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SKYTERRA COMMUNICATIONS INC

Form 10-Q

May 17, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

/x/ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the period ended March 31, 2004, or

/ / Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission file number 0-13865

SKYTERRA COMMUNICATIONS, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

23-2368845
(I.R.S. Employer
Identification Number)

19 West 44th Street, Suite 507
New York, New York
(Address of principal executive offices)

10036
(Zip Code)

Registrant's telephone number, including area code: (212) 730-7540

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 periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes /x/ No / /

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

Yes / / No /x/

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

As of May 13, 2004, 6,067,476 shares of the registrant's voting common stock and 8,990,212 shares of the registrant's non-voting common stock were outstanding.

SKYTERRA COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands except share data)

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	March 2004
	(Unaudi
Assets	
Current assets:	
Cash and cash equivalents	\$
Short-term investments	
Total cash, cash equivalents and short-term investments	-----
Accounts receivable, net	
Note receivable from Verestar, Inc.	
Prepaid expenses and other current assets	
Total current assets	-----
Property and equipment, net	
Notes receivable from the Mobile Satellite Venture, L.P.	
Note receivable from Motient Corporation, net	
Investments in affiliates	
Other assets	
Total assets	----- \$ =====
Liabilities and Stockholders' Deficit	
Current liabilities:	
Accounts payable	
Accrued liabilities	
Deferred revenue	
Total current liabilities	-----
Series A Convertible Preferred Stock, \$.01 par value, net of unamortized discount of \$35,880 and \$36,979, respectively	-----
Minority interest	-----
Stockholders' deficit:	
Preferred stock, \$.01 par value. Authorized 10,000,000 shares; issued 1,185,230 shares as Series A Convertible Preferred Stock at March 31, 2004 and 1,171,612 shares at December 31, 2003	
Common stock, \$.01 par value. Authorized 200,000,000 shares; issued and outstanding 6,078,591 shares at March 31, 2004 and 6,075,727 shares at December 31, 2003	
Non-voting common stock, \$.01 par value. Authorized 100,000,000 shares; issued and outstanding 8,990,212 shares at each of March 31, 2004 and December 31, 2003	
Additional paid-in capital	5
Accumulated deficit	(5
Treasury stock, at cost, 6,622 shares	
Total stockholders' deficit	-----
Total liabilities and stockholders' deficit	----- \$ =====

See accompanying notes to unaudited consolidated financial statements.

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SKYTERRA COMMUNICATIONS, INC.
 UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS
 (In thousands except share data)

	Three Months
	2004
Revenues	\$817
Cost of revenues	748
Gross profit	69
Expenses:	
Selling, general and administrative	1,764
Depreciation and amortization	15
Total expenses	1,779
Loss from operations	(1,710)
Interest income, net	2,161
Loss on investments in affiliates	(151)
Other income (expense), net	36
Minority interest	(300)
Income (Loss) before discontinued operations	36
Gain from wind-down of discontinued operations	--
Net income (loss)	36
Cumulative dividends and accretion of convertible preferred stock to liquidation value	(2,461)
Net loss attributable to common stockholders	\$ (2,425)
Basic and diluted (loss) earnings per share:	
Continuing operations	\$ (0.16)
Discontinued operations	--
Net loss per share	\$ (0.16)
Basic weighted average common shares outstanding	15,063,807

See accompanying notes to unaudited consolidated financial statements.

SKYTERRA COMMUNICATIONS, INC.
 UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (In thousands)

Three Months

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	----- 2004 -----
Cash flows from operating activities:	
Net income (loss)	\$36
Adjustments to reconcile net loss to net cash used in operating activities:	
Gain from discontinued operations	--
Depreciation and amortization	15
Loss on investments in affiliates	151
Non-cash compensation expense	263
Non-cash charge for issuance of warrant by consolidated subsidiary	--
Changes in assets and liabilities:	
Accounts receivable, net	(68)
Prepaid expenses, interest receivable and other assets	(2,151)
Accounts payable, accrued and other liabilities	(306)
Deferred revenue	(86)

Net cash used in continuing operations	(2,146)
Net cash used in discontinued operations	(18)

Net cash used in operating activities	(2,164)
Cash flows from investing activities:	
Sales of short-term investments	5,100
Purchases of short-term investments	(2,206)
Cash paid for investments in affiliates	(334)
Purchases of property and equipment, net	(3)

Net cash provided by investing activities	2,557
Cash flows from financing activities:	
Proceeds from issuance of common stock in connection with the exercise of options	6
Proceeds from contributions to a consolidated subsidiary	--

Net cash provided by financing activities	6

Net increase (decrease) in cash and cash equivalents	399
Cash and cash equivalents, beginning of period	9,897

Cash and cash equivalents, end of period	\$10,296 =====

See accompanying notes to unaudited consolidated financial statements.

SKYTERRA COMMUNICATIONS, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) Description of the Business

SkyTerra Communications, Inc. (the "Company") operates its business through a group of complementary companies in the telecommunications industry, including the Mobile Satellite Venture, L.P. joint venture ("MSV Joint Venture"), Electronic System Products, Inc. ("ESP"), IQStat, Inc. (now doing business as Navigauge, Inc., "Navigauge"), and Miraxis, LLC ("Miraxis"). Consistent with this strategy, in April 2004, the Company acquired a majority interest in AfriHUB LLC ("AfriHUB"). Through exclusive partnerships with certain Nigerian based universities, AfriHUB intends to provide satellite based broadband Internet access, domestic and international calling services, and a

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combination of instructor led and distance based technical training.

Through its 80% owned MSV Investors, LLC subsidiary ("MSV Investors Subsidiary"), the Company is an active participant in the MSV Joint Venture, a joint venture that also includes TMI Communications, Inc., Motient Corporation ("Motient"), and certain other investors (collectively, the "Other MSV Investors"). The MSV Joint Venture is currently a provider of mobile digital voice and data communications services via satellite in North America. The Company has designated three members of the 12-member board of directors of the MSV Joint Venture's corporate general partner.

On February 10, 2003, the Federal Communications Commission (the "FCC") released an order relating to an application submitted by the MSV Joint Venture and certain of its competitors that could greatly expand the scope of the MSV Joint Venture's business by permitting the incorporation of ancillary terrestrial base stations (which we refer to as an "ancillary terrestrial component" or "ATC") into its mobile satellite network. A similar application is pending before Industry Canada, the FCC's counterpart in Canada. With the FCC's issuance of the ATC order, the MSV Joint Venture has entered a new stage of development which requires significant future funding requirements and/or a need for one or more strategic partners.

In the ATC order, the FCC established certain requirements with which a mobile satellite service provider must comply in order to operate an ATC. In November 2003, the MSV Joint Venture filed an application demonstrating its compliance with the requirements. The FCC has put the application out for public comment, and all objections and responses, if any, should be filed with the FCC during the second quarter of 2004.

The Company is headquartered in New York, New York.

