wireless Network Services segment were impacted by customer delays of expenditures which were attributed to the capital requirements to support bids for the AWS auction in September 2006, a reduction in outsourced services after the merger of one of our customers with another carrier as well as due to pricing pressures experienced in our legacy RF business in both the U.S. and Europe.

Revenues by operating segment for the nine months ended September 30, 2005 and 2006 are as follows (in millions):

	2005	2006	\$ change	% change
Wireless network services	\$168.3	\$150.4	\$ (17.9)	(10.6)%
Enterprise network services	49.5	42.9	(6.6)	(13.3)%
Government network services	62.7	61.1	(1.6)	(2.6)%

Revenues generated by geographic segment for the nine months ended September 30, 2005 and 2006 are as follows (in millions):

	<u>2005</u>	<u>2006</u>	<u>\$ change</u>	<u>% change</u>
United States	\$ 251.5	\$ 233.9	\$ (17.6)	(7.0)%
EMEA	21.8	13.0	(8.8)	(40.4)%
Latin America	7.2	7.5	0.3	4.2%
Total revenues	<u>\$ 280.5</u>	<u>\$ 254.4</u>	<u>\$ (26.1)</u>	<u>(9.3)%</u>

As described in the section “Critical Accounting Principles and Estimates” and in the footnotes to our unaudited consolidated financial statements, a significant portion of our revenue is derived from fixed-price contracts whereby revenue is calculated using the percentage-of-completion method based on the ratio of total costs incurred to date compared to estimated total costs to complete the contract. These estimates are reviewed monthly on a contract-by-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. Significant management judgments and estimates, including the estimated costs to complete projects, which determine the project’s percent complete, must be made and used in connection with the revenue recognized in any accounting period. Material differences may result in the amount and timing of our revenue for any period if management makes different judgments or utilizes different estimates. During the reporting periods contained herein, we did experience revenue and margin adjustments of certain projects based on the aforementioned factors, but the effect of such adjustments, both positive and negative, when evaluated in total were determined to be immaterial to the consolidated financial statements.

Cost of Revenues. Cost of revenues decreased 4% from \$217.7 million for the nine months ended September 30, 2005 to \$209.3 million for the nine months ended September 30, 2006 primarily due to the corresponding aforementioned decrease in total revenues. Gross margin decreased from 22.4% of total revenues for the nine months ended September 30, 2005 to 17.8% for the same period in 2006. The decrease in gross margin primarily resulted from the impact of competitive pricing pressures that we are experiencing in our legacy Radio Frequency engineering business in the U.S. and our EMEA business. In addition, gross margins have been negatively impacted by a large national deployment program under which one customer is issuing purchase orders for each phase of the project rather than for the entire project, resulting in recording at zero profit margin or below the anticipated project margin at completion. We will not record the anticipated project full profit margin until we receive the requisite purchase orders from the customer. Gross margin was also negatively impacted by cost overruns and execution issues that we encountered in the first quarter of 2006. In addition, included in cost of revenues for the nine months ended September 30, 2006 is approximately \$0.9 million of stock compensation expense resulting from our adoption of SFAS No. 123R in January 2006. Excluding the impact of the stock compensation expense in 2006, gross margin decreased from 22.4% in the first nine months of 2005 to 18.1% in the same period for 2006.

Selling, General and Administrative Expenses. Selling, general and administrative expenses decreased 7.8% from \$51.2 million for the nine months ended September 30, 2005 to \$47.2 million for the nine months ended September 30, 2006. The decrease in dollars incurred is a result of cost reduction measures that we have taken in 2006, as well as a reduction in professional fees related to first year compliance with the Sarbanes Oxley Act, offset partially by an increase of \$1.5 million of stock compensation expense as a result of our adoption of SFAS 123R. As a percentage of revenues, selling, general and administrative expenses costs increased slightly at 18.3% in the first nine months of 2005 compared to 18.6% in the same period in 2006. Excluding the stock compensation expense of \$1.5 million in 2006 and \$0.1 million in 2005, selling, general and administrative costs as a percentage of revenues decreased slightly at 18.0% in the first nine months of 2006 compared to 18.2% for the first nine months of 2005.

Contingent Acquisition Consideration. Included in the nine months ended September 30, 2005 operating results is a credit of \$2.5 million resulting from the reduction of earn-out consideration related to our acquisitions of certain of the ENS companies in 2003. Included in the results for the nine months ended September 30, 2006 is a \$0.1 million contingent consideration resulting from an increase in the earn-out consideration for these same acquired companies.

Other Income (Expense), Net. For the nine months ended September 30, 2005, net other expense was \$0.3 million compared to net other income of \$0.3 million for the nine months ended September 30, 2006. The change is primarily attributable to the interest income recorded in the nine months ended September 30, 2006 on the Note Receivable relating to the sale of our Mexican subsidiary partially offset by interest expense for the borrowings on the Line of Credit.

Provision for Income Taxes. Our effective income tax rate for the nine months ended September 30, 2005 was a 28% provision rate compared to a negative 31% provision rate for the nine months ended September 30, 2006. The effective tax rate for the nine months ended September 30, 2006 is negative due to the fact that the Company has recorded a net loss from operations before taxes, attributable solely to its foreign operations, for which no tax benefit has been realized on the financial statements. For US purposes, the Company has recognized income and recorded a tax expense.

Income from Discontinued Operations. Income from discontinued operations decreased from income of \$2.2 million for the nine months ended September 30, 2005 to income of \$0.2 million for the nine months ended September 30, 2006. The decrease of \$2.0 million resulted from the wind-down of operations in Latin America at the end of 2005 and the sale of the Mexico operations effective on February 17, 2006.

Liquidity and Capital Resources

Our sources of liquidity include cash and cash equivalents and short-term investments, cash from operations and other external sources of funds. As of September 30, 2006, we had cash and cash equivalents totaling \$12.9 million.

Our operating cash flow is used to finance trade accounts receivable, fund capital expenditures and make strategic acquisitions. Financing trade accounts receivable is necessary because, on average, the customers and payers for our services do not pay us as quickly as we pay our vendors and employees for their goods and services. Capital expenditures consist primarily of investment in field equipment, computer hardware and software and improvement of our physical properties in order to maintain suitable conditions to conduct our business.

Cash from continuing operations is primarily derived from our customer contracts in progress and associated changes in working capital components. Cash provided by continuing operations was \$16.0 million for the nine months ended September 30, 2005 whereas cash used in operations was \$3.3 million for the nine months ended September 30, 2006. The change between periods is primarily due to the increase in the days to collect our trade receivables. The days sales outstanding increased from 107 days at September 30, 2005 to 116 days at September 30, 2006. The increase in days sales outstanding is a result of the timing of achieving production milestones on our large fixed-price deployment projects, for which we have not met the contractual milestones and are therefore unable to invoice our customers.

Cash used in investing activities from continuing operations was \$47.5 million and \$5.6 million for the nine months ended September 30, 2005 and 2006, respectively. During the nine months ended September 30, 2006, investing activities represented capital expenditures of \$6.5 million, cash paid of \$8.4 million for contingent consideration related to prior acquisitions, offset by cash received on the sale of discontinued operations of \$9.3 million. During the nine months ended September 30, 2005, investing activities represented cash paid of \$33.4 million, net of cash received for the acquisition of TLA, capital

expenditures of \$5.7 million; cash paid of \$16.0 million for contingent consideration related to prior acquisitions, and cash received on the sale of short term investments of \$7.6 million. See Note 6 to our unaudited consolidated financial statements for further discussion of our acquisitions.

Cash provided by financing activities from continuing operations was \$8.3 million for the nine months ended September 30, 2006. The positive cash flow from financing for this period consisted primarily of proceeds from the issuance of common stock totaling \$0.5 million associated with exercises of employee stock options and net borrowings on the line of credit totaling \$8.0 million offset partially by repayment of capital lease obligations of \$0.2 million. Cash provided by financing activities from continuing operations was \$3.2 million for the nine months ended September 30, 2005. The positive cash flow from financing activities for this period consisted primarily of proceeds from the issuance of common stock totaling \$3.5 million associated with exercises of employee stock options and purchases under our Employee Stock Purchase Plan, offset partially by the repayment of capital lease obligations of \$0.3 million.

Cash used in discontinued operations was \$0.7 million for the nine months ended September 30, 2006. Cash used in discontinued operations was \$8.8 million for the nine months ended September 30, 2005 and included cash used in operations of \$8.0 million and cash used in investing activities of \$0.8 million.

We believe that our cash and cash equivalent balances, our expected cash flows from operations, our expected collections on the sale of our Mexican subsidiary and our credit facility will be sufficient to satisfy cash requirements for at least the next twelve months.

As discussed in Part II, Item 1A, "Risk Factors" section of this Quarterly Report on Form 10-Q, our quarterly and annual operating results have fluctuated in the past and may vary in the future due to a variety of factors, many of which are external to our control. If the conditions in the wireless industry deteriorate or our customers cancel or postpone projects or if we are unable to sufficiently increase our revenues or further reduce our expenses, we may experience, in the future, a significant long-term negative impact to our financial results and cash flows from operations, thus limiting our available liquidity and capital resources.

Contractual Obligations and Commitments

On March 16, 2005, we 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 had a three-year term and could have been expanded to a \$60.0 million facility. The Company intended to use the facility for general corporate purposes and to fund acquisitions. As of September 30, 2006, we had drawn \$8.0 million on the facility and had a cash balance of \$12.9 million.

On October 2, 2006 the Company acquired Madison Research Technology Corporation (MRC), a privately-held technical solutions and services company focused on advanced telecommunications programs, software and IT solutions, product solutions and space programs. The purchase price was approximately \$69 million, subject to certain post-closing adjustments. The Company paid \$62.1 million at closing, with the working capital adjustment due in December 2006 and the remaining \$6.9 million was held back to secure the Company's indemnity rights and will be released, subject to indemnity rights, in installments following 6, 12, and 18 months from the date of close. The Company entered into a new credit facility with KeyBank National Association ("KeyBank") to fund the acquisition with a new \$85 million credit facility, which replaced the Company's existing credit facility of \$15 million. The results of operations of MRC will be included in the Company's consolidated statement of operations for the period from the acquisition date of October 2, 2006 in the fourth quarter of 2006. As of November 2, 2006, we had drawn \$63 million and had a cash balance of approximately \$9.9 million. The amounts drawn on the credit facility primarily relate to amounts paid for the MRC acquisition on October 2, 2006.

Other than our normal recurring trade payables, expense accruals, operating and capital leases and working capital adjustments and purchase holdbacks related to our acquisition of MRC which are currently expected to be funded through existing working capital and future cash flows from operations, we have no other material commitments. Aside from these recurring operating expenses, future capital expenditures and overall expansion including potential future acquisitions, our future capital needs will depend upon many factors, including the timing of payments under existing contracts and technology requirements within the wireless telecommunications industry. Other future cash requirements may include the payment of certain tax contingencies and potential future acquisitions. We continue to evaluate and use new technology including electronic equipment and software in our business operations. Additional capital expenditure may be required as deemed necessary, in order to stay competitive and effectively service our customers.

Related Party Transactions

For detailed information regarding related party transactions, see Note 10 to our unaudited consolidated financial statements.

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 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. We do not expect this statement to have a material impact on the Company.