(2) Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared by the Company in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting only of those of a normal recurring nature, necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated. While the Company believes that disclosures presented are adequate to make the information not misleading, these unaudited consolidated financial statements should be read in conjunction with the audited financial statements and related notes for the year ended December 31, 2003 which are contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission. The results of the three months ended March 31, 2004 are not necessarily indicative of the results to be expected for the full year. Certain prior year amounts in the consolidated financial statements have been reclassified to conform to the current year's presentation.

(3) Interest in the MSV Joint Venture

On November 26, 2001, through its MSV Investors Subsidiary, the Company purchased an interest in the MSV Joint Venture in the form of a convertible note with a principal amount of \$50.0 million. Immediately prior to the purchase of the convertible note, the Company contributed \$40.0 million to the MSV Investors Subsidiary and a group of unaffiliated third parties collectively contributed \$10.0 million. The note bears interest at a rate of 10% per year, has a maturity date of November 26, 2006, and is convertible at any time at the

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option of the MSV Investors Subsidiary into equity interests in the MSV Joint Venture.

On August 13, 2002, the MSV Joint Venture completed a rights offering allowing its investors to purchase their pro rata share of an aggregate \$3.0 million of newly issued convertible notes with terms similar to the convertible note already held by the MSV Investors Subsidiary. The MSV Investors Subsidiary exercised its basic and over subscription rights and purchased approximately \$1.1 million of the convertible notes. The group of unaffiliated third parties collectively contributed \$0.2 million to the MSV Investors Subsidiary in connection with the MSV Joint Venture rights offering.

Pursuant to the joint venture agreement among the partners of the MSV Joint Venture (the "MSV Joint Venture Agreement"), in the event that the MSV Joint Venture had received final regulatory approval from the FCC, as that phrase is defined in the MSV Joint Venture Agreement, by March 31, 2003 for its ATC applications, the Other MSV Investors would have been obligated to invest an additional \$50.0 million in the MSV Joint Venture. As the final regulatory approval from the FCC, as defined in the MSV Joint Venture Agreement, was not received by March 31, 2003, the additional investment was not required. However, the Other MSV Investors retained the option to invest the \$50.0 million on the same terms and conditions until June 30, 2003. Prior to its expiration, the option was extended until August 2003. On August 8, 2003, the MSV Joint Venture Agreement was amended and certain of the Other MSV Investors agreed to invest \$3.7 million in the MSV Joint Venture and retain the option to invest an additional \$17.6 million under certain terms and conditions. On April 2, 2004, those certain Other MSV Investors exercised the option in full.

Under the amended MSV Joint Venture Agreement, the convertible notes held by the MSV Investors Subsidiary will automatically convert into equity interests in the MSV Joint Venture upon the repayment of (i) the outstanding principal and accrued interest on certain outstanding debt of the MSV Joint Venture and (ii) the accrued interest on all outstanding convertible notes of the MSV Joint Venture, including the convertible notes held by the MSV Investors Subsidiary. Such principal and accrued interest totaled approximately \$39.1 million following the April 2, 2004 exercise of the option held by the certain Other MSV Investors and will need to increase thereafter by an amount equal to the additional interest accrued on the certain outstanding debt and convertible notes. Any additional equity investments used to repay these obligations must be made at a valuation of the MSV Joint Venture equal to or greater than the valuation at the time the MSV Investors Subsidiary purchased the notes. Currently, the MSV Investors Subsidiary owns, upon conversion, approximately 27.4% of the equity interests in the MSV Joint Venture.

The \$10.2 million received from unaffiliated persons as an investment into the MSV Investors Subsidiary, as well as their share of the equity in earnings of the MSV Investors Subsidiary, is reflected in the accompanying consolidated financial statements as minority interest.

(4) Business Transactions

(a) Verestar Transactions

In August 2003, the Company signed a securities purchase agreement to acquire, through a newly formed subsidiary, approximately 66.7% (on a fully-diluted basis) of Verestar. Concurrent with the signing of the securities purchase agreement, the Company purchased a 10% senior secured note with a principal balance of \$2.5 million and a due date of August 2007. The Company terminated the securities purchase agreement on December 22, 2003. Subsequently, Verestar filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code.

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In March 2004, the Company executed an asset purchase agreement to acquire, through a newly formed subsidiary, substantially all of the assets and business of Verestar pursuant to Section 363 of the Bankruptcy Code. The transaction was subject to a number of contingencies, including an auction on March 30, 2004 at which Verestar considered higher and better offers. At the auction, a bid was accepted from a strategic buyer at a price higher than the Company was willing to offer.

In April 2004, Verestar paid the Company approximately \$2.9 million representing the \$2.5 million outstanding principal amount of the senior secured note and approximately \$0.4 million representing certain other amounts owed to the Company and/or one of its subsidiaries.

In connection with the termination of the August 2003 securities purchase agreement on December 22, 2003, the Company believes that it is entitled to a \$3.5 million break up fee and potentially certain other damages from Verestar's parent company. Verestar's parent company has not agreed that all such amounts are due, and the Company is currently in discussions to resolve the issue (see Note 9).

(b) Interest in Miraxis

In May 2002, the Company acquired Series B Preferred Shares and a warrant from Miraxis for approximately \$0.4 million, representing an ownership of approximately 30%. Miraxis is a development stage, privately held telecommunications company that has access to a Ka-band license with which it intends to provide satellite based multi-channel, broadband data and video services in North America. The Company has the right to appoint two of the five directors of the manager of Miraxis. Additionally, the Company entered into a management support agreement with Miraxis under which the Company's current Chief Executive Officer and President provided certain services to Miraxis through February 2003 in exchange for additional Series B Preferred Shares and warrants being issued to the Company. In addition, in December 2002, the Company acquired Series C Preferred Shares and warrants from Miraxis for approximately \$0.1 million.

In February 2003, the Company entered into a consulting agreement with Miraxis pursuant to which Miraxis personnel provided services to the Company through May 2003. In addition, Miraxis extended the management support agreement whereby the Company's current Chief Executive Officer and President continued to provide certain services to Miraxis through May 2003. In connection with these agreements, the Company paid Miraxis approximately \$40,000 but also received additional Series C Preferred Shares and warrants.

In April 2003, the Company acquired additional Series C Preferred Shares and warrants for approximately \$40,000. Between June 2003 and September 2003, the Company purchased promissory notes from Miraxis with an aggregate principal amount of approximately \$0.1 million. In November 2003, the promissory notes were converted to Series D Preferred Shares. In 2004 through the date hereof, the Company purchased additional promissory notes with an aggregate principal balance of approximately \$0.1 million. Currently, the Company holds approximately 40% of the ownership interests of Miraxis. The Company's President and Chief Executive Officer currently holds an approximate 1% interest in Miraxis.