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. We do not expect this statement to have a material impact on the Company.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) "Accounting for Uncertainty in Income Taxes" which prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, FIN 48 provides guidance on the derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions. The accounting provisions of FIN 48 will be effective for the Company beginning December 30, 2006. The Company is in the process of determining the effect, if any, the adoption of FIN 48 will have on its financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Guidance re: the Use of a Cumulative Effect Adjustment to Correct Immaterial Misstatements" ("SAB 108"). SAB 108 expresses the SEC Staff's views regarding the process of quantifying financial statement misstatements. SAB 108 addresses the diversity in practice in quantifying financial statement misstatements and the potential under current practice for the build up of improper amounts on the balance sheet. SAB 108 will be effective for the Company for the year ending December 31, 2006. The cumulative effect of the initial application of SAB 108 will be reported in the carrying amounts of assets and liabilities as of the beginning of the fiscal year, with the offsetting balance to retained earnings. The Company is in the process of determining the impact, if any, the adoption of SAB 108 will have on its financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"). This new standard provides guidance for using fair value to measure assets and liabilities and information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. SFAS 157 also expands financial statement disclosure requirements about a company's use of fair value measurements, including the effect of such measures on earnings. The provisions of SFAS 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007. While the Company is currently evaluating the provisions of SFAS 157, the adoption is not expected to have a material impact on its financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to foreign currency risks due to both transactions and translations between functional and reporting currencies primarily in our Brazilian and European foreign subsidiaries. We are exposed to the impact of foreign currency fluctuations due to the operations of and net monetary asset and liability positions in our Brazil and European foreign subsidiaries. Significant monetary assets and liabilities expected to be realized in the foreseeable future include trade receivables, trade payables and certain intercompany payables that are not denominated in their local functional currencies. As of September 30, 2006, our Brazilian and European subsidiaries were in average net liability positions (i.e., monetary liabilities were greater than monetary assets subject to foreign currency risk) of approximately \$16.9 million and \$10.7 million, respectively. The potential foreign currency translation losses from a hypothetical 10% adverse change in the exchange rates from the net liability positions at September 30, 2006 were approximately \$1.7 million and \$1.1 million for the Brazil and European subsidiaries, respectively. In the event that the functional currency of our operations in China does not continue to be based on the U.S. dollar, we may be exposed to foreign currency fluctuations due to the activities of our corporate resource center in China.

In addition, we estimate that an immediate 10% change in foreign exchange rates would impact reported net income by approximately \$0.1 million for the quarter ended September 30, 2006. This was

estimated using a 10% deterioration factor to the average monthly exchange rates applied to net income or loss for each of the related subsidiaries in the respective period.

Due to the difficulty in determining and obtaining predictable cash flow forecasts in our foreign operations based on the overall challenging economic environment and associated contract structures, we do not currently utilize any derivative financial instruments to hedge foreign currency risks.

Cash and cash equivalents as of September 30, 2006 were \$12.9 million and are primarily invested in money market interest bearing accounts. A hypothetical 10% adverse change in the average interest rate on our money market cash investments and short-term investments would have had an immaterial effect on net income for the three and nine months ended September 30, 2006. We currently do not utilize any derivative financial instruments to hedge interest rate risks.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) that are designed to ensure that information required to be disclosed in our reports pursuant to the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Security and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our Principal Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Under the supervision of, and with the participation of, our management, including our Principal Executive Officer and Principal Financial Officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Exchange Act.

As previously disclosed in Item 9A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, we determined that, as of December 31, 2005, there were two material weaknesses affecting our internal control over financial reporting and, as a result of those weaknesses, the Company's disclosure controls and procedures were not effective as of that date. As described below, we are still in the process of remediating one of the two material weaknesses. Consequently, based on the evaluation described above, our Principal Executive Officer and Principal Financial Officer have concluded that, as of September 30, 2006, the Company's disclosure controls and procedures were not effective.

Changes in Internal Control over Financial Reporting

The company continues to address and correct the material weakness that existed at December 31, 2005 related to our ability to retain and recruit sufficient finance and accounting personnel to support compliance with all of our financial reporting requirements. We are actively recruiting to fill open positions and are in the process of reorganizing the Corporate accounting and finance group to improve the distribution of responsibilities. We have succeeded in permanently filling the Corporate Controller position during the quarter ended March 31, 2006 and are actively recruiting additional personnel. Management is committed to remediating this weakness as expeditiously as possible and will continue to devote significant time and resources to the remediation effort.

Except as described above, there were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the fiscal quarter ended September 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Add all changes from previous legal sections

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 and Exchange Act Section 11 claims against the Company and the Securities 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 in the fourth quarter of 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, the 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. Defendants filed a motion to dismiss this complaint on June 8, 2006. Plaintiffs' opposition was filed on July 12, 2006, and Defendants' reply was filed on August 2, 2006. The motion and responsive briefs were taken under submission by the court in August 2006, and the judge has not made a decision on the motion. 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 our 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, Defendant's 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 was completed on June 14, 2006. Defendants' motion to dismiss the complaint against the non-California resident defendants was filed on July 14, 2006. In October 2006, with the personal jurisdiction motion body briefed by both sides, the court took the motion under submission. 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 our belief that a liability, while possible, is not probable and any range of potential future charge cannot be reasonably estimated at this time.

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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 in *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 on October 27, 2006, the court continued the stay pending the decisions on the federal derivative lawsuit. The parties will appear before the judge in April 2007 to apprise the court of the status of the federal 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 our belief that a liability, while possible, is not probable and any range of potential future charge cannot be reasonably estimated at this time.

In January 2005 a former independent contractor of the Company filed a lawsuit in Brazil against the Company's subsidiary, WFI do Brazil, to which he had been assigned for a period of time. He sought to be designated an employee of WFI do Brazil and entitled to severance and related compensation pursuant to Brazilian labor law. The individual sought back wages, vacation pay, stock option compensation and related benefits in excess of \$0.5 million. This matter was argued before the appropriate labor court in July 2005 and in July, 2006, the labor court awarded the individual the Brazilian currency equivalent of approximately \$0.3 million for his back wages, vacation pay and certain other benefits. The Company filed an appeal in the matter on July 20, 2006 and is challenging the basis for the award on several theories. The Company has accrued approximately \$0.3 million as of September 30, 2006 related to this matter. The Company intends to pursue the appeal of this award and is unable to determine the ultimate outcome of this matter.

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 1A. Risk Factors

You should carefully consider the following risk factors and all other information contained herein as well as the information included in our Annual Report on Form 10-K, for the year ended December 31, 2005, and other reports and filings made with the Securities and Exchange Commission in evaluating our business and prospects. Risks and uncertainties, in addition to those we describe below, that are not presently known to us or that we currently believe are immaterial may also impair our business operations. If any of the following risks occur, our business and financial results could be harmed and the price of our common stock could decline. You should also refer to the other information contained in this report, including our unaudited consolidated financial statements and related notes.

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Our success is dependent in part on new growth in the deployment of wireless networks, and to the extent that such growth slows, our business may be harmed.

The principal customers of our WNS business are large telecommunications carriers, many of whom have re-evaluated their network deployment plans in response to trends in the capital markets, changing perceptions regarding industry growth, the adoption of new wireless technologies, increasing pricing competition for subscribers and general economic conditions in the United States and internationally. While some large carriers in the U.S. have started to once again focus on network expansion, if the rate of growth slows or carriers reduce their capital investments in wireless infrastructure or fail to expand into new geographic areas, our business may be significantly harmed.

The uncertainty associated with rapidly changing telecommunications technologies may also negatively impact the rate of deployment of wireless networks and the demand for our services. Telecommunications service providers face significant challenges in assessing consumer demand and in acceptance of rapidly changing enhanced telecommunications capabilities. If telecommunications service providers perceive that the rate of acceptance of next generation telecommunications products will grow more slowly than previously expected, they may, as a result, slow their development of next generation technologies. Moreover, increasing price competition for subscribers could adversely affect the profitability of carriers and limit their resources for network deployment. Any significant sustained slowdown will further reduce the demand for our services and adversely affect our financial results.

If wireless carriers, network equipment vendors and enterprises do not outsource their network services, our business will suffer.

Our success depends upon the continued trend by wireless carriers and network equipment vendors to outsource their network design, deployment and management needs. If this trend does not continue and wireless carriers and network equipment vendors elect to perform more network deployment services themselves, our operating results and revenues may decline.

If enterprise customers do not invest in security systems and other new in-building technologies such as wireless local area networks, our business will suffer.

We intend to devote significant resources to developing our enterprise-based WLAN (Wireless Local Area Networks), but we cannot predict that we will achieve widespread market acceptance amongst the enterprises we identify as potential customers. It is possible that some enterprises will determine that capital constraints and other factors outweigh their need for WLAN systems. As a result, we may be affected by a significant delay in the adoption of WLAN by enterprises, which would harm our business.

Our failure to obtain new government contracts, the cancellation of government contracts, or a reduction in federal budget appropriations involving our services could materially adversely affect our revenues.

We anticipate that a material portion of our future revenues will come from our Government Network Services segment. Our revenues and cash flows from our Government Network Services segment may decline if a significant number of our government contracts are delayed or cancelled due to cutbacks in defense, homeland security or other federal agency budgets or for other reasons. In addition, our failure to successfully compete for and retain such government contracts could have an adverse effect on our revenues and cash flows. We cannot guarantee that we—or if we are a subcontractor, that the prime contractor—will win any particular bid, or that we will be able to replace business lost upon expiration or completion of a contract.

We anticipate that our Government Network Services segment will also be sensitive to changes in national and international defense and budget priorities. Demand for our services may decline if conflicts in the Middle East and other high-risk areas subside, or if U.S. defense budget appropriations are reduced.

We are subject to extensive government regulation, and our failure or inability to comply with these regulations could subject us to penalties or restrict our ability to operate our business, which could adversely affect our revenues.

The wireless networks that we design, deploy and manage are subject to various regulations issued by the U.S. Federal Communications Commission (“FCC”) and other regulatory bodies in the U.S. FCC regulations and other countries require that these networks meet certain radio frequency emission standards, not create unallowable interference to other services, and in some cases accept interference from other services. These networks are also subject to government regulations and requirements of local standards bodies in foreign countries in which we have business operations, where we are less prominent than local competitors and have less opportunity to participate in the establishment of regulatory and standards policies. We are also subject to state and federal health, safety and environmental regulations, as well as regulations related to the handling of and access to classified information. Additionally, because we conduct business throughout the U.S., many of our activities are subject to different state and local regulatory schemes, including those relative to licensing, taxes and employment matters, with which we are required to comply. We are subject to routine audits to assure our compliance with these requirements.

Our failure to comply with these regulations, rules and approvals could result in the imposition of penalties and the loss of our government contracts and disqualification as a U.S. government contractor, which could adversely affect our revenues. Additional regulations may be adopted, including changes in the allocation of available spectrum by the U.S. government and other governments or exclusion of our technology by a standards body, which may result in additional cost to us or restrict our current business operations, which could have a harmful effect on our operating results, liquidity and financial position.

We derive a significant portion of our revenues from a limited number of customers.

We have derived, and believe that we will continue to derive, a significant portion of our revenues from a limited number of customers. To the extent that any significant client uses less of our services or terminates its relationship with us, our revenues could decline significantly. As a result, the loss of any significant client could seriously harm our business. For the nine months ended September 30, 2006, two customers comprised approximately 36% of our revenues, and our five largest customers accounted for approximately 53% of our total revenues. None of our customers are obligated to purchase additional services from us. As a result, the volume of work that we perform for a specific client is likely to vary from period to period, and a significant client in one period may not use our services in a subsequent period.