Miraxis License Holdings, LLC ("MLH"), an entity unaffiliated with Miraxis, other than as described herein, holds the rights to certain orbital slots that Miraxis has acquired access to in order to implement its business plan. Miraxis issued 10% of its outstanding common equity on a fully diluted basis to MLH as partial consideration for access to those slots. In addition, Miraxis expects to pay certain royalties to MLH for use of the slots should it ever launch satellites. Prior to becoming affiliated with the Company, its

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Chief Executive Officer and President acquired a 2% interest in MLH. In addition, prior to the Company acquiring an interest in Miraxis, an affiliate of the Company's preferred stockholders acquired an approximate 70% interest in MLH.

In accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 46R, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN No. 46R"), beginning January 1, 2004, the operating results and financial position of Miraxis have been included in the consolidated financial statements. Prior to January 1, 2004, this investment was included in "Investments in Affiliates" on the accompanying consolidated balance sheets and was accounted for under the equity method with the Company's share of Miraxis' loss being recorded in "Loss on Investments in Affiliates" on the accompanying consolidated statements of operations. The consolidation of Miraxis did not have a material impact on the Company's operating results or financial position.

(c) Interest in Navigauge

In April 2003, the Company acquired Series B Preferred Shares from IQStat, now doing business as Navigauge, for approximately \$0.3 million, representing an ownership interest of approximately 5%. Navigauge is a privately held media and marketing research firm that collects data on in-car radio usage and driving habits of consumers and markets the aggregate data to radio broadcasters, advertisers and advertising agencies in the United States.

In connection with the acquisition of ESP in August 2003, the Company obtained indirect ownership of Series A Preferred Shares representing an additional 16% ownership interest in Navigauge. In December 2003, the Company acquired additional Series B Preferred Shares and warrants for approximately \$0.1 million. In 2004 through the date hereof, the Company acquired additional Series B Preferred Shares and warrants from Navigauge for approximately \$0.5 million. Furthermore, in April 2004 and May 2004, the Company purchased short-term promissory notes from Navigauge with an aggregate principal amount of approximately \$0.3 million. Currently, the Company owns approximately 25% of the outstanding equity of Navigauge.

This investment is included in "Investments in Affiliates" on the accompanying consolidated balance sheets and is being accounted for under the equity method with the Company's share of Navigauge's loss being recorded in "Loss on Investments in Affiliates" on the accompanying consolidated statements of operations.

(5) Note Receivable from Motient

On May 1, 2002, to mitigate the risk, uncertainties and expenses associated with Motient's plan of reorganization, the Company cancelled the outstanding amounts due under the original promissory notes issued by Motient and accepted a new note in the principal amount of \$19.0 million (the "New Motient Note") that was issued by a new, wholly-owned subsidiary of Motient that owns 100% of Motient's interests in the MSV Joint Venture ("MSV Holdings Inc."). The New Motient Note is due on May 1, 2005 and bears interest at a rate of 9% per annum. Although the New Motient Note is unsecured, there are material restrictions placed on MSV Holdings Inc.'s assets, and MSV Holdings Inc. is prohibited from incurring or guarantying any debt in excess of \$21.0 million (including the New Motient Note). Additionally, there are events of default (e.g., a bankruptcy filing by Motient) that would accelerate the due date of the New Motient Note. In April 2004, Motient paid approximately \$0.5 million of interest accrued on the New Motient Note. This amount has been reflected in the accompanying consolidated statement of operations as interest income and in the accompanying consolidated balance sheets in prepaid expenses and other current assets. As a result of the uncertainty with respect to the ultimate collection

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on the remaining amounts due on the New Motient Note, a reserve continues to be maintained for the entire principal amount of the note and unpaid interest accrued thereon (see Note 9).

(6) Stock Option Plans

The Company accounts for its stock option plan in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), which allows entities to continue to apply the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB Opinion No. 25"), as clarified by FASB Interpretation No. 44, "Accounting For Certain Transactions Involving Stock Compensation," and provides pro forma net income and pro forma earnings per share disclosures for employee stock option grants made in 1995 and future years as if the fair-value-based method, as defined in SFAS No. 123, had been applied. The Company has elected to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure required by SFAS No. 123.

APB Opinion No. 25 does not require the recognition of compensation expense for stock options granted to employees at fair market value. However, any modification to previously granted awards generally results in compensation expense or contra-expense recognition using the cumulative expense method, calculated based on quoted prices of the Company's common stock and vesting schedules of underlying awards. As a result of the re-pricing of certain stock options, for the three months ended March 31, 2004 and 2003, the Company recognized compensation expense of approximately \$0.3 million and \$7,000, respectively.

The following table provides a reconciliation of net loss to pro forma net loss as if the fair value method had been applied to all awards:

	Three Months Ended
	2004

Net income (loss), as reported	\$36
Add: Stock-based compensation expense, as reported	263
Deduct: Total stock-based compensation expense determined under fair value based method for all awards	(65)

Pro forma net income (loss)	\$234
	=====
Basic and diluted net loss attributable to common stockholders per share	
As reported	\$(0.16)
Pro forma	\$(0.15)

For the three months ended March 31, 2004, the Company issued options to purchase 145,000 shares of common stock at a weighted average fair value of \$1.77 using the Black-Scholes option pricing model. No stock options were issued during the three months ended March 31, 2003.

(7) Discontinued Operations

From 1998 through the third quarter of 2001, the Company's principal business was conducted through Rare Medium, Inc., which developed Internet e-commerce strategies, business processes, marketing communications, branding strategies and interactive content using Internet-based technologies and

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solutions. As a result of the weakening of general economic conditions that caused many companies to reduce spending on Internet-focused business solutions and in light of their performance and prospects, a decision to discontinue Rare Medium, Inc.'s operations, along with those of its LiveMarket, Inc. subsidiary ("LiveMarket"), was made at the end of the third quarter of 2001. As of March 31, 2004, cash of approximately \$32,000 (excluding the \$0.3 million of cash collateralizing a letter of credit) was the remaining asset of Rare Medium, Inc. and LiveMarket. The liabilities of these subsidiaries totaled approximately \$2.3 million, consisting of accounts payable and accrued expenses. Included in the total liabilities of these subsidiaries is \$1.0 million related to a lease obligation which is guaranteed by the Company. The total maximum potential liability of this guarantee is \$3.4 million, subject to certain defenses by the Company. Rare Medium, Inc. holds \$0.3 million of cash in a certificate of deposit which is maintained as collateral for a letter of credit supporting the lease obligation. For the three months ended March 31, 2004 and 2003, the Company recognized a gain of nil and approximately \$0.5 million, respectively, as a result of the settlement of Rare Medium, Inc. liabilities at amounts less than their recorded amounts.

(8) Related Party Transactions

During the three months ended March 31, 2004, ESP recognized revenues totaling approximately \$0.4 million for certain services provided to Navigauge and the MSV Joint Venture.

(9) Contingencies

Motient Note Receivable

On May 1, 2002, to mitigate the risk, uncertainties and expenses associated with Motient's plan of reorganization, the Company cancelled the outstanding amounts due under the original promissory notes issued by Motient and accepted a new note in the principal amount of \$19.0 million (the "New Motient Note") that was issued by a new, wholly-owned subsidiary of Motient that owns 100% of Motient's interests in the MSV Joint Venture ("MSV Holdings Inc."). The New Motient Note is due on May 1, 2005 and bears interest at a rate of 9% per annum. Although the New Motient Note is unsecured, there are material restrictions placed on MSV Holdings Inc.'s assets, and MSV Holdings Inc. is prohibited from incurring or guarantying any debt in excess of \$21.0 million (including the New Motient Note). Additionally, there are events of default (e.g., a bankruptcy filing by Motient) that would accelerate the due date of the New Motient Note. In April 2004, Motient paid approximately \$0.5 million of interest accrued on the New Motient Note. This amount has been reflected in the accompanying consolidated statement of operations as interest income and in the accompanying consolidated balance sheets in prepaid expenses and other current assets. As a result of the uncertainty with respect to the ultimate collection on the remaining amounts due on the New Motient Note, a reserve continues to be maintained for the entire principal amount of the note and unpaid interest accrued thereon. If the Company recovers any amount on the principal of the New Motient Note, adjustments to the reserve would be reflected as other income in the accompanying consolidated statements of operations.

Verestar Transactions

On August 29, 2003, we signed a securities purchase agreement to acquire, through a newly formed subsidiary, approximately 66.7% (on a fully-diluted basis) of Verestar. Concurrent with the signing of the securities purchase agreement, we purchased a 10% senior secured note with a principal balance of \$2.5 million and a due date of August 2007. We terminated the securities purchase agreement on December 22, 2003. Subsequently, Verestar filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code. In connection with the Verestar bankruptcy, we entered into a stipulation with

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Verestar under which the parties agreed to, among other things, the validity and enforcement of the obligation under the senior secured note and the Company's security interest in Verestar's assets. The bankruptcy court approved the stipulation on February 9, 2004. On March 26, 2004, the Company entered a consent order with the Creditors' Committee pursuant to which the Creditors' Committee stipulated to the allowance of the \$2.5 million secured claim on the senior secured note. On April 30, 2004, Verestar repaid the \$2.5 million principal amount of the senior secured note. The Company also stipulated to extend until June 16, 2004, the time in which the Creditors' Committee could object to certain additional claims of the Company under the note.

In connection with our termination of the securities purchase agreement on December 22, 2003, the Company believes that it is entitled to a \$3.5 million break up fee and potentially certain other damages from Verestar's parent company. Verestar's parent company has not agreed that all such amounts are due, and the Company is currently in discussions to resolve the issue. There can be no assurance that the Company will be successful in collecting all or part of the amount claimed. As such, we have not reflected this contingency in our consolidated financial statements. However, if the Company is successful in collecting any amount on this claim, a gain would be reflected in the accompanying consolidated statements of operations.

MSV Joint Venture Convertible Notes Receivable

As of March 31, 2004, the carrying value of the convertible notes from the MSV Joint Venture approximates fair value based on recent funding transactions. The MSV Joint Venture plans, subject to the receipt of certain FCC authorizations and Industry Canada approvals and raising adequate capital and/or entering into agreements with one or more strategic partners, to develop, build and operate a next-generation satellite system complemented by ATC. If the FCC authorization for the MSV Joint Venture to operate an ATC is not received, the MSV Joint Venture's business will be limited, and the value of the Company's interest in the MSV Joint Venture may be significantly impaired.

Litigation

On November 19, 2001, five of the Company's shareholders filed a complaint against the Company, certain of its subsidiaries and certain of the current and former officers and directors in the United States District Court for the Southern District of New York, *Dovitz v. Rare Medium Group, Inc. et al.*, No. 01 Civ. 10196. Plaintiffs became owners of restricted Company stock when they sold the company that they owned to the Company. Plaintiffs assert the following four claims against defendants: (1) common-law fraud; (2) violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder; (3) violation of the Michigan Securities Act; and (4) breach of fiduciary duty. These claims arise out of alleged representations by defendants to induce plaintiffs to enter into the transaction. The complaint seeks compensatory damages of approximately \$5.6 million, exemplary and/or punitive damages in the same amount, as well as attorney fees. On January 25, 2002, the Company filed a motion to dismiss the complaint in its entirety. On June 3, 2002, the Court dismissed the matter without prejudice. On or about July 17, 2002, the plaintiffs filed an amended complaint asserting similar causes of action to those asserted in the original complaint. On September 12, 2002, the Company filed a motion to dismiss on behalf of itself and its current and former officers and directors. On March 7, 2003, the Court denied the motion to dismiss, and discovery commenced. The Company expects to file and complete briefing on a motion for summary judgment in the third quarter of 2004. The Company intends to continue to dispute this matter vigorously.

The Company and certain of its subsidiaries (along with the Engelhard Corporation) are parties to an arbitration relating to certain agreements that

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existed between or among the claimant and ICC Technologies, Inc., the Company's former name, and the Engelhard/ICC ("E/ICC") joint venture arising from the desiccant air conditioning business that the Company and its subsidiaries sold in 1998. The claimant has sought \$8.5 million for (1) its alleged out of pocket losses in investing in certain of E/ICC's technology; (2) unjust enrichment resulting from the reorganization of E/ICC in 1998; and (3) lost profits arising from the fact that it was allegedly forced to leave the air conditioning business when the E/ICC joint venture was dissolved. The Company intends to vigorously dispute this action.

On July 26, 2002, plaintiffs James D. Loeffelbein, Terrie L. Pham and certain related parties filed suit against the lead plaintiff's counsel in the class action lawsuit, the Company, certain of its current and former officers, its former investor relations firm and a former employee of plaintiff Loeffelbein in the District Court of Johnson County, Kansas, *Loeffelbein v. Milberg Weiss Bershad Hynes & Lerach, LLP, et al.*, 02 CV 04867. The plaintiffs assert claims for fraud, negligence and breach of fiduciary duty against all of the Company and certain of its current and former officers in connection with allegedly false statements purportedly made to the plaintiffs. The plaintiffs have sought unspecified damages from the defendants. On September 11, 2002, the matter was removed to the United States District Court for the District of Kansas (the "Federal District Court"). On October 11, 2002, the plaintiffs sought to have the matter remanded to state court. On May 7, 2003, the Federal District Court denied the plaintiffs request to remand the matter as it related to the Company, the Company defendants and an additional defendant. On June 9, 2003, the Company and Company defendants filed a motion to dismiss. On August 4, 2003, the plaintiffs responded. On October 21, 2003, the Federal District Court dismissed the action, holding that it lacked personal jurisdiction over the Company and the Company defendants and, accordingly, found it unnecessary to rule upon the Company's other bases for dismissal. On February 26, 2004, the court denied a motion by the plaintiffs to reconsider the dismissal. On March 26, 2004, the plaintiffs filed a notice of appeal. The Company intends to vigorously oppose this appeal.