Recent business acquisitions and potential future business acquisitions could be difficult to integrate, disrupt our business, dilute stockholder value and adversely affect our operating results.

We have completed several acquisitions of complementary businesses in recent years, and we continually evaluate opportunities to acquire new businesses as part of our ongoing strategy. On October 2, 2006, we acquired Madison Research Corporation (MRC) as an expansion of our Government

Network Services segment, and we cannot assure you that we will obtain the anticipated benefits of this acquisition. Further, our integration of historic and future acquisitions, including MRC, will require significant management time and financial resources because we will need to integrate dispersed operations with distinct corporate cultures. We also may continue to expand our operations through business acquisitions over time. Our failure to properly integrate businesses we acquire and to manage future acquisitions successfully could seriously harm our operating results. In addition, acquired companies may not perform as well as we expect, and we may fail to realize anticipated benefits. We may issue common stock that would dilute our current stockholders' ownership and incur debt and other costs in connection with future acquisitions which may cause our quarterly operating results to vary significantly. In February 2004, we filed an acquisition shelf registration statement on Form S-4 that, subject to the rules and regulations of the Securities and Exchange Commission, will enable us to issue shares of our

newly issued common stock in one or more acquisition transactions for proceeds in an aggregate amount of up to \$200 million. In addition, our \$15 million senior credit facility with KeyBank National Association was replaced with an \$85 million senior credit facility with KeyBank National Association on October 2, 2006.

The consolidation of equipment vendors or carriers could adversely impact our business.

Recently, the wireless telecommunications industry has been characterized by significant consolidation activity including Cingular's acquisition of AT&T Wireless, both of whom are significant customers of ours, the merger between Alltel and Western Wireless and the merger between Sprint and Nextel Communications. The consolidation of carriers has reduced the number of our current or potential customers and increase the bargaining power of our remaining customers, any or all of which may adversely impact our business. Most recently, we have seen this consolidation, which has effectively reduced the number of major U.S. wireless carriers by half, begin reaching into the vendor market, with the Alcatel-Lucent, and Nokia-Siemens announcements. This wireless industry consolidation presents a challenge for us, and if we do not effectively adapt to this changing business environment, our business will suffer.

If our customers do not receive sufficient financing or fail to pay us for services performed, our business may be harmed.

A few of our customers rely upon outside financing to pay the costs of deploying their networks. These customers may fail to obtain adequate financing or experience delays in receiving financing and they may choose the services of our competitors if our competitors are willing and able to provide project financing.

In addition, we have historically taken significant write-offs of our accounts receivable. While the vast majority of our customers today are tier 1 carriers, large enterprises or the federal government, it is possible that in some instances we may not receive payment for services we have already performed. If our customers do not receive adequate financing or if we are required to write off significant amounts of our accounts receivables, then our net income will decline, and our business will be harmed.

We are in highly competitive markets, face competition from large, well-established competitors with significant resources, and may not be able to compete effectively.

Each of the vertical markets that we compete in is highly competitive. If we fail to compete successfully against current or future competitors, our business, financial condition and operating results may be harmed. We expect competition to continue and intensify in the future. We cannot be certain that we will be able to compete successfully with existing or new competitors.

Many of our current competitors have significantly greater financial, technical and marketing resources, generate greater revenues and have greater name recognition and experience than we do. This may place us at a disadvantage in responding to our competitors' pricing strategies, technological advances, advertising campaigns, strategic partnerships and other initiatives. In addition, many of our competitors have well-established relationships with our potential clients and have extensive knowledge of our industry. As a result, our competitors may be able to respond more quickly to new or emerging technologies and changes in customer requirements, and they may be able to devote more resources to the development, promotion and sale of their services than we can.

Our quarterly results fluctuate and may cause our stock price to decline.

Our quarterly operating results have fluctuated in the past and will likely fluctuate in the future. As a result, we believe that period-to-period comparisons of our results of operations are not a good indication

of our future performance. A number of factors, many of which are outside of our control, are likely to cause these fluctuations. Some of these factors include:

- telecommunications market conditions and economic conditions generally;
- the timing and size of network deployments and technology upgrades by our carrier customers;
- fluctuations in demand for outsourced network services;
- the timing of expansion into new markets, both domestically and internationally;
- changes in our effective tax rate including changes in our judgment as to the necessity of the valuation allowance recorded against our deferred tax assets;
- the length of sales cycles;
- the ability of certain customers to sustain capital resources to pay their trade accounts receivable balances and required changes to our allowance for doubtful accounts based on periodic assessments of the collectibility of our accounts receivable balances;
- reductions in the prices of services offered by our competitors which increases pressure on our margins;
- our success in bidding on and winning new business;

- changes in the actual and estimated costs and time to complete fixed-price, time-certain projects that may result in revenue adjustments for contracts where revenue is recognized under the percentage of completion method;
- our sales, marketing, and administrative cost structure; and
- the costs of integrating businesses that we acquire.

Because our operating results may vary significantly from quarter to quarter, our operating results may not meet the expectations of securities analysts and investors, and our common stock could decline significantly which may expose us to risks of securities litigation, impair our ability to attract and retain qualified individuals using equity incentives and make it more difficult to complete acquisitions using equity as consideration.

Our business is dependent upon our ability to keep pace with the latest technological changes.

The market for our services is characterized by rapid change and technological improvements. Failure to respond in a timely and cost-effective way to these technological developments will result in serious harm to our business and operating results. We have derived, and we expect to continue to derive, a substantial portion of our revenues from creating wireless networks that are based upon today's leading technologies and that are capable of adapting to future technologies. As a result, our success will depend, in part, on our ability to develop and market service offerings that respond in a timely manner to the technological advances of our customers, evolving industry standards and changing client preferences.