In August 2003, a former employee of the Company's discontinued services subsidiary, filed a putative class action against Rare Medium, Inc. and the Company, and certain other former subsidiaries that were merged into Rare Medium, Inc., in Los Angeles County Superior Court captioned *Joe Robuck, individually and on behalf of all similarly situated individuals v. Rare Medium Group, Inc., Rare Medium L.A., Inc., Rare Medium, Inc., and Rare Medium Dallas, Inc.*, Los Angeles County Superior Court Case No. BC300310. The plaintiff filed the action as a putative class action and putative representative action asserting that: (i) certain payments were purportedly due and went unpaid for overtime for employees with five job titles; (ii) certain related violations of California's overtime statute were committed when these employees were not paid such allegedly due and unpaid overtime at the time of their termination; and (iii) certain related alleged violations of California's unfair competition statute were committed. Plaintiff seeks to recover for himself and all of the putative class, alleged unpaid overtime, waiting time penalties (which can be up to 30 days' pay for each person not paid all wages due at the time of termination), interest, attorneys' fees, costs and disgorgement of profits garnered as a result of the alleged failure to pay overtime. Plaintiff has served discovery requests and all of the defendants have submitted objections and do not intend to provide substantive responses until the Court determines whether Plaintiff must arbitrate his individual claims. The Company intends to vigorously dispute this action.

Though it intends to continue to vigorously contest each of the aforementioned cases, the Company is unable to predict their respective outcomes, or reasonably estimate a range of possible losses, if any, given the current status of these cases. Additionally, from time to time, the Company is subject to litigation in the normal course of business. The Company is of the

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opinion that, based on information presently available, the resolution of any such additional legal matters will not have a material adverse effect on the Company's financial position or results of its operations.

(10) Subsequent Events

On April 19, 2004, the Company signed an agreement to acquire 80% of the outstanding membership interests of AfriHUB for an aggregate purchase price of \$1.5 million. Through exclusive partnerships with certain Nigerian based universities, AfriHUB intends to provide satellite based broadband Internet access, domestic and international calling services, and a combination of instructor led and distance based technical training. The Company's investment is payable in three tranches based upon progress made by AfriHUB against its business plan. As of the date hereof, the Company has purchased \$0.5 million of membership interests from AfriHUB. Our ownership interest is subject to dilution if AfriHUB meets certain operating and financial metrics.

On April 30, 2004, Verestar paid the Company approximately \$2.9 million representing the \$2.5 million outstanding principal amount of the senior secured note and approximately \$0.4 million representing certain other amounts owed to the Company and/or one of its subsidiaries.

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

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties, including statements regarding our capital needs, business strategy, expectations and intentions. We urge you to consider that statements that use the terms "believe," "do not believe," "anticipate," "expect," "plan," "estimate," "intend" and similar expressions are intended to identify forward-looking statements. These statements reflect our current views with respect to future events and because our business is subject to numerous risks, uncertainties and risk factors, our actual results could differ materially from those anticipated in the forward-looking statements, including those set forth below under this "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere in this report. Actual results will most likely differ from those reflected in these statements, and the differences could be substantial. We disclaim any obligation to publicly update these statements, or disclose any difference between our actual results and those reflected in these statements. The information constitutes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Overview

We operate our business through a group of complementary companies in the telecommunications industry, including the MSV Joint Venture, ESP, IQStat (now doing business as Navigauge) and Miraxis. Consistent with this strategy, in April 2004, we acquired a majority interest in AfriHUB LLC ("AfriHUB"). AfriHUB intends to provide satellite based broadband Internet access and domestic and international calling services to the African continent with a particular focus on the Nigerian market.

On April 19, 2004, we signed an agreement to acquire 80% of the outstanding membership interests of AfriHUB for an aggregate purchase price of \$1.5 million. Our ownership interest is subject to dilution if AfriHUB meets certain operating and financial metrics. Through exclusive partnerships with certain Nigerian based universities, AfriHUB intends to provide satellite based broadband Internet access, domestic and international calling services, and a combination of instructor led and distance based technical training. The first two campus facilities are expected to be operational by the third quarter of

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2004.

On August 29, 2003, we signed a securities purchase agreement to acquire, through a newly formed subsidiary, approximately 66.7% (on a fully-diluted basis) of Verestar. Concurrent with the signing of the securities purchase agreement, we purchased a 10% senior secured note with a principal balance of \$2.5 million and a due date of August 2007. We terminated the securities purchase agreement on December 22, 2003. Subsequently, Verestar filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code.

On March 8, 2004, we executed an asset purchase agreement to acquire, through a newly formed subsidiary, substantially all of the assets and business of Verestar pursuant to Section 363 of the Bankruptcy Code. The transaction was subject to a number of contingencies, including an auction on March 30, 2004 at which Verestar considered higher and better offers. At the auction, a bid was accepted from a strategic buyer at a price higher than we were willing to offer.

We continue to evaluate a number of other business opportunities and are currently engaged in a number of separate and unrelated preliminary discussions concerning possible joint ventures and other transactions. We are in the early stages of such discussions and have not entered into any definitive agreements with respect to any material transaction, other than what has been described in this Form 10-Q. Prior to consummating any transaction, we will have to, among other things, initiate and satisfactorily complete a due diligence investigation, negotiate the financial and other terms (including price) and conditions of such transaction, obtain appropriate board of directors', regulatory and other necessary consents and approvals and secure financing, to the extent deemed necessary.

As a result of the decision to discontinue the operations of Rare Medium, Inc. and its subsidiary LiveMarket, the results of operations of these businesses have been accounted for as discontinued operations. Accordingly, our discussion in the section entitled "Results of Operations" focuses on our continuing operations and includes our results and those of our MSV Investors Subsidiary, ESP and Miraxis. As we acquired a controlling interest in AfriHUB in April 2004, we will include the operating results of AfriHUB in our consolidated statements of operations beginning in the second quarter of 2004.

Results of Operations for the Three Months Ended March 31, 2004 Compared to the Three Months Ended March 31, 2003

Revenues

Revenues are derived from fees generated for product development, consulting and engineering services performed by ESP, including reimbursable travel and other out-of-pocket expenses, and the sales of its electronic database of parts commonly used in printed circuit design. Revenues from contracts for services that ESP provides its clients are recognized on a time-and-materials or on a percentage-of-completion basis. Revenues from time-and-materials service contracts are recognized as the services are provided. For service contracts where revenue is recognized under the percentage-of-completion basis, revenues recognized in excess of billings would be recorded as work in progress on the accompanying balance sheet. Billings in excess of revenues recognized are recorded as deferred revenue. Losses on contracts are recognized during the period in which the loss first becomes probable and reasonably estimable. Contract losses are determined to be the amount by which the estimated costs of the contract exceed the estimated total revenues that will be generated by the contract.

Revenues for the three months ended March 31, 2004 increased to \$0.8 million from nil for the three months ended March 31, 2003, an increase of \$0.8

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million. This increase was due to the acquisition of ESP on August 25, 2003. In future periods, we expect to report an increase in revenues as AfriHUB expects to begin offering its services on two university campuses in Nigeria by the third quarter of 2004.