Failure to properly manage projects may result in costs or claims.

Our wireless network engagements often involve large scale, highly complex projects. The quality of our performance on such projects depends in large part upon our ability to manage the relationship with our customers, and to effectively manage the project and deploy appropriate resources, including third-party contractors, and our own personnel, in a timely manner. Any defects or errors or failure to meet clients' expectations could result in claims for substantial damages against us. Our contracts generally limit our liability for damages that arise from negligent acts, error, mistakes or omissions in rendering

services to our clients. However, we cannot be sure that these contractual provisions will protect us from liability for damages in the event we are sued. In addition, in certain instances, we guarantee customers that we will complete a project by a scheduled date or that the network will achieve certain performance standards. If the project or network experiences a performance problem, we may not be able to recover the additional costs we will incur, which could exceed revenues realized from a project. Finally, if we underestimate the resources or time we need to complete a project with capped or fixed fees, our operating results could be seriously harmed.

Our failure to attract and retain key managerial, technical, selling and marketing personnel could adversely affect our business.

Our success depends upon our attracting and retaining key members of our management team. The loss of any of our key members might delay or prevent the achievement of our development and strategic objectives. Our future performance will be substantially dependent upon our ability to attract, retain and motivate key members of our management team.

We must also continue to hire and retain additional highly skilled engineering, managerial, business development and sales personnel. In an effort to manage our costs, it is our policy to hire employees on a project-by-project basis. Upon completion of an assigned project, the employees are no longer employed by us until we elect to hire them for the next project. Competition for such highly skilled personnel in our industry is intense, especially for engineers and project managers, and we can not be certain that we will be able to hire or re-hire sufficiently qualified personnel in adequate numbers to meet the demand for our services. We also believe that our success depends to a significant extent on the ability of our key personnel to operate effectively, both individually and as a group. If we are unable to identify, hire and integrate new employees in a timely and cost-efficient manner, our operating results will suffer.

Our failure to maintain appropriate staffing levels could adversely affect our business.

We can not be certain that we will be able to hire the requisite number of experienced and skilled personnel when necessary in order to service a major contract, particularly if the market for related personnel becomes competitive. Conversely, if we maintain or increase our staffing levels in anticipation of one or more projects and the projects are delayed, reduced or terminated, we may underutilize the additional personnel, which would increase our general and administrative expenses, reduce our earnings and possibly harm our results of operations. If we are unable to obtain major contracts or effectively complete such contracts due to staffing deficiencies, our revenues may decline and our business may be harmed.

Government regulations could restrict our ability to hire employees or to utilize employees effectively.

As of September 30, 2006, approximately 138 or 8% of our employees in the United States were working under H-1B visas. H-1B visas are a special class of nonimmigrant working visas for qualified aliens working in specialty occupations, including, for example, radio frequency engineers. The H-1B program refers to a provision of the United States Immigration and Nationality Act that allows highly skilled foreigners to work in the United States for as long as six years. Current law limits the number of foreign workers who may be issued a visa or otherwise be provided H-1B status to 65,000 plus 20,000 additional numbers for the U.S. advanced degree exception through 2006.

Immigration policies are subject to rapid change, and these policies have become more stringent since the terrorist attacks on September 11, 2001. Any additional significant changes in immigration law or regulations may further restrict our ability to continue to employ or to hire new workers on H-1B visas and otherwise restrict our ability to utilize our existing employees as we see fit, and, therefore, could harm our business.

International uncertainties and fluctuations in the value of foreign currencies could harm our profitability.

We currently have international operations, including offices in Brazil, China, India, the United Kingdom, Sweden and Turkey. For the nine months ended September 30, 2006, international operations accounted for approximately 8% of our total revenues. Our international business operations are subject to a number of material risks, including, but not limited to:

- difficulties in building and managing foreign operations;
- regulatory uncertainties in foreign countries, including changing regulations and delays in licensing carriers to build out their networks in various locations;
- difficulties in enforcing agreements and collecting receivables through foreign legal systems and addressing other legal issues;
- longer payment cycles;
- foreign and U.S. taxation issues;
- potential weaknesses in foreign economies, particularly in Europe and Latin and South America;
- fluctuations in the value of foreign currencies;
- general economic and political conditions in the markets in which we operate; and
- unexpected domestic and international regulatory, economic or political changes.

Our significant international subsidiaries (i.e., in Brazil and the United Kingdom) procure certain transactions that are denominated in U.S. dollars. Downward fluctuations in the value of foreign currencies, compared to the U.S. dollar, may make our services more expensive than local service offerings in international locations. This would make our service offerings less price competitive than local service offerings, which could harm our business. To date, our experience with this foreign currency risk has predominately related to the Brazilian Real and Mexican Peso. In addition, we also conduct business in British Pound Sterling, Chinese Renminbi, Indian Rupee, Euro, Swedish Krona and Turkish Lira. We do not currently engage in currency hedging activities to limit the risks of currency fluctuations. Therefore, fluctuations in foreign currencies could have a negative impact on the profitability of our global operations, which would harm our financial results.

Payment for the sale of our operations in Mexico was made in part by promissory note, which could be placed into default in the event of non-payment by the buyer.

As part of the sales price of the Company's subsidiaries in Mexico, we received a \$17.4 million promissory note from the buyer of which the current balance is \$9.6 million. Although the note is secured by a pledge of assets and a personal guaranty, the buyer could default on the note. If upon the execution of the pledges on the assets and the personal guaranty, there were insufficient funds for a full payment of the note, we would incur a loss on the transaction.

If we fail to maintain an effective system of internal controls, we may not be able to accurately report our financial results or prevent fraud.

As described in Item 9A of our annual report on Form 10-K for the year ended December 31, 2005, we restated our previously issued financial statements for the quarters ended July 1, 2005 and September 30, 2005 to reflect the accounting impact of the cancellation of sites by one of our customers in Mexico in those periods. In addition, as described in Item 4 of this Report, we are still in the process of remediating one of the two material weaknesses identified in Item 9A of our annual report on Form 10-K

for the year ended December 31, 2005 and as a result, management was unable to conclude that our disclosure controls and procedures were effective as of September 30, 2006. We have implemented, and continue to implement, actions to address this weakness and to enhance the reliability and effectiveness of our internal controls and operations, however, we cannot assure you that the measures we have taken to date or any future measures will remediate the material weakness discussed in this Report.

In addition, from time to time we acquire businesses which could have limited infrastructure and systems of internal controls. Performing assessments of internal controls, implementing necessary changes, and maintaining an effective internal controls process is costly and requires considerable management attention, particularly in the case of newly acquired entities. Internal control systems are designed in part upon assumptions about the likelihood of future events, and all such systems, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

We also cannot assure you that we will implement and maintain adequate controls over our financial processes and reporting in the future or that additional material weaknesses or significant deficiencies in our internal controls will not be discovered in the future. Any failure to remediate any future material weaknesses or implement required new or improved controls, or difficulties encountered in their implementation, could harm our operating results, cause us to fail to meet our reporting obligations or result in material misstatements in our financial statements or other public disclosures. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could have a negative effect on the trading price of our stock.

Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, SEC regulations and NASDAQ Stock Market rules, are creating uncertainty for companies such as ours. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest appropriate resources to comply with evolving standards, and this investment has resulted in and may continue to result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

If our officers, directors and principal stockholders choose to act together, they may be able to exert significant influence over our management and operations, acting in their best interests and not in the best interests of other stockholders.

As of September 30, 2006, our executive officers and directors and their affiliates beneficially owned, in the aggregate, approximately 34.7% of our outstanding common stock, after giving effect to the conversion of Series B Convertible Preferred Stock. In particular, our current Chairman, Masood K. Tayebi, beneficially owned approximately 9.1% of our outstanding common stock. 8.7% of our outstanding common stock is beneficially owned by certain of our other officers and directors and their affiliates. The remaining 16.9% is beneficially owned by other members of the Tayebi family. As a result, the executive officers, directors and their affiliates are able to collectively exercise significant influence over matters requiring stockholder approval, such as the election of directors and the approval of significant corporate transactions. The interests of this group of stockholders may not always coincide with our

interests or the interests of other stockholders, and they may act in a manner that advances their best interests and not necessarily those of other stockholders. As a result of their actions or inactions, our stock price may decline.

We may need additional capital in the future to fund the growth of our business, and financing may not be available.

We currently anticipate that our available capital resources, including our line of credit, and operating cash flows will be sufficient to meet our expected working capital and capital expenditure requirements for at least the next 12 months. However, we cannot assure you that such resources will be sufficient to fund the long-term growth of our business. In particular, we may experience a negative operating cash flow due to billing milestones and project timelines in certain of our contracts. We may raise additional funds through public or private debt or equity financings if such financings become available on favorable terms or we may expand the \$85 million senior credit facility the Company entered into on October 2, 2006 to fund future acquisitions and for general corporate purposes. We also filed a universal shelf registration statement on Form S-3. Under this shelf registration statement, we may sell, in one or more public offerings, shares of newly issued common stock or preferred stock, warrants or debt securities, or any combination of such securities, for proceeds in an aggregate amount of up to \$200 million. Such financing or offerings would likely dilute our stockholders' equity ownership. In addition, we cannot assure you that any additional financing we may need will be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, we may not be able to take advantage of unanticipated opportunities, develop new products or otherwise respond to competitive pressures. In any such case, our business, operating results or financial condition could be materially adversely affected.

Litigation may harm our business or otherwise distract our management.

Substantial, complex or extended litigation could cause us to incur large expenditures and distract our management. For example, lawsuits by employees, stockholders or customers could be very costly and substantially disrupt our business. Disputes from time to time with such companies or individuals are not uncommon, and we cannot assure you that that we will always be able to resolve such disputes on terms favorable to us.

In addition, we and certain of our current and former officers and directors have been named defendants in class action and derivative lawsuits. While we believe that allegations lack merit and we intend to vigorously defend all claims asserted, we are unable to estimate what our liability in these matters may be. We may be required to pay judgments or settlements and incur expenses in connection with such matters in aggregate amounts that could have a material adverse effect on our business financial condition, results of operations and cash flows.

Disclosure of trade secrets could aid our competitors.

We attempt to protect our trade secrets by entering into confidentiality and intellectual property assignment agreements with third parties, our employees and consultants. However, these agreements can be breached and, if they are, there may not be an adequate remedy available to us. In addition, others may independently discover our trade secrets and proprietary information and in such cases we could not assert any trade secret rights against such party. Enforcing a claim that a party illegally obtained and is using our trade secret is difficult, expensive and time consuming, and the outcome is unpredictable. If our trade secrets become known we may lose our competitive position.

Our stock price may be volatile, which may result in lawsuits against us and our officers and directors.

The stock market in general and the stock prices of technology and telecommunications companies in particular, have experienced volatility that has often been unrelated to or disproportionate to the operating performance of those companies. The market price of our common stock has fluctuated in the past and is likely to fluctuate in the future. Factors which could have a significant impact on the market price of our common stock include, but are not limited to, the following:

- quarterly variations in operating results;
- announcements of new services by us or our competitors;
- the gain or loss of significant customers;
- changes in analysts' earnings estimates;
- rumors or dissemination of false information;
- pricing pressures;
- short selling of our common stock;
- impact of litigation;
- general conditions in the market;
- political and/or military events associated with current worldwide conflicts; and
- events affecting other companies that investors deem comparable to us.