Cost of Revenues

Cost of revenues includes the salaries and related employee benefits for ESP employees that provide billable product development, consulting and engineering services, as well as the cost of reimbursable expenses. Cost of revenues for the three months ended March 31, 2004 increased to \$0.7 million from nil for the three months ended March 31, 2003, an increase of \$0.7 million. This increase was due to the acquisition of ESP on August 25, 2003. In future periods, we expect to report an increase in cost of revenues as AfriHUB expects to begin offering its services on two university campuses in Nigeria by the third quarter of 2004.

Selling, General and Administrative Expense

Selling, general and administrative expense includes facilities costs, finance, legal and other corporate costs, as well as the salaries and related employee benefits for those employees that support such functions. Selling, general and administrative expense for the three months ended March 31, 2004 decreased to \$1.8 million from \$1.9 million for the three months ended March 31, 2003, a decrease of \$0.1 million. This decrease was primarily related to the approximately \$0.6 million charge recognized in the three months ended March 31, 2003 relating to bonuses for certain executive officers for services provided during the year ended December 31, 2002 and the severance and benefits for the Company's former Controller and former Treasurer, partially offset by the \$0.3 million of expenses incurred by ESP in the three months ended March 31, 2004. Furthermore, we recognized approximately \$0.3 million and \$7,000 of non-cash compensation expense in the three months ended March 31, 2004 and 2003, respectively, relating to the re-pricing of certain stock options in 2001 and 2002. As these costs relate to our current operations, including ESP and AfriHUB, we expect our selling, general and administrative expense, excluding any non-cash compensation expense arising from fluctuations in the price of our common stock in association with the repricing of certain stock options in 2001 and 2002, to increase in future periods as AfriHUB continues to build its business.

Depreciation and Amortization Expense

Depreciation and amortization expense consists of the depreciation of property and equipment and the amortization of the financing costs associated with the issuance of our Series A convertible preferred stock. Depreciation and amortization expense for the three months ended March 31, 2004 increased to approximately \$15,000 from approximately \$7,000 for the three months ended March 31, 2003, an increase of approximately \$8,000. This increase is primarily the result of the depreciation of ESP's property and equipment after the August 2003 acquisition. We expect depreciation and amortization expense to increase in future periods as AfriHUB builds the network infrastructure necessary for it to launch its service.

Interest Income, Net

Interest income, net for the three months ended March 31, 2004 is mainly comprised of the interest earned on our cash, cash equivalents, and short-term investments and on our notes receivable from the MSV Joint Venture, Verestar and Motient. As a result of the uncertainty with respect to the ultimate collection of amounts due under the New Motient Note, interest income is recognized as payments are received.

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Loss on Investment in Affiliates

For the three months ended March 31, 2004, we recorded a loss on investments in affiliates of approximately \$0.2 million relating to our proportionate share of Navigauge's operating loss. For the three months ended March 31, 2003, we recorded a loss on investments in affiliates of approximately \$0.1 million for our proportionate share of Miraxis' operating loss. We will continue to monitor the carrying value of our remaining investments in affiliates.

Minority Interest

For each of the three months ended March 31, 2004 and 2003, we recorded minority interest of approximately \$0.3 million relating to the equity in earnings, primarily the interest income earned on the convertible notes from the MSV Joint Venture, which is attributable to the group of unaffiliated third parties who invested approximately \$10.2 million in our MSV Investors Subsidiary.

Gain from Discontinued Operations

At the end of the third quarter of 2001, a decision to discontinue the operations of Rare Medium, Inc. and its LiveMarket subsidiary was made in light of their performance and prospects. For the three months ended March 31, 2004 and 2003, we recognized a gain of nil and \$0.5 million, respectively, as a result of the settlement of Rare Medium, Inc. liabilities at amounts less than their recorded amounts.

Net Loss Attributable to Common Stockholders

For the three months ended March 31, 2004, we recorded a net loss attributable to common stockholders of approximately \$2.4 million. The loss was due primarily to the \$2.5 million of non-cash deemed dividends and accretion related to the issuance of our Series A convertible preferred stock. Dividends were accrued related to the pay-in-kind dividends payable quarterly on Series A convertible preferred stock and to the accretion of the carrying amount of the Series A convertible preferred stock up to its \$100 per share face redemption amount over 13 years.

Liquidity and Capital Resources

We had \$26.2 million in cash, cash equivalents and short-term investments as of March 31, 2004. Cash used in operating activities from continuing operations was \$2.2 million for the three months ended March 31, 2004 and resulted primarily from cash used for general corporate overhead including payroll and professional fees. We expect cash used in continuing operations to increase in future periods as AfriHUB launches its service. Cash used by discontinued operations was \$18,000 for the three months ended March 31, 2004 and resulted from cash used for settlement of vendor liabilities and legal and advisory fees.

For the three months ended March 31, 2004, cash used in investing activities, excluding purchases and sales of short-term investments, consisted primarily of the \$0.3 million used to purchase investments in Navigauge. Other than our agreements with ESP and AfriHUB as described below, we do not have any future funding commitments with respect to any of our investments. However, we expect that the MSV Joint Venture, Miraxis, and Navigauge will require additional funding from time to time, and we may choose to provide additional funding, subject to our liquidity and capital resources at the time.

Motient Promissory Note

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On May 1, 2002, to mitigate the risk, uncertainties and expenses associated with Motient's plan of reorganization, we cancelled the outstanding amounts due under the original promissory notes issued by Motient and accepted a new note in the principal amount of \$19.0 million that was issued by MSV Holding, Inc., a new, wholly-owned subsidiary of Motient that owns 100% of Motient's interests in the MSV Joint Venture. The New Motient Note is due on May 1, 2005 and bears interest at a rate of 9% per annum. Although the New Motient Note is unsecured, there are material restrictions placed on the use of MSV Holdings Inc.'s assets, and MSV Holdings Inc. is prohibited from incurring or guarantying any debt in excess of \$21.0 million (including the New Motient Note). Additionally, there are events of default (e.g., a bankruptcy filing by Motient) that would accelerate the due date of the New Motient Note. In April 2004, Motient paid approximately \$0.5 million of interest accrued on the New Motient Note. This amount has been reflected in the accompanying consolidated statement of operations as interest income and in the accompanying consolidated balance sheets as prepaid expenses and other current assets. As a result of the uncertainty with respect to the ultimate collection on the remaining amounts due on the New Motient Note, a reserve continues to be maintained for the entire principal amount of the note and unpaid interest accrued thereon. If the Company recovers any amount on the principal of the New Motient Note, adjustments to the reserve would be reflected as other income in the accompanying consolidated statements of operations.