Companies that have experienced volatility in the market price of their stock have frequently been the object of securities class action litigation. We and certain of our current and former officers and directors have been named defendants in class action and derivative lawsuits. These matters and any other securities class action litigation in which we may be involved, could result in substantial costs to us and a diversion of our management's attention and resources, which could materially harm our financial condition and results of operations.

Our charter documents and Delaware law may deter potential acquirers and may depress our stock price.

Certain provisions of our charter documents and Delaware law, as well as certain agreements we have with our executives, could make it substantially more difficult for a third party to acquire control of us. These provisions include:

- authorizing the board of directors to issue preferred stock;
- prohibiting cumulative voting in the election of directors;
- prohibiting stockholder action by written consent;
- establishing advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted on by stockholders at meetings of our stockholders;
- Section 203 of the Delaware General Corporation Law, which prohibits us from engaging in a business combination with an interested stockholder unless specific conditions are met; and
- a number of our executives have agreements with us that entitle them to payments in certain circumstances following a change in control.

In addition, on December 16, 2004, we adopted a stockholder rights plan (“Rights Plan”). Pursuant to the Rights Plan, our Board of Directors declared a dividend distribution of one preferred share purchase

right (“Right”) on each outstanding share of our common stock. Each Right will entitle stockholders to buy one one-hundredth of a share of newly created Series C Preferred Stock at an exercise price of \$54, subject to adjustment, in the event that the Rights become exercisable. Subject to limited exceptions, the Rights will become exercisable if a person or group acquires 15% or more of our common stock or announces a tender offer for 15% or more of the common stock. If we are acquired in a merger or other business combination transaction which has not been approved by our Board of Directors, each Right will entitle its holder to purchase, at the Rights then-current exercise price, a number of the acquiring company’s common shares having a market value at the time of twice the Rights exercise price. These provisions may discourage certain types of transactions involving an actual or potential change in control and may limit our stockholders’ ability to approve transactions that they deem to be in their best interests. As a result, these provisions may depress our stock price.

Item 6. Exhibits

(a). *Exhibits:*

- 2.1 Stock Purchase Agreement by and among the Company, JMA Associates, Inc. d/b/a TLA Associates and the Stockholders of JMA Associates, Inc. dated as of January 27, 2005.(1)
- 2.2 Equity Purchase Agreement, dated February 17, 2006, by and between Sakoki LLC and the Company.(6)
- 2.3 Addendum and Waiver Related to the Equity Purchase Agreement, dated June 26, 2006, by and between Sakoki LLC and the Company.(7)
- 3.1 Amended and Restated Certificate of Incorporation.(2)
- 3.2 Bylaws in effect since November 5, 1999.(3)
- 3.3 Certificate of Designations, Preferences and Rights of Series B Preferred Stock.(4)
- 3.4 Certificate of Designation of Series C Preferred Stock.(5)
- 4.1 Reference is made to Exhibits 3.1, 3.2, 3.3 and 3.4.
- 4.2 Specimen Stock Certificate.(1)
- 4.3 Rights Agreement, dated as of December 16, 2004, between the Company and Wells Fargo, N.A.(5)
- 31.1 Periodic Report Certification by Chief Executive Officer of Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
- 31.2 Periodic Report Certification by Chief Financial Officer of Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
- 32.1 Periodic Report Certification by Chief Executive Officer of Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*
- 32.2 Periodic Report Certification by Chief Financial Officer of Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2006, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

* Filed herewith.

- (1) Filed as an exhibit to the Company’s Current Report on Form 8-K, filed on January 16, 2004 and incorporated herein by reference.
- (2) Filed as an exhibit to the Company’s Quarterly Report on Form 10-Q for the quarter ended September 28, 2001, filed on November 13, 2001 and incorporated herein by reference.
- (3) Filed as an exhibit to the Company’s Registration Statement on Form S-1 (No. 333-85515), and incorporated herein by reference.
- (4) Filed as an exhibit to the Company’s Current Report on Form 8-K/A filed on June 5, 2002, and incorporated herein by reference.
- (5) Filed as an exhibit to the Company’s Current Report Form 8-K filed on December 17, 2004 and incorporated herein by reference.
- (6) Filed as an exhibit to the Company’s Current Report on Form 8-K filed on February 23, 2006 and incorporated herein by reference.
- (7) Filed as an exhibit to the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2006 and incorporated herein by reference.

SIGNATURE

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

WIRELESS FACILITIES, INC.

By: /s/ ERIC M. DEMARCO
Eric M. DeMarco
Chief Executive Officer, President

By: /s/ DEANNA H. LUND, CPA
Deanna H. Lund
Senior Vice President, Chief Financial Officer

By: /s/ LAURA L. SIEGAL
Laura L. Siegal
Vice President, Corporate Controller and Principal Accounting Officer

Date: November 9, 2006

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Eric M. DeMarco, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Wireless Facilities, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2006

/s/ ERIC M. DEMARCO

Eric M. De Marco

Chief Executive Officer and President

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Deanna H. Lund, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Wireless Facilities, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2006

/s/ DEANNA H. LUND

Deanna H. Lund

Chief Financial Officer

**CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)**

In connection with the accompanying Quarterly Report of Wireless Facilities, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2006 (the "Report"), I, Eric M. DeMarco, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 9, 2006

WIRELESS FACILITIES, INC.

By: /s/ ERIC M. DEMARCO

Eric M. DeMarco

Chief Executive Officer

**CERTIFICATION PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002
(18 U.S.C. SECTION 1350)**

In connection with the accompanying Quarterly Report of Wireless Facilities, Inc. (the "Company") on Form 10-Q for the quarter ended September 30, 2006 (the "Report"), I, Deanna H. Lund, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: November 9, 2006

WIRELESS FACILITIES, INC.

By: /s/ DEANNA H. LUND

Deanna H. Lund

Chief Financial Officer