MSV Joint Venture Convertible Notes Receivable

Through our 80% owned MSV Investors Subsidiary, we are an active participant in the MSV Joint Venture, a joint venture that also includes TMI Communications, Inc., Motient and the Other MSV Investors. The MSV Joint Venture is currently a provider of mobile digital voice and data communications services via satellite in North America. On November 26, 2001, through our MSV Investors Subsidiary, we purchased a \$50.0 million interest in the MSV Joint Venture in the form of a convertible note. Immediately prior to the purchase of the convertible note, we contributed \$40.0 million to the MSV Investors Subsidiary and a group of unaffiliated third parties collectively contributed \$10.0 million. The note bears interest at a rate of 10% per year, has a maturity date of November 26, 2006, and is convertible at any time at the option of our MSV Investors Subsidiary into equity interests in the MSV Joint Venture.

On August 13, 2002, the MSV Joint Venture completed a rights offering allowing its investors to purchase their pro rata share of an aggregate \$3.0 million of newly issued convertible notes with terms similar to the convertible note already held by our MSV Investors Subsidiary. The MSV Investors Subsidiary exercised its basic and over subscription rights and purchased approximately \$1.1 million of the convertible notes. The group of unaffiliated third parties collectively contributed \$0.2 million to the MSV Investors Subsidiary in connection with the MSV Joint Venture rights offering.

Pursuant to the MSV Joint Venture Agreement, in the event that the MSV Joint Venture had received final regulatory approval from the FCC, as that phrase is defined in the MSV Joint Venture Agreement, by March 31, 2003 for its ATC applications, the Other MSV Investors would have been obligated to invest an additional \$50.0 million in the MSV Joint Venture. As the final regulatory approval from the FCC, as defined in the MSV Joint Venture Agreement, was not received by March 31, 2003, the additional investment was not required. However, the Other MSV Investors retained the option to invest the \$50.0 million on the same terms and conditions until June 30, 2003. Prior to its expiration, the option was extended until August 2003. On August 8, 2003, the MSV Joint Venture Agreement was amended and certain of the Other MSV Investors agreed to invest \$3.7 million in the MSV Joint Venture and retained the option to invest an additional \$17.6 million under certain terms and conditions. On April 2, 2004, those certain Other MSV Investors exercised the option in full.

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Under the amended MSV Joint Venture Agreement, the convertible notes held by our MSV Investors Subsidiary will automatically convert into equity interests in the MSV Joint Venture upon the repayment of (i) the outstanding principal and accrued interest on certain outstanding debt of the MSV Joint Venture and (ii) the accrued interest on all outstanding convertible notes of the MSV Joint Venture, including the convertible notes held by the MSV Investors Subsidiary. Such principal and accrued interest totaled approximately \$39.1 million following the April 2, 2004 exercise of the option held by the certain Other MSV Investors and will need to increase thereafter by an amount equal to the additional interest accrued on the certain outstanding debt and convertible notes. Any additional equity investments used to repay these obligations must be made at a valuation of the MSV Joint Venture equal to or greater than the valuation at the time the MSV Investors Subsidiary purchased the notes. Currently, the MSV Investors Subsidiary owns, upon conversion, approximately 27.4% of the equity interests in the MSV Joint Venture.

The fair value of the convertible notes approximates book value based on the equity value of the MSV Joint Venture's recent funding transactions assuming conversion of such note.

Verestar Transactions

On August 29, 2003, we signed a securities purchase agreement to acquire, through a newly formed subsidiary, approximately 66.7% (on a fully-diluted basis) of Verestar. Concurrent with the signing of the securities purchase agreement, we purchased a 10% senior secured note with a principal balance of \$2.5 million and a due date of August 2007. We terminated the securities purchase agreement on December 22, 2003. Subsequently, Verestar filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code. In connection with the Verestar bankruptcy, we entered into a stipulation with Verestar under which the parties agreed to, among other things, the validity and enforcement of the obligation under the senior secured note and the Company's security interest in Verestar's assets. The bankruptcy court approved the stipulation on February 9, 2004. On March 26, 2004, we entered a consent order with the Creditors' Committee pursuant to which the Creditors' Committee stipulated to the allowance of the \$2.5 million secured claim on our senior secured note. The Company also stipulated to extend until June 16, 2004, the time in which the Creditors' Committee could object to certain additional claims of the Company under the note. On April 30, 2004, Verestar repaid the \$2.5 million principal amount of the senior secured note, along with an additional approximately \$0.4 million representing certain other amounts owed to the Company and/or one of its subsidiaries.

On March 8, 2004, we executed an agreement to acquire, through a newly formed subsidiary, substantially all of the assets and business of Verestar pursuant to Section 363 of the Bankruptcy Code. The transaction was subject to a number of contingencies, including an auction on March 30, 2004 at which Verestar considered higher and better offers. At the auction, a bid was accepted from a strategic buyer at a price higher than we were willing to offer. The Company continues to pursue certain amounts owed under that agreement.

In connection with our termination of the August 29, 2003 securities purchase agreement on December 22, 2003, we believe that we are entitled to a \$3.5 million break up fee and potentially certain other damages from Verestar's parent company. Verestar's parent company has not agreed that all such amounts are due, and we are currently in discussions to resolve the issue. There can be no assurance that we will be successful in collecting all or part of the amount claimed. As such, we have not reflected this contingency in our consolidated financial statements. However, if we are successful in collecting any amount on this claim, a gain would be reflected in our consolidated statements of

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operations.

ESP Senior Secured Promissory Notes

On August 25, 2003, for nominal consideration, we acquired all of the outstanding common stock of ESP, a product development and engineering services firm that creates products for and provides consulting and engineering services to the telecommunications, broadband, satellite communications, and wireless industries. Subsequent to the stock purchase, we agreed to purchase up to \$0.8 million of senior secured promissory notes from ESP and up to an additional \$0.6 million of senior secured promissory notes if ESP meets certain financial performance metrics. As of March 31, 2004, we purchased approximately \$1.2 million in aggregate principal of these senior secured notes.

AfriHUB Commitment

On April 19, 2004, we signed an agreement to acquire 80% of the outstanding membership interests of AfriHUB for an aggregate purchase price of \$1.5 million. Through exclusive partnerships with certain Nigerian based universities, AfriHUB intends to provide satellite based broadband Internet access, domestic and international calling services, and a combination of instructor led and distance based technical training. Our investment is payable in three tranches based upon progress made by AfriHUB against its business plan. As of the date hereof, we have purchased \$0.5 million of membership interests from AfriHUB. If AfriHUB meets the remaining funding milestones, we would purchase the remaining \$1.0 million of membership interests by the end of the second quarter of 2004. Our ownership interest is subject to dilution if AfriHUB meets certain operating and financial metrics.

Recently Issued Accounting Standards

In December 2003, the FASB issued Interpretation No. 46R, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN No. 46R"). FIN No. 46R provides clarification on the consolidation of certain entities that do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties or in which equity investors do not have certain characteristics of a controlling financial interest ("variable interest entities" or "VIEs"). FIN No. 46R requires that VIEs be consolidated by the entity considered to be the primary beneficiary of the VIE and is effective immediately for VIEs created after January 31, 2003 and in the first fiscal year or interim period beginning after December 15, 2003 for any VIEs created prior to January 31, 2003. In accordance with FIN No. 46R, we have included the operating results and financial position of Miraxis in our consolidated financial statements. The consolidation of Miraxis did not have a material impact on our operating results or financial position.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of March 31, 2004, we had \$26.2 million of cash, cash equivalents and short-term cash investments. These cash, cash equivalents and short-term cash investments are subject to market risk due to changes in interest rates. In accordance with our investment policy, we diversify our investments among United States Treasury securities and other high credit quality debt instruments that we believe to be low risk. We are averse to principal loss and seek to preserve our invested funds by limiting default risk and market risk.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and

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principal accounting officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, our chief executive officer and principal accounting officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

Internal Control Over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates 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

On November 19, 2001, five of the Company's shareholders filed a complaint against the Company, certain of its subsidiaries and certain of the current and former officers and directors in the United States District Court for the Southern District of New York, *Dovitz v. Rare Medium Group, Inc. et al.*, No. 01 Civ. 10196. Plaintiffs became owners of restricted Company stock when they sold the company that they owned to the Company. Plaintiffs assert the following four claims against defendants: (1) common-law fraud; (2) violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder; (3) violation of the Michigan Securities Act; and (4) breach of fiduciary duty. These claims arise out of alleged representations by defendants to induce plaintiffs to enter into the transaction. The complaint seeks compensatory damages of approximately \$5.6 million, exemplary and/or punitive damages in the same amount, as well as attorney fees. On January 25, 2002, the Company filed a motion to dismiss the complaint in its entirety. On June 3, 2002, the Court dismissed the matter without prejudice. On or about July 17, 2002, the plaintiffs filed an amended complaint asserting similar causes of action to those asserted in the original complaint. On September 12, 2002, the Company filed a motion to dismiss on behalf of itself and its current and former officers and directors. On March 7, 2003, the Court denied the motion to dismiss, and discovery commenced. The Company expects to file and complete briefing on a motion for summary judgment in the third quarter of 2004. The Company intends to continue to dispute this matter vigorously.

The Company and certain of its subsidiaries (along with the Engelhard Corporation) are parties to an arbitration relating to certain agreements that existed between or among the claimant and ICC Technologies, Inc., the Company's former name, and the Engelhard/ICC ("E/ICC") joint venture arising from the desiccant air conditioning business that the Company and its subsidiaries sold in 1998. The claimant has sought \$8.5 million for (1) its alleged out of pocket losses in investing in certain of E/ICC's technology; (2) unjust enrichment resulting from the reorganization of E/ICC in 1998; and (3) lost profits arising from the fact that it was allegedly forced to leave the air conditioning business when the E/ICC joint venture was dissolved. The Company intends to vigorously dispute this action.

On July 26, 2002, plaintiffs James D. Loeffelbein, Terrie L. Pham and certain related parties filed suit against the lead plaintiff's counsel in the class action lawsuit, the Company, certain of its current and former officers,

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its former investor relations firm and a former employee of plaintiff Loeffelbein in the District Court of Johnson County, Kansas, Loeffelbein v. Milberg Weiss Bershad Hynes & Lerach, LLP, et al., 02 CV 04867. The plaintiffs assert claims for fraud, negligence and breach of fiduciary duty against all of the Company and certain of its current and former officers in connection with allegedly false statements purportedly made to the plaintiffs. The plaintiffs have sought unspecified damages from the defendants. On September 11, 2002, the matter was removed to the United States District Court for the District of Kansas (the "Federal District Court"). On October 11, 2002, the plaintiffs sought to have the matter remanded to state court. On May 7, 2003, the Federal District Court denied the plaintiffs request to remand the matter as it related to the Company, the Company defendants and an additional defendant. On June 9, 2003, the Company and Company defendants filed a motion to dismiss. On August 4, 2003, the plaintiffs responded. On October 21, 2003, the Federal District Court dismissed the action, holding that it lacked personal jurisdiction over the Company and the Company defendants and, accordingly, found it unnecessary to rule upon the Company's other bases for dismissal. On February 26, 2004, the court denied a motion by the plaintiffs to reconsider the dismissal. On March 26, 2004, the plaintiffs filed a notice of appeal. The Company intends to vigorously oppose this appeal.

In August 2003, a former employee of the Company's discontinued services subsidiary, filed a putative class action against Rare Medium, Inc. and the Company, and certain other former subsidiaries that were merged into Rare Medium, Inc., in Los Angeles County Superior Court captioned Joe Robuck, individually and on behalf of all similarly situated individuals v. Rare Medium Group, Inc., Rare Medium L.A., Inc., Rare Medium, Inc., and Rare Medium Dallas, Inc., Los Angeles County Superior Court Case No. BC300310. The plaintiff filed the action as a putative class action and putative representative action asserting that: (i) certain payments were purportedly due and went unpaid for overtime for employees with five job titles; (ii) certain related violations of California's overtime statute were committed when these employees were not paid such allegedly due and unpaid overtime at the time of their termination; and (iii) certain related alleged violations of California's unfair competition statute were committed. Plaintiff seeks to recover for himself and all of the putative class, alleged unpaid overtime, waiting time penalties (which can be up to 30 days' pay for each person not paid all wages due at the time of termination), interest, attorneys' fees, costs and disgorgement of profits garnered as a result of the alleged failure to pay overtime. Plaintiff has served discovery requests and all of the defendants have submitted objections and do not intend to provide substantive responses until the Court determines whether Plaintiff must arbitrate his individual claims. The Company intends to vigorously dispute this action.

Item 2. Changes in Securities

- (a) Not applicable
- (b) Not applicable
- (c) Not applicable
- (d) Not applicable

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Submissions of Matters to a Vote of Security Holders

None

Item 5. Other Information

None

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Item 6. Exhibits and Reports on Form 8-K

(a) The following sets forth those exhibits filed pursuant to Item 601 of Regulation S-K:

Exhibit Number	Description
31.1	- Certification of Jeffrey A. Leddy, Chief Executive Officer and President of SkyTerra Communications, Inc., required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	- Certification of Craig J. Kaufmann, Controller and Treasurer of SkyTerra Communications, Inc., required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	- Certification of Jeffrey A. Leddy, Chief Executive Officer and President of SkyTerra Communications, Inc., Pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	- Certification of Craig J. Kaufmann, Controller and Treasurer of SkyTerra Communications, Inc., Pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) The following sets forth the Company's reports on Form 8-K that have been filed during the quarter for which this report is filed:

On March 9, 2004, the Company filed a report on Form 8-K announcing the execution of a purchase agreement (subject to certain contingencies) to acquire substantially all of the assets and business of Verestar, Inc.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, this Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: May 17, 2004

By: /s/ JEFFREY A. LEDDY

Jeffrey A. Leddy
Chief Executive Officer and President
(Principal Executive Officer and
Principal Financial Officer)

Date: May 17, 2004

By: /s/ CRAIG J. KAUFMANN

Craig J. Kaufmann
Controller and Treasurer
(Principal Accounting Officer)